

Editor's Note: Decision vacated by Board Order dated Jan. 23, 2001. See Order attached to this decision at 313 A through 113-B.

SHELL OIL CO.

IBLA 95-141, 96-538, 98-74

Decided September 30, 1999

Appeals from decisions of the Minerals Management Service denying appeals of orders requiring recalculation of royalties or payment of additional royalties. MMS-90-0214-O&G, MMS-92-0363-O&G, MMS-92-0503-O&G, MMS-95-0590-O&G, and MMS-95-0322-O&G.

Affirmed.

1. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Oil and Gas Leases: Royalties: Generally-- Statute of Limitations

The 6-year statute of limitations at 28 U.S.C. § 2415(a) (1994) for commencement by the United States of civil actions for damages does not apply to limit administrative action by the Department. MMS orders to recalculate and to pay additional royalty are administrative actions not subject to the statute of limitations.

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

Under 30 C.F.R. § 206.103 (1984), "reasonable value of the product" for the purpose of calculating royalties due to the United States will be the highest price paid in a fair and open market for a major portion of like-quality product in the same field or area where the leased lands are situated.

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

Under 30 C.F.R. § 206.102(c)(1) (1988), the value of production not purchased or sold in arm's-length contracts is properly determined by looking to contemporaneous prices used in arm's-length transactions for purchases or sales of significant quantities of like-quality oil in the same field or area.

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OPINION BY ADMINISTRATIVE JUDGE IRWIN

Shell Oil Company (Shell), on behalf of Shell Western E&P Inc. (SWEPI), has appealed three decisions by the Associate Director for Policy and Management Improvement, Minerals Management Service (MMS), involving the valuation for royalty purposes of crude oil SWEPI produced from the Cedar Creek area in eastern Montana and North Dakota. The three MMS decisions concern Shell appeals to the Director of MMS of five orders for audit periods covering from October 1, 1980, through September 30, 1992. ^{1/}

The August 31, 1994, MMS Decision

In the first of these decisions, MMS denied Shell's appeal of an MMS Royalty Management Program (RMP) order dated March 28, 1990, that was based on a review of production from 12 Federal leases in three units in Montana and North Dakota for sample months during the period from October 1, 1980, through September 30, 1983.

The order quoted 30 C.F.R. § 206.103 (1984), "Value basis for computing royalties":

The value of production * * * shall be the estimated reasonable value of the product[,] * * * due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field, to the price received by the lessee, to posted prices, and to other relevant matters. * * * In the absence of good reason to the contrary, value computed on the basis of the highest price * * * paid or offered

^{1/} The appeals to us and the corresponding MMS actions are:

IBLA Docket MMS Director's Decision MMS Order Dated

IBLA 95-141 MMS-90-0214-O&G, 8/31/94 March 28, 1990

IBLA 96-538 MMS-92-0363-O&G, 6/3/96 July 29, 1992

 MMS-92-0503-O&G, " August 31, 1992

 MMS-95-0590-O&G, " July 24, 1995

IBLA 98-74 MMS-95-0322-O&G, 11/21/96 April 13, 1995

We consolidated these appeals by orders dated Nov. 14, 1996, and Dec. 11, 1997.

at the time of production in a fair and open market for the major portion of like-quality oil * * * produced and sold from the field or area where the leased lands are situated will be considered to be a reasonable value.

The order stated that Shell underpaid royalties because it valued the crude oil at Shell's posting for Montana Mixed crude pursuant to a nonarm's-length contract. A review by the Montana Department of Revenue and the North Dakota Office of the State Auditor, acting under authority delegated to them in accordance with 30 U.S.C. § 1735 (1994), showed that other producers who sold to nonaffiliated third party purchasers in the same area received consistently higher prices for like-quality oil than Shell did.

The order responded to a Shell statement that Montana Mixed and Montana Sweet crudes were not "like-quality oil." ^{2/} According to MMS regulations, the order stated, "like-quality oil is determined by sulphur content, specific API gravity, and pore [sic] point." ^{3/} The order referred to a March 26, 1990, report to the State of Montana by the RMP's Royalty Valuation and Standards Division (RVSD) entitled "Like-Quality Oil, Cedar Creek Area, Montana," and stated the report showed that oil produced from various wells in the Cedar Creek area were like-quality. (March 28, 1990, RMP order at 2.)

The RMP order stated that prices received under nonarm's-length contracts may be accepted as the basis for value for royalty purposes if the lessee can show that the price is similar to the price in arm's-length contracts in the same field or area for like-quality oil. The States had shown that Shell's price was not similar, the RMP concluded, so it ordered Shell to recalculate and pay additional royalties "using Amoco's Crude Oil Price Bulletins for Montana and/or Wyoming sweet crude adjusted for gravity for all the Federal leases" in Montana and North Dakota for which Shell had used its own posting. Id. at 2, 5.

Shell appealed the March 28, 1990, order to the Director of MMS. It argued that the Montana Mixed crude oil it produced from the Pine and Pennel Units was not of like quality to Montana/Wyoming sweet crude oil.

^{2/} The order refers to this statement as being in a "January 30, 1990, response" from Shell. The record does not contain any such written response, so presumably it was an oral response to the Jan. 22, 1990, issue letter from Montana to Shell. See Feb. 18, 1993, Montana Department of Revenue memorandum to the MMS Appeals and Litigation Support Division concerning Docket No. MMS-90-0214-O&G (Montana field report), Attachment D. See 30 C.F.R. § 290.3(b).

