

Appeal from the decision of the Alaska State Office, Bureau of Land Management, rejecting the high bid for tract 15 in competitive oil and gas lease sale 831. AA 51218.

Set aside and remanded.

1. Oil and Gas Leases: Competitive Leases -- Oil and Gas Leases:
Discretion to Lease

The Secretary of the Interior has the discretionary authority to reject a high bid for a competitive oil and gas lease in the National Petroleum Reserve -- Alaska because it is less than fair market value where the record discloses a rational basis for the conclusion that the amount of the bid was inadequate. The explanation provided must inform the bidder of the factual basis of the decision and must be sufficient for the Board to determine the correctness of the decision if disputed on appeal.

2. Oil and Gas Leases: Competitive Leases -- Oil and Gas Leases:
Discretion to Lease

Where the high bid for a competitive oil and gas lease sale in the National Petroleum Reserve -- Alaska is rejected as inadequate, and on appeal the bidder raises considerable doubt whether the bid is, in fact, inadequate, and the record fails to disclose a sufficient factual basis for the conclusion of inadequacy, the decision rejecting the bid will be set aside and the case remanded to BLM for reconsideration of the bid.

APPEARANCES: William J. Bonner, Esq., Anchorage, Alaska, for appellant.

OPINION BY ADMINISTRATIVE JUDGE IRWIN

ARCO Alaska, Inc., has appealed the decision of the Alaska State Office, Bureau of Land Management (BLM), dated August 12, 1983, rejecting its high bid of \$603,513.75 for tract 15 in the National Petroleum Reserve -- Alaska

(NPR-A) which was offered at competitive oil and gas lease sale 831 held on July 20, 1983. BLM concluded that the bid was not sufficient because it was less than the BLM estimate of fair market value, \$1.7 million. In support of its decision BLM attached a memorandum dated August 2, 1983, from the Deputy State Director for Mineral Resources to the Alaska State Director concerning high bid acceptance or rejection for lease sale 831.

[1] Section 100 of the Department of the Interior Appropriations Act for Fiscal Year 1981, 42 U.S.C. § 6508 (Supp. IV 1980), directs the Secretary of the Interior to conduct a program of competitive leasing of oil and gas in the NPR-A pursuant to such regulations as the Secretary may prescribe and under the guidelines listed in section 100. As a result, the Secretary determined that the provisions of the Mineral Leasing Act of 1920, as amended, 30 U.S.C. §§ 181-287 (1976), and procedures in 43 CFR Group 3100 were not applicable to the NPR-A and promulgated separate regulations at 43 CFR 3130 to govern oil and gas leasing in the NPR-A. See 46 FR 55494, 55497 (Nov. 9, 1981). These regulations provide for competitive oil and gas leasing in the NPR-A under the guidelines of 42 U.S.C. § 6508 and consistent with the Secretary's authority under the Naval Petroleum Reserves Production Act of 1976, 42 U.S.C. §§ 6501-6507 (1976), and the Federal Land Policy and Management Act of 1976 (FLPMA), as amended, 43 U.S.C. §§ 1701-1784 (1976 and Supp. IV 1980). 1/

Section 102(a)(9) of FLPMA, 43 U.S.C. § 1701(a)(9) (1976), declares that it is the policy of the United States to "receive fair market value of the use of the public lands and their resources unless otherwise provided for by statute." Thus, as with competitive leasing under the Mineral Leasing Act of 1920, the Secretary must seek the return of fair market value for the grant of a competitive lease in the NPR-A and may reject any high bid that will not provide a fair return. 43 CFR 3132.5(b). This Board will uphold the authority to do so, here, as under the Mineral Leasing Act of 1920, so long as there is a rational basis for the conclusion that the highest bid does not represent a fair market value for the parcel. In rejecting a high bid, BLM must inform the bidder of the factual basis of the decision; the explanation must be sufficient for this Board to determine the correctness of the decision if disputed on appeal. Exxon Corp., 73 IBLA 176 (1983); Amoco Production Co., 71 IBLA 241 (1983). 2/ See Southern Union Exploration Co., 51 IBLA 89 (1980).

BLM's August 2, 1983, memorandum explains the methods by which BLM determined the fair market value for the parcels that received bids at lease sale 831 and states the values and its conclusions as to whether each high bid should be accepted or rejected. In BLM's analysis, the estimate of fair market value is termed the current expected value (CEV). That value is developed

by performing multiple simulations of any given tract and then calculating the statistical average (mean) of those simulations.

