UNION OIL COMPANY OF CALIFORNIA

IBLA 2003-113 Decided December 28, 2005

Appeal from a decision of the Acting Deputy Commissioner of Indian Affairs, Bureau of Indian Affairs, affirming an order directing oil and gas lessee to recalculate royalties due on Indian leases in accordance with dual accounting requirements. MMS-00-0024-IND.

Affirmed.

1. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Indians: Mineral Resources: Oil and Gas: Royalties--Oil and Gas Leases: Royalties: Payments

The Minerals Management Service (MMS) properly directs a lessee to perform restructured accounting and recalculate royalties due on Indian oil and gas leases where the leases require such accounting and an MMS audit revealed instances of the lessee's failure to calculate and pay royalties utilizing that method.

2. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Indians: Mineral Resources: Oil and Gas: Royalties-- Oil and Gas Leases: Royalties: Payments

The regulation applicable to an audit of Navajo Allotted leases for the January 1993 through December 1996 audit period provided that prior to or at the same time as claiming a gas processing allowance on Form MMS-2014, a lessee must submit page one of the initial Form MMS-4109. The applicable regulation provided that failure to timely file Form MMS-4109 subjects a lessee to forfeiture of processing allowances taken on Form MMS-2014 until such time as the lessee cures the failure to submit page one of Form MMS-4109. The lessee is required to file

Form MMS-4109 before claiming a processing allowance in deriving a theoretical price for processed gas.

3. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Indians: Mineral Resources: Oil and Gas: Royalties--Oil and Gas Leases: Royalties: Payments

MMS' interpretation of the applicable regulation as requiring a lessee of Indian oil and gas leases to timely file Form MMS-4109 prior to or at the same time as claiming a processing allowance on Form MMS-2014 does not constitute the promulgation of a new rule requiring notice and comment.

4. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Indians: Mineral Resources: Oil and Gas: Royalties--Oil and Gas Leases: Royalties: Payments--Statute of Limitations

The 6-year statute of limitations for the commencement by the United States of civil actions for money damages, found at 28 U.S.C. § 2415(a) (2000), does not limit administrative actions within the Department. Orders by MMS to recalculate and pay additional royalties due under Indian leases are administrative actions not subject to the statute of limitations.

APPEARANCES: Carol J. Westmoreland, Esq., Sugar Land, Texas, for appellant; Stephen L. Simpson, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE ROBERTS

Union Oil Company of California (Unocal) [1/] has appealed the September 8, 2002, decision of the Acting Deputy Commissioner of Indian Affairs (Acting Deputy Commissioner), Bureau of Indian Affairs (BIA), denying the appeal of a January 12, 2000, order of the Minerals Management Service (MMS), directing it to apply dual

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[1/] In its statement of reasons (SOR) for appeal, Unocal states, regarding its name: "In order to clarify Unocal's name and avoid any confusion, Unocal at one time had a division that operated its leases in the United States, which was called 'Spirit Energy 76.' The division has since been reorganized and that name is no longer used by Unocal." (SOR at 2.)

accounting procedures in the recalculation of royalties due on Navajo Allotted leases for the period January 1993 through December 1996. MMS based its determination on the dual accounting calculations it performed on a single lease (Navajo Allotted Lease 525-003778-0) for three sample months (July and December 1994 and January 1995).

In its order directing Unocal to perform restructured accounting, MMS noted that all Unocal's Navajo Allotted leases require dual accounting pursuant to Paragraph 3(c), which states that "royalty will be computed on the value of gas or casinghead gas, or on the products thereof (such as residue gas, natural gasoline, propane, butane, etc.), whichever is greater." MMS stated that "[s]ince UNOCAL did not file the Gas Processing Allowance Summary Report, Form MMS-4109, * * * no processing allowances can now be taken for any of [the audit] period."

Unocal paid royalties on the sample Navajo Allotted lease on a wet gas basis, meaning that the gas was sold at the wellhead, without including deductions for processing or transportation allowances. [2/] When it paid its royalties, Unocal completed Form MMS-2014 based on wet gas sales, making no entries on the Form for processing or transportation allowances. Based upon his comparison of the wet gas price to the processed gas price for the three sample months on the Navajo Allotted lease, the MMS auditor disallowed a processing or transportation allowance in calculating the value of the processed gas.

In its appeal from MMS' January 12, 2000, order to the Acting Deputy Commissioner, Unocal provided the following context for deciding this case:

> During the sample months in question, Unocal sold the gas from the sample lease in arms-length transactions at the wellhead, and did not process the gas or retain processing rights. Any calculation of royalties based on processing would therefore have to be on a theoretical basis, as Unocal does not process the gas. In the captioned order the MMS used a theoretical calculation, but did not use a manufacturing allowance, based on the fact that Unocal had not submitted a Form MMS-4109 and based on a 1997 ruling by the Deputy Commissioner of Indian Affairs in Alexander Energy Corporation,

[2/] Unocal offers the following explanation of its use of the term "wet gas:" "For purposes of this appeal, Unocal will use the term 'wet gas' to refer to gas that is valued at the wellhead, without processing, and the term 'processed gas' will be used to refer to the combined value of the natural gas liquids and the gas remaining after the natural gas liquids are extracted, which is also commonly referred to as residue gas." (SOR at 2.)

> MMS-93-0096-IND. [[3]] It is Unocal's position that a manufacturing or processing allowance, as well as a transportation allowance, should be included in the theoretical calculation. * * *
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> For reasons stated below, Unocal believes the ruling in Alexander is not applicable to the question of whether or not a manufacturing or processing allowance, or a transportation allowance, can be taken in a theoretical calculation for dual accounting purposes when the lessor does not process the gas. The question decided in Alexander was whether the lessor could deduct a processing or transportation allowance in calculating what was to be paid, not in calculating whether or not the theoretical value exceeds the unprocessed gas price that was received. Unocal's position is supported by the July 27, 1992 Dear Payor order issued by the MMS, in which the MMS states:
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>> "The MMS also stresses that when the value of the processed gas determined under 30 CFR §206.153 (1991) is higher than the value of the unprocessed gas, the requirements to submit appropriate allowance forms prior to claiming transportation and/or processing allowances must be met."
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> In other words, the forms for the processing or transportation allowances need not be submitted to perform the theoretical calculations. Which makes sense, since otherwise the MMS would be inundated each month with theoretical numbers for Indian leases that do not pertain to the royalty being paid.