^{3/} "Like-quality lease products" means lease products which have similar chemical, physical, and legal characteristics." 30 C.F.R. § 206.101, 53 Fed. Reg. 1218 (Jan. 15, 1988).

"[T]he conclusion of the RVSD that the crude oils produced * * * are considered like quality was limited to a comparison of gravity and sulfur content. The RVSD did not report on the most critical chemical characteristic affecting the value of such crude oil: the pitch content." (April 27, 1990, Notice of Appeal at 4.) Shell submitted an assay report comparing Montana Mixed crude with Wyoming Sweet crude. The summary of the seven samples showed the percentage of pitch ranged from 19.68 - 26.9 for the samples from the Pine, Pennel, and Cabin Creek Units, and from 11.08 - 12.87 for the samples from other units. Id., Exhibit I. 4/ "It is this factor which causes Shell to conclude that Montana Mixed crude oil and Montana/Wyoming Sweet crude oil are not of like quality," Shell argued. Id. at 4.

Montana asked the RVSD to comment on Shell's rebuttal. In an August 14, 1991, report, the RVSD concluded, based on an analysis of Shell's seven assay samples along with three others from the Cedar Creek area, that "the ten crude oils can be divided into three distinct groups, each of like quality, based on API gravity and on distillate fractions. However, we believe that all of the oils can be valued the same for royalty purposes[,] given adjustments for gravity." 5/ (August 14, 1991, RVSD report at 1.) The RVSD found that two of the four samples in the group with high pitch content sold at North Dakota sweet crude prices and two at Shell's Montana Mixed price, "contrary to Shell's statement that oil purchased by Shell under its posting has a much higher pitch content than oils purchased under other postings." Id. at 5. The report stated

4/ The Assay Analysis Procedure explained:

"By laboratory distillation, crudes are separated into boiling fractions. The lightest fractions, IBP to 155 Deg. F, and heaviest, 1,000 Deg. F. plus, have much lower value to a refiner. * * * The bottom fraction, 1,000 Deg. F. plus, is called pitch in refinery operation. This is a very viscous, heavy material and is normally solid at room temperature. Pitch is blended with cutter stock and sold as residual fuel oil which is a low valued product."

(Exhibit I.)

5/ The RVSD Aug. 14, 1991, report's three groups are based on similarity of API gravity. Group 1 (highest API gravity) contains two samples with a posted designation as "sweet," and one posted as "mixed." The pitch content of the three samples in group 1 ranges from 11.08 to 12.87 percent. All three samples in Group 2 (middle API gravity) are "mixed," the pitch content ranges from 19.68 to 22.44 percent. The pitch content for the four samples in Group 3 (lowest API gravity), two of which are "sweet" and two of which are "mixed," ranges from 26.90 to 28.43 percent. (RVSD Aug. 14, 1991, Report at 3, Table 1.)

The report notes that "the pitch content of the assayed oils is approximately the same within each group. More important, the pitch content is inversely related to the API gravity and independent of posted designations." Id. at 4.

that Shell used Amoco's posting for North Dakota sweet crude for almost all of its arm's-length purchases of crude oil in the Cedar Creek area and for approximately half of its nonarm's-length purchases; it used its Montana Mixed posting for the rest of its nonarm's-length purchases. Id. at 4, and Attachment 1. The RVSD stated that because the API gravities of the samples were inversely related to the pitch content of the samples and because posted prices were adjusted for gravity, it could conclude that the prices were also indirectly adjusted for pitch content. Id. at 6. Because the RVSD could find no arm's-length purchasers in the Cedar Creek area who bought at Shell's price for Montana Mixed crude and found that Shell as well as others purchased at Amoco's North Dakota sweet crude price, it concluded that all 10 oils it analyzed could be valued for royalty purposes under the Amoco pricing structure. Id. at 7.

Montana relied on the August 14, 1991, RVSD report in preparing its field report on Shell's appeal, which MMS sent Shell in March 1993. See note 2, supra. In response, Shell sent MMS copies of letters from four refiners who "regularly purchase Mixed Montana crude oil for their refineries. Without exception, these refiners conclude that the high pitch content of Mixed Montana crude oil renders it less valuable as a refinery stock." (May 24, 1993, response at 3.) Shell also enclosed a letter to it from Amoco stating that "the very high yield of resid[uals] makes it [Montana Mix] unattractive at pricing higher than [West Texas] sour crude." Id., Attachment 5. In response to the RVSD finding that Montana Mixed crude sometimes sold at North Dakota sweet crude prices, Shell observed that would only occur "if small volumes of the high pitch content crude oil [were] blended (mixed in the pipeline or storage tanks) with sweet crude oil. Such blending masks the true pitch content of the crude oil to the ultimate refiner." Id. Shell also disputed the RVSD's conclusion that API gravities were inversely related to pitch content and therefore prices were indirectly adjusted for pitch content. That relationship is not universally the case, Shell contended, and the specific characteristic that lowers the value of Montana Mixed crude is its high pitch content.

