EDITOR'S NOTE: Decision Reaffirmed on Reconsideration by Order dated Jan. 30, 2001

KIRBY EXPLORATION COMPANY OF TEXAS
(ON RECONSIDERATION)

IBLA 95-446R, 96-567R

Decided June 16, 1999


Petition granted; Board decision vacated; agency decision affirmed in part, set aside in part, and remanded for further consideration.

1. Indians: Leases and Permits—Indians: Mineral Resources: Oil and Gas: Royalties—Minerals Management Service: Appeals to Director—Oil and Gas Leases: Royalties—Rules of Practice: Appeals: Timely Filing

Where MMS issues an order to pay additional royalty indicating that it is subject to immediate appeal, but subsequently extends the royalty payor's time to comply with that order, agrees to meet with the payor to continue to adjudicate "outstanding audit issues" and proceeds to do so, purports to reach a settlement as to certain of the issues presented, and issues a new order to pay, its initial order is not a "final" order, so that failure to file a notice of appeal from that order has no consequences. Where a timely notice of appeal was filed following the issuance of the new order, all issues presented therein are justiciable.


Where MMS points out on reconsideration that its decision to reject the Blanchard Decision methodology adopted by a royalty payor in allocating production to various Indian lessors was based on Departmental regulations, a decision of the Board of Land Appeals ruling that the MMS decision was based on considerations of State law is properly vacated, as it proceeded from a flawed premise.

149 IBLA 205
By using the Blanchard Decision methodology (established under Oklahoma State law), a royalty payor overpaid some Indian lessors and underpaid others, in violation of the "gross proceeds" rule established by 30 C.F.R. § 221.110. MMS is not bound to follow State law governing collection of royalty.

Where MMS gave express notice (by publication in the Federal Register) that it was terminating any previous acceptance of use of the Blanchard Decision methodology in calculating allotted Indian lease royalty effective with the production month of November 1985, an MMS decision disallowing the use of that methodology for production months commencing January 1985 is properly set aside and the matter remanded for recalculation of the royalty due using the announced deadline.


OPINION BY ADMINISTRATIVE JUDGE HUGHES

The Minerals Management Service (MMS), through counsel, has filed a petition for reconsideration of our decision in Kirby Exploration Company of Texas, 143 IBLA 133 (1998), reversing two decisions of the Acting Deputy Commissioner for Indian Affairs (ADC), Bureau of Indian Affairs (BIA) (MMS 92-0309-IND). 2/

MMS' petition demonstrates extraordinary circumstances and sufficient reasons to justify our reconsideration of that decision. See 43 C.F.R. § 4.403. Accordingly, its petition for reconsideration is granted.

MMS asserts on reconsideration that Kirby did not appeal MMS' April 8, 1991, order with respect to a communitized lease area with the State of Oklahoma, and that it accordingly became administratively final. We did

1/ Counsel for appellant did not make an appearance in connection with the petition for reconsideration.
2/ No response has been filed by Kirby Exploration Company of Texas (Kirby).
not reach that question in our decision. \(^3\) We do so now, and expressly conclude that that order did not become final.

[1] We stated as follows concerning the April 8, 1991, order and the events leading up to it and the Houston Compliance Office's (HCOs) decision to further consider outstanding audit issues after the issuance of that order:

On December 20, 1989, MMS's [HCO] notified Kirby that it was initiating an audit of all of Kirby's Federal and Indian oil and gas leases. In an issue letter dated January 23, 1991, HCO advised Kirby that its preliminary review of Kirby's royalty payments for the period January 1, 1985, through December 31, 1989, had revealed that during various sample months, Kirby had underpaid royalties for lease No. 607-033822-0 by using a lower composite price of all the gas sold, rather than the higher price Kirby actually received. The letter requested Kirby to review the outlined factual information and either concur or specify the reasons for nonconcurrence with the letter's conclusions. Kirby responded on February 22, 1991, stating that, as required by the Federally approved communitization agreement, it had paid royalties on the communitized production consistent with Oklahoma law as formulated in the Blanchard Decision.

