KIRBY EXPLORATION COMPANY OF TEXAS

IBLA 95-446, 96-567 Decided March 12, 1998

Appeals from Decisions of the Acting Deputy Commissioner of Indian Affairs and the Deputy Commissioner of Indian Affairs, Bureau of Indian Affairs, denying appeals of a demand to pay additional royalties and an assessment of late payment charges. MMS-92-0309-IND and MMS-92-0234-IND.

Reversed.

1. Administrative Procedure: Adjudication--Administrative Procedure: Administrative Review--Appeals: Generally--Oil and Gas Leases: Royalties: Generally--Res Judicata

The Board of Land Appeals is not limited by the doctrine of administrative finality from correcting or reversing an erroneous decision made by the Secretary's subordinates if compelling legal or equitable reasons exist, such as violation of basic rights of the parties or the need to prevent an injustice. Even assuming arguendo that an MMS order to recalculate royalties was a final order, a declaration by a U.S. Circuit Court of Appeals that the State statute underpinning that order is invalid provides compelling grounds for reversing the recalculation order and the orders to pay additional royalties and late payment charges based thereon.

APPEARANCES: Gary W. Catron, Esq., and Myrna Schack Latham, Esq., Oklahoma City, Oklahoma, and L. Poe Leggette, Esq., and Nancy L. Ford, Esq., Washington, D.C. for Appellant; Peter J. Schaumberg, Esq., Howard W. Chalker, Esq., Sarah L. Inderbitzin, Esq., and Lisa K. Hammer, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Bureau of Indian Affairs and the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE HUGHES

Kirby Exploration Company of Texas (Kirby) has appealed from the December 30, 1994, Decision of the Acting Deputy Commissioner for Indian Affairs (Acting Deputy Commissioner), Bureau of Indian Affairs (BIA),

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denying its appeal of a May 1, 1992, Order issued by the Minerals Management Service (MMS), requiring the payment of $307,893.64 in additional royalties for Indian allotted leases Nos. 607-033817-0, 607-033818-0, 607-033822-0, and 607-060567-0. That appeal was docketed at BIA as MMS-92-0309-IND and here as IBLA 95-446.

Kirby has also appealed from a June 21, 1996, Decision of the Deputy Commissioner for Indian Affairs (Deputy Commissioner), BIA, denying its appeal of MMS's February 10, 1992, Order assessing $49,955.39 for the late payment of royalties on gas produced from those leases. That appeal was docketed at BIA as MMS-92-0234-IND and here as IBLA 96-567.

Kirby has moved to consolidate these two appeals, and BIA concurs in this request. Since the two appeals are integrally related, we grant Kirby's motion and consolidate the appeals.

In 1977 and 1979, Kirby Exploration Company, the original lessee and forerunner to Kirby (referred to collectively as Kirby), acquired a working interest in four oil and gas leases of allotted Indian lands in Caddo County, Oklahoma. Leases Nos. 607-033817-0, 607-033818-0, and 607-033822-0 were dated January 11, 1977, and approved by a designee of the Secretary of the Interior in March 1977. Lease No. 607-060567-0 was dated March 22, 1979, and approved by the Secretary's designee on May 11, 1979. Kirby assigned 40 percent of the working interest in the four leases (the Kirby leases) to Lyco Acquisition 1983-I, Ltd., on June 28, 1983, and the Secretary's designee approved the assignment on October 4, 1983.

In a series of three orders dated March 10, 1980, August 17, 1981, and February 1, 1982, the Oklahoma Corporation Commission established a 680-acre drilling and spacing unit that included the lands and minerals described in the Kirby leases. The drilling and spacing unit also encompassed Indian allotted leases Nos. 607-033815-0 and 607-033816-0 owned by Saxon Oil Company (the Saxon leases).

On August 20, 1981, Kirby, Saxon, and the other lessees of the lands included in the drilling and spacing unit entered into a communitization agreement which was approved by the Anadarko Area Office of the BIA on March 22, 1982. The agreement incorporated applicable State law and the Oklahoma Corporation Commission's drilling and spacing orders, which modified the individual leases' royalty provisions by pooling the normal one- eighth royalty interests within the drilling and spacing unit. Royalty was allocated to each royalty owner using the proportion of the total royalty that his acreage bore to the entire acreage in the drilling and spacing unit. See, e.g., Feb. 1, 1982, Order No. 207588 at 3, paragraph 4.