In its August 31, 1994, decision on Shell's appeal of the March 28, 1990, order, MMS reviewed Shell's submissions from the refiners comparing Montana Mixed crude with other crudes but found they did not compare Montana Mixed crude with crudes that were produced or sold in the field or area involved in this appeal and thus were not helpful in determining like quality. (MMS Decision at 13.) MMS reviewed the assay report submitted by Shell as well as the August 4, 1991, RVSD like-quality report and concluded that the pitch content of the different samples did not appear to be a significant determinant of price. Because the RMP could not find any purchasers in the area that used Shell's posted price for Montana Mixed crude in their arm's-length transactions, MMS concluded that the RMP had not erred in finding Montana Mixed crude and North Dakota Sweet crude to be of like quality. (MMS Decision at 15-16.) In its decision, MMS also rejected Shell's argument that 28 U.S.C. § 2415(a) (1994) precludes MMS from demanding payment of additional royalties for periods more than 6 years before the demand. Id. at 3-4.

The June 6, 1996, Consolidated MMS Decision

In the second decision, MMS consolidated appeals from three RMP orders, two orders dated July 29 and August 31, 1992, dealing with the October 1, 1983 - September 30, 1989, audit period for leases in North Dakota and Montana, respectively, and a July 24, 1995, order dealing with the October 1, 1989 - September 30, 1992, period for leases in North Dakota.

Because MMS amended its royalty valuation regulations effective March 1, 1988, these orders referred to both 30 C.F.R. § 206.103 (1984), supra, and 30 C.F.R. § 206.102(c) (1988):

(c) The value of oil production from leases subject to this section which is not sold pursuant to an arm's-length contract shall be the reasonable value determined in accordance with the first applicable of the following paragraphs:

(1) The lessee's contemporaneous posted prices or oil sales contract prices used in arm's-length transactions for purchases or sales of significant quantities of like-quality oil in the same field (or, if necessary to obtain a reasonable sample, from the same area); provided, however, that those posted prices or oil sales contract prices are comparable to other contemporaneous posted prices or oil sales contract prices used in arm's-length transactions for purchases or sales of significant quantities of like-quality oil in the same field (or, if necessary to obtain a reasonable sample, from the same area). In evaluating the comparability of posted prices or oil sales contract prices, the following factors shall be considered: Price, duration, market or markets served, terms, quality of oil, volume, and other factors as may be appropriate to reflect the value of the oil.

53 Fed. Reg. 1184, 1220-21 (Jan. 15, 1988).

The July 29, 1992, order determined that Montana Mixed and other crudes from the Cedar Creek area could be valued the same for royalty purposes, based on the RVSD like-quality reports, recalculated sales value and royalty due on oil production from various Federal leases based on Amoco's North Dakota Crude Oil Price Bulletin, and directed SWEPI to pay \$374,143.01 additional royalties. The order also rejected SWEPI's argument that a portion of the audit period was beyond the statute of limitations in 28 U.S.C. § 2415(a) (1994).

The August 31, 1992, order found that pitch content was not a critical factor in determining the value of oil in the Cedar Creek area, based on the August 4, 1991, RVSD report. The order stated that Shell's arguments concerning pitch content were insufficient to reverse the RVSD like-quality and value determination and directed Shell to pay \$23,519.45 additional royalties. The order also rejected Shell's statute of limitations argument.

The July 24, 1995, order based a recalculation of royalty due by Shell on Amoco's posting for North Dakota sweet crude and directed Shell to pay \$269,137.12 additional royalties. The order stated that 30 C.F.R. § 206.102(c)(1), supra, was not applicable because Shell did not have any arm's-length transactions of like-quality oil or a posting for the crude, so it quoted subsection (c)(2):

(c) The value of oil production from leases subject to this section which is not sold pursuant to an arm's-length contract shall be the reasonable value determined in accordance with the first applicable of the following paragraphs:

* * * * *

(2) The arithmetic average of contemporaneous posted prices used in arm's-length transactions by persons other than the lessee for purchases or sales of significant quantities of like-quality oil in the same field (or, if necessary to obtain a reasonable sample, from the same area).

In its June 3, 1996, decision concerning Shell's appeals of these three orders, MMS rejected the argument that Montana Mixed crude was not of like quality and was of lesser value on the same grounds as it did in its August 31, 1994, decision. The letters from refiners submitted by Shell "neither verify actual sales of like-quality crude oil nor explain the consistently higher values received by other producers in arm's-length sales of like quality oil." (MMS Decision at 4.) In response to Shell's argument that MMS had not shown that significant quantities of Montana Mixed crude had been sold arm's length at Amoco prices, ^{6/} MMS concluded

^{6/} "The MMS has now advised SWEPI informally that a total of about 1,000 barrels per day of Montana Mixed are sold by various producers at or near the Amoco Posting. These volumes are insignificant when compared to the sales of Montana Mixed by SWEPI to Shell under a nonarm's-length contract. Although the MMS contends that the determination of a significant volume, as required by the valuation regulations, is only made with respect to arm's-length sales, the regulations also provide that reasonable value will be determined on the basis of sales in a "fair and open market." There is not a "fair and open market" for sales of SWEPI's production of Montana Mixed at or near the Amoco Posting. SWEPI simply produces too much Montana Mixed to be absorbed into "light sweet" streams of crude oil destined for refining. Thus, SWEPI is in a "catch 22" situation: it has no market for its large volumes of Montana Mixed crude oil at a price higher than the

that, excluding Shell's nonarm's-length sales, Amoco postings were used for "a part or for a majority of production of like quality in the same field" under 30 C.F.R. § 206.103 (1984) and for sales of "significant quantities of like-quality oil in the same field" under 30 C.F.R. § 206.102(c)(2) (1995). Id. at 5-8. The decision again rejected Shell's argument that the statute of limitations in 28 U.S.C. § 2415(a) (1994) barred MMS from collecting royalties on transactions more than 6 years before. Id. at 8-9. Finally, the decision remanded the appeals concerning the July 1992 and July 1995 orders to the RMP to investigate whether and to what extent those orders involved volumes of oil taken in-kind. Id. at 9.