In a letter dated April 8, 1991, HCO rejected Kirby's claim that royalties had been properly paid. While agreeing that the tracts subject to a communitization agreement should be operated as an entirety, HCO contended that each lease committed to the communitization agreement should still be treated as a separate contract and that valuation of the proportionate share of production from the communitized area allocated to each tract should be based on the actual price received by the working interest owner. Because lease royalty calculations should be based on the sales value of the allocated production, HCO determined that Kirby should have paid royalties for Indian allotted lease No. 607-033822-0 based on the value it received for the production attributed to that lease instead of the lower composite price of all the gas sold. Based on its preliminary finding that Kirby owed additional royalties for the sample months, HCO extrapolated that Kirby had underpaid royalties on all its communitized leases during the period January 1985 through the date of Kirby's disposition of its working interest in the leases. Accordingly, HCO directed Kirby to identify total communitized sales by sales month during the relevant period; specify the lease allocation percentage and the price

\(^3\) We ruled that, even assuming arguendo that the letter became a final Departmental decision, we were not bound to accept as precedent erroneous decisions. 143 IBLA at 139-40.
Kirby received for its allocated share of sales for the leases in which it held a working interest; compute the value of the lease allocations based on the price it received for its allocated share of sales; recalculate and pay any additional royalty due; and submit copies of all supporting workpapers and schedules.

Although the April 8, 1991, letter informed Kirby of its right to appeal, Kirby sought and received an extension of time in which to comply with the order. On June 21, 1991, Kirby advised HCO that its review of the leases had revealed that Kirby had overpaid royalties for the leases. The HCO apparently rejected Kirby's calculations because they were based on Kirby's 60-percent working interest in the Kirby leases instead of 100 percent of the revenues as required by Kirby's status as the designated payor on the leases. After holding several meetings and exchanging numerous telephone calls and correspondence, HCO and Kirby reached an oral settlement in which Kirby was allowed to offset overpayments of royalty amounting to $307,983.64 on the Saxon leases against the $380,702.07 royalty underpayment on the Kirby leases. Pursuant to this oral agreement, by letter dated December 24, 1991, Kirby sent MMS a check for $72,718.99, accompanied by a 36-page audit report on Form MMS-2014 prepared by HCO detailing the offsetting methodology approved by HCO.

143 IBLA at 135-36. MMS concedes in its petition that HCO not only extended Kirby's time to comply with the April 8, 1991, order, but engaged in meetings with Kirby's representatives "in an effort to resolve outstanding audit issues," including whether Kirby was required to pay "royalties based on the gross proceeds requirement for the period after November 1, 1985," instead of using the Blanchard Decision methodology. (Petition at 6-7.)

In Shell Oil Co., 52 IBLA 74 (1981), the Board considered the question of the finality of a royalty assessment decision and the resulting timeliness of a challenge to the assessment. In that case, as here, the agency (the Conservation Division (CD) of the U.S. Geological Survey, MMS predecessor), following issuance of a nominally "final" order to pay additional royalty, convened a conference with Shell (the royalty payor) to reconsider the agency's position, met with Shell and actively discussed the matter, and submitted the matter to its legal counsel for review. Despite language in CD's order indicating that it was final, and despite the fact that CD refused Shell's request to defer payment of the sum at issue, 4/ we held that the order was not "final" and that Shell's failure to appeal it within 30 days had no consequences:

4/ In the present case, MMS went even further in retracting its nominally "final" decision by extending the time for Kirby to comply.

149 IBLA 208
The logic of Shell's position is hard to dispute. While Survey's order of July 6 bears all the indicia of a final order, its willingness to schedule a conference with Shell to discuss its position suggests that it may have been inclined to negotiate a solution to the issue at hand. Such a posture is contradictory to the idea of a final decision. While not entirely helpful, the definition of a final decision, as enunciated by the Supreme Court in construing the present 28 U.S.C. § 1291 (1976), offers some insight: "A 'final decision' generally is one which ends the litigation on the merits and leaves nothing for the court to do but execute the judgment." Catlin v. United States, 324 U.S. 229, 233 (1945). [DC's] scheduling of its August 17 conference with appellant persuades us that a final decision had not yet been rendered. We need not determine when a final decision was rendered by [CD]. What is clear is that it was not rendered prior to August 17. Shell's notice of appeal, filed with [CD] on September 13, 1979, was received within a 30 day period of August 17 and hence is timely without need for further precision. See Mesa Petroleum Co., 44 IBLA 165 (1979); Carl Wittman, 16 IBLA 188 (1974).

