UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FINA OIL & CHEMICAL COMPANY and PETROFINA DELAWARE, Inc.,	)	
Plaintiffs,	)	
v.	)	**Case No. 99-2392 (HHK)**
BRUCE BABBITT, Secretary of the Interior	)	
Defendant	)	

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF DEFENDANT'S CROSS MOTION FOR SUMMARY JUDGMENT

Bruce Babbitt, named as Defendant in this action in his official capacity as Secretary of the Interior, hereby files this Memorandum of Points and Authorities In Support Of Defendant's Cross Motion For Summary Judgment seeking affirmance of the administrative order under review, and dismissal of the complaint in this action with prejudice.

I. INTRODUCTION

In this action, the Plaintiffs, Fina Oil and Chemical Company ("FOCC") and the Petrofina Delaware, Inc. ("PDI"), two affiliated natural gas producers, seek judicial review of a decision issued June 11, 1999 by the Interior Board of Land Appeals ("IBLA"). In that decision, the IBLA affirmed a June 7, 1996 decision ("Director's decision") issued by an Associate Director of the Mineral Management Service ("MMS") affirming an MMS Dallas Area Audit Office order requiring Plaintiffs to perform a restructured accounting of royalties on gas sales originating from certain

Federal and Indian leases. In the June 1996 decision, MMS found that Plaintiffs had underpaid royalties on gas sold to their sales affiliate, Fina Natural Gas Company ("FNGC"), by valuing the gas for royalty valuation purposes at a lower price "negotiated" between the affiliates, instead of the higher price that FNGC received in subsequent sales of the gas in arm's-length transactions with third parties. 1/

1/ As noted above, the IBLA issued its decision on June 11, 1999. Title 30 U.S.C. § §1724(h), enacted by section 4 of Federal Oil and Gas Royalty Simplification and Fairness Act of 1996 ("RSFA"), Pub. L. 104-185, 110 Stat. 1700, 1709-1710, requires the Secretary to issue a final decision in administrative appeals involving federal oil and gas royalties within thirty-three months from the date the appeal commences, or, for appeals pending on the date of enactment (August 13, 1996), within thirty-three months of the date of enactment (*i.e.*, by May 13, 1999). For any appeal involving more than $10,000 that is still pending at the conclusion of the thirty-three month period, RSFA directs that a final decision be entered in favor of the Secretary.

On June 3, 1999, while the matter was pending before IBLA, counsel for MMS filed a motion to dismiss Fina's appeal on the ground that a final decision in favor of the Secretary had been imposed by operation of statute on May 13, 1999, because it involved a monetary obligation of more than $10,000, and because the appeal was still pending as of May 13, 1999, the end of the thirty-third month after the effective date of the RSFA.
In the June 11, 1999 decision, the IBLA denied MMS' motion on grounds that certain actions of the parties had extended the RSFA deadline. AR 19 n.1. IBLA then ruled on the merits and affirmed the Director's decision. Believing that the RSFA deadline had not been extended and that the IBLA acted after RSFA had deprived it of jurisdiction, counsel for MMS filed a motion with the Director of the Office of Hearings and Appeals (OHA), of which the IBLA is a part, to assume jurisdiction for the sole purpose of vacating the IBLA's decision because of lack of jurisdiction. At the time of this writing, the OHA Director still has not acted on that motion. Because of the pendency of that motion, Defendant filed a motion for a temporary judicial stay of this action. Plaintiffs opposed that motion, arguing that the IBLA's June 11 decision was properly reviewable by this Court. Defendant's motion for a judicial stay was denied by this Court on April 20, 2000.

If the OHA Director ultimately should grant the motion, the final departmental decision that is subject to judicial review would, in Defendant's view, be the final decision imposed by the RSFA provision, 30 U.S.C. 1724(h), which in this case operates to affirm the June 1996 Director's decision. Nonetheless, it does not matter for the purposes of this action whether the Director of OHA grants MMS's motion to dismiss Fina's appeal. Thus, regardless of whether the IBLA's June 11 decision or the final decision imposed by 30

In a complaint filed September 8, 1999, Plaintiffs seek to have the IBLA's June 11 decision order set aside because it allegedly violates the Mineral Leasing Act (the "MLA") and MMS's royalty valuation regulations. As we now explain, the agency's decision should be affirmed, and Plaintiffs' complaint should be dismissed with prejudice, because the final decision of the Department of the Interior is supported by substantial evidence and reflects a correct and reasonable interpretation of MMS's royalty valuation regulations.

II. STATUTORY AND REGULATORY BACKGROUND

The Department of the Interior ("Interior") issues and administers oil and gas leases for federal and Indian lands pursuant to the Mineral Leasing Act, 30 U.S.C. §§ 181-287 (for onshore public domain lands); the Mineral Leasing Act for Acquired Lands, 30 U.S.C. §§ 351-359, Indian leasing statutes -- 25 U.S.C. §§ 396a - 396g (tribal leases), 25 U.S.C. § 396 (allotted leases) -- and the Outer Continental Shelf Lands Act, 43 U.S.C. §§ 1331-1356. The MMS, an agency within Interior, collects, verifies and distributes revenues from gas leases issued pursuant to these authorities. Under the leasing statutes and regulations, lessees must pay royalties to the government based on the value of gas produced from federal and Indian leases.

In 1982, Congress enacted the Federal Oil and Gas Royalty Management Act (FOGRMA), 30 U.S.C. 1701 et seq., stating that the industry previously had been permitted "to operate essentially

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U.S.C. § 1724(h) is deemed the final agency action in this case, the substantive legal issues involved would be the same. In Defendant's view, the legal issues addressed in the Director's decision are the same as those that were pending before, and were resolved by, the IBLA. Moreover, in defending this action, the Defendant would be relying on the principles articulated in the Texaco decision to the same degree that the IBLA did in its June 11 decision. Therefore, the legal analysis contained in this memorandum would be the same regardless of whether the decision under review is the IBLA decision or a statutorily-imposed final departmental decision.

on an honor system" with respect to the payment of royalties. H.R. Rep. No. 97-859 at 15. To remedy potential abuses of the system, Congress in the FOGRMA acted "to clarify, reaffirm, expand and define the authorities and responsibilities of the Secretary of the Interior to implement and maintain a royalty management system for oil and gas leases." 30 U.S.C. 1701(b)(2)-(3). FOGRMA thus directs the Secretary to establish "a comprehensive inspection, collection and fiscal and production accounting and auditing system . . . to accurately determine oil and gas royalties . . . and to collect and account for such amounts in a timely manner." 30 U.S.C. §1711(a).

Pursuant to the leasing statutes, a lessee who produces gas from a federal or Indian lease must pay a royalty set as a specified percentage of the "value" of the gas saved, removed, or sold from the lease. See 43 U.S.C. 1337(a)(1) (OCSLA); 30 U.S.C. 226 (MLA); see also California Co. v. Udall, 296 F.2d 384 (D.C. Cir. 1961); United States v. Ohio Oil Co., 163 F.2d 633, 640 (10th Cir. 1947), cert. denied, 333 U.S. 833 (1948); Marathon Oil Co. v. United States, 807 F.2d 759, 766 (9th Cir. 1986), cert. denied, 480 U.S. 940 (1987). The mineral leasing statutes provide Interior with sole authority to "prescribe such rules and regulations as may be necessary to carry out" the leasing provisions. 43 U.S.C. § 1334(a) (OCSLA); 30 U.S.C. § 189 (MLA); 25 U.S.C. §§396 and 396d (tribal and allotted leases). Further, the lease terms specifically reserve to the Secretary the authority to establish the reasonable value of production for royalty purposes. In conformity with these statutory provisions and the lease terms, Interior's regulations define the value of production for royalty purposes as the "value of [the] gas . . . less applicable allowances." 30 C.F.R. § 206.152(a)(2).

Under those regulations, when gas is sold under an "arm's-length contract," i.e., "a contract or agreement that has been arrived at in the market place between independent, nonaffiliated persons with opposing economic interest regarding that contract," see 30 C.F. R. § 206.151, the value of the gas is the "gross proceeds accruing to the lessee." 30 C.F. R. § 206.152(b)(1)(i). As defined in the regulations, "gross proceeds" means "the total monies and other consideration accruing to an oil and gas lessee for the disposition of unprocessed gas, residue gas, or gas plant products produced . . . ." 30 C.F.R. § 206.151. See Hoover & Bracken Energies, Inc. v. Dept. of Interior, 723 F.2d 1488 (10th Cir. 1983), cert. denied, 469 U.S. 821 (1984); Pennzoil Exploration and Production Co. v. Lujan, 751 F. Supp. 602, 605 (E.D. La 1990), aff'd, 928 F.2d 1139 (Em. App. 1991); Marathon Oil Co. v. United States, 604 F. Supp. 1375 (D. Alaska 1985), aff'd, 807 F.2d 759 (9th Cir. 1986), cert. denied, 480 U.S. 940 (1987); Enron Oil & Gas v. Lujan, 778 F. Supp. 348 (S.D. Tex. 1991), aff'd, 978 F.2d 212 (5th Cir. 1992), cert. denied, 510 U.S. 813 (1993).

