MOBIL EXPLORATION AND PRODUCING U.S. INC.

IBLA 97-434 Decided April 8, 1999

Appeal from a decision of the Associate Director for Policy and Management Improvement, Minerals Management Service, finding that a transportation allowance previously approved in writing was terminated on April 30, 1990. MMS-93-0997-O&G.

Reversed.

1. Minerals Management Service: Generally--Minerals Management Service: Appeals to Director--Oil and Gas: Pipelines--Regulations: Generally--Regulations: Interpretation

Departmental regulation 30 C.F.R. § 206.157(c)(2)(v) did not confer authority on MMS to revoke an approved gas transportation allowance in effect when the regulation was promulgated on Mar. 1, 1988, in the absence of changed circumstances which caused the allowance to terminate. The allowance, which was previously approved in writing by MMS, contained no time limitation, and none was provided by the rule.

APPEARANCES: L. Poe Leggette, Esq., and Thad S. Huffman, Esq., Jackson & Kelly, Washington, D.C., for Appellant; Peter J. Schaumberg, Esq., Geoffrey Heath, Esq., and Howard W. Chalker, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE TERRY

Mobil Exploration & Producing U.S. Inc. (Mobil or Appellant), as agent of Mobil Producing Texas & New Mexico Inc. (MPTM) and Mobil Oil Corporation, has appealed from a November 6, 1996, Decision of the Associate Director for Policy and Management Improvement (Associate Director), Minerals Management Service (MMS), that denied Mobil's appeal of a May 28, 1992, Decision of the MMS Royalty Valuation and Standards Division (RVSD).

This appeal concerns the extent to which the costs of transporting carbon dioxide (CO_2) produced from Federal leases may be deducted from the value of the CO_2 in calculating royalty due the United States. RVSD's

May 28, 1992, Decision held that Mobil's Cortez Pipeline tariff had terminated, so that RVSD's previous approval of use of that tariff as a transportation allowance had also terminated under 30 C.F.R. § 206.157(c)(2)(v), and that after April 30, 1990, Mobil instead became subject to the reasonable actual cost provisions of 30 C.F.R. § 206.157(b) (covering cases where a company furnishes transportation services for itself) and was required to compute its transportation allowance on that basis.

Appellant, Shell Oil Company (Shell), and Cortez Vickers, Inc., own the Cortez Pipeline, a 500-mile CO_2 pipeline that is one part of a link that connects the McElmo Dome Unit in Colorado where CO_2 is produced with West Texas oil fields where CO_2 is used to enhance oil recovery. Rates for transporting CO_2 through the Cortez Pipeline were established by contract. See May 18, 1982, Cortez Pipeline Contract (1982 Contract). The 1982 Contract provides, inter alia, (1) that rates shall be determined by using the methodology approved by the Department of Justice in the 1941 Consent Decree in United States v. Atlantic Refining Co., Civ. No. 14060 (D.D.C. Dec. 23, 1941), and (2) that in performing the necessary calculations under the 1941 Consent Decree methodology, a theoretical projected throughput of 1,000 MMCF per day shall be assumed for the first 6 years after operations commence. See 1982 Contract, paragraph 16.

The purpose of using a temporary, theoretical throughput in calculating the transportation rates under the 1941 Consent Decree was to encourage use of the pipeline by all potential transporters during the early years of pipeline operations. (1992 Statement of Reasons (SOR) at 2.) Accordingly, the tariff rate charged was lower than it would have been if actual throughput data had been used. Thus, the pipeline company was subsidizing the transportation of the carbon dioxide to ensure maximum use of the pipeline.