(Unocal's Appeal to the Acting Deputy Commissioner from MMS' Jan. 12, 2000, Order.)

Unocal argued, as a related matter, that MMS does not have the authority to order a restructured accounting in this case. According to Unocal, "the ruling in Alexander is incorrect about whether or not a lessee can claim a processing allowance under the circumstances existing in Alexander, or in Unocal's case if the theoretical calculations for royalties on Unocal's Navajo Allotted leases in fact result in a higher value for the royalties." Id. Unocal pointed out that the applicable lease "clearly provides that 'a reasonable allowance for the cost of manufacture shall be made,'" and that "such allowance shall be two-thirds, unless the Secretary of the Interior determines some amount other than two-thirds, either on application by the lessee or

[3] This matter was decided by the Board in Alexander Energy Corp., 153 IBLA 238 (2000), and guides our decision herein.

on his own initiative." Id. Thus, Unocal argued, "the calculations performed by the MMS for comparison with the prices actually received at the wellhead by Unocal for the unprocessed gas are clearly erroneous, since the MMS failed to include the processing allowance that the lease clearly states is to be used in calculating the value of processed gas." Id. Unocal contended that there is no basis for ordering a restructured accounting, since it had not "made identified underpayments or overpayments which are demonstrated * * * to be based upon repeated, systemic reporting errors for a significant number of leases or a single lease for a significant number of reporting months with the same type of error which constitutes a pattern of violations and which are likely to result in either significant underpayments or overpayments," as provided by section 115(d)(4)(B)(i) of the Federal Oil and Gas Royalty Simplification and Fairness Act of 1996 (RSFA), 30 U.S.C. § 724(d)(4)(B)(i) (2000). Id. Unocal maintained that because no additional royalty is due for the sample months, it should not be required to recalculate royalties on all its Navajo Allotted leases, as set out in MMS' January 12, 2000, order.

In his decision, regarding the filing requirements issue, the Acting Deputy Commissioner noted that effective March 1, 1988, the regulations governing gas processing allowances were amended to require the submission of a Gas Processing Allowance Summary Report (Form MMS-4109) prior to claiming an allowance on Form MMS-2014. 30 CFR 206.159(c)(1), applicable to Federal and Indian gas (53 FR 1272 (Jan. 15, 1988)), redesignated at 30 CFR 206.179(c)(1), applicable to Indian gas (61 FR 5467 (Feb. 12, 1996)). [4/] As to late reporting or failure to report a processing allowance, the Acting Deputy Commissioner also noted that 30 CFR

[4/] Regulation 30 CFR 206.159(c)(1) was promulgated on Jan. 15, 1988, as part of "30 CFR Subpart D--Federal and Indian Gas," and applied to the Navajo Allotted leases held by Unocal during most of the January 1993 through 1996 audit period. 53 FR 1272. On Feb. 12, 1996, MMS published "30 CFR Subpart E–Indian Gas," which "[e]liminate[d] allowance forms for production from Federal mineral leases, but did "not change the existing regulations applicable to Indian leases at this time." 61 FR 5448 (Feb. 12, 1996). Regulation 30 CFR 206.159(c)(1) was redesignated at 30 CFR 206.179(c)(1), and thus continued the requirement that the lessee submit page one of Form MMS-4109 prior to, or at the same time as, the processing allowance is reported on Form MMS-2014. 61 FR 5467 (Feb. 12, 1996). The Acting Deputy Commissioner cites the 1992 iteration of the valuation regulations, which was in effect when Alexander was litigated substantively. However, we perceive no significance to MMS' citation of the 1992 regulation, given that the 1996 rulemaking expressly provided that the rules applicable to Indian leases were not changed.

In this opinion, I cite to the 1992 version of the regulations, cognizant that effective Feb. 12, 1996, they were redesignated at 30 CFR Subpart E–Indian Gas.

206.159(d)(1) (1992) [5] provides that "the lessee shall pay interest only on the amount of such deduction until the requirements of this section are complied with," and that "[t]he lessee shall also repay the amount of any allowance which is disallowed by this section." The Acting Deputy Commissioner interprets these regulations, consistent with Alexander Energy Corp., 153 IBLA 238 (2000), as establishing that "the failure to timely file Form MMS-4109 subjects the lessee to forfeiture of processing allowances taken on Form MMS-2014 until such time as that failure is cured." (Acting Deputy Commissioner's Decision at 3.) In rejecting Unocal's argument that Alexander addressed only the question of whether a lessee could deduct a processing or transportation allowance in calculating royalties to be paid, and not whether an allowance could be used in a theoretical calculation for dual accounting purposes, the Acting Deputy Commissioner found the following analysis from Alexander to be controlling:

> Late reporting or failure to report elicits sanctions: the lessee is subject to the forfeiture of processing allowances * * * until the late reporting or failure to report is cured. See 30 C.F.R. 206.159(d)(1) (1992). In the instant case, Alexander sold its unprocessed gas from Indian leases at the wellhead and the requested processing allowance was sought for comparison purposes after MMS requested that Appellant derive a theoretical value for the gas as processed gas. [Emphasis added.]

Id. at 4, quoting 153 IBLA at 243. Moreover, he deemed the facts in Alexander to be "the same as in the instant case." (Acting Deputy Commissioner's Decision at 4.) Thus, he ruled that Unocal was required to meet the filing requirements of 30 CFR 206.159(c)(1) (1992) by submitting Form MMS-4109 prior to or at the time the processing allowance is claimed on Form MMS-2014. The Acting Deputy Commissioner thus reasoned that Unocal had forfeited the processing allowance until the failure to report is cured.