For gas that is not sold pursuant to an arm's-length contract, the MMS requires that valuation be "the reasonable value" based on the "first applicable" benchmark of a series of three benchmarks ("prioritized benchmarks") enumerated in the regulations. 30 C.F.R. § 206.152 (c). If applicable to the lessee, the first prioritized benchmark for "non-arm's-length contracts" is the "gross proceeds accruing to the lessee" under those contracts, "provided that those gross proceeds are equivalent to the gross proceeds derived from, or paid under, comparable arm's-length contracts for purchases, sales, or other dispositions of like-quality gas in the same field (or, if necessary to obtain a reasonable sample, from the same area). 1/ If the foregoing is not applicable, a second prioritized benchmark is a "value determined by consideration of other information relevant in valuing like-quality gas, including gross proceeds under arm's-length contracts for gas in the same field or in

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2/ 30 C.F.R. § 206.102(c)(1) further provides: "In evaluating the comparability of arm's length contracts . . . the following factors shall be considered: price, time of execution, duration, market or markets served, terms, quality of gas, [and] volume ."

nearby fields or areas, posted prices for gas, prices received in arm's-length spot sales of gas, [or] other reliable public sources of price or market information . . . ." 30 C.F.R. § 206.152(c)(2). 1/ If a non-arm's length transaction is between a lessee and a "marketing affiliate" within the meaning of 30 C.F.R. § 206.151, the prioritized benchmarks of 30 C.F.R. § 206.152(c) do not apply to valuation of the gas sold by the lessee to the affiliate, and instead the gas valued as the gross proceeds accruing to the marketing affiliate in a subsequent arm's-length sale to a third party purchaser. 30 C.F.R. 206.152(b)(1)(i). 1/

In addition to the "gross proceeds" principle, Interior regulations provide detailed guidance concerning the calculation of the figures upon which the royalty should ultimately be based. See 30 C.F.R. Parts 202, 203, 206. Of particular relevance here, these regulations governing specific expenses which may or may not be deducted for the purpose of calculating the royalty due on production of gas from federal and Indian leases -- namely transportation expenses (which may be deducted) and marketing costs (which may not). When gas is sold at points remote from the lease, the costs of transporting the production to the point of sale are deducted to arrive at the value at or near the lease. See 30 C.F.R. §§ 206.156, 206.157.

3/ If neither of the first two prioritized benchmarks applies, then the third and final applicable benchmark shall be a "net-back method or any other reasonable method to determine value." 30 C.F.R. § 206.102(c)(3).

4/ MMS regulations define "marketing affiliate" as an "affiliate of the lessee whose function is to acquire only the lessee's production and to market that production." 30 C.F.R. § 206.151 (1993). FNGC is not a marketing affiliate because it also acquires gas supply from non-affiliated producers, in addition to FOCC's and PDI's gas supply.

III. FACTUAL BACKGROUND AND PROCEDURAL HISTORY

FOCC and PDI are gas-producing affiliates with Federal gas leases located both onshore and offshore. In the course of a routine audit of FOCC's royalty payments for gas from the "High Island Block 571" production area of the offshore Texas Outer Continental Shelf ("Block 571"), MMS discovered that FOCC had sold gas to its affiliate, FNGC, and paid royalties based on the lower price it received from FNGC instead of the higher competitive market prices that FNGC had received from arm's-length purchasers to whom FOCC previously sold gas directly. FOCC sought to justify its royalty valuation based on the lower prices on the ground that the gas sold to FNGC had been valued in accordance with the "non-arm's-length" contract benchmarks of 30 C.F.R. § 206.152(c).

On September 29, 1992, MMS issued an order requiring FOCC to recalculate royalties related to Block 571 production based on the arm's-length prices FNGC received in the sale to FOCC's former gas buyers. Administrative Record ("AR") at 1086. MMS subsequently learned that PDI had a similar agreement with affiliate FNGC to sell PDI gas to PDI's former arm's-length purchasers, and that FNGC's agreements to buy FOCC and PDI production were not limited to Block 571, but also included gas supply from eight other production areas (supply sources). MMS thus withdrew the September 1992 order as it pertained to the inter-affiliate valuation of FOCC's production from Block 571, and expanded its audit of FOCC and PDI to include all inter-affiliate transactions with FNGC from the additional supply sources. See AR 876.

A. The Area Manager's May 3, 1993 Order

After completing the expanded audit, the Area Manager of MMS's Dallas Area Audit Office issued an order on May 3, 1993 finding that the non-arm's length contract prices that FNGC had paid FOCC and PDI for gas from the nine supply sources were less than arm's-length contract prices of FOCC, PDI, and other producers in those production areas, and that, as a result, "FOCC and PDI significantly underpaid royalties due on the gas sold from the nine supply sources identified in the non-arm's-length contracts with FNGC for the period October 1990 to present." AR 1077. Specifically, the Area Manager found that from June 1990 until October 1990 (i.e., before the FOCC-FNGC transactions commenced, FOCC sold gas from Block 571 to arm's-length purchasers. The Area Manager further found that:

> In October 1990, FOCC transferred its Block 571 Field arm's-length gas contracts to FNGC. FNGC then sold the gas from Block 571 Field under those arm's-length contracts to the same purchasers, for the same contract price, and delivered to the same sales point FOCC used prior to October 1990. FOCC began paying royalties based on a non-arm's-length contract price received from FNGC, which resulted in a significant reduction in royalties paid. FOCC's non-arm's-length contract price does not represent the actual value of the gas. FOCC's non-arm's-length price was significantly lower than arm's-length prices of FNGC or other producers in the Block 571 field.

AR 1078. With respect to supply sources other than Block 571, MMS found that gas from other leases held by FOCC and PDI was likewise "sold twice before it leaves the lease, once under a non-arm's-length contract [to FNGC] and once under an arm's-length contract [by FNGC to an unaffiliated purchaser]." Id. at 1079-80.

The Area Manager determined that FOCC's non-arm's-length contract price in its sales to FNGC did not qualify as a proper royalty valuation under the first prioritized "benchmark" set forth in 30 C.F.R. 206.152(c) (1989). For that benchmark to apply, the Area Manager reasoned, FOCC's non-arm's-length contract price would have had to be "equivalent to the gross proceeds derived from, or paid under, comparable arm's-length contracts for purchases, sales, or other dispositions of like-quality gas in the same field." AR 1080. MMS' comparison of FOCC's non-arm's-length contract prices with the arm's-length contract prices of eight other producers in the same production field, however, showed that the former were "significantly lower" than the latter. Id. at 1081. Thus, he ruled that "FOCC's non-arm's-length contract price is not acceptable for royalty valuation purposes because it is not equivalent to arm's-length contract prices for gas sold from the same field." Id. Instead, he determined that FOCC and PDI should have valued the gas at the prices that FNGC had obtained in subsequent arm's-length sales of the gas, because those prices were equivalent to arm's-length contract prices for gas sold from the same field. AR 1079.

As a remedy for these "patterns of irregularities," the Area Manager's May 3, 1993 order directed FOCC to perform a "restructured accounting" and to "bring royalty payments into compliance" with the MMS royalty valuation regulations. AR 1081-82. In particular, MMS directed FOCC to provide it with a schedule identifying other leases "where either FOCC or PDI sold unprocessed gas to FNGC," and to provide MMS with a schedule reflecting recalculated royalties for all of the nine supply sources from which FOCC and/or PDI sold gas to FNGC. AR 1081.

Fina appealed the Area Manager's May 3, 1993 order to the Director of MMS. In its Statement of Reasons, Fina claimed that the prices at which FOCC and PDI reported sales to FNGC for royalty valuation purposes complied with the first two of the "prioritized benchmarks" set forth in 30 C.F.R. § 206.152(c), because they were equivalent to the price at which FNGC purchased gas in the same field from non-affiliated third parties, or because (in circumstances where FNGC was not purchasing gas from nonaffiliated entities in the same production field) they were consistent with a legitimate "spot index" price. AR 1026-1030. Fina complained that there was no record support for the MMS's findings that gas from leases held by FOCC and PDI was sold twice before it left the lease. AR 1039. Fina asserted that the price at which FNGC resold FOCC and PDI gas was not the value of the gas at the lease because it reflected costs (aggregation of supply, gas measurement, pipeline transportation nominations, pipeline transportation imbalance management, handling, dispatching, invoicing, price forecasting, and statistical information processing) that FNGC incurred to market the production away from the wellhead. AR 1024.

On March 24, 1994, the MMS's Area Manager issued a "Field Report" responding to Fina's Statement of Reasons. AR 875-891. In that response, the Area Manager reconfirmed the audit results and reasserted, based on the record compiled during its audit that:

> most of FNGC's sales occurred at the wellhead. As a result, FNGC rarely performed transportation services. The other services performed by FNGC (as described by Fina) are functions to place the gas in marketable condition which are not allowed for royalty valuation purposes. There is no basis to reduce royalties for the costs of these marketing services. A deduction for transportation is allowed on those few sales where FNGC did perform transportation services.

AR 880. In addition, the Area Manager refuted Fina's claims that FOCC's and PDI's sales prices to FNGC were equivalent to prices of other arm's-length sales in the same production field. and therefore, would have satisfied the benchmark valuation criteria for non-arm's-length contracts set forth in 30 C.F.R. § 206.152(c). AR 887.

MMS also countered Fina's claim that there was no evidence that FOCC's and PDI's gas was sold twice at the wellhead. Thus, the Area Manager pointed out that

> [t]he 23 sales agreements identified in the MMS Order (page 3) were obtained from FOCC, and they clearly show FNGC's sales point is at the wellhead. As a result, MMS concluded that the gas FOCC produced from High Island Block 571 was sold twice before it left the wellhead . . . . In addition, FNGC's sales agreements for the other supply sources show that FNGC also sold that gas at the wellhead.

AR 885. Finally, the Area Manager explained that, in the May 1993 order, he compared the FNGC's resale price to the prices of arm's length sales in the same production field and found them to be "equivalent to other producers' arm's-length prices," and thus the best determinant of gross proceeds to FOCC and PDI. AR 882.

B. The Associate Director's June 7, 1996 Order On Appeal

In an order issued June 7, 1996, MMS's Associate Director for Policy and Management Improvement denied Fina's initial administrative appeal. In that order, she agreed with the Dallas Area Manager that FNGC's resale price was the "gross proceeds" on which FOCC and PDI must compute the royalty obligation owed the United States. In so doing, she specifically rejected any lower value that FOCC and PDI sought to justify through the application of the "prioritized benchmarks"of 30 C.F.R. § 206.152(c). AR 769.