After negotiation of the 1982 Contract, Shell, as principal owner and operator of the pipeline, and Mobil, as part owner and one of the principal users, requested that MMS authorize them to claim a transportation allowance determined on the basis of the tariff calculation procedure established by the 1982 Contract. 1/ The MMS agreed, subject to backing out Federal and state income taxes which would have been included under the 1941 Consent Decree methodology. 2/ Mobil and Shell appealed from those decisions insofar as they refused to permit "consideration * * * of Federal and State income taxes in computing transportation costs," and this Board set aside those portions of the MMS decisions. See Mobil Producing Texas & New Mexico, Inc., 115 IBLA 164, 178 (1990); Shell Western E & P, Inc., 112 IBLA 394, 400 (1990). During the pendency of these appeals, MMS

1/ Shell's Request was dated Dec. 9, 1983. Mobil's request was dated Oct. 28, 1985.

2/ MMS' decision concerning Shell was dated Mar. 29, 1984. Its decision concerning Mobil was dated Dec. 31, 1986.

promulgated new regulations governing deduction of transportation allowances from the value of production in determining the royalty from Federal leases. These regulations became effective March 1, 1988.

Although the request is not in the record, during the pendency of these appeals, on July 1, 1987, Mobil requested approval of a transportation allowance based on the Cortez Pipeline tariff. 3/ RVSD approved (subject to audit) the 1985 transportation allowances:

> The Cortez Pipeline `tariff calculation' procedure to arrive at a value deduction for transportation costs proposed by MPTM is acceptable, with the exception that, for royalty purposes, State and Federal income taxes are not to be considered in computing transportation costs. * * * The MMS-approved 1985 * * * transportation allowance * * * was based on actual allowable costs submitted by [Mobil]. The 1985 allowances which [Mobil] may deduct will be the lesser of the approved allowances (the sum of the approved transportation allowances for the pipeline segments to each delivery point) or 50 percent of the value of the CO_2 at the sales point.

(MMS Field Report Exh. 10, Encl. 1, at 3-4.)

On October 1, 1991, Mobil requested that RVSD approve the deductibility of the Cortez Pipeline tariff rate for production of CO_2 during January 1989 through December 1991. (Exh. 13 to 1994 Supplemental (Supp.) SOR at 1.) In the October 1, 1991, letter, Mobil noted that MMS had previously approved the tariff procedure, that the tariff rate was reasonable, and that MMS allowed Chevron and other third-party users to deduct the full amount of the tariff as a transportation allowance. Id. at 6-9.

In its May 28, 1992, Decision, RVSD denied Mobil's request. (Exh. 14 to 1994 Supp. SOR.) Although RVSD in its decision had approved Mobil's use of the tariff rate from January 1984 through February 29, 1988 (Id. at 1), it nevertheless determined that the pipeline's tariff reached its termination date on April 30, 1990. The RVSD determined that the tariff calculation procedure it had previously approved "would apply [only] to the period April 15, 1984 through April 30, 1990." Id. at 2. The RVSD therefore ordered Mobil "to compute its transportation allowance based on reasonable actual costs in accordance with the regulations at 30 C.F.R. § 206.157(b) (1991)" for the period after April 30, 1990. Id. That provision applies where the transportation contract is not arm's-length. Mobil filed a timely notice of appeal.

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3/ Mobil's request for approval of transportation allowance pertained to CO_2 production transported from the McElmo Dome Unit through (1) Cortez Pipeline, (2) MPTM Pipeline, and (3) West Texas Pipeline.

Subsequently, on February 11, 1994, RVSD's successor, the Valuation and Standards Division (VSD), submitted its field report on Mobil's appeal. In the report, VSD claimed that the text of Mobil's CO_2 sales contract with Shell demonstrated that the tariff calculation procedure terminated on April 30, 1990, but it recommended to the MMS Director that the previously approved tariff remain in force until June 1, 1992, the date Mobil received RVSD's May 28, 1992, Decision. Id. at 10. The VSD also found in its field report that MMS had merely approved transportation allowances for specified years and that the last such approval terminated on February 29, 1988, the day before the March 1, 1988, regulations became effective. For this reason, VSD argued that "the regulations at 30 C.F.R. § 206.157(c)(2)(v) (1992), extending the transportation allowance approval beyond March 1, 1988, do not apply at McElmo Dome." Id. at 4.