The Acting Deputy Commissioner rejected Unocal's contention that because MMS had not shown that additional royalties were due, there was no basis for ordering Unocal to perform a restructured accounting. As stated by the Acting Deputy Commissioner, "[t]he issue of processing arises only because the Appellant is required to derive a theoretical value for the subject gas as processed gas for purposes of comparison (i.e., dual accounting.)" Id. at 3. Noting Unocal's acknowledgment that it did not perform a dual accounting for the Navajo Allotted leases, because it did not believe it was required to do so, and likewise that it did not

[5] This regulation was also initially promulgated on Jan. 15, 1988, and applied to gas production on Federal and Indian oil and gas leases. 53 FR 1272. Effective Feb. 12, 1996, this regulation was redesignated at 30 CFR 206.179(d)(1), and governed gas production on Indian oil and gas leases. 61 FR 5467.

file the allowance reporting forms pursuant to 30 CFR 206.159(c)(1) (1992), the Acting Deputy Commissioner ruled as follows:

> The Appellant's failure to file the required reports prohibits the Appellant from claiming processing allowances in calculating the processed value of the production from its leases of Navajo allotments for the time period at issue. The MMS reasonably concluded that, in performing a dual accounting, the value of the Appellant's gas after processing would be found to be higher than the unprocessed value, and that it was, therefore, highly likely that the Appellant underpaid the royalties for that gas.

(Acting Deputy Commissioner's Decision at 5.) As to Unocal's argument that there is no requirement that it perform a restructured accounting, the Acting Deputy Commissioner stated:

> With regard to the standard for requiring a lessee to perform a restructured accounting, the IBLA explained in Union Texas Petroleum Energy Corporation, 153 IBLA 170, 179 (August 25, 2000), that:
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> > We do not believe it appropriate to attempt to set out a definitive rule regarding what constitutes a systemic error or deficiency, as it should be addressed on a case-by-case basis. However, we can state that if an error or deficiency is detected, a finding of error would not justify restructured accounting without a showing that it is likely that the error was repeated in other months and/or other leases. On the other hand, an error or deficiency detected over an extended period of time and for a number of leases would clearly establish a pattern sufficient to justify restructured accounting.
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> Here, the existence of deficiencies in royalty calculation and reporting has been clearly established and, in fact, has been acknowledged by the Appellant. With regard to the Appellant's contention that there was no showing of additional royalties due, the record clearly shows that MMS found royalty underpayments in all three of the test months it examined. See the schedules attached to the January 12, 2000, MMS order.

Id. The Acting Deputy Commissioner concluded "that the identified, recognized deficiencies in royalty calculation and reporting were more than sufficient to justify the issuance of the subject restructured accounting order." Id. at 6.

On appeal to this Board, Unocal repeats, for the most part, the arguments it made before the Acting Deputy Commissioner. Unocal's principal argument, as further explained, is that "MMS [in]correctly interpreted its regulations in calculating that Unocal underpaid royalties for the three months of the single lease that was audited." (SOR at 2.) In making this argument, Unocal attempts to distinguish and to limit the Board's ruling in Alexander, which also involved a lessee which had sold gas on a wet gas basis at the wellhead and did not perform dual accounting. Unocal recognizes that "Alexander sold its unprocessed gas from Indian leases at the wellhead and the requested processing allowance was sought for comparison purposes after MMS requested that Appellant derive a theoretical value for the gas as processed gas." (SOR at 3, quoting 153 IBLA at 243.) Unocal maintains that 30 CFR 206.159(a) does not require the filing of Form MMS-4109 prior to taking a processing allowance in the theoretical accounting context. [6] Rather, that regulation refers "to an actual processing allowance being taken for gas that is actually being processed and not to a theoretical calculation made only for comparison purposes, for gas that is sold at the wellhead and not processed." (SOR at 4.)

Unocal explains its position that the regulations do not apply when making a theoretical calculation in the following terms:

> Here the regulations in question, 30 C.F.R. §206.159(a) and 30 C.F.R. §206.159(d)(1) (1992), plainly require that a lessee file a Form MMS-4109 before or when a processing allowance is actually reported on Form MMS-2014. The regulations only require a Form MMS-4109 when a processing allowance is reported, whether because of an arms-length, non-arms-length or no contract. The regulations do not state that a lessee must file a Form MMS-4109 before it can do a theoretical calculation to determine whether or not to pay royalties based on a wet gas or processed gas valuation.
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> If dual accounting shows the gas royalties should be paid on a processed gas basis and not a wet gas basis, a Form MMS-4109 should be filed "prior to the time, or at the same time the processing allowance . . . is reported on Form MMS 2014" as required in 30 C.F.R. §206.159(a) and 30 C.F.R. §206.159(d)(1) (1992). The distinction that is being raised in this appeal, that the Deputy Commissioner

[6] 30 CFR 206.159(a) provides that "[b]efore any deduction may be taken, the lessee must submit a completed page one of Form MMS-4109, Gas Processing Allowance Summary Report, in accordance with paragraph (c)(1) of this section. A processing allowance may be claimed retroactively for a period of not more than 3 months prior to the first day of the month that Form MMS-4109 is filed with MMS, unless MMS approves a longer period upon a showing of good cause by the lessee."

> ignored, and that apparently was not raised in Alexander, is that if the dual accounting shows that the gas royalties should be paid on a wet gas basis, there is no requirement in either the regulations or the lease that the lessee file a Form MMS-4109 in order to pay the royalties and report them on Form MMS-2014 on a wet gas basis. [Emphasis added.]

