

ALEXANDER ENERGY CORPORATION

IBLA 97-450

Decided August 31, 2000

Appeal from a Decision of the Deputy Commissioner of Indian Affairs, Bureau of Indian Affairs, affirming an Order directing oil and gas lessee to recalculate royalties due on Indian leases in accordance with dual accounting requirements. MMS-93-0096-IND.

Affirmed.

1. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Indians: Mineral Resources: Oil and Gas: Royalties--Oil and Gas Leases: Royalties: Payments

MMS properly directs a lessee to perform dual accounting and recalculate royalties due on Indian oil and gas leases where the leases require such accounting and an MMS audit revealed instances of the lessee's failure to calculate and pay royalties utilizing that method.

2. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Indians: Mineral Resources: Oil and Gas: Royalties--Oil and Gas leases: Royalties--Regulations: Generally

The regulation at 30 C.F.R. § 206.159(c)(1) (1992) provides that prior to or at the same time as claiming a gas processing allowance on Form MMS-2014, a lessee must submit page one of the initial Form MMS-4109. The regulation at 30 C.F.R. § 206.159(d)(1) provides that failure to timely file Form MMS-4109 subjects a lessee to forfeiture of processing allowances taken on Form MMS-2014 until such time as lessee cures the failure to submit page one of Form MMS-4109.

APPEARANCES: Myrna Schack Latham, Esq., Oklahoma City, Oklahoma, for Alexander Energy Corporation; Michael D. Bloomquist, 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

Alexander Energy Corporation (Alexander) 1/ has appealed the March 11, 1997, Decision of the Deputy Commissioner of Indian Affairs, Bureau of Indian Affairs (BIA), denying its appeal of a January 19, 1993, Order of the Minerals Management Service (MMS), directing it to apply dual accounting procedures in the recalculation of royalties due on Indian leases No. 518-006211-0, No. 607-061208-0, No. 607-061427-0, and No. 607-02197-0. Additionally, MMS denied Alexander's request for a manufacturing deduction and denied its request for an exception to the 3-month retroactivity rule for late submittal of Gas Processing Allowance Summary Reports (Form MMS-4109) for the period September 1, 1987, through August 31, 1992, on royalties accruing from those same leases.

In its Statement of Reasons (SOR) for appeal, Alexander does not dispute MMS' authority to conduct an audit of its Indian lease royalty payments and to order adjustments to royalty payments by dual accounting. 2/ Alexander contends, however, that it fulfilled its royalty payment obligations by paying royalties on the proceeds it received from the sale of unprocessed gas from its Indian leases, pursuant to 30 C.F.R. § 206.152 (1992). Further, Alexander asserts that it had sold only unprocessed gas at arm's-length contracts and had no royalty obligations from processed gas sales. Thus, when ordered to recalculate royalties owed to the Indian lessors using dual accounting, Alexander sought a manufacturing allowance deduction, which MMS disallowed, citing the regulation at 30 C.F.R. § 206.159(a) (1992). Alexander argues that paragraph 3(c) of its Indian leases "plainly and unambiguously states that 'a reasonable allowance for the cost of manufacture shall be made.'" (SOR at 7; (emphasis supplied by Appellant).) Alexander concludes that "[t]o the extent 30 C.F.R. § 206.159 * * * purported to require prior approval of a manufacturing allowance, the regulation was inconsistent with the provisions of the Indian leases and cannot be applied," and the MMS decision to deny Appellant's request for a manufacturing allowance because it failed to timely file Form MMS-4109 "is clearly erroneous." (SOR at 7.)

Additionally, Alexander argues that "[e]ven if the Form MMS-4109 was applicable despite the plain language of Alexander's Indian leases, 30 C.F.R. § 206.159(a) * * * allowed a processing allowance to be claimed

1/ National Energy Group, Inc., is the successor-in-interest to Alexander Energy Corporation and has appealed from the order of the Deputy Commissioner of Indian Affairs dated Mar. 11, 1997, which denied Alexander's appeal from an MMS order.