Shell Oil Co., supra at 77. From this it is evident that the April 8, 1991, HCO letter was not a final action subject to appeal. To the extent that HCO may have originally intended it as such, the totality of its actions in extending Kirby's time to comply with it, in agreeing to meet with Kirby and to continue to adjudicate "outstanding audit issues," in proceeding to do so, and in purporting to reach a settlement as to certain of the issues presented, clearly rendered the April 8, 1991, order ineffective and, thus, no longer subject to appeal. Although HCO was certainly free to (and did) issue a second decision following its reconsideration reaffirming its earlier position, its decision to reopen and reconsider "outstanding audit issues" pushed back the time for initiating an appeal to the date that reconsideration concluded, that is, to the date of the second decision.

Further, had the matter been appealed prior to completion of these discussions, it would have had to have been dismissed because no final MMS action had taken place. The record clearly shows that the results of Kirby's assertedly improper use of the Blanchard Decision methodology were not clear until after HCO completed its reexamination; that is, not until it issued its May 1, 1992, order.

In sum, when MMS agreed to extend Kirby's time to comply and to further consider the issues presented by the April 8, 1991, letter and then proceeded to do so, its actions rendered that order no longer a final decision subject to appeal. Accordingly, the failure to appeal it has no significance.

149 IBLA 209
We expressly reject MMS' suggestion on reconsideration that the April 8, 1991, decision became final because HCO was powerless to extend the time for appealing the decision. (Petition at 6-7.) HCO's May 16, 1991, letter extending Kirby's time for compliance and its subsequent reconsideration and readjudication of the issues raised in the April 8 order clearly had the effect, not of attempting to extend the time to appeal, but of vacating the original order. Accordingly, the subsequent decisions by HCO and the Casper Section of the Lessee Contact Branch became the decisions that were subject to appeal, and all issues presented therein, including the propriety of using the Blanchard Decision methodology, are justiciable by this Board.

Nor are we persuaded that there is any significance in the fact that HCO lacked authority to enter into a final, binding settlement. We need only determine whether HCO's action superseded its April 8, 1991, order. We conclude that it did.

[2] In addition to the administrative finality argument (rejected herein), MMS argues that its decision to reject the Blanchard Decision methodology used by Kirby was based on 30 C.F.R. § 206.103 (requiring that royalty is due on no less than the gross proceeds accruing to the lessee for the sale of lease production) rather than on any considerations of State law. MMS states on reconsideration that, when it "began to reconsider application of the Blanchard Decision to federal and Indian leases," its "audits had demonstrated, in some instances, the royalties paid under the Blanchard Decision were less than application of the gross proceeds rule would have established." (Petition at 3-4.) MMS indicates that "[t]his discrepancy occurred in Kirby's case," citing to "January 1986 and March 1987, two test months under the Kirby audit, showing the effect of the various calculation methods." (Petition at 4 n.3.) MMS has thus shown that our decision proceeded from a flawed premise, and we conclude that it must accordingly be vacated.

[3] Under the so-called Blanchard Decision methodology as applied herein, all Indian lessors receive royalty in the amount of 12-½ percent of the weighted average of all sales of communitized production by all lessors. The result of this procedure is that lessors whose leases provide for a higher-than-average price for production receive royalty that is less than they would have received if the royalty had been calculated using the "gross proceeds" from their leases. At the same time, lessees whose leases provide for a lower-than-average price receive more than if the "gross proceeds" had been used. Thus, according to MMS, although Kirby may have paid the correct total amount of royalty, by using the Blanchard Decision methodology, it disbursed the royalty incorrectly, overpaying some lessors and underpaying others an equal amount. (Petition at 5.) MMS ruled that Kirby should not have used the Blanchard Decision methodology, but should instead have paid royalty to each Indian lessor on no less than the gross proceeds determined under the terms of that lessor's specific lease.