Id. [7/]

Unocal contends that the regulations do not require it to file a Form MMS-4109 "in order to use a processing allowance or transportation allowance to determine if the processed gas or the wet gas value is higher and which is the value that should be used to pay royalties." Id. at 5. Unocal reasons that if the dual accounting shows the wet gas value to be higher, then "Unocal has properly paid its royalties." Id. On the other hand, Unocal proceeds, "[i]f the dual accounting shows, after deducting a reasonable processing and transportation cost, that the processed gas value is higher, the ruling in Alexander would possibly apply to whether or not the processing or transportation allowances could be taken when the royalty is paid on a processed gas value and reported on MMS Form-2014." Id. at 5-6. Unocal concludes that MMS lacks the authority to order a restructured accounting when there is no basis, as here, and if there is such authority, that MMS lacks the authority to require the filing of Forms MMS-4109 and MMS-2014.

[1] We must reject as without basis Unocal's argument that MMS lacks authority to order a restructured accounting based upon its finding that theoretical calculations on its Navajo Allotted leases resulted in a higher value than the prices actually received at the wellhead for unprocessed gas. According to Unocal, MMS' theoretical calculations were erroneous because MMS failed to include the processing allowance which should have been used in calculating the value of processed gas. Thus, if the processing allowances were taken, as appropriate, in making the theoretical calculations, the value of the wet gas sold at the wellhead is greater, and there are no "identified underpayments or overpayments which are demonstrated * * * to be based upon repeated, systemic reporting errors * * * which constitutes a pattern of violations and which are likely to result in either significant underpayments or overpayments," under section 115(d)(4)(B)(I) of RSFA, 30 U.S.C.

[7/] In Alexander, the Board observed that Section III of NTL-1A, which remained in effect only until Mar. 1, 1988, required dual accounting for Indian leases, and that that requirement was retained in the 1988 regulatory revision. See 42 FR 18135, 18137 (Apr. 5, 1977); 30 CFR 206.155 (1995). The Board concluded: "It is thus reasonable to interpret these regulations to mean that processed gas must be valued and that a royalty computed on that value must be paid, if higher than royalty computed on the value of the unprocessed gas. See, e.g., Robert L. Bayless, 148 IBLA 140, 150-51 (1999)." 153 IBLA at 243.

§ 1724(d)(4)(B)(I) (2000). Unocal contends that since no additional royalty is due for the sample months, it should not be required to recalculate royalties on all its Navajo Allotted leases, as required by MMS. With no "repeated, systemic reporting errors * * * constitut[ing] a pattern of violations," MMS has no authority to order a restructured accounting.

The short answer to Unocal's argument is that Paragraph 3(c) of its "Oil and Gas Mining Lease–Allotted Indian Lands" requires dual accounting. Moreover, 30 CFR 206.155(b) [8] required dual accounting by lessees holding Tribal leases in accordance with the following methodology:

> [T]he value, for royalty purposes, shall be the greater of (1) the combined value for royalty purposes of the residue gas and gas plant products resulting from processing the gas determined pursuant to § 206.153 of this subpart * * * or (2) the value, for royalty purposes, of the gas prior to processing determined in accordance with § 206.152 of this subpart.

30 CFR 206.155(a).

As the Board observed in Alexander: "It is well-settled that a reasonable interpretation of Departmental regulations and the terms of Paragraph 3(c) of the standard Indian lease require a lessee on an Indian lease to perform dual accounting and, additionally, that dual accounting had always been required of lessees on Indian leases." 153 IBLA at 242, citing Amoco Production Co. (On Reconsideration), 143 IBLA 54A, 54E (Nov. 30, 1998). As in Alexander, we find it "reasonable to interpret these regulations to mean that processed gas must be valued and that a royalty computed on that value must be paid, if higher than royalty computed on the value of the unprocessed gas." 153 IBLA at 243; see, e.g., Robert L. Bayless, 149 IBLA at 150-52. We reject Unocal's argument that MMS lacks the authority to order restructured accounting in this case.

[2] We likewise reject Unocal's argument that, in complying with MMS' order that it compute royalty based upon restructured accounting, it should be allowed to deduct processing allowances from the value of processed gas, even though it has not filed Form MMS-4109. As noted, Unocal paid royalty on a wet gas price, and thus did not claim any processing allowances on the MMS-2014 that was filed with the payment. Unocal contends that the question was not raised or addressed in Alexander as to whether there is a requirement that Form MMS-4109 must be filed

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[8] This regulation was redesignated at 30 CFR 206.175 by final rulemaking on Feb. 12, 1996. 61 FR 3804.

"in order to pay the royalties and report them on Form MMS-2014 on a wet gas basis." (SOR at 4.) In Unocal's view, "the regulations do not require Unocal to file a MMS Form-4109 or any other form in order to use a processing allowance or transportation allowance to determine if the processed gas value or the wet gas value is higher and which is the value that should be used to pay royalties." Id. at 5. I again quote Unocal's argument:

> If in fact the dual accounting shows the wet gas value to be higher, then Unocal has properly paid its royalties. If the dual accounting shows, after deducting a reasonable processing and transportation cost, then the processed gas is higher, the ruling in Alexander would possibly apply to whether or not the processing or transportation allowances could be taken when the royalty is paid on a processed gas value and reported on MMS Form-2014.

(SOR at 5-6.)

I see no meaningful "distinction" between the respective situations of Alexander and Unocal. In Alexander, the lessee argued that it did not apply dual accounting because it sold unprocessed gas from its Indian leases, and had no comparative prices of processed and unprocessed gas. When Alexander was required to calculate royalties based on the comparative prices, it sought a gas processing allowance, which MMS denied for failure to timely file the requisite Form MMS-4109. Unocal stands in the same position.