The November 21, 1996, MMS Decision

MMS' third decision denied a Shell appeal of an April 13, 1995, order covering the period October 1, 1989, through September 30, 1992, for 17 sample leases in Montana. The order stated that the State of Montana had compared Shell's prices with prevailing prices for like quality crude oil in the field and area and found Shell's prices to be consistently lower. The order stated that Montana had recalculated Shell's royalties using Amoco's posting for North Dakota Sweet crude and directed Shell to remit \$1,329,821.25 for crude oil sold in nonarm's-length transactions.

MMS' November 21, 1996, decision rejected Shell's arguments concerning like quality and "significant quantities," stating they had been addressed by the August 31, 1994, and June 3, 1996, MMS decisions and found to be without merit. (MMS Decision at 3.)

Shell filed timely notices of appeal and statements of reasons (SOR) in IBLA 95-141 and in IBLA 96-538. In IBLA 98-74 Shell's SOR incorporates its previous SOR's, except as to the argument concerning the statute of limitations. MMS filed a consolidated Answer after settlement negotiations proved unsuccessful. Shell's appeals to us involve the statute of limitations and valuation issues. 7/

fn. 6 (continued)

real value of such crude oil to a refiner, but yet is required by the MMS to pay royalty based on the Amoco Posting because there are a couple of purchasers of crude oil who have no qualms about deluding the ultimate refiner as to the quality of the total crude oil stream being delivered. These are not "fair and open market conditions." (Shell's Oct. 12, 1995, Response to North Dakota Office of the State Auditor field report in MMS-92-0363-O&G at 2-3.)

7/ The statute of limitations issue does not arise in MMS' Nov. 21, 1996, decision. See Shell SOR in IBLA 98-74 at 2. The dual accounting issue discussed in MMS' Aug. 31, 1994, decision was settled and does not arise in IBLA 95-141. See MMS Answer at 4, n.3, and Exhibit 1 at A-2. The question of whether and to what extent volumes of oil were taken in-kind that was remanded in MMS' June 3, 1996, decision will be dealt with in a separate MMS decision; the amount Shell will owe under that separate decision will be controlled by the outcome of the valuation issue in these appeals. See MMS Response to Request for Explanation dated Oct. 2, 1996, at 1-2; MMS Answer at 5, n.4.

Statute of Limitations in 28 U.S.C. § 2415(a) (1994)

Shell states it is raising the statute of limitations defense because failure to do so may be regarded as waiving the right to assert the defense on judicial review. (SOR in IBLA 95-141 at 1-2; SOR in IBLA 96-538 at 5.) It states that in Phillips Petroleum Co. v. Lujan, 4 F.3d 858 (10th Cir. 1993), the court decided that if the government fails to initiate an audit within 6 years after the records were generated, the delay is unreasonable. Id. at 2.

[1] 28 U.S.C. § 2415(a) (1994) provides that "every action for money damages brought by the United States * * * which is founded upon any contract express or implied in law or fact, shall be barred unless the complaint is filed within six years after the right of action accrues." We have consistently ruled that statutes establishing time limitations for the commencement of judicial actions for damages on behalf of the United States do not limit administrative proceedings within the U.S. Department of the Interior. Santa Fe Minerals, Inc., 145 IBLA 317, 323-4 (1998); W.A. Moncrief, Jr., 144 IBLA 13, 15 (1998); Texaco Exploration and Production, Inc., 134 IBLA 267, 270 (1995); Chevron U.S.A., Inc., 129 IBLA 151, 154 (1994). Moreover, we have specifically declined to rule that MMS demands for additional royalty are barred by that provision. Marathon Oil Co., 128 IBLA 168, 170-71 (1994); Anadarko Petroleum Corp., 122 IBLA 141, 147-48 (1992). As we stated in Alaska Statebank, 111 IBLA 300, 311 (1989), a Departmental proceeding requiring payments that accrued more than 6 years before the proceeding was initiated "is not an action for money damages brought by the United States, but rather is administrative action not subject to the statute of limitations." Concerning Phillips Petroleum Co. v. Lujan, supra, we stated in Marathon Oil Co., 149 IBLA 287, 291 (1999):

As the U.S. Court of Appeals for the Fifth Circuit stated in a September 7, 1994, order granting rehearing of its opinion in Phillips Petroleum Co. v. Johnson, 22 F.3d 616 (5th Cir. 1994), and affirming the district court's grant of summary judgment to the defendants in two of four consolidated cases:

The term "action for money damages" refers to a suit in court seeking compensatory damages. The plain meaning of the statute bars "every action for money damages" unless "the complaint is filed within six years." (Emphasis added.) Thus, actions for money damages are commenced by filing a complaint. Actions that do not involve the filing of a complaint are not "action[s] for money damages." Since the government has filed no complaint, the agency action is not "a[n] action for money damages." Thus, [28 U.S.C.] § 2415 is no bar.