149 IBLA 210
In deciding that Kirby properly used the Blanchard Decision methodology, we placed great stock in the fact that it had been replaced as the law controlling disposition of royalty in the State of Oklahoma by an act of the State Legislature known as Oklahoma Senate Bill 160 (SB 160), and that SB 160 had been declared invalid "in its entirety" by the Tenth Circuit. 5/ 143 IBLA at 135, 140. Finding that MMS had, in its Oil and Gas Payor Handbook, specifically cited SB 160 as the basis for not applying the Blanchard Decision methodology, we reasoned that the invalidation of SB 160 would open the way to using that methodology in calculating Federal royalty. 6/ That conclusion was not correct.

As MMS points out on reconsideration, the issue presented here is whether, by using the Blanchard Decision methodology, Kirby violated the terms of Departmental regulations governing payment of royalty, as the Department is not bound to follow Oklahoma State law governing collection of royalty. As the Associate Solicitor, Energy and Resources, pointed out in his March 18, 1983, Memorandum:

Congress intended that the Secretary of the Interior should retain the authority to determine whether state pooling orders affecting federal oil and gas leases would control the lessee's obligations to the United States. Kirkpatrick Oil and Gas Co. v. United States, 675 F.2d 1122, 1125 (10th Cir. 1982). Without such authority, the Secretary would be unable to protect the interests (most importantly the ownership and royalty interests) of the Federal Government in the face of adverse state policies. The maintenance of an orderly national policy controlling the obligations of federal lessees to the Federal Government is essential to the management of the public lands. Therefore, without the Secretary's approval, no state law can overrule the Secretary's control over federal mineral lessees. Id. at 1126.

* * * The regulation governing computation of royalties from federal lessees states, in relevant part:

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6/ MMS also stated in its Federal Register notice advising that the Blanchard Decision rationale could not be used that its policy was a consequence of the passage of SB 160.

That notice explained that "AFS Payor Handbook contains specific requirements currently followed by payors in calculating and reporting royalties on Federal and Indian oil and gas leases, subject to the so-called 'Blanchard Decision,'" and that SB 160 had "effectively replace[d] Blanchard Decision requirements used in calculation and payment of royalties in Oklahoma." 50 Fed. Reg. 49468. MMS concluded, "Consequently, the MMS is discontinuing the 'Blanchard Decision' requirements of its AFS Payor Handbook." Id (emphasis supplied).
Under no circumstances shall the value of production . . . for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee from the sale thereof . . .

30 C.F.R. § 221.110 [(1982)].

The Blanchard Decision raises the possibility that the United States would be compelled to use the weighted average price of all oil or gas produced and sold from the unit. This, in turn, could result in a determination of the value of production which would be less than the gross proceeds accruing to the federal lessee. Because this procedure is contrary to the value basis regulation, promulgated under authority of the Mineral Leasing Act of 1920 ***, designed to promote orderly and efficient development and production of federal oil and gas, the Blanchard Decision cannot control the royalty obligation of federal lessees to the United States without the consent of the Secretary.

We adopt this statement as our own. The question thus becomes, did the Department consent to the use of the Blanchard Decision methodology during the period in question?

[4] In December 1985, the Department gave express notice that it was terminating any previous acceptance of use of the Blanchard Decision methodology in calculating allotted Indian lease royalty, by publishing notice of an Addendum to the Auditing and Financial System (AFS) Payor Handbook changing the

required royalty calculation methodology for production from Federal and Indian oil and gas leases committed to unitization and communitization agreements in the State of Oklahoma. The change will require lessees, or their designated payors, to follow standard Federal procedures for calculating and reporting royalties due on production allocated to oil and gas leases subject to pooling agreements.