Unocal is technically correct that neither the regulations nor the lease specifically address filing Forms MMS-4109 and MMS-2014 as a prerequisite for claiming processing allowances in performing restructured accounting. Unocal acknowledges that 30 CFR 209.159(a) and 30 CFR 206.159(d)(1) "plainly require that a lessee file a Form MMS-4109 before or when a processing allowance is actually reported on Form MMS-2014." (SOR at 4.) However, Unocal would limit these regulations to the situation where a lessee actually reports a processing allowance on Form MMS-2014 without having filed a Form MMS-4109. Unocal cannot excuse itself from the requirement to file Form MMS-4109 on the basis that it believed that dual accounting was not required. Unocal requested the processing allowance only after MMS directed it to derive a theoretical value for the gas as processed gas. The Board in Alexander agreed with MMS that this was "late reporting" which "elicits sanctions: the lessee is subject to forfeiture of processing allowances taken on Form MMS-2014 until the late reporting or failure to report is cured." 153 IBLA at 243. Had Unocal sought processing allowances in connection with timely dual accounting, it would have been appropriate for Unocal to claim such a deduction provided it had filed Form MMS-4109. We agree with MMS that in order to claim this processing allowance it should have filed Form MMS-4109 prior to, or at the same time, it claimed the deduction on Form MMS-2014.

The initial Form MMS-4109, once filed, is "effective for a reporting period beginning the month that the lessee is first authorized to deduct a processing allowance and shall continue until the end of the calendar year, or until the applicable contract or rate terminates or is modified, whichever is earlier." 30 CFR 206.159(c)(ii) (now 30 CFR 206.179(c)(ii)) (emphasis added). The consequence of Unocal's decision not to file Form MMS-4109 when it was first authorized to do so was that it could not deduct a processing allowance. Under Paragraph 3(c) of the lease and 30 CFR 206.159(c)(1), Unocal should have been performing dual accounting on its Navajo Allotted leases in order to determine which method, as between reporting royalty based on processed or unprocessed gas, yields the greatest value. MMS' audit disclosed that Unocal was not in lease compliance in that it had not performed dual accounting. Unocal cannot now avail itself of a processing cost deduction and ignore the filing obligation established by the regulation. [9/]

Under Alexander, there is no avoiding the conclusion that MMS properly ordered Unocal to perform a restructured accounting, meaning that "processed gas must be valued and * * * a royalty computed on that value must be paid, if higher than royalty computed on the value of the unprocessed gas." 153 IBLA at 243. Further, Unocal can only claim the processing allowance on the value of the processed gas if it has complied with the filing requirements of 30 CFR 206.159(c)(1). Unocal's conclusion that the value of the wet gas is higher than processed gas, despite MMS' calculations to the contrary, rests upon its having to claim processing allowances which are disallowed for failure to file the required forms. The Acting Deputy Commissioner's analysis, previously quoted, demonstrates the error in Unocal's analysis. Unocal's position that there is no need to file the Forms unless and until the dual accounting shows the value of processed gas to be higher than wet gas does not square with the plain wording of 30 CFR 206.159(c)(1). We adhere to our ruling in Alexander.

[3] In addition, Unocal contends that "MMS' apparent position that a lessee must file a Form MMS-4109 to claim a processing allowance in order to calculate a processed gas value for gas that is not being processed is a new rule and inconsistent with previous interpretations, as shown in NTL-1A and the July 27, 1992 Dear Payor Letter quoted above." (SOR at 6, citing 5 U.S.C. § 551(4) (2000).) Unocal

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[9/] Further, exempting a lessee in Unocal's posture from the requirement to file Forms MMS-4109 and MMS-2014 in order to claim a processing allowance in performing dual accounting would undermine the purpose for requiring the filing of the Forms, i.e., they are necessary for MMS' administration of the processing allowance program. See, e.g., 53 FR 1230, 1269 (Jan. 15, 1988).

complains that MMS has engaged in improper rulemaking, given that it was not provided notice of the rule and an opportunity to comment on it, and that even if MMS' "new rule" had been properly promulgated, it "could be applied only prospectively, not retroactively for nearly a decade as MMS is attempting to do here." (SOR at 6, citing Bowen v. Georgetown University Hospital, 488 U.S. 204 (1988).)

In its answer, MMS responds that requiring the payor in Alexander to perform dual accounting, and to timely file Form MMS-4109 prior to or at the same time as claiming a processing allowance on Form MMS-2014 under 30 CFR 206.159(c)(1) (1992) does not constitute a new rulemaking. Rather, according to MMS, Alexander involved an adjudication of "whether the payor's past conduct complied with MMS regulations." (Answer at 4, citing Attorney General's Manual on the Administrative Procedure Act, 14-15 (1947).) We agree with MMS that this case similarly involves an adjudication of whether Unocal has complied with MMS' duly promulgated regulations, and not the promulgation of a new rule.

We find clear support for our ruling in Amoco Production Co. v. Watson, 410 F.3d 722 (D.C. Cir. 2005), in which the D.C. Circuit addressed the argument that the Payor Letter cited in MMS' orders finding the producers deficient in their royalty payments constituted a new rule which the agency could promulgate only through notice and comment rulemaking. In rejecting the argument, the D.C. Circuit followed Indep. Petroleum Ass'n of America v. Babbitt, 92 F.3d 1248 (D.C. Cir. 1996), which held that a similar MMS letter did not amount to a rule subject to notice and comment because nothing in the Department's regulations vests the Letter's author (i.e., MMS' Associate Director for Royalty Management) with the authority to announce rules binding on the Department. Id. at 1256. "The letter is not an agency rule at all, legislative or otherwise, because it does not purport to, nor is it capable of, binding the agency." 410 F.3d at 732, quoting Indep. Petroleum Ass'n of America v. Babbitt, 92 F.3d at 1257.

In adjudicating whether Unocal had complied with applicable statutes and regulations in calculating and paying royalty on the Navajo Allotted leases, MMS (and this Board) reached the same result as in Alexander and the Payor Letter which MMS therein followed. In Alexander, the Board agreed with MMS' interpretation of 30 CFR 206.159(c)(1) (1992). As the Board found in Alexander, MMS properly interpreted and applied a duly promulgated regulation. By following Alexander, MMS does not engage in improper rulemaking, but rather in the implementation of a binding decision. [10/]

[10/] Moreover, it is incumbent upon MMS to follow the Board's ruling in Alexander, since the Board issued that ruling in the exercise of authority delegated to it by the Secretary of the Interior. As the Board stated regarding its decision in Eugene V. (continued...)