The Associate Director went on to clarify what costs FOCC and PDI may lawfully deduct from gross proceeds in computing "applicable allowances" for royalty reporting purposes. Specifically , she acknowledged that FOCC and PDI would be allowed to deduct the costs for transportation of the gas "for those sales where FNGC performs transportation services." AR 769. On the other hand, the Associate Director enumerated a variety of other expenses that Fina is not authorized to deduct. These included the costs of placing the gas into marketable condition (i.e., removing impurities from the gas, measuring, gathering, dehydrating, and compression), as well as broker fees, marketing fees, and sales commissions. Id.

The Associate Director also rejected Fina's argument that FOCC and PDI could lawfully deduct or exclude these costs from the royalty base by selling gas to FNGC and arranging for FNGC to incur these costs away from the lease. As she explained, "[i]t makes no difference that any of these marketing functions takes place downstream from the wellhead sales meter and is performed by a third party." AR 770. Because the Associate Director found that the "difference between the price received by FOCC and PDI and the competitive market value price received by FNGC constituted an unlawful deduction for marketing costs," AR 771, she upheld the Area Manager's order directing FOCC and PDI to perform a restructured accounting.

FOCC and PDI then appealed the Associate Director's June 1996 order to the IBLA.

C. The Secretary's Decision In Texaco Exploration and Production, Inc., Docket No. MMS-92-0306-O&G

On May 18, 1999, while FOCC's and PDI's joint administrative appeal to the IBLA was still pending, the Acting Assistant Secretary of the Interior, with the Secretary's express concurrence, issued an order in Texaco Exploration and Production, Inc., Docket No. MMS-92-0306-O&G ("Texaco" or the "Secretary's decision") (AR20A - AR20AA) . 1/

In Texaco, a lessee (Texaco Producing) holding certain federal oil and gas leases in California sold the oil production from these leases to an affiliate (Texaco Marketing), which in turn resold the production to non-affiliated purchasers. Because Texaco Marketing also purchased oil from other producers in the same field, it was not a "marketing affiliate" of Texaco Producing within the meaning of MMS's regulation, 30 C.F.R. § 206.101. Notwithstanding that Texaco Marketing's activities did not bring it within the definition of "marketing affiliate" for purposes of 30 C.F.R. §

5/ In the June 11 order under review in this action, the IBLA adopted the analysis and rulings of the Acting Assistant Secretary and the Secretary on the virtually identical issues raised in Texaco as its own. To that end, the IBLA attached the Texaco opinion as an addendum to its order denying Fina's administrative appeal. See AR 19. In the event that the OHA Director grants MMS's motion and withdraws the IBLA's decision for lack of jurisdiction pursuant to the RSFA, the Texaco decision nevertheless is the relevant precedent.

206.101, the Acting Assistant Secretary determined that the "gross proceeds" rule for oil, 30 C.F.R. § 206.102(h), required Texaco Producing to pay royalties based on Texaco Marketing's arm's-length resale price to third party purchasers.

In so ruling, the Acting Assistant Secretary determined that MMS's "prioritized benchmark" regulations did not address how the "gross proceeds" rule "applies when there is both a non-arm's-length transaction and an arm's-length sale in the course of disposition of the same production." AR 20 F. As she explained, in those circumstances, production could not lawfully be valued at the inter-affiliate transaction price because that would allow "any lessee to avoid the gross proceeds requirement by the simple and facile device of creating a wholly-owned subsidiary and then first transferring the production to the affiliate for a price the lessee determines unilaterally, before selling the production at arm's-length at a higher price." AR 20 G 1/.

6/ The Acting Assistant Secretary in Texaco also rejected the lessee's argument that MMS could not look to the price received by Texaco Marketing in its resale of the oil to a non-affiliated purchaser because it would subject all affiliates to the same royalty valuation regulation that applies to "marketing affiliates." She explained that the "marketing affiliate" regulation was originally adopted to assuage the oil and gas industry's concerns that lessees not become subject to the prioritized benchmark mode of royalty regulation when they engaged in sales to marketing affiliates, who purchased only the lessee's production. She further reasoned that nothing in the marketing affiliate regulation (or its preamble) suggested "that MMS intended to prevent itself from looking to the subsequent arm's-length sale as establishing the lessee's gross proceeds if an affiliate is not a 'marketing affiliate.'" AR 20 .

The Acting Assistant Secretary and the Secretary also interpreted the term "gross proceeds accruing to the lessee" to mean "the true measure of the gross proceeds derived from the disposition of the production" as reflected by "the proceeds which the enterprise receives in selling oil at arm's-length on the open market." AR 20 I. Furthermore, the Acting Assistant Secretary concluded that the term "lessee" within the meaning of its "gross proceeds" rule must be interpreted to include wholly owned or wholly-commonly-owned affiliates of lessees. AR 20 G. 1/ As she explained, when there are inter-affiliate transfers of production, coupled with affiliate resales at higher prices, "common sense, reasonableness, and the underlying logic and purpose of the [gross proceeds] rule itself support interpreting the term 'lessee' to encompass both entities." AR 20 K. She also stressed that it was not necessary to engage in a factual analysis that would justify "disregard[ing] the corporate form" or "pierc[ing] the corporate veil" to interpret the "gross proceeds" rule in this manner. Id.

In Texaco, the Acting Assistant Secretary and Secretary also ruled that a lessee "may not deduct the expenses of, or disregard the additional value accruing from, its marketing efforts by using an affiliate to perform marketing functions." AR 20 L. In reaching this determination, she reaffirmed a long line of Interior Department precedent establishing that oil and gas lessees have an implied duty to market production at no cost to the government, and that lessees cannot exclude the costs of marketing the production to a purchaser, wherever that market might exist. AR 20 M - 20 V. Because lessees themselves may not deduct these expenses from the value of production for royalty purposes, the she explained that they also may not avoid performing these obligations at no

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7/ In Texaco, the Acting Assistant Secretary was construing 30 C.F.R. § 206.102(h), the gross proceeds rule for oil. That regulation is, in all material respects identical to 30 C.F.R. § 206.152(h), the gross proceeds rule for natural gas.

cost to the lessor by working through an affiliate. AR 20 W.

Finally, the Acting Assistant Secretary in Texaco rejected the lessee's contention that MMS lacked the authority to require the lessee to perform a restructured accounting because, according to the lessee, that would amount to requiring the lessee to perform a "self-audit." AR 20 V. She reasoned that by the time MMS directs a lessee to perform a restructured accounting, it has already performed an audit and found irregularities and/or patterns of non-compliance. As she explained, an order to perform a restructured accounting requires the lessee

> to locate accounting transactions meeting specifically identified conditions and then make certain directed corrections. Rather than calling for first-instance investigation and testing to assess the adequacy of compliance, it simply requires correction of a class of mistakes or errors already identified.

AR 20 X. Thus, she concluded there is ample authority in section 107(a) of FOGRMA to require accounting revisions of this nature. Id.

D. The IBLA's June 11, 1999 Order Affirming The Associate Director's Decision Based On Texaco

On June 11, 1999, the IBLA issued a decision in this proceeding rejecting Fina's administrative appeal, finding the Secretary's decision in Texaco to be dispositive of all of the issues raised in Fina's appeal. As the IBLA explained, in Texaco:

> the Acting Assistant Secretary examined the nature of a sale between affiliates including application of the benchmark system to determine value of production in accordance with the gross proceeds rule, the marketable condition requirement, a lessee's duty to market production, the authority of MMS to require a Federal oil and gas lessee to perform restructured accounting and affirmed MMS in all respects.

AR 19. The IBLA went on to state that, "under Texaco, supra, we find that MMS properly applied the gross proceeds rule to disallow the deduction of such marketing costs from the value of production for royalty purposes." It thus attached the Texaco opinion as an addendum to the June 11 order, and expressly stated that it adopted the analysis and rationale of Texaco to affirm the MMS. AR 19.

As explained above, the IBLA's decision rejected MMS' motion to dismiss the appeal due to a statutory final decision. On September 8, 1999, Plaintiffs filed their complaint in this action seeking to overturn the IBLA's June 11, 1999 decision. In their complaint, Plaintiffs allege that the IBLA's decision is arbitrary and capricious, in excess of the Secretary's authority under the Mineral Leasing Act and the Outer Continental Shelf Lands Act, and otherwise unlawful in several respects. 1/

IV. ISSUES PRESENTED

1. Whether the IBLA and MMS properly concluded that the gas produced by FOCC and PDI should be valued at their wholly-commonly--owned affiliate's arm's-length resale price under the "gross proceeds" rule.

2. Whether the IBLA and MMS reasonably determined that FOCC and PDI may not lawfully exclude from the value of production gain derived from its marketing

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8/ Fina's suit compelled MMS to address the question of whether the passing of the RSFA deadline for a final departmental decision had deprived the IBLA of jurisdiction over the appeal. MMS therefore filed its motion with the Director of Interior's Office of Hearings and Appeals to take jurisdiction over the matter for the sole purpose of vacating the IBLA's decision. DOI has never disputed that a final decision imposed by the RSFA provision at 30 U.S.C. 1724(h) is subject to judicial review; indeed, that section specifically so provides. Nevertheless, MMS did not believe the government could defend without comment a decision that MMS believed the IBLA did not have authority to issue. Accordingly, the government advised the court of the motion submitted to the OHA Director.

As noted previously, a statutory final decision under RSFA would operate to affirm the MMS Associate Director's decision. Because the issues addressed in that decision are the same as the issues presented to and briefed before the IBLA, the substantive legal issues on judicial review do not change, regardless of whether the IBLA decision is withdrawn.

efforts.