2/ Dual accounting is defined in the Decision of Mar. 11, 1997, as a computational process that "compare[s] the wellhead value of the wet gas with the value that the gas and separated liquids would have if lease production were processed, less applicable deductions, and * * * royalties [would then be paid] based on the greater of the calculated values." (Decision at 1.)

retroactively for more than three months upon a showing of good cause by the lessee." (SOR at 8.) Appellant further asserts that "[w]here * * * MMS initiates an audit of royalty payments, fundamental fairness dictates that the lessee should be allowed to make a retroactive manufacturing deduction when the audit requires recalculation of royalties on the value of the processed products," when lessee was paid no proceeds for the processed products. (SOR at 8.)

MMS has filed an Answer to Alexander's SOR, arguing that, pursuant to the terms of its Indian leases, relevant case law, and applicable Federal regulations, Alexander was required to use dual accounting on its leases from September 1, 1987, through August 31, 1992, and because it failed to file forms that were required, Alexander was not entitled to take processing allowances from March 1, 1988, through August 31, 1992.

In support of its assertion that the Indian leases, by their terms, require dual accounting in computing royalties owed, MMS cites Paragraph 3(c) of Appellant's Indian leases, which provides, in pertinent part, that lessees "pay * * * a royalty of 20 percent of the value or amount of all oil, gas, and/or natural gasoline * * * and that royalty will be computed on the value of gas or casinghead gas, or on the products thereof (such as residue gas, natural gasoline, propane, butane, etc.), whichever is greater." MMS argues further that "no language in the leases exempts lessees that do not process their own gas from the requirement." (Answer at unnumbered page 3.) MMS also points out that in 1988 when Appellant had the duty to employ dual accounting under its Indian leases, the royalty valuation regulation at 30 C.F.R. § 206.155(b) (1988) "recognized that the specific provisions of an Indian lease supersede any inconsistent provision of the valuation regulations," and the terms in the Indian leases requiring accounting by comparison governed. (Answer at unnumbered page 3.)

MMS asserts that the holding in Jicarilla Apache Tribe v. Supron Energy Corporation, 782 F.2d 855 (10th Cir. 1986), modified, 793 F.2d 1171 cert. denied, 479 U.S. 471 (1986), required dual accounting for royalties derived from leases with Paragraph 3(c) provisions and argues further: "Because the Supron decision became final in 1986, any argument by [Alexander] disputing [its] obligation to perform dual accounting is without merit. Consequently, [Alexander] was obligated to dual account under the terms of its Indian leases and it simply failed to meet its obligations." (Answer at unnumbered page 3.)

MMS also argues that Federal regulations in effect from 1977 through 1988 placed Appellant on notice that compliance with the dual accounting provisions of its lease was required:

In 1977, the Federal Register stated that the specific terms of an Indian lease requiring dual accounting control despite any contrary MMS regulations. See Notice To Lessees and Operators of Indian Oil & Gas Leases (NTL-1A) - Procedures for Reporting and Accounting for Royalties, 42 Fed. Reg. 18135,

18137 (April 5, 1977). MMS again put [Alexander] on notice of its obligation to dual account when it revised 30 C.F.R. part 206 in 1988 to address dual accounting. Part 206.155(b) provided that when the lease terms required dual accounting, that provision governs, and they must perform the dual accounting according to Part 206.155(a). 30 C.F.R. § 206.155(b) (1988). MMS provided an additional reminder to [Alexander] in its September 30, 1988, "Dear Payor" letter. The letter reemphasized the dual accounting obligations of Indian lessees. Accordingly, for more than a decade [Alexander] was consistently reminded of, and consistently ignored, its duty to dual account.

(Answer at unnumbered page 4.)

MMS further argues that Alexander improperly relies on the regulation at 30 C.F.R. § 206.152(b)(1)(i) (1992), stating that "the value of gas which is sold pursuant to an arm's-length contract shall be the gross proceeds accruing to the lessee * * *." MMS asserts that the regulation at 30 C.F.R. § 206.155(b) provides that dual accounting as required by the terms of the Indian leases overcomes provisions in the regulations which are contrary to the dual accounting requirement. See 30 C.F.R. § 206.150(b) (1992). Thus, MMS argues, "[b]ecause the Indian leases specifically obliged [Alexander] to perform dual accounting * * *, royalties were to have been paid only after [Alexander] made a comparison between the two methods of accounting to determine which was more beneficial to the Indian lessee." (Answer at unnumbered pages 4-5.)