VSD gave additional reasons in its report for terminating MMS' prior approval of the tariff procedure. First, it claimed the procedure "has never been approved by any State or FERC jurisdictional authority." (Exh. 15 to 1994 Supp. SOR at 6.) Second, although this Board had held in Mobil Producing Texas & New Mexico, Inc., supra, and Shell Western E. & P., Inc., supra, that Federal and state income taxes were allowable expenses, VSD now found their inclusion barred by the March 1, 1988, regulations. Id. at 8. Third, VSD stated that certain administrative fees and interest costs allowed under the tariff procedures would not be allowed under the 1988 regulations. Id. Fourth, VSD claimed it would not be administratively burdensome for Mobil to calculate the pipeline's actual costs. And fifth, VSD asserted that its decision did not discriminate against Mobil because of its affiliation with Cortez Pipeline, Inc., even though Chevron and others were being allowed to deduct the full cost of the tariff. This was so, VSD claimed, because "the costs for third party users are actual `out of pocket' costs paid directly to the owners of the pipeline, including Mobil." Id. at 9.

In her November 6, 1996, Decision here under appeal, the Associate Director, MMS, found that VSD had acted lawfully in modifying Mobil's transportation allowance and in requiring Mobil to compute its actual transportation costs. (1996 Decision at 9.) The Associate Director found that the clear purpose of 30 C.F.R. § 206.157(b)(1) was to allow MMS to adjust transportation allowances that are not reasonable and to direct a lessee to modify its estimated or actual transportation allowance deduction if MMS concludes that an existing allowance is excessive. (1996 Decision at 16.) The Associate Director determined that, in contrast to Shell, which had an "open-ended" approval for a transportation allowance, Mobil's allowances were all time-delimited and that, on March 1, 1988, Mobil had no approved allowance in effect, thus allowing the VSD to modify without terminating an approved allowance. (1996 Decision at 18.)

The Associate Director further determined that Mobil was required to use actual cost transportation allowances under 30 C.F.R. § 206.157(b) because its transportation agreement with the Cortez Pipeline Company was not an arm's-length contract. (1996 Decision at 21.) The Director found that the relationship between Mobil and the Cortez Pipeline Company is not one of opposing economic interests and thus is not arm's length under either the pre-1988 approach reflected in section 647.2.3B(5) of the Conservation Division Manual (Aug. 15, 1977) or under the definition contained in the current 30 C.F.R. § 206.151. Therefore, the Associate Director reasoned, Mobil did not rebut the presumption of control established in 30 C.F.R. § 206.151 as a result of its part ownership of the pipeline, and the contract was not, therefore, an arm's-length contract. (1996 Decision at 27.)

A third rationale advanced by the Associate Director for approving the VSD requirement that Mobil calculate actual costs is the fact that the Cortez Pipeline tariff calculation procedure has never been approved by any State or FERC jurisdictional authority. (1996 Decision at 27.) The Associate Director disallowed the Consent Decree methodology, because it included many nonallowable expenses such as interest expense, banking fees, and income taxes, and was not FERC- or state-approved, such that it was not reasonable when compared to the allowance computed using allowable actual costs under 30 C.F.R. § 206.157.

The Associate Director next addressed whether the VSD modification violated Mobil's due process rights and/or the terms of section 2(d)(2) of Mobil's leases by terminating use of the tariff procedure without first granting Mobil a hearing. The Director determined that the May 28, 1992, modification did not violate Mobil's lease terms and did not retroactively terminate the tariff methodology. The Associate Director found that the May 28, 1992, Decision "did not terminate an approved allowance then in effect at all--it merely approved use of the tariff procedure for a specific time period (March 1, 1988, through April 30, 1990)." (1996 Decision at 30.) The Associate Director further noted that Appellant was not without notice of the changes in the 1988 regulations, having participated in the notice and comment procedures prior to their publication. Id.