Kirby, the designated operator of the communitized area, timely drilled and completed the Mindemann #1-30 well as a producing well. Kirby operated the well until April 1988 when American Exploration Company succeeded Kirby as the operator. During the period Kirby operated the well and paid royalties as the designated royalty payor for the Kirby and the

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Saxon leases, the company computed and remitted royalties pursuant to Oklahoma law as interpreted by the Oklahoma Supreme Court in Shell Oil Co. v. Corporation Commission, 389 P.2d 951 (Okla. 1963) (the Blanchard Decision). Thus, Kirby paid the Indian lessors their proportionate share of one-eighth of all production from the communitized well based on the ratio their acreage bore to the entire acreage of the communitized area.

Effective October 17, 1985, the Oklahoma legislature enacted Oklahoma Senate Bill 160 (SB 160), which, inter alia, amended the previous method of determining a royalty owner's interest in a drilling and spacing unit. See Panhandle Eastern Pipeline Co. v. State of Oklahoma, 83 F.3d 1219, 1223 (10th Cir. 1996). Although MMS had previously accepted royalty payments for communitized leases in Oklahoma computed according to the Blanchard Decision, after enactment of SB 160, MMS discontinued the Blanchard Decision requirements and directed payors for Federal and Indian oil and gas leases committed to communitization agreements within Oklahoma to undertake no special procedures in reporting and paying royalties, beginning with the November 1985 production month. See MMS Oil and Gas Payor Handbook (Payor Handbook), Vol. II, sec. 1.1.12.

On December 20, 1989, MMS's Houston Compliance Office (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

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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 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. 1/

By Order dated February 10, 1992, HCO 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. Kirby appealed the late payment charges to the Commissioner of Indian Affairs pursuant to 30 C.F.R. § 290.6, asserting that the additional royalties had been paid as a settlement and compromise, not as an admission of the correctness of MMS's methodology or computations and that the original royalty payments had been correctly calculated in accordance with applicable state law and the approved communitization agreement.

While that matter was pending, by Order dated May 1, 1992, 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 also appealed the May 1, 1992, Order to the Commissioner of Indian Affairs, asserting that its initial royalty payments had been

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1/ On Jan. 16, 1992, Kirby sent MMS an amended Form MMS-2014 for the audit, again reallocating the overpayments on the two Saxon leases to the four Kirby leases.

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correctly computed pursuant to the Blanchard Decision and the approved communitization agreement, and that, since the MMS Order was based on HCO's royalty calculations, which improperly ignored the Blanchard Decision, the Order should be overturned. In the field report prepared in response to Kirby's appeal, MMS declined to address the merits of the appeal on the ground that Kirby's right to appeal the audit issues had lapsed due to the company's failure to appeal the April 8, 1991, audit letter. In its response to the field report, Kirby argued that it was entitled to raise the issues regarding the incorrect royalty computation methodology in the current appeal because the April 1991 letter was not a final order or decision. It also argued that its payment of royalties in accordance with the Blanchard Decision complied with Federal law concerning the communitization of royalty payments, that the MMS Order was grounded on a misapplication of Oklahoma law, and that the MMS Order unlawfully prevented Kirby from recouping overpayments on leases within a single communitized area.

The December 30, 1994, Decision of the Acting Deputy Commissioner denying the appeal of the May 1, 1992, Order (MMS-92-0309-IND) did not mention Kirby's arguments challenging the validity of MMS's royalty computation methodology or address whether Kirby had forfeited its right to raise these issues by failing to appeal the April 8, 1991, letter. Instead, the Decision focussed solely on the contents of the May 1, 1992, Order. The Acting Deputy Commissioner concluded that the May 1 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 revenues. 2/

The Acting Deputy Commissioner further found that the record established that HCO personnel had represented to Kirby that they had the authority to offer and were offering to settle MMS's claim of $380,702.07 in royalty underpayments in return for Kirby's payment of $72,718.99 and submission of the Form MMS-2014 drafted by HCO and that Kirby had fulfilled its obligations under the oral agreement, thus satisfying the requirement of accord and satisfaction. Nevertheless, she determined that the settlement was not enforceable against the Government because the verbal agreement had not been reduced to writing or signed by an authorized person. Kirby appealed the Acting Deputy Commissioner's Decision to this Board (IBLA 95-446).

