

Appeal from a decision of the New Mexico State Office, Bureau of Land Management, rejecting appellant's high bids for competitive oil and gas leases NM 58868, NM 58869, and NM 58875.

Affirmed.

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 in a competitive oil and gas lease sale where the record discloses a rational basis for the conclusion that the amount of the bid was inadequate. In such cases, a decision rejecting a bid should set forth the basis for rejection with sufficient detail to inform the bidder of the factual basis of the decision and allow the Board to make an informed determination of the correctness of the decision of the decision is disputed on appeal.

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

The Secretary has discretionary authority to reject a high bid for a tract offered at a competitive sale of oil and gas leases if he has reason to believe the bid price is less than the fair market value. If BLM supports the rejection with sufficient evidence to demonstrate a rational basis for its decision, an appellant must show BLM has erred when formulating the fair market value. If an appellant demonstrates an error in BLM's calculation of the fair market value, the net effect is to create question as to the underlying fair market value determination. This being the case, an appellant also has an affirmative obligation to establish that the bid it submitted is a reasonable reflection of the fair market value. If an appellant fails to establish this fact, this Board will uphold the Secretary's discretionary authority and affirm the rejection decision.

APPEARANCES: Bruce A. Studer, Vice President, Burton/Hawks, Inc., for appellant; Margaret C. Miller, Esq., U.S. Department of the Interior, Office of the Solicitor, Southwest Region, Santa Fe, New Mexico, for the Bureau of Land Management.

OPINION BY ADMINISTRATIVE JUDGE MULLEN

Burton/Hawks, Inc. (Burton), appeals from a July 11, 1985, decision of the New Mexico State Office, Bureau of Land Management (BLM), rejecting for the second time its high bids submitted for oil and gas leases NM 58868, NM 58869, and NM 58875 (parcels 18, 19, and 25, respectively). The bids of \$210 (\$5.25 per acre) for each 40-acre parcel, were made at the April 25, 1984, competitive oil and gas lease sale.

By decision dated May 24, 1984, the New Mexico State Office, BLM, rejected the bids because its evaluation of each parcel showed that "the bid was less than the pre-sale tract evaluation." That decision was based upon a memorandum dated May 3, 1984, in which the Deputy State Director for Mineral Resources advised the Deputy State Director for Operations that the Branch of Economic Evaluation had recommended the high bids for parcels 18, 19, and 25 be rejected.

On appeal in Burton/Hawks, Inc., 85 IBLA 193 (1985), this Board set aside and remanded BLM's May 24, 1984, decision for further consideration. The Board's decision stated: "If the bids are rejected again, BLM shall detail the reasons for its decision and shall include the presale evaluation so as to create a reviewable record in the event of an appeal." Id. at 195.

On July 11, 1985, BLM issued a decision rejecting appellant's high bids for a second time, based upon the recommendation of BLM's Southwest Region Evaluation Team (SRET). A June 28, 1985, memorandum prepared by SRET accompanied the decision. This memorandum stated, in part:

The SRET valuation for this parcel is \$50.00 per acre, or \$2,000.00 total. Burton/Hawks bid \$5.25 per acre, or \$210.00 total. Current data available to the SRET indicate proven production in the immediate area of the subject from at least three target zones. These zones are locally known as "Pictured Cliffs," "Gallup," and "Chacra." Since there is a minimum of six "Chacra" wells within a mile of the subject, the SRET has evaluated this parcel on the basis of "Chacra" potential.

The SRET utilized parameters that are considered to be typical for drilling costs, operating costs, taxes, etc., in arriving at the above valuation. The methodology applied was a discounted cash flow (DCF) model which implements the "Monte Carlo" technique and performs 5,000 iterations. Proven production and test data from nearby wells were utilized. The SRET used a conservative risk factor of 50 percent, and the mathematical result was \$60.28 per acre as a minimum bonus value. (Refer to copy of DCF printout attached.) In view of the strong potential for a

downward trend in gas prices and demand, the SRET adjusted this value to \$50.00 per acre as the absolute minimum for bonus.