Finally, the Associate Director addressed the issue of discriminatory treatment and whether Mobil was entitled to use the same tariff rate that nonaffiliates are using to avoid discrimination. The Director found that the fact that MMS authorizes third parties to claim a transportation allowance based on the tariff rate is not discriminatory and unlawful, since the third-party user incurs actual out-of-pocket costs which are paid directly to the owners of the pipeline. (1996 Decision at 32.)

In its 1997 SOR for appeal filed with this Board on May 5, 1997, Appellant first explains that Mobil is only seeking to deduct the actual reasonable amount which it pays to the Cortez Pipeline Company, a process previously approved in the very similar case of Shell Oil Co., 136 IBLA 203, 207 (1996), (petition for reconsideration denied) (Feb. 5, 1997). Appellant points out that the actual amount paid was precisely what this Board approved for Shell (also a part owner of the pipeline) in finding that the MMS language approving the tariff procedure for Shell (precisely the same language used for Mobil) was an "open ended approval" remaining in effect "until the party granted the allowance made application for and received MMS approval of a new allowance." (1997 SOR at 2, quoting Shell Oil Co., supra at 207.) Appellant points out that this Board rejected MMS' effort to terminate its prior approval of Shell's transportation allowance and that that Decision applies with equal force here. (1997 SOR at 2.)

Second, Mobil states that the Associate Director continues to argue that it (Appellant) is not entitled to the full tariff solely because its affiliate has an interest in the pipeline. Mobil explains that this Board has already resolved this issue and that the Director "has simply reinstituted the same irrational discrimination against a producer affiliated with a pipeline that the Board denounced in Shell Western E & P Inc., 112 IBLA 394 (1990), and Mobil Producing Texas & New Mexico, Inc., 115 IBLA 164 (1990). (1997 SOR at 2.)

Third, Appellant states that although an affiliate owns a 37-percent interest in the Cortez Pipeline Company, Mobil's transportation contract with that company is at arm's length within the meaning of 30 C.F.R. § 206.157(a)(1)(i). Appellant claims this is so because Mobil's interests are economically opposed to those of the pipeline. (1997 SOR at 3.) Mobil further explains that the structure of the partnership comprising the Cortez Pipeline Company gives that entity an interest in raising the tariff; yet the Appellant reminds that the Associate Director admitted on page 25 of the 1996 Decision that Mobil was financially better off with a lower tariff. Id.

Fourth, Appellant claims that under the terms of Mobil's leases, MMS' approval of the tariff calculation procedure must remain in effect until rescinded prospectively after an opportunity for hearing on the reasons for rescission. (1997 SOR at 3.) Appellant claims the Associate Director has wrongly upheld a 1992 rescission retroactive to 1990, and upheld it without a hearing. Id.

Finally, Appellant asks this Board to examine the consequences of following the Associate Director's Decision. If this Board were to uphold the Associate Director's Decision, Appellant asserts, Mobil would be the only lessee in the Unit not allowed to deduct the full tariff. Even Shell, whose affiliate owns a larger share of the pipeline than Mobil's affiliate owns, will be deducting the full tariff, while Mobil would be left in the competitive disadvantage of paying higher royalties on precisely the same production. (1997 SOR at 3.)

In its Answer filed with this Board on August 4, 1997, MMS claims this Board's decision in Shell Oil Co., supra, does not control this case. MMS states that the only approvals MMS had issued to Appellant prior to March 1, 1988, pertained to calendar years 1985 and 1986. (Answer at 10.) Quite simply, MMS claims that Mobil did not have an allowance in effect on March 1, 1988, while Shell did, so that Mobil does not fall within the purview of Shell Oil Co., supra. Id. at 11.

Second, MMS claims that if VSD's tacit approval of Mobil's transportation allowance for the period March 1, 1988, through April 30, 1990, was unauthorized, then Mobil should be required to use its actual, reasonable costs of transportation for the period March 1, 1988, forward. The MMS claims that if VSD's May 28, 1992, Decision benefits Mobil improperly, the correct course is to remove the improper benefit. (Answer at 12.)