Meanwhile On June 21, 1996, the Deputy Commissioner issued his Decision on Kirby's appeal of the February 10, 1992, Order imposing late payment charges (MMS-92-0234-IND). He found that the appropriateness of the

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2/ We note that the primary case cited by the Acting Deputy Commissioner as support for the limitations on cross-lease recoupment on Indian allotted leases has subsequently been reversed by the Board. See Mustang Fuel Corp., 134 IBLA 1 (1995).

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methodology used to determine the underlying royalty payments had no relevance to the issue of the propriety of the late payment charges. Since Kirby had provided no reason for overturning the assessment, he denied the appeal. Kirby appealed this Decision to this Board (IBLA 96-567).

In the latter appeal, Kirby asserts that it owed no interest, since its original royalty payments had been properly computed, and that the interest demand violated its settlement with HCO. Because these issues coincide with those raised in Kirby's previous appeal of the demand for payment of additional royalties, our resolution of Kirby's challenge to the royalty payment order will necessarily dispose of its appeal of the interest assessment as well.

Kirby objects to the Acting Deputy Commissioner's omission of any analysis of the decisive point of whether Kirby's original royalty payments were correctly computed in accordance with Oklahoma law as incorporated in the approved communitization agreement, arguing that its failure to appeal the April 8, 1991, MMS letter does not preclude it from raising this issue because that letter was not final on its face and was not treated as final by MMS. Kirby maintains that its royalty payments pursuant to the Blanchard Decision conformed to Federal law since, by approving the communitization agreement which adopted the Oklahoma Corporation Commission spacing orders and relevant state law, the Department agreed to be bound by Oklahoma law, including the Blanchard Decision.

Kirby asserts that (as acknowledged by MMS in section 1.1.12 of Volume II of the Payor Handbook) under the Blanchard Decision, each royalty owner of lands included in a drilling and spacing unit created by the Oklahoma Corporation Commission has a property right in all gas sold from the communitized area and shares in the one-eighth royalty on all sales of production from the pooled area in the ratio that his acreage bears to the communitized property. Payment on this basis, Kirby submits, fully comports with the Department's gross proceeds rule. Kirby contends that MMS erroneously relied on SB 160 as the basis for discontinuing its longstanding policy of requiring royalty payments on communitized lands in Oklahoma in accordance with the Blanchard Decision because that statute has been declared unconstitutional. Since it properly calculated and paid royalty during the audit period in accordance with the Blanchard Decision, Kirby insists that it owes no additional royalties on the Kirby leases.

Alternatively, Kirby argues that the Acting Deputy Commissioner's Decision should be reversed because, under the doctrine of accord and satisfaction, MMS is bound by the settlement between HCO and Kirby. Kirby further avers that MMS's restrictions on the recoupment of overpayments on Indian allotted leases based on the Payor Handbook, which lacks the force and effect of law, ignores the lessors' agreement to be bound together as a single communitized area and Departmental policy permitting offsets of overpayments and underpayments between leases included in the same communitization agreement.

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In the Answer filed on behalf of the Acting Deputy Commissioner, MMS does not address the validity of Kirby's original royalty payments under the communitization agreement and the Blanchard Decision. Instead, after summarily referring to the answer filed in Mustang Fuel Corp., supra., another case for its arguments on the issue of whether Kirby lawfully recouped the overpaid royalties, MMS argues that Kirby has relinquished its right to contest HCO's April 1991 letter. As noted above, the Board reversed MMS's decision in Mustang Fuel Corp., supra.