3. Whether the MMS lawfully ordered Fina to perform a restructured accounting.

4. Whether the MMS orders are barred by the statute of limitations at 28 U.S.C. 2415(a).

V. ARGUMENT

A. APPLICABLE STANDARDS OF REVIEW

1. Standard of Review Under The APA

Because the complaint seeks judicial review under the Administrative Procedure Act ("APA"), the applicable standard of review here is whether the agency action was "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law." 5 U.S.C. § 706(2)(A). " This standard is highly deferential to the agency: The Court must consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment. Although this inquiry into the facts is to be searching and careful, the ultimate standard of review is a narrow one. The Court is not empowered to substitute its judgment for that of the agency." Jack Wood Const. Co., Inc. v. USDOT, 12 F.Supp.2d 25, 28 (D.D.C.1998) , citing Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 416 (1971); and Motor Vehicle Manufacturers Ass'n v. State Farm Mutual Automobile Insurance Co., 463 U.S. 29, 43 (1983).

Although the arbitrary and capricious standard of the APA "mandat[es] that an agency take whatever steps it needs to provide an explanation that will enable the court to evaluate the agency's rationale at the time of decision," Pension Benefit Guaranty Corp. v. LTV Corp., 496 U.S. 633, 654 (1990), "this does not mean that an agency's decision must be a model of analytic precision to survive a challenge." Frizelle v. Slater, 111 F.3d 172, 176-77 (D.C. Cir. 1997). Indeed, a "reviewing court will 'uphold a decision of less than ideal clarity if the agency's path may reasonably be discerned.' Bowman Transp., Inc. v. Arkansas-Best Motor Freight System, 419 U.S. 281, 286 (1974). All that is required is that the agency's decision "minimally contain 'a rational connection between the facts found and the choice made.' " Frizelle, 111 F.3d at 77.

2. Standard Of Review Of Agency's Interpretation Of Its Own Regulations

Plaintiffs' complaint presents several challenges to an agency's interpretation of Interior Department regulations. Where resolution of an issue requires this Court to review an agency's interpretation of its own regulations, this Court must defer to the agency's interpretation if reasonable. See Martin v. Occupational Safety and Health Review Comm'n, 499 U.S. 144, (1991) ("Because applying an agency's regulation to complex or changing circumstances calls upon the agency's unique expertise and policymaking prerogatives, we presume that the power authoritatively to interpret its own regulations is a component of the agency's delegated lawmaking powers"); Lyng v. Payne, 476 U.S. 926, 939, 106 S.Ct. 2333, 2341, 90 L.Ed.2d 921 (1986) ("agency's construction of its own regulations is entitled to substantial deference"); Udall v. Tallman, 380 U.S. 1, 16-17 (1965) (same). "This is especially true where the agency's interpretation involves 'significant expertise . . . entail [ing] the exercise of judgment grounded in policy concerns.'" Sandstone Resources, Inc. v. FERC, 973 F.2d 956, 959 (D.C. Cir. 1992), citing Pauley v. BethEnergy Mines, Inc., 501 U.S. 680 (1991). "Thus, the ultimate criterion is the administrative interpretation, which becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation." Sandstone, 973 F.2d at 959 (emphasis added), citing Bowles v. Seminole Rock & Sand Co., 325 U.S. 410, 414 (1945); and Mullins Coal Co. v. Director, Office of Workers' Compensation Programs, United States Dep't of Labor, 484 U.S. 135, 159 (1987).

3. Rule 56 Standard of Review On Summary Judgment

In their Joint Meet and Confer Report filed with the Court on April 14, 2000, the parties agreed that is case is appropriate for disposition through the Fed. R. Civ. P. 56 summary judgment procedure. Id. at 3. It is well-settled that a court may enter summary judgment if the moving party demonstrates that there is no genuine issue of material fact and that the movant is entitled to judgment as a matter of law. Fed.R.Civ.P. 56(c). When more than one party moves for summary judgment, each party must carry its own burden of proof. United States Dep't. of Justice v. Reporters Comm. for Freedom of the Press, 489 U.S. 749, 755 (1989). On cross-motions for summary judgment, the court may not grant summary judgment unless one of the parties is entitled to judgment as a matter of law. 325-343 E. 56th Street Corp. v. Mobil Oil Corp., 906 F.Supp. 669, 674 (D.D.C.1995) (citing Rhoads v. McFerran, 517 F.2d 66, 67 (2d Cir.1975)).

B. THE AGENCY REASONABLY CONCLUDED THAT THE GROSS PROCEEDS RULE REQUIRES THAT THE GAS SOLD BY FOCC AND PDI TO ITS AFFILIATE, FNGC, BE VALUED FOR ROYALTY PURPOSES AT THE PRICE OF FNGC'S ARM'S-LENGTH RESALE OF THAT GAS (LESS APPLICABLE ALLOWANCES)

As previously explained, in its June 11 order, the IBLA determined that MMS regulations required FOCC and PDI to value gas sold to FNGC at the price at which FNGC resold the gas to nonaffiliated third party purchasers in subsequent arm's-length transactions. 1/ In the complaint,

9/ The MMS reached the same determination in the June 7, 1996 Associate Director's decision. Thus, if the Director of Interior's Office of Hearings and Appeals, based on MMS' still pending motion to rescind the IBLA's June 11 order, ultimately rescinds the IBLA's order, finding it to have been issued after the 33-month deadline imposed by RSFA expired (see note 1, supra), the following analysis would apply equally to the MMS's June 1996 decision. Because of the possibility that MMS's June 1996 decision, not the IBLA's June 11 order, could be deemed the final agency action subject to judicial review in this case, we hereinafter use the term "agency" to refer interchangeably to the IBLA and the MMS, and the term "agency's decision" to refer interchangeably to the

Plaintiffs allege that the IBLA's decision (and by implication, a final decision imposed under RSFA) is unlawful because it "improperly attributes gross proceeds accruing to an affiliate of the lessee as gross proceeds accruing to the lessee." Comp. ¶ 87. As we now explain, because the agency's decision is consistent with the gross proceeds rule, 30 C.F.R. § 206.102(h), Plaintiffs' allegation is wholly without merit.

As relevant here, MMS' overarching "gross proceeds" rule for gas, 30 C.F.R.§ 206.152(h) (1993), states that "under no circumstances shall the value of production for royalty purposes be less than the gross proceeds accruing to the lessee for lease production, less applicable allowances." (Emphasis added.) The regulations further specify that the price that a lessee receives in any given transaction shall be augmented by the cost of certain services which are the lessee's duty to perform at no cost to the lessor. 30 C.F.R. § 206.152 (i).

In this case, the agency reasonably interpreted the "gross proceeds" principle of 30 C.F.R. § 206.152(h) as authorizing MMS to look beyond the price at which FOCC and PDI sold gas to FNGC to FNGC's subsequent arm's-length resale price when circumstances dictate that a production affiliate and a wholly-owned or wholly-commonly-owned sales affiliate be treated as one for purposes of royalty valuation. Indeed, in the preamble to its royalty regulations, MMS stressed that "[v]alue is determined by prices set by individuals of opposing economic interests transacting business between themselves," 53 Fed. Reg. 1230, 1233 (1988), and FOCC and PDI simply do not have the kind of opposing economic interests that would make the price "negotiated" between the affiliates a reliable indicator of value.

IBLA's June 11 order and the MMS's June 7, 1996 decision, depending on which decision is ultimately determined to be the final agency action in this case.

Moreover, in Texaco, the Acting Assistant Secretary and the Secretary correctly ruled that MMS must look to the arm's-length sales prices of a wholly-owned or wholly-commonly-owned affiliate in transactions with a third party purchaser, because to do anything less would allow a "lessee to avoid the gross proceeds requirement by the simple and facile device of creating a wholly-owned subsidiary and then first transferring the production to the affiliate for a price the lessee determines unilaterally, before selling the production at arm's-length at a higher price." Moreover, they properly reasoned that the term "gross proceeds accruing to the lessee" for lease production, within the meaning of the gross proceeds rule, is reflected by "the proceeds which the enterprise receives in selling [production] at arm's-length on the open market." AR 20 I (emphasis added).

Thus, in these circumstances, the Assistant Secretary and the Secretary rationally concluded that "common sense, reasonableness, and the underlying logic and purpose of the gross proceeds rule itself support[ed] interpreting the term 'lessee' to encompass " both the production affiliate and its wholly-owned or wholly-commonly-owned sales affiliate. Texaco, AR 20 K. And, as MMS declared in 1988, "in no instance can value be less than the amount received by a lessee in a particular transaction." 53 Fed. Reg. at 1233.

As a reasonable interpretation by an agency of its own regulations, the agency's conclusion that MMS may "look through" a transaction negotiated between a lessee and its sales affiliate, and base the valuation of a lessee's production on proceeds accruing to the sales affiliate in a subsequent arm's-length sale, is entitled not just to deference but "controlling weight" from this Court. See Sandstone Resources, Inc. v. FERC, 973 F.2d 956, 959 (D.C. Cir.1992) (citing Bowles v. Seminole Rock & Sand Co., 325 U.S. 410, 414 (1945) ("the ultimate criterion is the administrative interpretation, which becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation"[emphasis added.]). Such an interpretation is especially reasonable here because it is consonant with the well-established principle recognizing that "[w]here the statutory purpose could . . . be easily frustrated through the use of separate corporate entities, [an agency] is entitled to look through corporate form and treat the separate entities as one and the same for purposes of regulation." Transcontinental Gas Pipe Line Corp. v. FERC, 998 F.2d 1313, 1321 (5th Cir. 1993); see also General Tel. Co. v. United States, 449 F.2d 846, 855 (5th Cir. 1971) (same); Mansfield Journal Co. v. FCC, 180 F.2d 28, 37 (D.C. Cir. 1950) ("to carry out statutory objectives, it is frequently necessary to seek out and give weight to the identity and characteristics of the controlling officers and stockholders of a corporation.").