MMS disputes Alexander's claim that it was entitled to a gas processing allowance in computing the value of processed gas under dual accounting. MMS asserts that Appellant's failure to timely file Form MMS-4109, pursuant to the regulation at 30 C.F.R. § 206.159(a), results in forfeiture of the processing allowance, since Federal regulations in effect during the audit period required a lessee to file proper forms before taking a processing deduction. (Answer at unnumbered page 5.) MMS also argues that while it has the authority, pursuant to the regulation at 30 C.F.R. § 206.159(a) (1992), to extend, for good cause shown, the 3-month grace period within which a processing allowance can be filed, Alexander's conduct failed to bring it within the ambit of the good cause exception. (Answer at unnumbered pages 5-7.)

[1] Alexander argues that it did not apply dual accounting to the royalty calculations on its Indian leases because it sold unprocessed gas only from those leases and thus had no comparable market figures for the sale of processed gas. When Alexander was required, pursuant to the MMS audit, to calculate royalties based on the comparative prices of processed and unprocessed gas, it sought a gas processing allowance, which MMS denied for failure to timely file the requisite Form MMS-4109.

Appellant supplies for the record a copy of a standard lease entitled "Oil and Gas Lease—Allotted Indian Lands" and does not dispute the MMS

assertion that Paragraph 3(c) of that lease requires dual accounting. It is well-settled that a reasonable interpretation of Departmental regulations and the terms of Paragraph 3(c) of the standard Indian lease require a lessee on an Indian lease to perform dual accounting and, additionally, that dual accounting had always been required of lessees on Indian leases. Amoco Production Co. (On Reconsideration), 143 IBLA 54A, 54E (Nov. 30, 1998), (citing Burlington Resources Oil and Gas Co. v. U.S. Dept of the Interior (USDI), 21 F. Supp. 2d 1, 6 (D.D.C. 1998)).

Section III of NTL-1A required dual accounting by lessees holding Tribal leases:

Unless and until the Supervisor has established that one of the following methods consistently yields the greatest royalty to the Indian lessor, lessees and operators shall compute royalty based on (1) the value of the wet gas produced from the lease adjusted for its Btu content, (2) the value of the separate components after processing and adjustments for the approved manufacturing allowance, and (3) the gross proceeds accruing to the operator. The method that yields the greatest royalty on a monthly basis each month will be reported as royalty due.

42 Fed. Reg. at 18137. NTL-1A remained in effect only until March 1, 1988, but the requirement for dual accounting for Indian leases was retained in the 1988 regulatory revision, which was in effect for the balance of that time. Under 30 C.F.R. § 206.155 (1995),

[t]he requirement for accounting for comparison contained in the terms of leases, particularly Indian leases, will govern as provided in § 206.150(b) of this subpart. When accounting for comparison is required by the lease terms, such accounting for comparison shall be determined in accordance with paragraph (a) of this section.

Paragraph (a) provides the following methodology:

[T]he value, for royalty purposes, shall be the greater of (1) the combined value for royalty purposes of the residue gas and gas plant products resulting from processing the gas determined pursuant to § 206.153 of this subpart * * * or (2) the value, for royalty purposes, of the gas prior to processing determined in accordance with § 206.152 of this subpart.

From this it is clear that, even when (as here) gas from Indian leases is unprocessed, the value for royalty purposes may be the value of gas after processing. This interpretation is consistent with the language of 30 C.F.R. § 206.152(a)(1), governing valuation standards for "all gas that is not processed and all gas that is processed but is sold or otherwise disposed of by the lessee pursuant to an arm's-length contract prior

to processing * * * " and to "processed gas that must be valued prior to processing in accordance with § 206.155." It is thus reasonable to interpret these regulations to mean that processed gas must be valued and that a royalty computed on that value must be paid, if higher than royalty computed on the value of the unprocessed gas. See, e.g., Robert L. Bayless, 149 IBLA 140, 150-51 (1999).