(Order at 3-4, quoted in Texaco Exploration and Production, Inc., 134 IBLA 267, 270-71 (1995).)

Phillips Petroleum Co. v. Lujan, 4 F.3d 858 (10th Cir. 1993), cited by Marathon does not necessarily hold to the contrary. That court noted that "[t]he parties agree that 28 U.S.C. § 2415(a) is the applicable statute for determining when the government must commence its action to collect the royalty underpayment." Id. at 860. The pending appeal is an administrative action seeking recalculation of royalties using dual accounting, not an action to collect royalty underpayments, and under the authorities cited above is not subject to the statute of limitations. See Amoco Production Co., 144 IBLA 135, 139-40 (1998); Meridian Oil, Inc., 140 IBLA 135, 145-46 (1997).

Even if this decision might be construed as sustaining the application of the statute to administrative proceedings, this Board has expressly declined to follow isolated decisions of Federal courts in limited circumstances even while recognizing that such a decision is the law of the case. See, e.g., Amoco Production Co., 144 IBLA at 140; Conoco, Inc., 114 IBLA 28, 32 (1990); Oregon Portland Cement Co. (On Judicial Remand), 84 IBLA 186, 190 (1984); Gretchen Capital, Ltd., 37 IBLA 392, 395 (1978). The Board has eschewed following Federal court decisions primarily in those situations where the effect of the decision could be extremely disruptive to existing Departmental policies and programs and where, in addition, a reasonable prospect exists that other Federal courts might arrive at a differing conclusion. Amoco Production Co., supra. We find those conditions present here, especially in light of the Fifth Circuit's contrary conclusion on rehearing in Phillips Petroleum Co. v. Johnson, cited above.

Accordingly, we find that 28 U.S.C. § 2415(a) (1994) does not bar MMS from requiring Shell to pay additional royalties or recalculate royalties due.

Valuation of Montana Mixed Crude Oil

Shell argues that the letters from the four refiners it submitted demonstrate that the higher pitch content of Montana Mixed crude makes it of lower value than sweet crude oil. One of these letters is a September 14, 1990, letter from Farmland Industries, Inc., to the office of the North Dakota tax commissioner and a September 12, 1990, Farmland memorandum. The letter states that in Farmland's experience "Mixed Montana [crude] yields a considerably higher percentage of lower valued by-products than do the typical sweet crudes that we refine, primarily West Texas Intermediate [WTI]. These value differences are justifiably reflected in the lower posted prices for Mixed Montana in the field." Farmland's memorandum states that Montana Mixed crude has a "typical API gravity of 33.5" and that for purposes of refining, Farmland blends Montana Mix crude with lighter crudes because its refinery is not designed "to run 100 percent of a crude with a gravity as low as 33.5" (compared to WTI's API gravity of 42). The memorandum states that Montana Mixed crude is

worth significantly less to Farmland than WTI because refining yields more low-cost by-products and less value-added products (such as gasoline and diesel fuel) than WTI crude. A September 25, 1990, letter from Conoco to the office of the North Dakota tax commissioner states that in Conoco's experience Montana Mixed crude "produces a higher volume of resid, or bottom of the barrel product, when refined as compared to the higher quality crudes noted above," i.e., Williston Basin Sweet and Wyoming Sweet crude.

Clark Oil & Refining Corporation's September 11, 1990, letter states that Wyoming and North Dakota light sweet crudes "will yield approximately 15% pitch as opposed to 'Mixed Montana' at 25%." "Since this fraction of the crude oil barrel is the least valuable downstream, 'Mixed Montana' is considerably less valuable as a refinery feedstock than 'Light Sweet,'" Clark states. Shell observes that these percentages of pitch closely parallel those in the 10 samples evaluated in the August 14, 1991, RVSD report. ^{8/} One of the samples with low pitch content that assayed as a sweet crude was priced in error by SWEPI at the Montana Mixed price, Shell states. Rather than conclude, from the fact that two of the crudes with high pitch content were sold at sweet crude prices, that pitch content does not appear to be a critical factor in determining the value of crude oil, Shell argues, one should conclude that "the [sale] of the high pitch content crude oil at sweet crude prices was an anomaly and does not represent the real value of high pitch content crude oil such as Montana Mix." (SOR in IBLA 95-141 at 4.) Conoco and Clark do compare Montana Mixed crude with sweet crude oils purchased in the area, Shell observes, contrary to the statement in MMS' August 31, 1994, decision that the letters were not helpful in determining like quality because they did not concern oils produced and sold in the field or area. "[T]he only comparison that we have of crude oils produced and sold in the area is the evidence introduced in this proceeding consisting of the ten assays of crude oil," Shell adds. "The evidence shows that seven of the ten assays had high pitch contents and that the refiners consider such crude oils less valuable than crude oils with lower pitch content." Id.