Substantial evidence in the record of this case also provides ample justification for the agency's determination that FNGC should be treated as one with its lessee affiliates, FOCC and PDI, for purposes of reporting royalties on the value of FOCC and PDI gas production. Through its audit of Fina's transactions that occurred during the period from October 1990 through May 1991, MMS has produced competent evidence establishing that FOCC and PDI sold gas to FNGC at the wellhead, and that most if not all of FNGC's resales of that gas also occurred at the wellhead at prices significantly higher than the non-arm's-length prices that FNGC paid to FOCC and PDI for the gas. AR 878; AR 955. The audit further established that the prices at which FNGC resold the gas at the wellhead were equivalent to other producers' arm's-length prices concerning sales from the same production area. AR 882.

In the face of such evidence, MMS rationally concluded that the differential in the prices at which FOCC and PDI sold gas to FNGC, and the price at which FNGC resold that gas to arm's-length purchasers reflected either that FOCC and PDI were engaged in "paper transactions" with

FNGC designed to arrive at a lower value of the gas for royalty reporting purposes, see AR 1081, or that FOCC and PDI had transferred gas to FNGC for a price that was did not reflect marketing costs that FOCC and PDI are required to perform at no cost to the United States. See AR 771. 9/

In these circumstances, Fina's allegation (Comp. ¶ 88) that MMS violated its regulations by not applying the prioritized benchmark provisions of 30 C.F.R. § 206.152(h) to the so-called "non-arm's-length transactions" between FOCC and FNGC, and between PDI and FNGC, has no merit. As the Acting Assistant Secretary pointed out in Texaco, MMS's "prioritized benchmark" regulation does not address how it "applies when there is both a non-arm's-length transaction and an arm's length sale in the course of disposition of the same production." AR 20G. And MMS regulations simply do not require the application of the prioritized benchmarks enumerated in 30 C.F.R. § 206.152(c) to determine value where (as here) such benchmarks would yield a lower value for FOCC's and PDI's production than gross proceeds, the minimum value. To the contrary, as MMS long ago stated, the prioritized benchmark provisions must yield to the gross proceeds rule whenever the gross proceeds rule results in a higher value for the production. Thus, construing proposed 30

9/ Despite their status as wholly-commonly-owned companies, Plaintiffs, at Comp. ¶ 44, allege that these companies are nonetheless separate corporations, with separate boards of directors, and that FNGC conducted its own business, holds it own shareholders meetings, and maintains its own corporate and financial records. Comp. ¶¶ 44 -47. MMS disputes the degree of corporate separateness among FOCC, PDI, and FNGC that is alleged in ¶¶ 44-47 of the complaint, see AR 107-114. But these apparent factual disagreements are not material to any issue in this case, because the agency did not rely on the common law doctrine of "piercing the corporate veil" in determining that FNGC's gross proceeds were the proper measure of gross proceeds. Indeed, the agency's decision is consistent with its inherent authority to disregard the corporate form, and to treat unregulated affiliates as part of one company with regulated affiliates, where necessary to carry the statutory purposes. As explained, supra, the agency had ample authority to do this without piercing Fina's corporate veil. See Transcontinental Gas Pipe Line Corp., 998 F.2d at 1321.

C.F.R. § 206.102(h), the gross proceeds rule for oil, MMS stated that:

> The purpose of § 206.102(h) is to make clear that no matter what valuation method is used the value for royalty purposes cannot be less than the lessee's gross proceeds less applicable allowances. Therefore, if a benchmark derived value less applicable allowances is less than gross proceeds less applicable allowances, [then] gross proceeds less applicable allowances is to be used for royalty purposes.

52 Fed. Reg. 30826, 30843-44 (1987) (emphasis added). 10/

C. THE AGENCY'S DETERMINATION THAT THE DIFFERENCE BETWEEN THE NON-ARM'S LENGTH PRICE AT WHICH FOCC AND PDI SOLD GAS TO FNGC AND THE ARM'S LENGTH PRICE AT WHICH FNGC RESOLD THE GAS TO UNAFFILIATED ARM'S LENGTH PURCHASERS IS NOT EXCLUDIBLE FROM FOCC'S AND PDI'S ROYALTY OBLIGATION MUST ALSO BE SUSTAINED

The analysis in the preceding section, standing alone, compels the conclusion that the agency's assessment of additional royalties must be upheld. As we now explain, there is a second independent ground upon which the agency's decision should be affirmed. In the June 1996 Associate Director's decision, MMS additionally concluded that the disparity between the prices that FNGC paid FOCC and PDI for the gas at the wellhead and the competitive market prices that FNGC received for subsequent arm's-length sales of that gas at the same wellhead was attributable to marketing costs which FOCC and PDI are required to bear at no cost to the United States. AR 782. The Associate Director also pointed out (AR 782) that while the costs of moving gas physically to market (i.e., transportation) are deductible from gross proceeds, "the costs of removing impurities, measuring, gathering, dehydrating, compression" (i.e. the costs of placing production into marketable condition), as well as broker fees, marketing fees, sales commissions, or any

10/ As previously explained, see note 7, supra, 30 C.F.R. § 206.102(h) is identical in all material respects to 30 C.F.R. § 206.152(h), the gross proceeds rule for gas.

combination thereof, for gas produced on a Federal or Indian lease "may not be deducted for purposes of computing the royalty value of gas." Moreover, as the Associate Director also explained, "[i]t makes no difference that any of these marketing functions takes place downstream from the wellhead sales meter and is performed by a third party." AR 782.11/ In their complaint, Plaintiffs devote most of their energies to attacking the principle that the lessee must bear marketing costs. See Comp. at ¶¶ 56 through 70, 74, 76-77, 80-81, 84, 89, 97, 102. As we now explain, Plaintiffs' challenges to the agency's disallowance of any deduction from the gross proceeds accruing to FOCC and PDI for marketing costs are without merit. Moreover, Plaintiffs' attempt to exclude gain derived from its sales affiliate's marketing efforts is indefensible.

In their complaint, Plaintiffs allege (Comp. ¶ 56) that the following activities, performed by FNGC, should not be reflected in the value of FOCC's and PDI's production:

- purchasing gas from multiple producers and aggregating it into larger volumes that are more attractive to buyers (Comp. ¶ 57);
- undertaking the risks of market fluctuations (Comp. ¶ 57);
- assuming tort exposure (Comp. ¶ 57);
- storing the gas (Comp. ¶ 57);
- transporting the gas and ultimately selling the gas (Comp. ¶ 57);
- assuming potential liability for personal injury and property damage caused by a pipeline explosion, and for environmental liabilities associated with leaks and spills (Comp. ¶ 58);
- assuming inventory costs to store the natural gas until there is demand for the gas (which sometimes results in a loss on the transaction) (Comp. ¶ 59);
- assuming exposure to the price risks of long-term transportation contracts which

11/ In its June 11 order, the IBLA sustained this finding. See AR 20.

require it to transport certain volumes of gas through a pipeline every day over a period of years, even when doing so results in losses (Comp. ¶ 60); and

- selling aggregated gas at locations thousands of miles from the original purchase points (Comp. ¶ 61).

Plaintiffs' objections to the attribution of the costs of these services to FOCC's and PDI's gross proceeds are wholly unfounded because, as we now explain, each of the above services is a marketing activity that FOCC and PDI are obligated to perform at no cost to the lessor (unless it qualifies for a transportation allowance under MMS regulations and precedent). 12/

The first judicial discussion of what today are called "marketing costs" arose in one of the first federal royalty cases, United States v. General Petroleum Corp., 73 F. Supp. 225 (S.D. Cal. 1946), aff'd sub nom., Continental Oil Co. v. United States, 184 F.2d 802 (9th Cir. 1950). In that case, the district court rejected a lessee's argument that certain costs paid to a sales broker to market the gas should be deducted in determining the royalty value of production, stating that the sales commission:

> is an item of concern only between the lessees and Kenda [the operator/seller] . . . it does not affect the royalty relations of the government with the lessees. The gross field realizations of the

12/ At the outset, we note that Plaintiffs do not challenge the well-established "marketable condition" rules. Such rules, which are currently codified at 30 C.F.R. 206.152(i) (unprocessed gas) and 206.153(i) (processed gas), and which have been in force through prior codifications for almost 60 years, require the lessee to "place gas in marketable condition" at no cost to the Federal lessor. The costs of putting gas production into marketable condition ordinarily include desulphurization (or "sweetening"), dehydration, compression, and gathering. The non-deductibility of these costs and the validity of the "marketable condition" rule uniformly have been upheld. E.g., Mesa Operating Limited Partnership v. Department of the Interior, 931 F.2d 318 (5th Cir. 1991), cert. denied, 502 U.S. 1058 (1992); Amerada Hess Corp. v. Department of the Interior, 170 F.3d 1032 (10th Cir. 1999); see also, California Co. v. Udall, 296 F.2d 384 (D.C. Cir. 1961). In their complaint, Plaintiffs do not appear to assert that such costs are deductible. Should it appear otherwise in Plaintiffs' summary judgment briefs when they are filed, the government will respond accordingly.

> lessees within the meaning of the order of June 7, 1937, are the sums actually paid over by Southern Fuel Company to Kenda. That from such sums certain amounts were deducted in fulfillment of a contract for payment of a commission to [the sales broker] is of no moment in determining the lessees' gross receipts.

73 F. Supp. at 257. Approximately 15 years after the District Court's decision in General Petroleum, the Court of Appeals for the District of Columbia Circuit decided California Co. v. Udall, 296 F.2d 384 (D.C. Cir. 1961). In that case, the D.C. Circuit noted that "the lessee was obliged to market the product[ion]," observing that the rule then in force regarding waste prevention (part of the former 30 C.F.R. § 221.35) incorporated that duty. 296 F.2d at 387.