In the alternative, MMS argues that even if Shell Oil Co., supra, controls, MMS has met the requirements the Board articulated in denying MMS' Request for Reconsideration. The MMS quotes the Board for the "authority to modify a transportation allowance prospectively where circumstances cause the previously allowed deduction to represent more than a reasonable allowance for the cost of transportation" if MMS "articulates a rational basis for finding that the approved allowance no longer represents a reasonable deduction from the value of production." (Answer at 13; see Feb. 5, 1997, Order at 1-2.)

In its Reply dated September 16, 1997, Appellant again cites the same language approving Shell's tariff calculation as was used in Mobil's approval. (Reply at 2.) Appellant asserts that MMS' documents do not support the Associate Director's view that MMS only approved the tariff calculation procedure for the Cortez Pipeline annually upon Mobil's request. To the contrary, Appellant explains that, while MMS reiterated that the MPTM pipeline (an entirely different pipeline segment) allowance had to be computed annually based on actual allowable costs, it simply stated that the use of the tariff was approved for the Cortez Pipeline. (Reply at 6.) Appellant points out that MMS, in its two June 26, 1989, letters to Mobil concerning approval of both the MPTM and Cortez Pipelines (first for the 1987 year and then for the period January 1988 through February 1988), made clear that the decision to allow tariff calculation procedures for the Cortez Pipeline had already been made. Further, those letters showed that MMS had

> "proved the costs incurred in the Cortez Pipeline Tariff, with the exception of income tax, as a transportation allowance for the shipment of CO_2," and that the "approved `tariff calculation' procedure allowed certain transportation charges assessed by Cortez Pipeline Company in accordance with a 1941 pipeline consent decree."

Id., quoting Exhs. 11 and 12 to 1994 SOR.

Appellant further claims that MMS has not shown that the tariff is unreasonable. (Reply at 8.) Mobil asserts that, just as MMS' treatment of Shell and Mobil was identical before 1988, it was identical after 1988. Appellant further explains that for both companies, MMS treated the pre-1988 approvals of the use of the Cortez Pipeline tariff as continuing notwithstanding the promulgation of the 1988 regulations. (Reply at 9.) MMS then purported to "terminate" the approvals retroactively as of April 30, 1990, on the theory that the transportation contract had terminated then. Id. Appellant argues that this rationale was not accepted in Shell Oil Co., supra, and should not be accepted here. (Reply at 10.)

Mobil argues that MMS has failed to articulate a rational basis for concluding that the previously approved allowance no longer represents a reasonable deduction. It asserts that MMS is denying the tariff simply because it is different from the procedure outlined in the 1988 regulations, while ignoring the fact that these new regulations provide that different procedures can be grandfathered if they were previously approved until they are terminated. (Reply at 10.)

Mobil also alleges that the 1996 Decision improperly discriminates against Appellant. Mobil explains that the Decision appealed from leaves it as the only company shipping CO_2 on the pipeline which is not allowed to deduct the full tariff as a transportation allowance. Mobil further claims that the Associate Director's assertion that the different treatment of Shell is justified because MMS may have made an "error in judgment" in granting Shell's approval is simply not substantiated. (Reply at 11.)

Finally, Mobil claims that even if the Board were to reject all of these arguments and hold that Mobil is subject to different nonarm's-length transportation allowance rules than was Shell, it should still prevail because its (Mobil's) transportation arrangement with the Cortez Pipeline was an arm's-length arrangement like those of other working interest owners in the unit. (Reply at 12.) Appellant reiterates that its interests in the transportation arrangement are economically opposed to those of the pipeline company, thus rebutting the presumption that the arrangement was not at arm's length. (Reply at 13.)

[1] We specifically find that Mobil's transportation allowance, approved in writing by MMS in 1984, was in effect on March 1, 1988. As we stated in Shell Oil Co., supra at 205-06, both the history and text of 30 C.F.R. § 206.157(c)(2)(v) lead to a conclusion that the regulation does not provide authority for unilateral revocation of a transportation allowance that was approved in writing by MMS and was in effect on March 1, 1988, in the absence of changed circumstances causing the allowance to terminate. The cited rule states:

> Non-arm's-length contract or no contract based transportation allowances which are in effect at the time these regulations become effective will be allowed to continue until such allowances terminate. For the purposes of this section, only those allowances that have been approved by MMS in writing shall qualify as being in effect at the time these regulations become effective.