[4] Unocal further argues that MMS is barred by 28 U.S.C. § 2415(a) (2000) from ordering it to pay additional royalties more than six years before its initial audit engagement letter or ordering Unocal to perform dual accounting prior to that period. That provision specifies that

> every action for money damages brought by the United States or an official or agency thereof which is founded upon any contract express or implied in law or fact, shall be barred unless the complaint is filed within six years after the right of action accrues or within one year after final decisions have been rendered in applicable administrative proceedings required by contract or by law, whichever is later.

We note Unocal's argument, not because we find it persuasive, but because of a disagreement among the Courts of Appeals for the Fifth, Tenth, and D.C. Circuits as to whether the statute of limitations found at 28 U.S.C. § 2415(a) (2000) governs an MMS order directing the payment of royalties. [11] Unocal states that it is raising the 6-year statute of limitations for the first time in its SOR for this appeal based upon OXY USA, Inc. v. Babbitt, 268 F.3d 1001 (10th Cir. 2001), in which, according to Unocal, the Tenth Circuit "held that section 2415's six year limitation period does apply to MMS." (SOR at 6.)

When presented with the argument that section 2415(a) applies to MMS orders directing the recalculation and payment of additional royalties due under an Indian lease, the Board in Union Texas Petroleum Energy Corp. 153 IBLA at 184, deemed it

> now well established that 28 U.S.C. § 2415(a) (1994) is not applicable to an administrative proceeding to collect additional royalties which became due beyond the statutory limitations period, since that statute applies only to a civil action initiated by a 'complaint,' filed by the United States in Federal court, seeking to collect money damages arising from a contract express or implied in law or fact, including additional royalties owed on production under a Federal or Indian oil

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[10] (...continued)
Simons v. BLM, 135 IBLA 125, 129 (1996), "[t]his decision is binding on employees of the Department of the Interior. It follows that to the extent Departmental employees refuse to implement the Board decision, their actions are unauthorized."

[11] This dispute does not apply to production after Sept. 1, 1996, for which Congress imposed a 7-year limitations period. See Federal Oil and Gas Royalty Management Act of 1982, Pub. L. No. 104-185, 110 Stat. 1700 (codified at 30 U.S.C. § 1724 (2000)).

> and gas lease. Shell Oil Co., 150 IBLA 298, 306 (1999), and cases cited therein. Further, the statute does not apply to preclude an administrative order to recalculate additional royalties which were originally due beyond the limitations period.

The Board was not "persuaded that Phillips Petroleum Co. v. Lujan, 4 F.3d 858 (10th Cir. 1993), [[12]] or OXY USA, Inc. v. Babbitt, No. 96-CV-1067-K (N.D. Okla Sept. 8, 1998), [[13]] dictate a contrary conclusion in this case." 153 IBLA at 184.

MMS acknowledges that the Tenth Circuit's en banc decision in OXY USA, Inc. v. Babbitt, 268 F.3d 1001 (2001), directly conflicts with the decision of the Fifth Circuit in Phillips Petroleum Co. v. Johnson, 22 F.3d 616 (5th Cir. 1994), notice of unpublished decision at 36 F.3d 89, cert denied, 514 U.S. 1092 (1995), which had ruled that an administrative order to pay royalties does not constitute an "action" for purposes of 28 U.S.C. § 2415(a), and that such an order does not seek "money damages" within the meaning of section 2415(a). During the pendency of this appeal, however, the U.S. Court of Appeals for the District of Columbia issued Amoco Production Co. v. Watson, 410 F.3d at 734-35, expressly joining the Fifth Circuit "in concluding that the statute of limitations in subsection 2415(a) does not apply to bar an administrative order demanding payment owed pursuant to the MLA and its regulations." [14] The D.C. Circuit stated that "[t]he phrase 'action for money

[12] The Tenth Circuit in Phillips Petroleum Co. v. Lujan stated: "Both parties recognize, and we agree, that oil and gas leases are contracts. Thus, we likewise agree with the parties that 28 U.S.C. § 2415(a) is the controlling statute of limitations as it applies to 'every action for money damages brought by the United States . . . which is founded upon any contract.'" 4 F.3d at 860 n.1 (citations and emphasis omitted).

[13] The U.S. District Court for the District of Oklahoma granted OXY's motion for summary judgment on the question of section 2415(a)'s applicability to MMS orders to recalculate and pay royalty, based upon the Tenth Circuit's statements from Phillips Petroleum Co. v. Lujan, 4 F.3d at 860 n.1, ruling that section 2415(a) operates to bar belated MMS orders. The Government appealed, and a divided Tenth Circuit panel reversed, holding that the remarks in Phillips were dicta, and that section 2415(a) is inapplicable because the MMS orders are not "actions" under that provision. OXY USA, Inc. v. Babbitt, 230 F.3d 1178, 1185-90 (10th Cir. 2000). The Tenth Circuit granted OXY's Petition for Rehearing, and the en banc court ruled that section 2415(a) indeed governs MMS orders directing oil and gas lessees to pay additional royalties. OXY USA, v. Babbitt, 268 F.3d at 1009.

[14] Amoco Production Co. v. Watson involved MMS orders that lessees add to gross proceeds, for royalty purposes, the cost of processing coalbed methane gas to the

(continued...)

damages' points strongly to a suit in a court of law, rather than an agency enforcement order that happens to concern money due under a statutory scheme." 410 F.3d at 733, citing OXY USA, Inc. v. Babbitt, 268 F.2d at 1010 (Briscoe, J., dissenting). Further, the D.C. Circuit found that "[a]ny doubt is removed by the fact that subsection 2415(a) measures the limitations period from the filing of a 'complaint.' It strains legal language to construe this administrative compliance order as a 'complaint' for money damages in any ordinary sense of the term." 410 F.3d at 733.