The current royalty valuation rules promulgated in 1988 contain three references to the lessees' implied covenant to market production. The rules provide that MMS may require the lessee to value production under the non-arm's-length "benchmarks" if MMS determines that the gross proceeds accruing to the lessee under an arm's-length contract do not reflect the reasonable value of production "because the lessee otherwise has breached its duty to the lessor to market the production for the mutual benefit of the lessee and the lessor." 30 C.F.R § 206.102 (b)(1)(iii) (oil); 30 C.F.R. § 206.152(b)(1)(iii) (unprocessed gas), and 30 C.F.R. § 206.153(b)(1)(iii) (processed gas).13/ Those provisions have never been challenged and have been in effect for 12 years.

Accordingly, the Department of the Interior consistently has required lessees to market production at no cost to the United States. Thus, as the Acting Assistant Secretary and the Secretary explained in Texaco:

13/ When the Indian gas valuation rules were separated from the Federal oil and gas rules in 1996, identical provisions were carried over into the Indian rules. 30 C.F.R. 206.172(b)(1)(iii) (unprocessed gas), and 206.173(b)(1)(iii) (processed gas) (1997 - present).

> In Walter Oil and Gas Corp., 111 IBLA 260 (1989), and Arco Oil and Gas Co., 112 IBLA 8 (1989), lessees of Federal leases on the offshore Louisiana Outer Continental Shelf contracted with independent marketers to locate buyers for the lessees' gas, negotiate sales contracts, and monitor gas sales. In Walter, the Board upheld MMS' denial of Walter's request to deduct the amounts it paid to its marketer from royalty value.

And, as the Acting Assistant Secretary and Secretary further explained, a lessee may not deduct marketing costs from royalty value because "[t]he lessee has a duty to market the gas. California Co. v. Udall, 296 F.2d 384, 387 (D.C. Cir. 1961)." AR 20 M, quoting Walter, 111 IBLA 265. Thus a "lessee may choose to employ its own personnel to find markets for its gas, or it may decide to hire an independent marketer to perform these functions," but the "the lessee's business decision as to which method it prefers does not affect the value of gas for royalty purposes. A lessee performing these duties with its own employees may not deduct the costs of finding markets for the gas; neither may a lessee that contracts out these functions deduct those costs." Texaco, AR 20 M, citing Walter.

In Texaco, the Acting Assistant Secretary and the Secretary also cited ARCO Oil and Gas Co. for the proposition that lessees are not entitled to an allowance or deduction from royalties for the expenses associated with the creation and development of markets. Thus, they explained:

> The creation and development of markets for production is the very essence of the lessee's implied obligation to prudently market production from the lease at the highest price obtainable for the mutual benefit of the lessee and lessor. Traditionally, Federal gas lessees have borne 100 percent of the costs of developing a market for gas. Appellant has cited no authority, nor do we find any, which supports an allowance for creation and development of markets for the royalty share of production.

AR 20 M, citing 112 IBLA at 11. Finally, the Assistant Secretary and Secretary pointed to the IBLA's more recent decision in Taylor Energy Co., 143 IBLA 80 (1998), as establishing that lessees may not deduct marketing fees from the royalty obligation, and may not avoid paying royalty on marketing costs, either because another entity performed these obligations on behalf of the lessee, or because title to the gas passed from the lessee before these obligations were performed. AR 20 M.

As the Acting Assistant Secretary and Secretary went on to summarize:

> Several principles are apparent from these decisions. First, the lessee has an implied duty to prudently market the production at the highest price obtainable for the mutual benefit of both the lessee and the lessor. The creation and development of markets is the essence of that obligation. Second, lessees have always borne all of the marketing costs, and the Department has never permitted an allowance or deduction from royalty value for marketing costs. . . . Further, marketing costs are not deductible, regardless of whether the lessee bears them directly or transfers the marketing function or costs to a contractor, affiliate, or any other entity . . . . Finally, the location of the market at which the lessee chooses to sell its production does not change the marketing obligation. For sales at distant markets, the lessee is entitled to an allowance for transportation costs, but not for marketing costs.

Texaco, AR 20 N - 20 O (footnotes omitted). Thus, as the Assistant Secretary and Secretary correctly ruled, "Sales away from (or "downstream" from) the lease often are the starting point for determining royalty value, and the costs of transportation always have been allowed in order to ascertain value at or near the lease." AR 20 O at n.13.

In light of these principles, the fact that FOCC and PDI arranged for a sales affiliate, FNGC, to conduct marketing activities after acquiring title does not mean that FOCC and PDI may lawfully exclude the value of these services from the gross proceeds that accrued to them by virtue of FNGC's subsequent resales of their gas supply in arm's-length transactions.

These principles necessarily mean that the agency's action in the instant case be upheld.

On March 28, 2000, in Independent Petroleum Association of America v. Armstrong, 91 F. Supp. 2d 117 (D.D.C. 2000) (IPAA"), U.S. District Judge Lamberth ruled that the lessee does not have a "duty to market downstream" at no cost to the lessor. 91 F. Supp. 2d at 130. The court's decision thus ruled invalid the provisions of 30 C.F.R. §§ 206.152(i) and 206.153(i), revised in 1997, that explicitly require a lessee to "market the gas for the mutual benefit of the lessee and the lessor" at no cost to the Federal government.

The IPAA decision is distinguishable from this case for several reasons. First, IPAA did not hold that marketing costs incurred for sales at the lease are deductible. In the instant case, many of Fina's arm's-length resales occurred at the lease. In addition, the IPAA decision did not take into account any of the IBLA decisions discussed and cited above, and thus ignored the substantial deference, if not controlling weight, that these long-settled administrative interpretations are owed by the Courts of this Circuit. See Sandstone Resources, Inc. v. FERC, 973 F.2d 956, 959 (D.C. Cir. 1992), citing Pauley v. BethEnergy Mines, Inc., 501 U.S. 680 (1991). Moreover, the IPAA decision does not expressly take into account the General Petroleum case discussed above. 14/ Finally, nothing in the IPAA decision even addresses the notion of excluding from the valuation base increased revenue or gain derived from effective marketing efforts.

For all of the above reasons, the agency's decision must be upheld. We emphasize, however, that even if the court were to disagree with the government on the marketing issue, the gross proceeds rule as analyzed in part II of this memorandum above compels the conclusion that the agency's assessment of royalties is correct.

D. THE AGENCY'S DECISION DOES NOT VIOLATE 5 U.S.C. § 553

14/ Additionally, at the time of this writing, a motion filed by the government to alter or amend the judgment under Rule 59(e), Fed. R. Civ. P., in IPAA was still pending. The government is evaluating its options in responding to the IPAA decision and is currently considering whether to appeal. (By virtue of the pending Rule 59(e) motion, the 60-day period for filing a notice of appeal has not yet begun to run.)

In their complaint, Plaintiffs raise a number of objections to the agency's decision. First, they claim that the agency's rulings in this case establish a new substantive rule without complying with the notice and comment procedures required by the APA. (Comp. ¶ 94.) As we now explain, this claim fares no better than their other arguments.

In this case, the MMS addressed what is for the Courts an issue of first impression, namely, whether it is consistent with the gross proceeds rule to value production for royalty purposes at the non-arm's-length inter-affiliate sales price when gas is sold between wholly commonly-owned production and sales affiliates before it is resold at arm's-length to non-affiliated entities. This is simply a question of how existing rules apply to a particular situation. Thus, this is the type of issue particularly well-suited for resolution through adjudication.

Nothing in the MLA, FOGRMA, or in any other statute requires the MMS to resolve an issue concerning the effect of existing rules through an additional rulemaking. In these circumstances, Supreme Court precedents make clear that MMS has ample authority to address such situations in an adjudicative proceeding, rather than a rulemaking. See NLRB v. Bell Aerospace Co., 416 U.S. 267 (1974). Indeed, the choice of which process -- adjudication or rulemaking -- is better-suited for a particular task is committed to the informed discretion of the administrative agency. NLRB v. Wyman-Gordon Co., 394 U.S. 759, 765-66 (1969); SEC v. Chenery Corp., 332 U.S. 194, 201 (1947). Thus, "[i]nherent in an agency's ability to choose adjudication rather than rulemaking is the option to make policy choices in small steps, and only as a case obliges it to." SBC Communications, Inc. v. FCC, 138 F.3d 410, 421 (D.C. Cir. 1998), citing Chenery. Accordingly, it does not matter that MMS has not addressed the specific royalty valuation issue here -- the appropriate valuation methodology to be applied to transactions between production and sales affiliates. Every issue that arises under a particular rule at some point is a matter of first impression that is appropriate for adjudication.

E. THE AGENCY'S DECISION IN THIS CASE DOES NOT PRESENT "RETROACTIVITY" PROBLEMS, OR OTHERWISE DEPRIVE FOCC AND PDI OF ANY PROPERTY INTERESTS WITHOUT JUST COMPENSATION

In their complaint, Plaintiffs also raise a host of allegations about the asserted unfairness of applying the agency's decision in this case "retroactively" to FOCC and PDI. In particular, they assert that "retroactive disapproval of Fina's royalty calculations would create a serious injustice and undue prejudice to Fina," (Comp. at ¶ 104). Plaintiffs also allege that the agency's decision in this case violates due process by "taking" their property without just compensation -- more specifically, by abrogating the lease agreements, and by taking unto itself "the value added by FNGC's downstream assets and business activities." As we now explain, these allegations are wholly unfounded.

Despite Plaintiffs' hyperbolic characterization of MMS's rulings as "retroactively" disapproving Fina's royalty calculations, MMS has not applied new rules retroactively in this case. All audits are retrospective in nature, insofar as they examine past transactions. When MMS finds that a particular royalty payment, or category of royalty payments, made in the past does not comply with rules that were in effect at the time the payments were made, it issues an order requiring payment or other appropriate corrective action. That is exactly what happened here, and there is nothing "retroactive" about it. Indeed, audits routinely result in retrospective "disapproval" of "royalty calculations" that were not correct ab initio.