In its statement of reasons on appeal Burton states with regard to the use of the Monte Carlo model:

According to the October issue of the Journal of Petroleum Technology, "It is suitable (i.e., the Monte Carlo model) for evaluation of off-shore prospects in Frontier exploration areas of Alaska and Canada." Accordingly we feel the application of this model for evaluation of these KGS development type parcels is inappropriate.

Appellant further contends that the annual operating expenses of \$4,000 to \$4,500 used in SRET's DCF analysis was too low, failing to consider the cost of wages and salaries of pumpers, technical employees, and consultants. Appellant alleges that the annual operating expense for a well on this location approximates \$12,000. Appellant asserts that a price range of \$2.25 to \$3.25 as used in SRET's analysis is inappropriate because purchasers have not obtained new gas from the area for 3 years. Appellant also asserts that the Monte Carlo model devised by SRET did not take into account lack of present market. Appellant concludes that the leases in the area of parcels 18, 19, and 25 were properly valued at between \$15 and \$20 per acre when a market for the gas existed.

The Office of the Regional Solicitor, representing BLM, has submitted an Answer in reply to Burton's statement of reasons. The Solicitor states in part:

The earnings approach to evaluation is described in the Uniform Appraisal Standards for Federal Land Acquisitions. It has been approved for use in oil and gas evaluation work by the Director, Bureau of Land Management, (see Instruction Memorandum 85-490). Evaluations developed through the earnings approach have been upheld by the Interior Board of Land Appeals (83 IBLA 80). It has long been a tenet of leading economists that the earnings approach is the only way to estimate the economic rent associated with a property and that it is proper for the government to attempt to capture such economic rent. (Boulding. Economic Analysis. 1948. Harper and Brothers. page 663.) It has also long been held that, when making decisions under risk or uncertainty, it is appropriate to use models that incorporate probabilities when certain key variables may take on more than one possible value. (Donnelly, Gibson and Ivancevich. Fundamentals of Management. 1971. Business Publications, Inc., pages 295, 296, 301 and 302.) The discounted cash flow model used in the evaluation of parcels 18, 19, and 25 incorporates the proper treatment of probability into an earnings evaluation and gives superior results when compared to earnings evaluation that assume certainty.

* * * * *

Appellant's attempt to characterize the setting surrounding parcels 18, 19 and 25 as a \$10.00 to \$15.00 per acre [sic] area is not supported by the facts. Attachment 2 to this memorandum lists 26 oil and gas lease parcels which have been offered for competitive sale by the State of New Mexico and/or the Federal Government in the area that includes parcels 18, 19 and 25. Only one accepted bid falls in the \$10.00 to \$15.00 area advanced by appellant as typical of the prices paid in this setting. Of the 22 accepted bids (unaccepted bids have no probative value as they could not, by definition represent fair market value), 20 were equal to or greater than \$25.00 per acre and 10 were from \$55.00 to \$57.00 per acre. Thus, this area cannot be properly characterized as a \$10.00 to \$15.00 per acre setting. In fact, the Most Likely Value Zone (MLVZ) is \$55.00 to \$75.00 per acre (probability of .455 based on 10 of 22 accepted bids being from \$55.00 to \$57.20 per acre).

[1] The Secretary of the Interior has discretionary authority to reject a high bid for a competitive oil and gas lease as inadequate. 30 U.S.C. § 226(b) (1982); see, e.g., Suzanne Walsh, 94 IBLA 249 (1986); Read & Stevens, Inc., 93 IBLA 61 (1986); Michael Shearn, 87 IBLA 168, 169 (1985); Viking Resources Corp., 80 IBLA 245 (1984). This Board has consistently upheld that authority, so long as there is a rational basis for the conclusion that the highest bid does not represent fair market value for the parcel. E.g., Clarence Sherman, 82 IBLA 64, 65 (1984); Viking Resources Corp., supra at 246; Glen M. Hedge, 73 IBLA 377, 378-79 (1983). Departmental policy in the administration of its competitive leasing program is to seek the return of fair market value of the grant of leases, and the Secretary reserves the right to reject a bid which will not provide a fair return. Viking Resources Corp., supra at 246; Glen M. Hedge, supra at 379.