50 Fed. Reg. 49467-68 (Dec. 2, 1985). The notice went on to explain that "AFS Payor Handbook contains specific requirements currently followed by payors in calculating and reporting royalties on Federal and Indian oil and gas leases, subject to the so-called 'Blanchard Decision,'" and that SB 160 had "effectively replace[d] Blanchard Decision requirements used in calculation and payment of royalties in Oklahoma." 50 Fed. Reg. 49468. MMS concluded:

\[7/\] MMS concedes on reconsideration that its predecessor, the U.S. Geological Survey, had "accepted royalties paid on unit and communitized area production within the State of Oklahoma in accordance with the Blanchard Decision." (Petition at 3.)

149 IBLA 212
Consequently, the MMS is discontinuing the "Blanchard Decision" requirements of its AFS Payor Handbook. Effective with the production month of November 1985, for royalty payments due December 31, 1985, payors for Federal and Indian oil and gas leases committed to unitization and communitization agreements within the State of Oklahoma are to follow the standard Federal procedures as outlined in the AFS Payor Handbook for reporting royalties due on production allocated to each lease under a pooling agreement.

50 Fed. Reg. 49468 (emphasis supplied). Thus, it is clear that, effective in November 1985, the Department formally decided not to follow Oklahoma State law on this question. The implicit conclusion was the royalty would instead be determined under pertinent Federal regulations.

We hold that, to the extent that it distributes royalty in a manner disproportionate to the comparative terms of the individual Indian leases, the Blanchard Decision methodology does not comply with Federal regulation 30 C.F.R. § 206.103 (1985), and MMS was justified in ordering Kirby to recalculate royalties.

However, we note that MMS' order affects a period of time prior to the effective date of MMS' policy that it would no longer accept use of the Blanchard Decision methodology, as set out in its December 2, 1985, Federal Register notice, which expressly states:

Effecive with the production month of November 1985, for royalty payments due December 31, 1985, payors for Federal and Indian oil and gas leases committed to unitization and communitization agreements within the State of Oklahoma are to follow the standard Federal procedures as outlined in the AFS Payor Handbook for reporting royalties due on production allocated to each lease under a pooling agreement.

50 Fed. Reg. 49468. To the extent that MMS' decision disallowed use of the Blanchard Decision in calculations dating before the production month of November 1985 (see 143 IBLA at 135 (HCO undertook "preliminary review of Kirby's royalty payments for the period" commencing January 1, 1985; "HCO extrapolated that Kirby had underpaid royalties on all its communitized leases during the period [commencing] January 1985")) it is set aside, and the matter is remanded for recalculation of royalty due using the deadline established in the Federal Register notice.

Following negotiations and the apparent partial settlement with Kirby (see 143 IBLA at 137), the binding nature of which MMS disavows, MMS issued an order dated May 1, 1992, by which the Chief of the Casper Section of the Lessee Contact Branch, MMS, found that Kirby's recoupment of lease overpayments violated MMS policy limiting recoupment of overpaid royalties on an Indian allotted lease to 50 percent of that lease's current month's net revenue. He therefore directed Kirby to pay $307,983.64 in additional royalties for the improper recoupment of overpayments on Indian
allotted leases. Kirby was allowed to recoup the amount it had overpaid to other Indian lessors, but subject to significant restrictions. In his December 30, 1994, Decision, the ADC concluded that the May 1, 1992, order properly refused to allow cross-lease recoupments of royalty overpayments on Indian allotted leases and correctly limited the recoupment of overpaid royalties to 50 percent of the overpaid lease's current monthly revenue. Thus, there were significant restrictions placed on the recoupment of the overpayment. Kirby specifically challenged those restrictions on appeal.

MMS frankly admits on reconsideration that the restrictions on recoupment mean that Kirby will not be able to recoup its overpayments:

   The problem which generated Kirby's appeal of the May 1992 Order is that production from the unit is now substantially less than what it was during the audit period. The May 1992 Order compelled Kirby to pay the $307,983.63 in underpaid royalties, which would be distributed to Kirby's allottee lessors, and then directed Kirby as to how -- under MMS regulations and the Royalty Payor Handbook -- to recoup those amounts from the overpaid leases in the communitized area through a fifty percent reduction in royalty payments for production as it occurred in the future. It appears, though, that as a practical matter total recoupment many never be possible because the Saxon leases [(on whose account the overpayment occurred)] now produce insufficient volumes to enable Kirby to recoup the $307,983.64. Thus, if Kirby pays the additional $307,983.64 [to the other, underpaid lessees], Kirby will have paid portions of the same royalties twice in order to make the underpaid allottee lessors whole.