The Tenth Circuit's decision in OXY USA, Inc. v. Babbitt, 268 F.3d 1001 (2001), notwithstanding, we will follow the D.C. and Fifth Circuits, with which our own precedent comports, in holding that the statute of limitations in section 2415(a) does not apply to MMS orders to calculate and pay royalty. In Marathon Oil Co., 149 IBLA 287, 291 (1999), the Board stated that "[a] demand for the recalculation of royalties for Indian oil and gas leases using dual accounting is not a judicial action for money damages brought by the United States, but is an administrative action not subject to the statute of limitations." The Board expressly declined to follow the Tenth Circuit's decision in Phillips Petroleum Co. v. Lujan, 4 F.3d 858 (10th Cir. 1993), to reach a contrary result:

> Even if this decision might be construed as sustaining the application of the statute to administrative proceedings, this Board has expressly declined to follow isolated decisions of Federal courts in limited circumstances even while recognizing that such a decision is the law of the case. See, e.g., Amoco Production Co., 144 IBLA [1356, 139-40 (1988)]; Conoco, Inc., 114 IBLA 28, 32 (1990); Oregon Portland Cement Co. (On Judicial Remand), 84 IBLA 186, 190 (1984); Gretchen Capital, Ltd., 37 IBLA 392, 395 (1978). The Board has eschewed following Federal court decisions primarily in those situations where the effect of the decision could be extremely disruptive to existing Departmental policies and programs and where, in addition, a reasonable prospect exists that other Federal courts might arrive at a differing conclusion. Amoco Production Co., supra. We find those conditions present here, here, especially in light of the Fifth Circuit's

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14/ (...continued)
level required to place it in marketable condition. The Mineral Leasing Act, 30 U.S.C. § 226(b)(1)(a) (2000), requires the lessees to pay the Government lessor "a royalty at a rate of not less than 12.5 percent in amount or value of the production removed or sold from the lease." See 30 CFR 206.152(h), amended and clarified in 1988 (Revision of Gas Royalty Valuation Regulations and Related Topics, 53 FR 1230 (Jan. 15. 1988)).

> conclusion on rehearing in Philips Petroleum Co. v. Johnson, cited above.

149 IBLA at 291. Accordingly, we reject Unocal's argument that section 2415(a) operates to bar MMS's January 12, 2000, order in this case.

In conclusion, we rule that MMS properly ordered Unocal to perform a restructured accounting of royalties due on its Indian Allotted leases for the period January 1993 through December 1996, and that Unocal may not deduct a gas processing allowance for that period because it did not timely file Forms MMS-4109 and MMS-2014, as required by applicable regulations.

Any other arguments presented by Unocal not addressed in this opinion have been considered and rejected.

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 affirmed.

James F. Roberts
Administrative Judge

ADMINISTRATIVE JUDGE PRICE CONCURRING SPECIALLY :

While I completely agree with my colleague's view of this appeal, I write separately to emphasize the rationale that leads to the result reached in this case.

To briefly reiterate the facts of the instant appeal, Unocal paid royalties on the sample Navajo Allotted lease on a wet gas basis, meaning that the leasehold's unprocessed gas was sold at the wellhead, without deductions for processing or transportation allowances. When it paid its royalties, Unocal completed Form MMS-2014, the Report of Sales and Royalty Remittance, based on unprocessed wet gas sales, making no entries on the Form for processing or transportation allowances, because none were claimed. MMS performed dual accounting calculations on a single lease (Navajo Allotted Lease 525-003778-0) for three sample months (July and December 1994 and January 1995). [1/] Wet gas values were compared to processed gas values for the three sample months. In calculating the processed gas values, MMS did not apply the processing or transportation allowance, because Unocal had not filed a Form MMS-4109, the Gas Processing Allowance Summary Report (or a Form MMS-4110). During the period relevant to this appeal, MMS required that Form MMS-4109 be filed before or at the same time as a processing allowance was reported on Form MMS-2014. 30 CFR 206.159(c)(1) (1992) for arm's-length contracts, or (c)(2) for non-arm's-length or no contracts. [2/] Unocal acknowledges

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[1/] Dual accounting is a comparison of wet gas values to gas values as if lease production was processed, less applicable deductions. See 30 CFR 206.155. Those deductions could include a transportation allowance, as well as a processing allowance. The transportation allowance could not be claimed unless page one of Form MMS-4110, Oil Transportation Allowance Report, was filed prior to or at the same time as the transportation allowance was reported on Form MMS-2014. 30 CFR 206.105(c)(1) (1992) for arm's-length contracts, or (c)(2) for non-arm's-length or no contracts. MMS' decision addressed only a processing allowance.

In the dual accounting Unocal performed to support its appeal, submitted as a schedule to its appeal to the MMS Director and provided as Ex. II to this appeal, Unocal provided columns for both a manufacturing and a transportation allowance, but entered "zero" for transportation. Nonetheless, Unocal explains that it did not include a transportation allowance only because the processing allowance alone reduced the processed gas value below the wellhead value. However, Unocal states that "it should also be given a transportation allowance in calculating whether a processed gas value or wet gas value is higher." (Statement of Reasons (SOR) at 2.)

[2/] The regulation, 30 CFR 206.159(c)(1) (1992), provided "the lessee shall submit page one of the initial Form MMS-4109 (and Schedule 1) prior to the time, or at the same time as, the processing allowance determined pursuant to an arm's-length

(continued...)

that it did not perform dual accounting, because it did not believe it was required to do so in light of the fact that all the lease production was sold as unprocessed wet gas at the wellhead. As noted, Ex. II, the dual accounting schedule Unocal prepared for its appeal below for the months in question reflects a theoretical processed gas value calculated by applying a processing allowance only. The calculated processed gas value was less than the wet gas value on which Unocal actually paid royalties. Unocal argues that it need not file the Form MMS-4109 in order to perform the theoretical calculation. By implication, the further argument is that, because dual accounting shows that it will be required to make no entries on MMS-2014, there can be no basis for applying the regulation requiring the filing of Form MMS-4109.