[2] Appellant Alexander asserts that it should be allowed to deduct a gas processing allowance in computing the value of processed gas under dual accounting, undertaken pursuant to an MMS audit and demand for additional royalties. Prior to the MMS demand and audit, Appellant computed royalties based only upon the sale of unprocessed gas at the wellhead and did not practice dual accounting, even though Paragraph 3(c) of its Indian leases and applicable regulations required the use of dual accounting in computing royalties due. Alexander argues that its request for a gas processing allowance was timely and should have been granted.

We find that the applicable regulations fail to support Appellant's arguments. The regulations governing gas processing allowances were amended, effective March 1, 1988, to require the submission of a Gas Processing Allowance Summary Report (Form MMS-4109), prior to claiming a gas processing allowance on Form MMS-2014. The regulation at 30 C.F.R. § 206.159(c)(1)(i) (1992) states, in pertinent part, that

the lessee shall submit page one of the initial Form MMS-4109 (and Schedule 1) prior to the time, or at the same time as, the processing allowance determined pursuant to an arm's-length contract is reported on Form MMS-2014, Report of Sales and Royalty Remittance. A Form MMS-4019 received by the end of the month that the Form MMS-2014 is due shall be considered to be timely received.

Since these regulations became effective March 1, 1988, the initial reporting period was March 1 through December 31, 1988. The regulations further provided that the initial Form MMS-4109, once filed, "shall be effective for a reporting period beginning the month that the lessee is first authorized to deduct a processing allowance and shall continue until the end of the calendar year, or until the applicable contract or rate terminates or is modified or amended, whichever is earlier." See 30 C.F.R. § 206.159(c)(1)(ii) (1992).

Late reporting or failure to report elicits sanctions: the lessee is subject to the forfeiture of processing allowances taken on Form MMS-2014 until the late reporting or failure to report is cured. See 30 C.F.R. § 206.159(d)(1) (1992). In the instant case, Alexander sold its unprocessed gas from Indian leases at the wellhead and the requested processing allowance was sought for comparison purposes after MMS requested that Appellant derive a theoretical value for the gas as processed gas. The regulation at 30 C.F.R. § 206.159(a) states in pertinent part that

[b]efore any deduction may be taken, the lessee must submit a completed page one of Form MMS-4109, Gas Processing Allowance

Summary Report, in accordance with paragraph (c)(1) of this section. A processing allowance may be claimed retroactively for a period of not more than 3 months prior to the first day of the month that Form MMS-4109 is filed with MMS, unless MMS approves a longer period upon a showing of good cause by the lessee.

In the Decision of March 11, 1997, the Deputy Commissioner of Indian Affairs found that Alexander's failure to perform dual accounting as defined in Paragraph 3(c) of its Indian lease and its failure to file the required forms before taking a gas processing allowance did not evidence "good cause" to extend the 3-month grace period within which one can request a retroactive processing allowance. ^{3/} The record before us shows that Alexander had a duty, under the terms of its Indian lease, to compute royalties due by employing dual accounting. The regulations are also clear that Alexander was required to file Form MMS-4109 before claiming a gas processing allowance. Appellant's claims that it first became aware of its duty to perform dual accounting at the time of the MMS audit cannot be supported by the record before us.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, we affirm the March 11, 1997, Decision of the Deputy Commissioner of Indian Affairs that Alexander was required, pursuant to the terms of its lease, to perform dual accounting for the period September 1, 1987, through August 31, 1992, and, further, that Alexander could not deduct a gas processing allowance for the period March 1, 1988, through August 31, 1992, because it had not timely filed the form required by regulation.

James P. Terry
Administrative Judge

I concur:

James L. Byrnes
Chief Administrative Judge

^{3/} While the regulations at 30 C.F.R. § 206.101 do not define the term "good cause" as used in 30 C.F.R. § 206.159(a), MMS, in its Decision of Mar. 11, 1997, offered the following:

"Within the discretion afforded by the provisions of 30 C.F.R. 206.159(a), 'good cause' for these purposes has been administratively defined by MMS in terms of two basic elements: (1) justifiable delay (i.e., the existence of an event proximate in time to the due date which was beyond the control of the lessee), and (2) due diligence (i.e., evidence that the lessee was diligent up to the point in time when the problem/justifiable delay occurred and acted promptly after the cause of the delay was identified and/or removed)."

(Decision at 5.)