The fact that a particular case may be the first to resolve a particular issue as to the applicability or meaning of a particular rule does not imply that an agency is trying to impose a new rule or changed rule retroactively. Indeed, in the instant case, the gross proceeds rule has been in effect for nearly six decades. The prioritized "benchmarks" for non-arm's-length dispositions of gas have been in effect for more than 12 years. The question of the interrelationship of these two provisions of longstanding rules in the context of wholly-commonly-owned affiliate transfers followed by an arm's-length resale is nothing more than a question of interpreting and applying those provisions to the facts.

Even if the agency's decision that the gross proceeds rules requires gas to be valued at the subsequent arm's-length resale price -- when gas is initially transferred or sold by and between two wholly-commonly-owned affiliates -- were to be regarded as a "new policy for a new situation," the agency's actions challenged in this case are plainly lawful under the principles recognized by the D.C. Circuit in <u>Williams Natural Gas Co.</u> v. <u>FERC</u>, 3 F.3d 1544 (D.C. Cir. 1993) ("<u>Williams</u>"). In <u>Williams</u>, the D.C. Circuit observed that over the past thirty years there has emerged from D.C. Circuit precedent:

> a basic distinction between (1) new applications of law, clarifications, and additions, and (2) substitution of new law for old law that was reasonably clear. In the latter situation, which may give rise to questions of fairness, it may be necessary to deny retroactive effect to a rule announced in an agency adjudication in order to protect the settled expectations of those who had relied on the preexisting rule. By contrast, retroactivity in the former case is "natural, normal, and necessary," a corollary of an agency's authority to develop policy through case-by-case adjudication rather than rulemaking. Thus, we have repeatedly held that <u>retroactivity is appropriate</u> when the agency's ruling represents "a new policy for a new situation," rather than being "a departure from a clear prior policy."

3 F.3d at 1553 (citations omitted; emphasis added.).

Because, as the Acting Asst. Secretary pointed out in <u>Texaco</u>, the MMS royalty regulations do not specifically address how the gross proceeds rule applies "when there is <u>both</u> a non-arm's-length transaction and an arm's-length sale in the course of disposition of the same production," AR 20G, the issue had to be resolved. Even if it were assumed arguendo that resolution of this issue was a matter of first impression for the agency, it presented a "new policy for a new situation" for MMS, not a "clear departure from a clear prior policy", and therefore it was "natural, normal and necessary"under Williams for MMS to apply to the FOCC and PDI transactions at issue in this case.

Finally, there is no merit to Plaintiffs' contentions that the royalty valuation methodology that IBLA applied to FOCC's and PDI's production in this case amounts to an unconstitutional taking of its property by abrogating their leases and by the Department of the Interior "taking unto itself the value added by FNGC's downstream assets and business activities." (Comp. at ¶¶ 96-99). Initially, this Court is without subject matter jurisdiction to consider purported taking claims where (as here) the amount in controversy in this dispute exceeds $10,000, because the Tucker Act, 28 U.S.C. § 1491, would vest exclusive jurisdiction over such claims in the U.S. Court of Federal Claims. See also 28 U.S.C. § 1346(a)(2).

In any event, there has been no "taking" of any property interest in Fina's leases or of any "value" added by FNGC. Neither the IBLA's order nor the MMS's orders abrogate any part of FOCC's and PDI's leases; all of the leases remain in full force and effect. Rather, the orders in this case simply direct FOCC and PDI to perform a restructured accounting and to pay additional royalties consistent with the restructured accounting. Contrary to Plaintiff's characterization of "takings," the IBLA's rulings in this case involve a straightforward application of the gross proceeds rule under which all federal lessees are required to operate when they accept leases from the United States on public lands. Simply stated, a dispute as to the meaning of a regulation or a challenge to the validity of an agency decision requiring payment is not a taking under any scenario.

F. THERE IS NO LEGAL OR FACTUAL BASIS FOR INVOKING THE DOCTRINE OF EQUITABLE ESTOPPEL IN THIS CASE

At Comp. ¶ 101-104, Plaintiffs allege that:

> MMS is barred from recalculating Fina's royalty payments by the doctrine of equitable estoppel. MMS has long accepted value at the lease and/or pursuant to the prioritized benchmark system for federal royalty purposes. In doing so, MMS and DOI were acting in their proprietary and not sovereign capacity. MMS reasonably knew that lessees would rely on its long-standing practice of accepting value at the lease and/or pursuant to the prioritized benchmark system in calculating their federal royalties. Plaintiffs calculated their royalties in reasonable reliance upon the belief that MMS found the valuation method acceptable. Retroactive disapproval of Fina's royalty calculations would create a serious injustice and undue prejudice to Fina..

As we now explain, these contentions lack substance.

Contrary to Plaintiff's allegations, this case presents no occasion for this Court to apply the doctrine of equitable estoppel against MMS. Initially, there is no factual justification for applying equitable estoppel. Plaintiffs' suggestion that MMS has not valued production "at the lease"is patently wrong. For decades, judicial and IBLA precedents as well as MMS rules have recognized that value at the lease is properly determined by starting with a sales price at a location distant from the lease and subtracting costs of transporting the production from the lease to the distant market. See 30 C.F.R. §§ 206.156 and 206.157; Marathon Oil Co. v. United States, 604 F. Supp. 1375 (D. Alaska 1985), affd., 807 F.2d 759 (9th Cir. 1986), cert. denied, 480 U.S. 940 (1987); United States v. General Petroleum Corp., 73 F.Supp. 225, 263 (S.D.Cal. 1949), aff'd, Continental Oil Co. v. United States, 184 F.2d 802 (9th Cir.1950); TXP Operating Co., 115 IBLA 195, 202 (1990); Conoco, Inc., 109 IBLA 89, 94 (1989); ARCO Oil & Gas Co., 109 IBLA 34, 38 (1989); Shell Oil Co., 52 IBLA 15

(1981); C & K Petroleum, Inc., 27 IBLA 15 (1976); Kerr-McGee Corp., 22 IBLA 124 (1975); Superior Oil Co., 12 IBLA 212 (1973). Further, it would defy credulity for Plaintiffs to argue that MMS is somehow estopped from relying on and applying the gross proceeds rule in determining value.

Apart from the Plaintiffs' failure to supply any factual basis for invoking equitable estoppel principles here, there is no legal justification for invoking the doctrine. Indeed, it is:

> well established that the doctrine of equitable estoppel is "rarely applicable to governmental actions." Moran Maritime Assoc. v. United States Coast Guard, 526 F.Supp. 335, 342 (D.D.C.1981), aff'd, 679 F.2d 261 (D.C.Cir.1982). As stated by the Supreme Court over seventy-five years ago, 'the United States is neither bound nor estopped by acts of its officers or agents in entering into an arrangement or agreement to do or cause to be done what the law does not sanction or permit.'

Washington Tour Guides Ass'n v. National Park Service, 808 F.Supp. 877 (D.D.C. 1992), citing Utah Power & Light Co. v. United States, 243 U.S. 389, 409 (1917). "Courts are especially reluctant to estop the government in cases involving rights to public lands. Estoppel will be applied only 'if the government's wrongful conduct threatens to work a serious injustice and if the public's interest would not be unduly damaged.' Marathon Oil Co. v. United States, 604 F.Supp. 1375, 1384 (D. Alaska 1985).

Contrary to Plaintiff's allegations (Comp. ¶ 104), there is no injustice that would befall FOCC and PDI if MMS's orders are enforced against them. As explained supra, until early 1999, the question of how to value a lessee's production when the lessee sells the production to an affiliate before it is resold at arm's-length by the affiliate at a higher price had not been definitively decided or specifically adjudicated. See Shell Oil Co. v. Babbitt, 125 F.3d 172, 178 (3rd Cir. 1997) (acknowledging that the Department could decide that the arm's-length price that a lessee's affiliate receives for the resale of the lessee's production constitutes gross proceeds accruing to the lessee, even though the affiliate does not technically meet the definition of "marketing affiliate" under MMS's royalty regulations). The Texaco case sets out the Department's interpretation. In these circumstances, Plaintiff's claims for equitable estoppel must be denied.

G. THE MMS'S ORDER DIRECTING FOCC AND PDI TO PERFORM A RESTRUCTURED ACCOUNTING AND RECALCULATE ROYALTIES OWED THE UNITED STATES DOES NOT VIOLATE FOGRMA

At Comp. ¶ 106, the Plaintiffs also allege the "Secretary lacks authority to require Fina to perform a self-audit o r restructured accounting." In addition, Plaintiffs allege that the FOGRMA "requires a finding of 'repeated, systemic reporting errors' before a lessee may be ordered to conduct a restructured accounting," and that "MMS has failed to identify any reporting errors, much less repeated systemic reporting errors." (Comp. at ¶¶ 107-108.) As we now explain, these claims are entirely baseless.

In Section 101(c)(1) of FOGRMA, Congress requires the Secretary of the Interior and his designated delegates to "audit and reconcile, to the extent practicable, all current and past lease accounts for leases of oil or gas." In Marathon Oil Co., 149 IBLA 287 (1999), the IBLA recognized that Congress:

> imposed this requirement to avoid a royalty accounting and collection system operating entirely on the honor principle, with no verification of production and sales data, since this sort of arrangement had led to underreporting of production and sales in the past. Instead, the statute required the Secretary and his delegates to audit and reconcile lease accounts.

149 IBLA at 287, citing H.R.Rep. No. 859, 97th Cong., 2d Sess. 15, 16 (1982), reprinted in 1982 U.S.C.C.A.N. 4269-70. As the same time, however, Congress "was also aware that 'auditing every account on an annual basis is clearly impractical.'" 149 IBLA at 292, citing H.R. Rep. No. 859, 97th

Cong., 2d Sess. 33 (1982), reprinted in 1982 U.S.C.C.A.N. 4287.