Sales of high pitch crudes at sweet crude prices only involve small volumes of high pitch crude that the purchasers commingle with sweet crude oil, Shell argues. Id. at 4. SWEPI was producing 19,000 barrels per day of Montana Mixed crude during the October 1, 1980, through September 30, 1983, audit period, Shell states, more than could be absorbed into sweet oil crude streams. "Although there is a market for small volumes of Montana Mix for commingling purposes, there is no market for large volumes of Montana Mix at the sweet crude oil price," Shell argues. Id. at 5.

Shell recites the factors 30 C.F.R. § 206.103 (1984) states should be considered in determining value for royalty purposes. North Dakota

^{8/} "Crude Oil Assay Summary," Attachment 1, Shell SOR in IBLA 95-141. The numbers of the samples in Shell's attachment do not correspond to those in Table 1 of the RVSD Aug. 14, 1991, report, but the percentages of pitch and the price designations do.

sweet crude has not been shown to be of like quality to Montana Mixed crude, Shell argues, so the price of the sweet crude is not relevant. The sweet crude price paid for Montana Mixed crude is for the part (small volumes, Shell repeats) that is commingled; the highest price paid for a majority of the Montana Mixed crude is the price Shell paid SWEPI. Id. Shell was the only party posting a price for Montana Mixed crude during this period. As for "other relevant matters," Shell argues, it is relevant that four refiners who purchase Montana Mixed crude state that its value is less than sweet crude oil because of its high pitch content. Id.

Shell observes that 30 C.F.R. § 206.103 also provides that value computed on the basis of the highest price paid in a fair and open market for the major portion of like-quality oil produced from the field where the leased lands are situated will be considered to be a reasonable value. The Montana Mixed crude that is sold for sweet crude prices is not sold in a fair and open market, Shell argues. In Shell's view, a fair and open market is one in which a purchaser would be willing to pay the same price for a crude oil despite the volume to be purchased. The market for Montana Mixed crude at sweet crude prices is limited to purchasers who can commingle small amounts with sweet crudes without degrading the total stream. The major portion of the Montana Mixed crude is sold under the Shell posting. "To allow * * * insignificant sales of Montana Mix for commingling purposes to establish the value for all Montana Mix crude is to ignore the realities of the market place which has clearly differentiated between the value for sweet crude and Montana Mix," Shell argues. Id. at 6. Finally, Shell repeats its view that API gravity and pitch content are not necessarily inversely related, and therefore prices are not indirectly adjusted for pitch content. Rather, high pitch content is a special quality of Montana Mixed crude that significantly reduces its value. "We believe it is unfair to further penalize Montana Mix by declaring the value for royalty purposes to be a price which cannot be obtained by the majority of Montana Mix produced," Shell argues. Id.

With its SOR in IBLA 96-538 Shell submitted a June 26, 1992, letter to Shell from Amoco stating that "Amoco continues to value Montana Mix crude at something less than West Texas Sour. Although the sulfur content is approximate[ly] ½ of 1 percent, the very high yield of resid makes it unattractive at pricing higher than sour crude."

Shell also submitted an analysis of Montana Mixed crude as compared to Oklahoma Sour postings, the basis for Shell's price from June 1986-October 1989. See June 3, 1996, MMS Decision at 2. This analysis was conducted by Purvin & Gertz, Inc., "to ascertain whether Shell's formula price adequately reflects the market value relative to the Oklahoma Sour." (SOR in IBLA 96-538, Attachment 7, Introduction.) The conclusions in Attachment 7 state in pertinent part:

Most importantly, the Mixed Montana crude exhibits very poor yield and quality characteristics for the vacuum residue. This residue must be blended into fuel or converted to lighter products through further processing such as coking. High viscosity vacuum residue such as exists in the Montana mix

requires substantially more cutter stock (distillate) to meet viscosity specifications for fuel oil, degrading the crude's value. As a coker feedstock, which is typical of most refiners in the region where the crude has been processed, the Montana mix vacuum bottoms has an unusually high carbon content which substantially reduces the yield of more valuable light products and increases the yield of low value coke.

Shell has based its payments for the Montana mix crude on a logistically adjusted price relative to Oklahoma Sour (Healdton) crude which has similar gravity but a higher sulfur content than the Montana. However, in comparison to Oklahoma Sour at Wood River, the refinery cracking value of Mixed Montana averaged \$0.05/Bbl. more than Oklahoma Sour over the 1989-1992 time frame as compared to a \$0.23 premium actually paid by Shell. In 1993, the value increased to \$0.25/Bbl. above Oklahoma Sour. The 1993 average cracking differential is in-line with the transportation adjusted crude price differential of \$0.23/Bbl.

Therefore, it appears that Shell's pricing formula has adequately represented the market value and, in fact, resulted in a price that was approximately \$0.18/Bbl. above its value on a cracking basis for the 1989-1992 period. The value of the Montana mix relative to Oklahoma Sour in a coking refinery is even lower and more in line with currently existing postings by Enron for the Montana mix crude oil.

(Attachment 7, Summary and Conclusions, at 2.)

Shell also submitted figures for the Enron posting "at which the SWEPI price for Montana Mix is determined and the Enron posted prices for Montana Mix crude for the period March 1, 1987, through June 1982." (SOR in IBLA 96-538 at 4, and Attachment 8.) Shell contends that the Enron posting supports its claim that Montana Mixed crude is of lower value "than sweet crudes that attract the Amoco Posting." (SOR in IBLA 96-538 at 4.)