30 C.F.R. § 206.157(c)(2)(v). We explained in Shell Oil Co., supra:

> The regulation was first proposed on February 13, 1987, at 52 FR 4732. In a preamble to the first proposed rulemaking,

MMS stated an intention "to terminate all existing transportation allowances with the issuance of final rulemaking. This termination would require all lessees to follow the new reporting requirements to be eligible for the deduction of transportation costs for production months subsequent to the effective date of the final rules." 52 FR 4739 (Feb. 13, 1987). On August 17, 1987, MMS published another notice of proposed rulemaking containing changes made after public hearings and comment. 52 FR 30776 (Aug. 17, 1987). The preamble to the August 17 proposed rulemaking posed the question "[s]hould current approved transportation allowances remain in effect until they expire?" One industry comment was reported to favor making such allowances "continue until the applicable contract or rate terminates, or is modified or amended." In response to the quoted question and comment, MMS stated that 30 CFR 206.157(c)(2)(v) was revised "to provide that any transportation allowances in effect on the date these regulations become effective be allowed to continue until such allowances terminate subject to later audit." 52 FR 30800 (Aug. 17, 1987).

A further notice of proposed rulemaking issued on October 23, 1987, at 52 FR 39792. The preamble thereto reports that agency review of further comments received led MMS to make changes to the final draft regulations, some of which were significant. The regulation at 30 CFR 206.157(c)(2)(v) was amended to add language requiring that allowances be approved in writing by MMS in order to qualify for continuation under the new rules. The reason given for adding this language was that MMS believed "that the intent of the final rules will be best served by having all allowances to be deducted under the new rules documented as of that date." 52 FR 39820 (Oct. 3, 1987). The same explanation was repeated in the preamble to the final regulations published January 15, 1988, at 53 FR 1230, 1260.

This regulatory history shows that MMS decided to allow certain transportation allowances that had written approval from MMS on March 1, 1988, to continue until they expired by their own terms. The revision in the second proposed rulemaking on August 17, 1987, was made in response to questions about allowances remaining in effect until they expire. If MMS intended to reserve authority to itself in the future to revoke approved transportation allowances it could have stated that allowances would continue until terminated by MMS. It did not do so. Instead, this regulation was revised to read "until such allowances terminate," in response to the question whether they would remain in effect until they expire (a result obviously different from revocation). Use of the words "until such allowances terminate" does not indicate any action by MMS was contemplated. This phrasing, combined with the history of the regulation as set forth herein, leads us to conclude that,

> absent further rulemaking, transportation allowances in existence on March 1, 1988, that were previously approved in writing by MMS would continue until they terminated by their own terms, or until the party granted the allowance made application for and received MMS approval of a new allowance.

Id. at 206-07.

It is also not correct, contrary to the assertion made by MMS in its Answer to Mobil's 1997 SOR, that the December 31, 1986, and July 1, 1987, MMS letters to MPTM approved use of the tariff by Mobil as a transportation allowance only for a defined period. As noted by Mobil in its Reply to MMS' Answer, there is no difference in the language used in the March 29, 1984, response to Shell, which MMS now claims to be an "open ended" approval, and to Mobil on December 31, 1986, which MMS claims was only for a defined period. In each, the language set forth below was identical.

> The "tariff calculation" procedure to arrive at a value deduction for transportation costs proposed by MPTM is acceptable, with the exception that, for royalty purposes, state and Federal income tax are not to be considered in computing transportation costs. Accordingly, state and Federal income tax should be eliminated before transportation costs are computed.