It appears that the Board's decision in Alexander Energy Corp., 153 IBLA 238 (2000), is the only appeal that has considered 30 CFR 206.159(c)(1) (1992). To briefly state the facts of that appeal, Alexander Energy involved Indian leases that specified an obligation to determine royalty by performing dual accounting, which Alexander did not do. Alexander sold the lease production as unprocessed gas at the wellhead pursuant to arm's-length contracts and had reported no royalty obligations from processed gas sales. MMS ordered the company to perform dual accounting and recalculate royalties, at which juncture Alexander Energy sought a manufacturing or processing allowance. Pursuant to 30 CFR 206.159(a) (1992), citing Alexander's failure to first file Form MMS-4109, MMS disallowed the adjustment.

On appeal, Alexander argued that it had not performed dual accounting because it sold only unprocessed gas and had no comparable market figures for processed gas sales; that its leases specifically contemplated and provided for a manufacturing allowance; and when an audit requires recalculation of royalties on the value of processed gas, fairness requires that it be permitted a retroactive manufacturing allowance, given that there had been no actual sales of processed gas. Thus, contrary to Unocal's assertion, the facts of Alexander Energy are precisely the same as those presented here.

2/ (...continued)
contract is reported on Form MMS-2014, Report of Sales and Royalty Remittance. A Form MMS-4109 received by the end of the month that the Form MMS-2014 is due shall be considered to be timely received." The regulations became effective Mar. 1, 1988, so that the initial reporting period was Mar. 1 through Dec. 31, 1988. Once filed, the initial Form MMS-4109 "shall be effective for a reporting period beginning the month that the lessee is first authorized to deduct a processing allowance and shall continue until the end of the calendar year, or until the applicable contract or rate terminates or is modified or amended, whichever is earlier." See 30 CFR 206.159(c)(1)(ii) (1992).

Unocal here contends that dual accounting for processed gas values is merely an abstract exercise in the circumstances of this appeal, since it in fact did not process its gas or make any corresponding entries on Form MMS-2014 to claim a processing or transportation allowance. Therefore, Unocal argues, it may properly apply the processing and transportation allowances that in theory would have been available to it, had it actually processed its lease production, to derive the theoretical value for processed gas. According to Unocal, it is only when, after deducting the processing and transportation allowances, dual accounting demonstrates that the processed gas value is higher, and it is thus established that additional royalty is due, that Form MMS-4109 (or MMS-4110) must be filed. Since the theoretical value of the processed gas after applying only one of the two allowances available (again, only the processing allowance) is lower than the actual wet gas value, there is no requirement to file the forms, and no basis for requiring a restructured accounting, because Unocal paid royalties on the higher of the two values, namely, the wet gas value.

The basis for Unocal's arguments, which are described in greater detail by Judge Roberts, is the fact that, while the Board correctly decided Alexander Energy, it did not directly articulate the reason why 30 CFR 206.159(c)(1)(ii) (1992) must be held applicable to theoretical calculations of value.

It would appear that, from Unocal's perspective, the critical question is whether Form MMS-2014 contains an entry claiming a processing or transportation allowance, the indication that lease production has actually been processed and/or transported beyond the leasehold. If there are no such entries on Form MMS-2014, there is no obligation to have first filed Form MMS-4109 (or MMS-4110). In this, Unocal obviously assumes that there is no practical significance to the theoretical calculation of processed gas values when lease production in fact was sold as unprocessed gas at the wellhead. The distinction Unocal urges ultimately fails substance, however, because the impact of applying the allowances to derive a theoretical value for processed gas is precisely the same as applying them to actual sales of processed gas.

Just as it would be the case were Unocal valuing gas that it had actually processed, the theoretical value of processed gas for royalty purposes is adjusted downward as a result of applying the allowances that in theory would be available to the lessee. It is this deduction from value, even in the theoretical case, that enables Unocal to assert in real time, in this appeal, that the wellhead value is the higher of the two values. The result is a real and measurable reduction of Unocal's royalty obligation and the avoidance of interest on underpaid royalty that would otherwise accrue. Thus, that "theoretical" impact is no less real than the impact in concrete circumstances; in both instances, the value of the gas for royalty purposes is actually reduced by the allowances claimed. The question is perhaps a close one, and I do believe the rule could have been more finely wrought. Nonetheless, MMS' construction is not plainly inconsistent with or foreclosed by the regulation or the explication in the preambles to the rulemaking cited by Judge Roberts in n. 4 at 5 of the lead opinion. [3/] As it is manifestly true that the value of the gas for royalty purposes is reduced in the theoretical case, MMS' conclusion that a timely filed Form MMS-4109 is a prerequisite to making any affirmative use of the processing allowance in performing dual accounting is properly upheld. [4/] Accordingly, the decision in Alexander Energy controls of the outcome of this appeal.

T. Britt Price
Administrative Judge

[3/] The 1977 NTL-1A and the July 27, 1992, Dear Payor letter quoted by Unocal do not dictate a contrary conclusion. The 1997 NTL-1A directs lessees to perform one of three calculations to determine the "method that yields the greatest royalty on a monthly basis each month," specifies the forms on which royalty is to be reported, and notes that "[w]hen appropriate, the Supervisor may require the lessee or operator to submit supporting information substantiating all three methods of royalty computation." See SOR at 5. Unocal relies on the following from the July 1992 Dear Payor letter, in which MMS emphasized the "when the value of the processed gas determined under 30 C.F.R. § 206.153 (1991) is higher than the value of the unprocessed gas, the requirements to submit appropriate allowance forms prior to claiming transportation and/or processing allowances must be met." Id.

[4/] As noted in the lead opinion, the rule requiring the submission of Form MMS-4109 as a condition precedent to making use of the processing allowance was eliminated in 1996 for Federal gas, but was retained for Indian gas. See n. 4 at 5. Ultimately, the rule was omitted from the regulations governing Indian gas as well. See 64 FR 43515 (Aug. 10, 1999).