Shell asserts that there is not a fair and open market for the sale of Montana Mixed crude at the Amoco posting. Shell notes that arm's-length sales of 30,000 barrels per month at the Amoco posting "pales in comparison to the SWEPI sales of Montana Mix of approximately 19,000 barrels per day." Id. at 4. Shell states that Enron declined Shell's offer of Montana Mix crude "at the Amoco Posting plus \$0.40 per barrel," which was the price at which Challenger Minerals was allegedly selling Montana Mixed crude to Enron. Shell asserts that this is clear evidence that sales of Montana Mixed crude are not occurring in a fair and open market, and that the only market for Montana Mixed crude, at the Amoco posting, "is for very small volumes of crude from a producer which can be commingled by the purchaser with a stream of sweet crude oil." Id. Shell asserts that a market for approximately 1,000 barrels per day at a high posted price should not be the determining factor for sales of approximately 19,000 barrels per day, where the evidence reveals that only small volumes can attract the higher price. Id. at 5.

In its Answer, MMS states that Shell's argument that Montana Mixed crude is not of like quality to crude oil sold arm's length in the area at Amoco's posting and that MMS has not demonstrated that Amoco's posting was used in the sale of significant quantities of crude oil is based on Shell's assumption that the issue is whether its nonarm's-length sales of Montana Mixed crude constituted the value of production for royalty purposes. (Answer at 8.) Shell's view is wrong, MMS argues; the regulations require value to be based on arm's-length purchases of production at Amoco's posted price. Id.

Under 30 C.F.R. § 206.103 (1984), applicable before March 1, 1998, the posted price that Shell used was never used in an arm's-length sale in the open market, MMS argues; thus, the price Shell received from its affiliate SWEPI "was the result of self-dealing within the corporate structure." Id. at 9. It was therefore appropriate for MMS to look beyond the price Shell received to "other relevant matters," i.e., to the Amoco posting used in arm's-length purchases of Montana Mixed crude in the area, because (1) that was the highest price paid for part of the like-quality oil in the same field or area, (2) Shell itself used that price for most of its arm's-length purchases, and (3) that posting was used extensively to value arm's-length transactions in the area. Id. at 9. These other relevant factors demonstrate that the Amoco price meets the requirements of the regulation and that MMS' orders are a valid exercise of its discretion. Id. at 10.

MMS rejects Shell's argument that there was not a fair and open market for Montana Mixed crude at the Amoco price. The argument is based on the fact that only small volumes of Montana Mixed could be sold arm's length at the Amoco price, MMS observes, but "[t]he rule does not require that all production be sold at a particular price." Id. at 10, note 9. Shell itself bought crude in the same area at the higher Amoco price, MMS argues, thus proving the existence of the market Shell claims does not exist. Id.

Under the regulation effective March 1, 1988, 30 C.F.R. § 206.102(c), MMS argues that, because Shell admits it bought oil from the same area in arm's-length transactions at Amoco's higher posting and has offered no evidence those sales were not for significant quantities of like-quality oil, the reasonable value for royalty purposes is "[t]he lessee's * * * oil sales contract prices used in arm's-length transactions for purchases * * * of significant quantities of like-quality oil in the same field * * *." Id. at 12. Table 1 of the August 14, 1991, RVSD report establishes that two samples of crude oil with pitch as high as or higher than Montana Mixed crude sold at Amoco's posting. Shell does not and cannot deny this, MMS argues. The letters from refiners are a red herring: they do not address arm's-length sales of like-quality crude and they cannot refute the fact that "sales of substantially the same crude oil and Montana Mixed sold at higher prices than the price for which Shell valued its own Montana Mixed production." Id. at 14.

To Shell's argument under 30 C.F.R. § 206.102(c) that only insignificant quantities of like-quality crude sold at the Amoco posting, MMS

quotes from the preamble to the proposed regulation concerning the meaning of "significant quantities":

The purposes of this phrase is to prevent abuses through application of unusually low or high postings under which little or no oil is actually purchased. The term "significant quantities" also is intended to be in relation to volumes moving under typical purchases in the field or area. Thus, for a highly productive OCS field, to meet the significant quantities test, a larger volume would be required to be purchased under a posting than in a less productive onshore field. 52 F.R. 1858, 1861 (Jan. 15, 1987).

Id. at 15. From this MMS concludes that "'significant quantities' are not limited to purchases and sales by one purchaser or seller. All of the purchases and sales from a field (or area) at a particular posted price taken together may constitute 'significant quantities' even if one particular lessee's purchases and sales standing alone do not." Id. MMS suggests that, as the major arm's-length purchaser of oil in the area at the Amoco posting, Shell must certainly have purchased a significant quantity. In any event, all other arm's-length purchasers of Montana Mixed crude used the Amoco posting rather than the Shell posting. Under these circumstances, MMS argues, it properly determined there were significant quantities of like-quality production sold in other transactions and properly required Shell to value its production at the Amoco posting. Id. at 16-17.

