NOS. 21-8047 & 21-8048

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

MERIT ENERGY COMPANY, LLC, and MERIT ENERGY OPERATIONS I, LLC,

Plaintiffs/Appellants

vs.

DEBRA HAALAND, in her official capacity as Secretary of the Interior, U.S. Department of the Interior, and the U.S. OFFICE OF NATURAL RESOURCES REVENUE,

Defendants/Appellees.

Appeal from the United States District Court for the District of Wyoming
Hon. Scott W. Skavdahl, U.S. District Court Judge
District Court Case No. 20-CV-32-SWS-DB

OPENING BRIEF OF APPELLANTS

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ORAL ARGUMENT REQUESTED

CORPORATE DISCLOSURE STATEMENT

Merit Energy Company, LLC, is a limited liability company formed under the laws of the state of Delaware. The members of Merit are: Bevo Partners, LP., a Texas Limited Partnership; Nazuni Partners, L.P., a Texas Limited Partnership; The Gayden 2002 Family Trust, a trust formed under the laws of Texas; Merit Energy Management, L.P., a Texas Limited Partnership; and Terry Gottberg, a resident of Texas. Merit Energy Company, LLC has no parent corporation.

Merit Energy Operations I, LLC is also a limited liability company formed under the laws of the state of Delaware. Merit Energy Company, LLC is the ultimate parent corporation that controls Merit Energy Operations I, LLC. No publicly held corporation owns 10% or more of the stock of Merit Energy Operations I, LLC.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

FEDERAL STATUTES

RULES

REGULATIONS

OTHER AUTHORITIES

STATEMENT OF PRIOR OR RELATED APPEALS

A related cross-appeal is pending in *Merit Energy Company et. al. v. Haaland et al.*, Appeal No. 21-8048 (Docketed August 5, 2021).

GLOSSARY OF TERMS

APA	Administrative Procedure Act
AR	Administrative Record
Department	U.S. Department of the Interior
IBLA	Interior Board of Land Appeals
IBMP	Index Based Major Portion
LCTD	Location and Crude Type Differential
FOGRMA	Federal Oil and Gas Royalty Management Act of 1982
Marathon	Marathon Oil Company
MEOI	Merit Energy Operations I, LLC
Merit	Merit Energy Company and MEOI, collectively
NYMEX	New York Mercantile Exchange
ONRR	Office of Natural Resources Revenue
Secretary	U.S. Secretary of the Interior
WCS	Western Canada Select

JURISDICTIONAL STATEMENT

Merit Energy Co., LLC and Merit Energy Operations I, LLC (collectively, "Merit") appeal the Order on Petition for Review of Agency Action and the Order on Post-Judgment Motions, issued by Judge Scott W. Skavdahl of the U.S. District Court for the District of Wyoming, on March 4, 2021 and May 25, 2021, respectively. The district court's orders disposed of all claims by and against all parties. Merit timely filed its Notice of Appeal with the district court on July 22, 2021 and docketed its appeal with this Court on August 5, 2021. This Court has jurisdiction pursuant to 28 U.S.C. § 1291.

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

1. Whether the Secretary of the Interior ("Secretary") acted arbitrarily, capriciously, or contrary to law under the Administrative Procedure Act ("APA"), 5 U.S.C. § 706(2), by requiring Merit to pay royalty on Wyoming asphaltic sour crude oil produced on the Wind River Reservation based on values derived by a regulatory Index Based Major Portion ("IBMP") formula when:

   a) Merit's leases expressly require royalty be paid based on "the highest price *paid or offered* . . . *at the time of production* for the major portion of the oil of the *same quality and gravity* . . . produced, sold, and saved *from the area where the Leased Premises are situated*"; and

   b) The Secretary's IBMP formula uses prices published by the New York Mercantile Exchange ("NYMEX") Index for sweet crude oil sold at Cushing, Oklahoma, with an adjustment for location and crude type differences that does not use or represent the highest prices paid for Wyoming asphaltic sour crude oil on the Reservation "*at the time of production*"?

2. Whether the district court erred in holding only one aspect of the IBMP formula was arbitrary and capricious—the 10 percent cap on monthly adjustments to the formula's location and crude type differential—even though the

Secretary's use of months-old pricing data in calculating the differential fails to reflect prices "*at the time of production*," as required by Merit's leases?