1/ Sections 202 and 603 of FLPMA, 43 U.S.C. §§ 1712, 1782 (1976), are not applicable to the NPR-A. 42 U.S.C. § 6508 (Supp. IV 1980).

2/ The references in these decisions to the Mineral Leasing Act and 43 CFR 3120.3-1 as authority for leasing in the NPR-A have been corrected. See Exxon Corp., 73 IBLA 176, Erratum dated Oct. 31, 1983; Amoco Production Co., 71 IBLA 241, Erratum dated Oct. 31, 1983.

Each simulation represents a potentially unique combination of price, reservoir, inflation and other assumptions that drive a discounted cash flow analysis to determine whether the tract is or is not economically producible. Doing multiple, rather than single, DCF [discounted cash flow] simulations allows for rigorous treatment of uncertainty.

BLM also estimates a delayed expected value (DEV) using the same procedure with one difference: Field start up is delayed (which may occur generally because of administrative concerns). The impact of a delay is explained as follows:

Delays may increase the value of production if there is rapid real price growth for petroleum in the future or decrease the value of production if production costs rise faster than oil/gas prices. a delay in production generally is viewed as decreasing the value of field output because of the declining value of money as a function of time.

BLM evaluated the acceptability of the high bids for each tract after calculating the CEV's and DEV's based on guidelines outlined by the Washington Office, BLM, and determining whether a particular tract is part of a distinct "prospect" or trap or, rather, is an area of high geologic uncertainty. ^{3/} BLM's memorandum explains:

[T]he Secretary is not required to assure the receipt of fair market value for each tract but is rather bound to assure receipt of fair market value for the lands or resources leased. Oil and gas * * * are distributed into traps that were formed by geological processes. These traps * * * rarely, if ever, conveniently fit the linear boundaries used in leasing. * * * The tract is an administrative convenience useful in defining the surface on which the lessee will operate but the tract is not necessarily the appropriate unit of analysis for making the determination of fair market value. The determination of receipt of fair market value is more appropriately made on the trap (or prospect) basis. Thus, where several tracts lie on one NPR-A prospect government's CEV and DEV are aggregated and then compared to the aggregate high bids offered for those tracts. (If the total high bids for all tracts sharing a prospect exceed the total of the CEV's or DEV's for those tracts, all high bids are accepted even though an individual high bid might be below its tract-specific CEV or DEV.) [Emphasis in original.]

^{3/} Tracts with a high geologic uncertainty are defined as

"tracts where no trap is 'seen', where a trap underlying several tracts is 'seen' but only one tract on the trap received bids, and/or where the location of the trap is subject to equally valid alternative interpretations and where these multiple interpretations frustrate an attempt to accept at the prospect level." Aug. 2, 1983, memorandum at 3.

Tract 15 is classed as an area of high geologic uncertainty. It is the only such tract in lease sale 831 where the high bid is less than the CEV and DEV for the tract. ^{4/} BLM's findings for tract 15 are summarized in table 3 of the August 2, 1983, memorandum:

<u>Tract</u>	<u>High Bid</u>	<u>CEV</u>	<u>DEV</u>	<u>HB</u>	<u>HB</u>	
			<u>As a</u> <u>per cent</u> <u>of CEV</u>	<u>As a</u> <u>per cent</u> <u>of DEV</u>		
15	\$603,153.75	\$1,700,000.00	\$1,500,000.00	35%	40%	

BLM's analysis specifically supporting its decision to reject appellant's high bid concludes the August 2, 1983, memorandum as follows:

We have been advised by [the Washington Office (WO)] that our bid acceptance procedures must follow those used at the second sale, assure integrity of process and be consistent with our memorandum of June 30, 1983, outlining bid acceptance decision criteria. These WO requirements were clearly stated in their memorandum of July 15, 1983, (attached). That memorandum set out a series of decision rules. Those decision rules are generally:

1. accept the high bid on any tract receiving three or more bids regardless of the relationship between the high bid and CEV;
2. on tracts receiving two bids calculate an average tract value (high bid + other bid + CEV divided by 3 equals ATV) and accept the high bid if it exceeds the average; and/or
3. for tracts receiving one bid accept the high bid only if it exceeds CEV or DEV.