See Exh. 20 to 1997 SOR at 2; cf. Exh. 21 to 1997 Reply to MMS Answer, Findings and Conclusions at 6. More importantly, this was clearly the intent of MMS at the time the dispositive December 31, 1986, letter was written. In MMS' Findings and Conclusions enclosed with its July 1, 1987, letter to Mobil, moreover, it advised that the approvals for Mobil and Shell to continue to use the tariff for the Cortez Pipeline segment had already been made, and it reiterated this same point in Enclosure 1 to its July 26, 1989, letter to Mobil. (Enclosure 1 to Exh. 11 to 1994 SOR.)

The Associate Director's Decision here under review claims a distinction between what it recognizes as an "open-ended" approval for Shell and a limited approval for Mobil, despite the same language in its approval letters. We can find none. Both approval letters also approved allowances for transportation through a segment of pipeline owned by MPTM, not by Cortez. Both letters distinguished between the approved Cortez tariff procedure for transportation on the Cortez Pipeline and the allowance for the separate MPTM pipeline, the latter of which "is computed annually based on actual allowable costs * * *." (Exhs. 11 and 12 to 1994 SOR at 6.)

The record establishes that MMS approved the use of the "Cortez Pipeline tariff calculation procedure," not a 6-year transportation allowance. The MMS had opportunities to set temporal limits on the Cortez allowance when it was approved in writing, and later, when the 1988 regulations were published, but chose not to do so. The plain language of 30 C.F.R. § 206.157(c)(2)(v) fails to provide authority upon which MMS could rely to terminate Mobil's approved open-ended allowance in the fashion described in this case. For this reason, the November 6, 1996, Decision of the Associate Director finding to the contrary lacks support in the record and must be reversed.

To the extent Appellant has raised other arguments which we have not specifically addressed herein, they have been considered and rejected.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the Decision appealed from is reversed.

James P. Terry
Administrative Judge

ADMINISTRATIVE JUDGE HUGHES CONCURRING:

Although in agreement with the result reached by Judge Terry, I arrive at this result for substantially different reasons. This case is controlled by the disposition of the question whether Mobil's transportation contract with the Cortez Pipeline is at arm's length. The regulations define "arm's-length contract" as follows.

> Arm's-length contract means a contract of agreement that has been arrived at in the marketplace between independent, nonaffiliated persons with opposing economic interests regarding that contract. For purposes of this subpart, two persons are affiliated if one person controls, is controlled by, or is under common control with another person.

30 C.F.R. § 206.151. Further, under that provision, ownership of 10- through 50-percent interest of one party by the other creates a presumption of control. Id. However, MMS has adopted the policy that such presumption may be rebutted by the lessee. See 53 Fed. Reg. 1230, 1239 (Jan. 15, 1988). Further, the lessee has the burden of demonstrating that its transportation contract is arm's length. 30 C.F.R. § 206.157(a)(1)(i).

Mobil owns less than 50-percent interest in Cortez Pipeline Company (37 percent), and it strenuously argues (1) that the terms of the management of the pipeline remove its ability to "control" the Cortez Pipeline Company within the meaning of 30 C.F.R. § 206.151; and (2) that those terms place its interests in opposition to those of Cortez Pipeline Company. Mobil asserts that it is unable to manipulate the tariff rate in order to inflate the transportation allowance and reduce its royalty. This is because Cortez Vickers, Inc., in which Mobil has no interest, has veto power over the adoption of the tariff procedures. Further, Cortez Vickers owns no interest in the production being shipped, but only in the pipeline. Mobil's interests opposed those of Cortez Pipeline Company because they oppose the interests of Cortez Vickers, which effectively controls, or has the power to effectively control, the Cortez Pipeline tariff. Mobil thus argues that the Cortez Pipeline Company is "acting in [its own] economic self-interest." See 53 Fed. Reg. 1239 (Jan. 15, 1988). MMS does not address this question in its Answer, but instead stands on the reasoning set out in the Director's decision.