[2] The Department is entitled to rely on the reasoned analysis by its technical experts in matters concerning geologic evaluation of tracts of land offered at a sale of competitive oil and gas leases. Don Nelson, 85 IBLA 156 (1985); L. B. Blake, 67 IBLA 103 (1982). If the record indicates a decision to reject a bid has been made in a careful and systematic manner utilizing the advice of such experts, that decision will not be reversed, even though the determination may be subject to reasonable differences of opinion. See Kerr-McGee Corp. v. Watt, 517 F. Supp. 1209, 1213-14 (D.D.C. 1981).

The Board has repeatedly stressed the need for BLM to document the reasons for its determination in the record. In the instant appeal the record was initially found to be insufficient for the Board to determine the correctness of the BLM decision or the merits of appellant's arguments. The Board stated that the record did not then reveal the underlying calculations or data to support rejection of appellant's bids, and therefore set aside BLM's initial rejection and remanded the case to BLM for further consideration. Burton/Hawks, Inc., supra.

In this case BLM supplemented the record with an analysis based upon the "Chacra" target zone and the success of six wells within 1 mile of appellant's parcels. Moreover, the Board has determined that a lease may not issue even though appellant shows BLM's minimum acceptable bid value was erroneous if a bidder fails to affirmatively show that its bid represents fair market value for the parcel. Thus, where BLM fails to provide a rational basis for its rejection decision or where appellant shows BLM has erred in its calculation of a minimum acceptable bid value, the Board must also be satisfied that appellant's bid represents fair market value in order for the appellant to be awarded the lease. Edward L. Johnson, 93 IBLA 391, 400 (1986); Harold Green v. BLM, 93 IBLA 237, 247 (1986). Therefore, appellant also has an affirmative obligation to demonstrate its bid represents the fair market value. Harris-Headrick, 95 IBLA 124 (1987); The Westlands Co., 83 IBLA 43 (1984). The Secretary or his delegate need not prove the bid submitted by a bidder is inadequate in order to support a rejection decision. Rejection is an exercise of the Secretary's discretion, and deference is given to such action if, in the public interest, the Secretary has reason to believe a bid to be in an amount which is less than the Department's estimate of fair market value. Read & Stevens, Inc., *supra*; Harvey E. Yates, 71 IBLA 134 (1983); Kerr McGee Corp., 6 IBLA (1972), *aff'd*, Kerr McGee Corp. v. Morton, 527 F.2d 838 (D.C. Cir. 1975).

In the case before us, appellant has called into question the figures used by BLM for the operating expenses and value of gas in its computer-assisted valuation of the tracts. If appellant is correct in this respect, appellant has placed the \$50-per-acre fair market value determination by BLM in question. However, BLM has submitted evidence regarding bids submitted for tracts in the general area. The lowest accepted bid was \$10.99 per acre, and 33 bids were in excess of that amount. On the other hand, appellant states in its statement of reasons that "bonuses for leases in the area were in the neighborhood of \$15-20.00 per acre when there was a gas market." No evidence is submitted to support a determination that, because of the changes in market conditions, the fair market value should be reduced from \$15 to \$20 per acre to \$5.25 per acre. Appellant has failed to demonstrate that its bid represents the fair market value for the tract.

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 New Mexico State Office is affirmed.

R. W. Mullen
Administrative Judge

We concur:

Will A. Irwin
Administrative Judge

Bruce R. Harris
Administrative Judge