These three decision rules reflect the guidance contained in Instruction Memorandum 83-687 (dated July 15, 1983). That IM stated that: "all tracts will be appraised prior to offering (them) for sale" and "the Federal Land Policy and Management Act requires the BLM to receive fair market value for the land sold" and "that the BLM will reject any bid for less than such value." For two bid tracts the ATV is the government's estimate of tract value. For single bid tracts CEV/DEV is the government's estimate of tract value. * * *

There is no way to be consistent with this WO guidance and to accept the high bid on tract 15. However, by memorandum of July 21, 1983, the ASD for Mineral Resources, ADO, who had the

^{4/} However, the high bids for two tracts (1 and 6) identified as being part of the Walakpa prospect were accepted even though they were less than the CEV for the tracts because the amount of the bids for the six tracts in the prospect totaled more than the amount of the CEV's for the tracts.

responsibility for preparing the CEV's and DEV's for tract 15 advised that:

We believe that ARCO's bids on Tracts 7 through 10 reflect an interest in . . . the "Kugrua Sandstone," . . . Our interpretation . . . places the most prospective part of the Kugrua Sandstone further downdip to the south and slightly to the east, trending through Tracts 14, 15, and 16. The prospect lies between widely spaced wells: the Walakpa wells, Kuyanak, Peard, Kugrua, South Meade, and Topagoruk wells. The Kugrua sandstone is present in the wells to the south, but there is considerable uncertainty as to whether the Kugrua sandstone correlates to sands in the northern Kuyanak or Walakpa wells. Since a single sandstone bed as thin as the Kugrua sandstone cannot be conclusively resolved on seismic records, then the location and type of the updip trapping mechanism is subject to considerable latitude in interpretation.

If the Kugrua sandstone is interpreted to be equivalent to the Kuyanuk sandstone, then the trends from the well data place the trap in Tracts 7 through 10. If the Kugrua sandstone is not interpreted to be equivalent to the Kuyanak sand, then the Kugrua sandstone must end and form a trap further south in Tracts 14 through 16. This is our interpretation. However, either interpretation is mostly a matter of subjective geologic guesswork based on hunches and subtle data changes in the well logs and seismic sections. Thus we feel that ARCO's guess is as good as ours.

If ARCO's interpretation is correct then the value of tracts 14, 15 and 16 might fall to the minimum price per acre. Tract 15 would then have a CEV of \$574,775.00 and the high bid would be acceptable. Notwithstanding the contention that the ARCO interpretation may be as good as the government's, we still must confront the fact that (a) government's estimate of fair market value (CEV) is 2.86 times what ARCO offered and (b) WO guidance requires that the high bid on single bid tracts be at least equal to DEV. It appears that, to be consistent with WO guidelines, the high bid on tract 15 must be rejected. Also, since IBLA has consistently stated that the Secretary is entitled to rely on government's own expertise so long as there is a rational basis for doing so, the IBLA should be allowed to address the merits of this case. The government's interpretation of the geology, as summarized by the Anchorage District ASD, is clearly defensible (although other reasonable interpretations are admitted). I am, therefore, recommending the rejection of the high bid on Tract 15 and recommending acceptance of the high bids on all other sale 831 tracts.

In its statement of reasons, appellant argues that its bid does represent fair market value and that BLM's estimate is "grossly overstated." Appellant contends that since the term "fair market value" was not defined in BLM's notice of sale or the applicable statutes and regulations, it must be assumed that the traditional legal definition applies; that is, fair market value is the "amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts" (Statement of Reasons at 3, quoting Black's Law Dictionary, 537 (5th ed. 1979)). Appellant argues that under that definition fair market value in this case is best determined by the prices offered at the lease sale by informed bidders because there is no accurate way, short of drilling, to determine the value of a tract. Appellant adds that computer simulations are only as accurate as the data used. Appellant urges that the fact that there was only a single bid in tract 15 does not detract from application of this definition because competitive bidding does not require more than one bid, only that all qualified bidders had the opportunity to do so, citing Tipperary Land & Exploration Corp., 7 IBLA 270, 275 (1972). Appellant suggests that the lack of bidders on tract 15 evidences the low value the bidders assigned to the tract. In addition, appellant claims that the Department's study of fair market value in Outer Continental Shelf leasing is consistent with its arguments, referring to Appendix 3 of Secretarial Issue Document for Tentative Proposed Final Five-Year OCS Leasing Program, dated March 1, 1983. ^{5/} Appellant concludes that there is no reason to believe that the lease market for sale 831 would yield less than the fair market value for the potential resources of the NPR-A. Appellant points out that it was one of 11 companies which made 23 bids for 18 of the 84 tracts offered and that the participation of 11 companies in the high-cost, high-risk NPR-A is indicative of the competitiveness of the sale. In addition, all bidders evaluated the sale area based on the same data provided by the Department. Thus, appellant urges, the independent judgments of responsible companies were the best assurances that the Government would receive fair market value and appellant's bid represented that value in tract 15.