The April 8, 1991, letter was final on its face, MMS submits, and became final for the Department when Kirby did not timely file an appeal, regardless of the subsequent discussions between HCO and Kirby concerning Kirby's compliance with directives set out in that letter. The MMS maintains that the doctrine of administrative finality precludes Kirby from now challenging the merits of the unappealed letter, and that the Board must, therefore, dismiss Kirby's appeal to the extent it disputes the findings made in the April 1991 letter. Furthermore, since neither MMS's May 1992 Order nor the Acting Deputy Commissioner's Decision addressed the issue of whether Kirby properly valued its production for royalty purposes based on the Blanchard Decision, MMS asserts that the Board has no jurisdiction to consider the issue. Finally, MMS denies that HCO and Kirby entered into a settlement regarding the April 8, 1991, letter, since whatever verbal agreement the parties may have reached was not reduced to writing or signed by the Director, MMS, the only official with the authority to enter into a binding settlement agreement.

[1] We need not decide whether the April 8, 1991, HCO letter was a final order which Kirby was required to appeal because, even assuming arguendo that the letter became a final Departmental decision upon Kirby's failure to appeal, the doctrine of administrative finality does not prevent us from considering whether MMS properly determined that Kirby owed additional royalties for the Kirby leases. As a general rule, the doctrine of administrative finality, which is the administrative counterpart of the principle of res judicata, precludes reconsideration of a decision of an agency official when a party, or his predecessor-in-interest, had an opportunity to obtain review within the Department and no appeal was taken, or an appeal was taken and the decision was affirmed. Thermal Energy Co., 135 IBLA 291, 305-06 (1996). The rule is not absolute, however,

> because decisions by administrative officials, as well as those of this Board, are made exercising the authority delegated by the Secretary of the Interior. The Secretary, and those exercising his authority, may review a matter previously decided and correct or reverse an erroneous decision. See Gabbs Exploration Co. v. Udall, 315 F.2d 37, 40 (D.C. Cir. 1963). * * * Reexamination of a decision which has become final is available only upon a showing of compelling legal or equitable reasons, such as violation of basic rights of the parties or the need to prevent an injustice.

Turner Brothers, Inc. v. OSMRE, 102 IBLA 111, 121 (1988). The Secretary of the Interior is not estopped by the principles of res judicata or finality

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of administrative action from correcting or reversing an erroneous decision by his subordinates or predecessors-in-interest. Ideal Basic Industries, Inc. v. Morton, 542 F.2d 1364, 1368 (9th Cir. 1976). It necessarily follows that the Board, exercising the Secretary's review authority, is not required to accept as precedent erroneous decisions made by the Secretary's subordinates. Pathfinder Mines Corp., 70 IBLA 264, 278, 90 Interior Dec. 10, 18 (1983), aff'd, Pathfinder Mines Corp. v. Clark, 620 F. Supp. 336 (D. Ariz. 1985), aff'd, Pathfinder Mines Corp. v. Hodel, 811 F.2d 1288 (9th Cir. 1987).

The MMS does not dispute that, until the November 1985 production month, it considered royalties for communitized Federal and Indian leases in Oklahoma computed in accordance with the Blanchard Decision as properly calculated and paid. Nor does MMS deny that, as section 1.1.12 of Volume II of the Payor Handbook indicates, the decision to discontinue the Blanchard Decision requirements stemmed from the Oklahoma legislature's enactment of SB 160 which MMS interpreted as superseding the Blanchard Decision. The U.S. Court of Appeals for the Tenth Circuit, however, has declared SB 160 invalid in its entirety. Panhandle Eastern Pipeline Co. v. State of Oklahoma, 83 F.3d at 1231. Since MMS has proffered no other justification for rescinding its longstanding policy of accepting royalty payments calculated pursuant to the dictates of the Blanchard Decision, the invalidity of SB 160 provides the necessary compelling reason for reexamining the April 1991 letter and reversing that letter's erroneous determination that Kirby had underpaid royalties on the Kirby leases by computing those royalties in accordance with the Blanchard Decision. The subsequent MMS Orders and the Decisions of the Acting Deputy Commissioner and the Deputy Commissioner all emanate from the April 1991 letter and must also be reversed.

Our reversal of the challenged Decisions renders unnecessary any discussion of the additional issues raised in Kirby's appeals.

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 reversed.

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David L. Hughes
Administrative Judge

I concur:

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Will A. Irwin
Administrative Judge

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