Pursuant to FOGRMA's statutory scheme, the IBLA has held that FOGRMA does not restrain the Secretary from directing a lessee to review royalty accounts in order to locate and report underpayments that are traceable to an identified defect in the lessee's original computation of royalties due. BHP Petroleum (Americas) Inc., 124 IBLA 185, 187 (1992). See also 30 U.S.C. § 1717(a)(1) (authorizing authorizes MMS to require lessees to submit workpapers demonstrating compliance with recalculation orders by providing that MMS may, in conducting "any investigation . . . require by special . . . order, any person to submit in writing such . . . answers to questions as [MMS] may reasonably prescribe." The Tenth Circuit has ruled likewise in Phillips Petroleum Co. v. Lujan, 963 F.2d 1380, 1386 (10th Cir.1992), making clear that MMS has the authority to require "lessees to make changes to correct repeated royalty underpayments caused by systemic deficiencies." The Court further specifically rejected the argument that this was tantamount to requiring a lessee to perform an impermissible "self-audit" in contravention of FOGRMA. Id.

In accordance with this authority, MMS typically orders a lessee to perform a restructured accounting and pay the royalties due under the recomputation when an audit indicates that a royalty payment error may be "systemic" in nature, i.e., recurring as a pattern in other production months or under other leases. Consistent with that practice, MMS in this case ordered FOCC and PDI to perform a restructured accounting because of "systemic" errors in their royalty computations. Thus, as the MMS Area Manager explained in the Field Report:

> The systemic problem causing the royalty underpayments was due to FOCC and PDI basing royalties on non-arm's-length prices which included (sic) their affiliate's (FNGC) costs to place the gas in

> marketable condition. 15/ The MMS initially found the problem on High Island 571. The MMS reviewed FOCC's non-arm's-length sales, for eight consecutive months (October 1990 through May 1991). The MMS audit found the difference in prices was due to FNGC's costs to place the gas in marketable condition. This was a systemic problem since it existed in all eight months reviewed.

AR 888. The MMS further found systemic problems existed with respect to other productions areas during the same time period. See AR 889.

Thus, as shown above, MMS's audit uncovered a systematic exclusion of the proceeds received in FNGC's resales of gas at arm's-length from FOCC's and PDI's calculations of royalties owed the United States from their production. FINA does not claim otherwise. Instead, the main thrust of its complaint appears to be that MMS erred in requiring the inclusion of such proceeds in FOCC's and PDI's royalty base at all. Because, as we have shown, FOCC and PDI improperly excluded from the value of their production the proceeds that FNGC received in subsequent arm's-length resales of FOCC and PDI gas supply for royalty purposes, Fina's "systemic" errors fully justify the MMS order to perform a restructured accounting.

H. MMS'S ORDERS DIRECTING FOCC AND PDI TO PERFORM A RESTRUCTURED ACCOUNTING AND TO PAY ADDITIONAL ROYALTIES DOES NOT VIOLATE ANY STATUTE OF LIMITATIONS

In apparent reliance on 28 U.S.C. § 2415(a), Plaintiffs also allege that MMS is without authority to collect royalties on any FOCC and PDI payment obligation that is more than six years old. (Comp. ¶ 110.) This claim likewise cannot be sustained.

Section 2415(a) states (emphasis added):

15/ In above quotation from the MMS Field Report, the MMS Area Manager used the word "included" in referring to the marketing costs as a component of FOCC's and PDI's non-arm's-length prices. We believe that it is clear from the context that this term means the value used reflected a deduction of costs. See AR 885.

> Subject to the provisions of section 2416 of this title, and except as otherwise provided by Congress, every action for money damages brought by the United States or an officer or agency thereof 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 or within one year after final decisions have been rendered in applicable administrative proceedings required by contract or by law, whichever is later . . . .

Contrary to Plaintiffs' allegation, 28 U.S.C. § 2415(a) has no application here because an MMS order directing an oil and gas lessee to pay royalties is not an "action" within the meaning of Section 2415(a). Stated succinctly, Section 2415(a) does not apply at all to administrative actions such as to MMS order directing FOCC and PDI to perform a restructured accounting.

In an unpublished decision, the United States Court of Appeals for the Fifth Circuit ruled that MMS orders directing lessees to pay royalties are not "actions" within the meaning of Section 2415(a). Phillips Petroleum Co. v. Johnson, Civil No. 93-1377, 1994 WL 484506 (5th Cir., Sept. 7, 1994), notice of unpublished decision at 36 F.3d 89, cert. denied, 514 U.S. 1092 (1995). The court there stated (footnote omitted, emphasis deleted) 16/:

16/ A copy of the Fifth Circuit's Phillips decision is available on Westlaw, at 1994 WL 484506. The rules of the Fifth Circuit allow its unpublished decisions to be cited as precedent. See Fifth Circuit Rule 47.5.4. Moreover, Fifth Circuit Rule 47.5.3. states in pertinent part:

> Unpublished opinions issued before January 1, 1996, are precedent. However, because every opinion believed to have precedential value is published, such an unpublished opinion should normally be cited only when the doctrine of res judicata, collateral estoppel or law of the case is applicable (or similarly to show double jeopardy, abuse of the writ, notice, sanctionable conduct, entitlement to attorney's fees, or the like).

(Emphasis added.) Moreover, the Phillips opinion itself notes that under Local Rule 47.5.1., publication of opinions that decide cases on the basis of well-settled principles of law are disfavored. Phillips, at 1, n.**. Relying on that rule, the Phillips court decided

> 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." 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 "action for money damages." Thus, § 2415 is no bar.

Moreover, in Phillips, the Fifth Circuit held that an MMS order to pay does not seek "money damages;" rather, it is an action seeking to enforce a statutory mandate. Thus, in Bowen v. Massachusetts, 487 U.S. 879, 893 (1988), the Supreme Court stated that "[t]he fact that a judicial remedy may require one party to pay money to another is not sufficient reason to characterize the relief as 'money damages." According to the Bowen Court, "money damages normally refers to a sum of money used as compensatory relief." Id. at 897. The Fifth Circuit correctly relied on these principles in Phillips. 17/

Even were it assumed arguendo that 28 U.S.C. § 2415(a) applies to MMS' claims of underpaid royalties in this case, Plaintiffs' statute of limitations argument has no factual basis in this case. Section 2415(a) requires the United States to commence a judicial action

> within six years after the right of action accrues, or within one year after final decisions have been rendered in applicable administrative proceedings required by contract or by law, whichever is later . . . .

In this case, the inter-affiliate transfers to FNGC did not begin until October 1990. The May 1993

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not to publish its opinion. Id.

17/ The District of Columbia U.S. District Court has agreed with the Fifth Circuit's ruling in the Phillips case. Vastar Resources, Inc. v. Armstrong, Civ. No. 94-2040 (D.D.C. 1997) (settled while appeal pending, No. 97-5305 (D.C. Cir.)); Samedan Oil Corp. v. Deer, Civ. No. 94-2123 (D.D.C. 1995), rev'd and vacated on other grounds sub nom., IPAA v. Babbitt, 92 F.3d 1248 (D.C. Cir. 1996).

MMS order covers the period from October 1990 through the date of the order. The earliest period covered by the order is less than 2.5 years before the order was issued. Thus, it is self-evident that the United States was not time-barred from pursuing unpaid royalties at that time.

Moreover, the Plaintiffs' successive administrative appeals at the Department of the Interior, and the instant complaint for judicial review, have conjunctively extended the time that the six-year limitations period runs (assuming it applies). Under departmental regulations and applicable Supreme Court authority, Fina was required to exhaust its administrative remedies - - by pursuing its administrative appeals before the MMS and, subsequently, before the IBLA -- before bringing suit in court. See 30 C.F.R. § 243.3 (1992 - 1998), and 43 C.F.R. § 4.21(c); Darby v. Cisneros, 509 U.S. 137, 147 (1993). Fina's administrative appeal to the Department therefore was "required by . . . law," and served to extend the running of any limitations period until at least one year after May 13, 1999 (if the Director of OHA rescinds the IBLA's June 11, 1999 pursuant to the RSFA), or one year after June 11, 1999 (if the Director does not rescind the IBLA decision).

As previously stated, Plaintiffs filed their complaint in this action on September 8, 1999, many months before the one-year limitations period prescribed by 28 U.S.C. § 2415(a) (following a final decision) would have expired under any scenario. And, as the Tenth Circuit has ruled, the limitations period of 28 U.S.C. § 2415(a) does not run during a period of judicial review of the final decision of the Department of the Interior. See Mesa Operating Limited Partnership v. USDOI, 17 F.3d 1288 (10^{th} Cir. 1994). Thus, in Mesa, the Tenth Circuit explained that:

> Plaintiff now having lost its appeal at all levels, it would seem unjust in the extreme to permit the delay through litigation initiated by Plaintiff . . . the cover of the statute of limitations to avoid payment of the royalties. We know of no authority that would require a separate suit or counterclaim in the circumstances before us, and we agree with the district court that we should not create such a

procedural trap for the unwary.

17 F. 3d at 1291-92 (citation omitted). Thus, even if 28 U.S.C. § 2415(a) were held to apply to claims for unpaid royalties, Plaintiffs have no colorable argument that the agency is now somehow time-barred.

CONCLUSION

For all of the foregoing reasons, the Defendant's cross motion for summary judgment should be granted, the agency's decision should be affirmed, and the complaint in this action should be dismissed with prejudice.

Respectfully submitted,

Date: June 7, 2000

Edward S. Geldermann
EDWARD S. GELDERMANN
Trial Attorney
United States Department of Justice
Environment & Natural Resources Division
General Litigation Section
Post Office Box 663
Washington, D.C. 20044-0663
(202) 305-0242

Barry Crowell
Office of the Solicitor
U.S. Department of the Interior
Washington, D.C.