We disagree with appellant's conclusions. The simple response to appellant's assertion that its high bid must represent fair market value under the traditional definition because it resulted from the competitive bidding of 11 companies evaluating the same data is that the present seller, BLM, is unwilling to sell at the price offered by appellant and thus a fundamental premise of that definition is missing. Exxon Company, USA, 15 IBLA 345, 357 (1974). BLM is obligated to obtain what it considers to be full value for leased lands. Bids received on a parcel do not necessarily represent an accurate test of fair market value as bidders may consider other factors in making their bids. M. Robert Paglee, 68 IBLA 231 (1982). A company could choose not to bid on a tract because it decides to use limited resources on other tracts. Such decision does not necessarily represent a finding that the tract has no value but only that it does not fit into the company's overall bidding strategy.

^{5/} This document was not submitted with appellant's statement of reasons nor is it part of the case record.

Appellant also argues that BLM's estimate of the fair market value of tract 15 is erroneous and that BLM has improperly failed to disclose the factual data on which the estimate was based. Appellant contends that BLM relied solely on a comparison of the high bid with the CEV and DEV, but failed to validate the CEV for the record or conduct a comparative tract analysis on a regional or structural basis to ensure consistency in its bid decisionmaking process as provided in BLM guidelines. ^{6/}

Appellant urges that the CEV for tract 15 is anomalously high and notes certain distinguishing facts in support of that finding: (1) Tract 15 had the second highest CEV for all tracts receiving bids; (2) the tract 15 CEV was higher than those for five of the six tracts included in the Walakpa prospect; and (3) the tract 15 CEV was higher than those for all tracts with high geologic uncertainty. Appellant complains that BLM did not set out data that distinguishes tract 15 from the others or that supports the higher CEV.

Appellant has reviewed the bidding for sale 831 applying a mean/standard deviation analysis, a technique BLM has used in the past to test the reasonableness of its estimate of fair market value. See Amoco Production Co., supra. Appellant found that its high bid for tract 15 fell well within one standard deviation for its four tract groupings and that BLM's CEV did not fall within one standard deviation ^{7/} (Statement of Reasons at 11-12, and table I). Appellant contends, therefore, that its high bid of \$26.25 per acre fits the pattern of industry bidding for a tract with high geologic uncertainty and BLM's estimated fair market value of \$73.94 per acre does not.

Appellant also argues that BLM's July 21, 1983, technical evaluation hardly bolsters the rejection of the high bid for tract 15 in that it concedes that appellant's analysis was as good as BLM's. Appellant suggests that the uncertainty expressed by BLM is not consistent with the very high CEV for tract 15.

Finally, appellant notes that tract 6, with the highest CEV, \$2,300,000, for this sale had a single bid of \$593,000 that BLM accepted under its prospect analysis permitting acceptance of all bids for a prospect if the total bids exceeds the total of the CEV's for the tracts in the prospect. Appellant challenges BLM's assertion that it need not receive fair market value on each tract but rather fair market value for all of lands or resources leased because leasing rights only exist with respect to the individual tracts. Appellant notes that this Board disapproved of this application of prospect analysis in Exxon Company, USA, supra at 361-62. Appellant contends that the failure to apply the CEV with respect to this bid demonstrates uncertainty

^{6/} See Memorandum, dated May 24, 1982, from Assistant Director, Onshore Energy and Mineral Resources, BLM, to Alaska State Director, entitled Bid Acceptance Criteria for NPR-A Lease Sale.

^{7/} The four groups analyzed were "all Tracts which received bids," "HGU Tracts which received bids," "All Tracts for which bids were accepted," and "HGU Tracts for which bids were accepted."

that the CEV is meaningful. Appellant urges that the difference in treatment of tract 6 and tract 15 is not adequately explained and thus the decision rejecting tract 15 is arbitrary and capricious.