Responding to Shell's argument concerning the Enron posting, MMS observes that this price is irrelevant to pre-March 1, 1988, audit periods, id. at 9, n.7, and that Shell has not offered evidence of sales of Montana Mixed crude at the Enron posting for later periods, id. at 13, n.11, 17. MMS argues that Shell's arguments concerning "like-quality" and "significant quantities" are based on the erroneous conclusion that the applicable regulation is 30 C.F.R. § 206.102(c)(2). Id. at 17. Even if Shell were correct, MMS argues, the arithmetic average of posted prices used in arm's-length transactions would be the Amoco posting because that was the price most extensively used in the field or area for Montana Mixed crude.

"Shell tries to divert the Board from the fact that its own posting for non-arm's-length sales of Montana Mixed was irrelevant under MMS' regulations. Shell does this because it cannot produce any evidence that its arm's-length purchases at Amoco's postings were not the value of production for royalty purposes," MMS concludes. Id. at 18.

[2, 3] In establishing the estimated reasonable value of the product under 30 C.F.R. § 206.103 (1984) and 30 C.F.R. § 206.102(c)(1) (1988), the Secretary "has considerable latitude in determining what is the 'value' of production from a lease on which royalty payments are made." Hoover & Bracken Energies, Inc., 52 IBLA 27, 33, 88 I.D. 7, 10 (1981), aff'd, Hoover & Bracken Energies v. United States Dep't of Interior, 723 F.2d 1488 (10th Cir. 1983), cert. denied, 469 U.S. 821 (1984); Amoco Production Co., 29 IBLA 234, 236 (1977). There must be a reasonable basis

in fact for determining value for royalty purposes as other than the actual price received. Supron Energy Corp., 46 IBLA 181, 187-88 (1980), appealed Supron Energy Corp. et al. v. Andrus, (Civ. No. 80-0463 JB, D.N.M., filed June 18, 1980), dismissed sub nom. Supron Energy Corp. v. Hodel, (Civ. No. 80-0463 JB, D.N.M., 1990). However, when the price is the result of a nonarm's-length contract between affiliates or subsidiaries, no presumption arises that it fairly reflects the marketplace and there must be independent indicia that it does. Shell Oil Co., 130 IBLA 93, 96 (1994) (rev'd on other grounds, Shell Oil Co. (On Reconsideration), 132 IBLA 354 (1995); Transco Exploration Co., 110 IBLA 282, 286 n.1, 322, 96 I.D. 367, 370 n.1, 389 (1989); Getty Oil Co., 51 IBLA 47, 51 (1980). When a party challenges a determination as to value, the party must establish that the methodology used is in fact erroneous. Ladd Petroleum Corp., 127 IBLA 163, 174 (1993); Phillips Petroleum Co., 109 IBLA 4, 7 (1989); Amoco Production Co., 78 IBLA 93, 100 (1983); Supron Energy Corp., supra at 195.

We find the August 14, 1991, RVSD report, discussed above, establishes a reasonable basis in fact for valuing Montana Mixed crude at the Amoco posted price rather than at the price Shell received for it under its nonarm's-length contract. Shell has not established that the RVSD's methodology for determining like quality was erroneous; the letters it has submitted from refiners do not compare Montana Mixed crude with like-quality oil in the same field. The RVSD's findings that Shell and others used Amoco's North Dakota sweet crude posting for arm's-length purchases and that no purchasers used Shell's posting for arm's-length purchases belie Shell's arguments that the two sales of assayed Montana Mixed crude at Amoco postings were anomalous, that no significant quantities of this crude were sold at that price, and that there was no fair and open market for sales of Montana Mixed crude. In our view, sales of 30,000 barrels/month of Montana Mixed crude at the Amoco posting, SOR in IBLA 96-538 at 4, supra, are not insignificant and indicate a fair and open market.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the decisions appealed from are affirmed as to the inapplicability of the statute of limitations, 28 U.S.C. § 2415(a) (1994), and the valuation of Montana Mixed crude oil.

Will A. Irwin
Administrative Judge

I concur:

C. Randall Grant, Jr.
Administrative Judge

January 23, 2001

IBLA 95-141R, 96-538R, 98-74R	:	MMS-90-0214-O&G <u>et al.</u>
	:	
150 IBLA 298 (1999)	:	Petition for Reconsideration
	:	
SHELL OIL COMPANY	:	Joint Motion for Order
(ON RECONSIDERATION)	:	Vacating and Dismissing
	:	Claims and Appeals
	:	Granted

ORDER

In response to our June 30, 2000, order requesting the parties to consider alternatives for handling Shell Oil Company's November 29, 1999, petition for reconsideration of our decision in Shell Oil Company, 150 IBLA 298 (1999), counsel have submitted a joint motion stating:

"Shell and the MMS have reached a settlement agreement on the issues involved in this case. Therefore, Shell and the MMS respectfully move the IBLA to vacate Shell Oil Company, 150 IBLA 298 (1999), and to dismiss Shell's petition for reconsideration of Shell Oil Company, 150 IBLA 298 (1999) with prejudice."

We find no apparent overriding public interest that contravenes the parties' motion.

Therefore, in accordance with the authority delegated to the Interior Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, our decision in Shell Oil Company, 150 IBLA 298 (1999), is vacated, and Shell Oil Company's petition for reconsideration of that decision is dismissed with prejudice.

Will A. Irwin
Administrative Judge

I concur:

Bruce R. Harris
Deputy Chief Administrative Judge

150 IBLA 313 A

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