(Petition at 29.) MMS characterizes this problem as resulting from Kirby's failure to comply with its 1985 Federal Register directive, 50 Fed. Reg. 49465 (Dec. 2, 1985), to pay Indian lessors on the basis of the lessees' gross proceeds, rather than as a percentage of the communitized area's gross proceeds: "Other lessors within Oklahoma followed the gross proceeds rules, and that 1985 directive. In short, the problem is Kirby's, and the consequences of Kirby's failure to live by the rules should not be borne by Kirby's Indian allottee lessors." (Petition at 30.)

After the ADC's decisions under review herein, the Board had occasion to review the question of what action is appropriate where the payor has made an overpayment on an Indian allottee lease and circumstances make it impossible to recoup the overpayment from future royalty payments on that lease. Mustang Fuel Corp., 134 IBLA 1 (1995). In that case, we noted substantial problems facing parties seeking to recoup overpayments from Indian lessors or, where no recoupment is possible, problems in seeking refunds of overpayments from BIA. We effectively approved a method suggested by

8/ MMS concedes that we have authority to address the consequences of the May 1, 1992, order regardless of whether the Apr. 8, 1991, order is administratively final (which we have concluded herein it is not).
the lessee wherein an amount overpaid to an Indian lessor on one lease was recouped by reducing payments to the same lessor on a different lease. Although we do not have information before us that would allow us to consider a similar arrangement here, it would appear that Kirby may wish to explore this avenue. Kirby may also wish to explore the possibility of seeking a refund of any overpayment from BIA. See Mustang Fuel Corp., 134 IBLA at 5 n.4, 5-6.

In these circumstances, we deem it appropriate to remand the matter to MMS for further consideration, specifically as to whether the restrictions placed on Kirby's recoupment of its overpayment are justified in light of our decision in Mustang Fuel Corp., supra.

Finally, MMS points out that its order dated February 10, 1992, assessed Kirby $49,955.39 in late payment charges based on the December 1991 payment of $72,718.99 in additional royalties for the Kirby leases, and that those additional royalties were due regardless of whether or not Kirby should have been allowed to use the Blanchard Decision methodology. (Petition at 25.) That statement, which is unchallenged on reconsideration, is consistent with the fact that Kirby's use of the Blanchard Decision methodology resulted not in miscalculation of the total amount of royalty due, but the overpayment of certain Indian lessors by the same amount as other Indian lessors were underpaid. MMS also points out that section 111(a) of the Federal Oil and Gas Royalty Management Act of 1983, 30 U.S.C. § 1721(a) (1994), and implementing regulations at 30 C.F.R. §§ 218.54 and 218.102 require lessees to pay interest on underpaid royalties. (Petition at 26.) Accordingly, the decision by MMS imposing late payment charges on the $72,719.99 underpayment is now affirmed.

In sum, MMS' petition for reconsideration is granted; our decision, Kirby Exploration Company of Texas, 143 IBLA 133 (1998), is vacated; MMS' decisions are affirmed to the extent that they ruled that Kirby's use of the Blanchard Decision methodology was improper from the November 1985 production month forward and assessed late payment penalties; and MMS' decisions are set aside and remanded for further consideration to the extent that they disallowed use of the Blanchard Decision methodology prior to the November 1985 report month and restricted Kirby's recoupment of royalties overpaid to Indian lessors.

9' The issue of whether there was a binding settlement is thus presented. Although we must question why (as the ADC stated) MMS allows its officials "to represent to Kirby that they had the authority to offer and were offering to settle MMS' claim" (see 143 IBLA at 137), we must agree that there is no evidence that a binding settlement agreement was reached between Kirby and the Director, MMS, or other Departmental official having authority to enter into a settlement. Accordingly, we conclude that MMS was not barred from collecting late payment charges.
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 above-described action is taken.

David L. Hughes
Administrative Judge

I concur:

Will A. Irwin
Administrative Judge