[2] As we stated earlier this Board will uphold the rejection of a competitive high bid where BLM has provided a rational basis for its decision and has so informed the bidder. In competitive bid situations we have held that BLM must reveal its estimate of fair market value and the underlying facts on which it was based. Southern Union Exploration Co., *supra*. It is not sufficient only to describe the method or process by which its estimate was calculated and the decision to reject the high bid made. *Id.*

In this case, BLM revealed its estimate of fair market value, described its decisionmaking process and supplied some analysis of its decision to reject appellant's high bid for tract 15. The rule on which BLM made its decision was that, in the circumstances of appellant's bid, it must be equal to or greater than BLM's CEV or DEV. Thus for BLM's decision to be sustainable on appeal, the record must at a minimum reveal the basis for BLM's CEV and DEV calculations for tract 15.

To support its valuation of tract 15, BLM explained that the high CEV was based on the conclusion of its technical staff that the "Kugrua sandstone must end and form a trap further south in Tracts 14 through 16," whereas appellant's lower evaluation is based on a conclusion that the trap ends in tracts 7 through 10. We have repeatedly stated that BLM may rely on its technical experts in matters concerning the geological evaluation of tracts of land offered at a sale of competitive oil and gas leases, and BLM may do so in this case. L. B. Blake, 67 IBLA 103 (1982). In relying on that analysis, however, BLM must ensure that a reasoned explanation is provided for the record to support the decision. Southern Union Exploration Co., 41 IBLA 81, 83 (1979). We do not find on the record before us that the evaluation of the technical experts as presented provides a rational basis for BLM's decision. The analysis is a general evaluation of the area, not a specific evaluation of tract 15. Although we are not concluding that the area-wide determination is or is not a reasonable approach in the analysis of NPR-A bids, we must be able to find some logical result of the area-wide analyses when this technique is used. ^{8/} BLM's analysis was based on the assumption that "the most prospective part of the Kugrua sandstone [trends] through Tracts 14, 15, and 16." The conclusion drawn was that "the Kugrua sandstone must end and form a trap further south in Tracts 14 through 16." After identifying the target in all three tracts the BLM analyses reaches a determination that the CEV for tract 14 was equal to the minimum bid of \$25 per acre. On the other hand, the same analysis reaches a result that the CEV for tract 15 was \$74.94 per acre. ^{9/} With this spread between CEV values, there must be some basis for a conclusion that the potential of tract 15 supports a bid almost three times greater

^{8/} Cf. Robert M. Paglee, *supra*, concerning results of determinations on tracts other than NPR-A tracts.

^{9/} There were no bids for tract 16 and, therefore, no CEV was reported.

then that of the adjoining tract. There being nothing in the record to support this determination, the implication is raised that an error has been made. In order to support a determination that the bid is properly rejected this Board must be satisfied that the determination is made on a rational basis and is free from material error. Exxon Corp., *supra*; Stephen M. Bess, 71 IBLA 122 (1983).

In conclusion, we note that there are several memoranda included in the record of the appeal that were identified as explaining the decision rules to be applied to competitive lease sale 831. It was difficult to ascertain whether they represented a consistent basis for evaluating fair market value because each memorandum seemed to state the rules in different ways using different terminology. It appears that the approach taken for this sale differs considerably from that used for competitive leasing under the Mineral Leasing Act in the past. In the latter, BLM typically evaluated the parcel or tract and estimated its fair market value. A high bid was rejected as inadequate if it was less than that fair market value. Under the rules for lease sale 831, BLM's overall approach seems to be to decide whether a high bid represents fair market value under the circumstances in which it was made, the rules changing as the circumstances of the bid and tract change. Thus, although appellant's bid was ultimately evaluated against BLM's fair market value estimate, that rule was only considered applicable because tract 15 was an area of high geologic uncertainty and it received only one bid. We note without further comment that in the absence of a clearly stated rational basis for the distinctions and specific support for decisions rejecting high bids, BLM opens itself to charges of being arbitrary such as appellant has made.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision of the Alaska State Office is set aside and the case is remanded for further action consistent with this opinion.

Will A. Irwin
Administrative Judge

We concur:

C. Randall Grant, Jr.
Administrative Judge

R. W. Mullen
Administrative Judge