I am persuaded that Mobil has rebutted the presumptive finding that its contract with Cortez Pipeline Company is not at arm's length. The issue is not, as stated in the Director's decision (at 24), whether the individual interests of the partners in the Cortez Pipeline Company were opposed to those of Mobil's. It is rather whether the interests of Cortez Pipeline Company were in opposition to Mobil's. Mobil has convincingly pointed out that the management of the pipeline was such that the pipeline's pricing mechanism could not be manipulated by Mobil (or Shell) and that the pipeline would be expected to charge a rate for its services that would not be inflated beyond its actual costs. It is significant in this regard that the pipeline pricing mechanism openly charged less than its actual costs (by assuming a minimum throughput far in excess of its actual throughput) for a period of time. Further, the record shows that the methodology used by Cortez Pipeline Company to set its tariff was similar to that in place in the petroleum industry at the time it was adopted (as discussed below).

Even disregarding the above, I would still reverse MMS here, for another reason different than that adopted by the lead opinion. The 1988 regulations cover nonhydrocarbon gas

> which is extracted from a reservoir and which has neither independent shape nor volume, but tends to expand indefinitely. It is a substance that exists in a gaseous or rarefied state under standard temperature and pressure conditions.

30 C.F.R. § 206.151. They are thus intended to apply to calculation of royalty on carbon dioxide (CO_2) produced from Federal leases. However, the terms provided for calculation of transportation allowances for a lessee who either has no transportation contract or a nonarm's-length contract are inappropriate for CO_2 pipelines. The regulations require that such lessee must base its transportation allowance on its "reasonable actual costs." 30 C.F.R. § 206.157(b)(1). However, an exception from that requirement is set out at 30 C.F.R. § 206.157(b)(5), which provides that, upon application by the lessee, "MMS may grant the exception only if the lessee has a tariff for the transportation system approved by" the Federal Energy Regulatory Commission (FERC) or a State agency." 30 C.F.R. § 206.157(b)(5). Mobil points out that FERC has declined jurisdiction over CO_2 pipelines. Cortez Pipeline Co., 7 FERC 3 ¶ 61.024 (1979). Since FERC does not review the Cortez Pipeline tariff, the absence of FERC approval is obviously irrelevant here if the exception set out in 30 C.F.R. § 206.157(b)(5) has any applicability to lessees producing and transporting CO_2.

This leaves us to consider whether the spirit of the regulation, which is plainly designed to allow use of tariffs where there has been an independent review of their legitimacy, is satisfied by the use of the 1941 Atlantic Refining Company methodology. I conclude that it is. The purpose of transporting CO_2 from Colorado to West Texas is to allow its use for tertiary recovery from oil wells there. The Cortez Pipeline, authorized under the Mineral Leasing Act, must be operated as a "common carrier." 30 U.S.C. § 185(r)(1). It must accordingly accept all oil or gas delivered to the pipeline without regard to whether it was produced on Federal or non-Federal lands; the pipeline has a common law obligation not to charge an excessive rate. The record indicates that the pipeline cost $500,000,000 to complete.

Cortez Pipeline has published a tariff rather than entering into written transportation contracts with its shippers. As noted, the tariff rate uses the historical method in Atlantic Refining. It is based on a traditional Interstate Commerce Commission ratemaking methodology for oil pipelines ("Oaks Formula"). For several years, the owners effectively charged less than their actual costs, using a theoretical minimum throughput of 1,000 MMCF/day (which was much higher than the actual throughput) and granting owners a 7-percent return on valuation. The tariff provides for a reasonable rate of return to the parties who constructed the pipeline and who operate it, both in the form of a dividend and for return for money risked in the venture.

We note that MMS does not object to the deduction of these costs from the royalty basis of producers other than the owners. The issue presented is whether Mobil, as owners of the pipeline who also pay to use the pipeline, may properly deduct payments to the pipeline, some of which ultimately come back to it as compensation for the money it expended in building the pipeline (apparently including money in lieu of loan interest representing moneys risked by Mobil to build the facility), plus a reasonable dividend. I find no basis for disallowing Mobil use of the tariff as its transportation allowance when other parties, including Shell, have been allowed to do so.

Accordingly, I concur in the result.

David L. Hughes
Administrative Judge