INTRODUCTION

The Secretary is requiring Merit to pay royalty on two oil and gas leases based on a formula that is inconsistent with the unambiguous language of the leases. The leases cover lands on the Wind River Reservation in Wyoming and are administered by the Secretary. Under the leases, the Secretary has the discretion to require Merit to pay royalty based on "the highest price *paid or offered* . . . *at the time of production* for the major portion of the oil of the *same quality and gravity* . . . produced, sold, and saved *from the area where the Leased Premises are situated*."

The Secretary claims that this provision—called a "major portion" provision—allows the Secretary to require Merit to pay royalty based on a formula tied to prices published by the NYMEX Index for sweet crude oil at Cushing, Oklahoma. But this formula, known as the IBMP formula, does not appropriately represent the prices actually paid for Wyoming asphaltic sour crude oil, the type of oil Merit produces from the leases. Wyoming asphaltic sour crude oil is very different from sweet crude oil and is sold by reference to prices published by an entirely different index, the Western Canada Select ("WCS") Index. The Secretary's NYMEX-based IBMP formula has led to a price that is about 20% to 85% higher than the highest price paid or offered for Merit's oil at the time of production during January–May 2020; the formula price was even 200% higher than Merit's market-based sale prices in late 2018. The IBMP formula price forced Merit to pay $1.1 million more in royalty than permitted by the leases in just the first five months of 2020—an increase of 44%.

The Secretary's demand that Merit pay royalty based on this IBMP formula violates the terms of Merit's leases because the formula price is not a "price paid or offered" for any Wyoming sour asphaltic crude oil on the Reservation "at the time of production," let alone the "major portion" of the production. The formula price is a fictional construct that bears no relationship to true market prices for Wyoming asphaltic sour crude oil produced on the Wind River Reservation.

Merit sought judicial review of the Secretary's action requiring Merit to pay royalty based on the IBMP formula before the U.S. District Court in Wyoming. The district court held that the application of the IBMP formula to Merit's Wind River leases was a reasonable exercise of the Secretary's discretion and that the IBMP formula was consistent with the terms of Merit's leases. But the court found that one aspect of the formula—monthly adjustments to the formula's location and crude type differential ("LCTD")—was arbitrarily capped at 10 percent and failed to replicate oil prices "at the time of production," as required by Merit's leases. The court ordered the Secretary to remove that 10 percent cap from the formula's differential but upheld application of the remainder of the formula-based regulation.

Merit subsequently filed a motion to amend the judgment because even after removing the 10 percent cap to the LCTD adjustment, the formula still does not result in a representative major portion price "at the time of production" because the Secretary uses months-old sales data to adjust the LCTD for any given month of production. Understanding that the district court's decision was to permit application of the IBMP formula to Merit's leases, Merit asked the district court to also order the Secretary to use the current month's prices to calculate the LCTD adjustment for each month of production, instead of the stale prices. The court denied Merit's motion.

The district court erred in two ways: first, as an initial matter, by finding that the IBMP formula was consistent with Merit's leases and, second, by concluding that removal of the 10 percent cap to the LCTD would somehow lead to an IBMP price that approximates the price of Wyoming asphaltic sour crude oil "at the time of production" where the Secretary can still use months-old data to adjust the LCTD.

Accordingly, Merit requests that this Court set aside the district court's holding that the IBMP formula is consistent with the terms of Merit's leases and, instead, require the Secretary to calculate royalty on Merit's Wind River leases in accordance with the terms of the "major portion" provision of the leases rather than the IBMP formula. Alternatively, if this Court upholds application of the IBMP formula as consistent with the terms of Merit's leases, then the Court should require the Secretary to determine the monthly LCTD based on prices in effect during the month of production, without limitation by any 10 percent cap, so that the Secretary's IBMP price more accurately reflects oil prices "at the time of production," as required by the leases.

STATEMENT OF THE CASE

I. Steamboat Butte And Circle Ridge Leases.

The oil and gas leases in this action are called the "Steamboat Butte" and "Circle Ridge" leases. *See* Aplt. App. Vol. III at A-595–631; Vol. IV at A-632–83. Marathon Oil Company ("Marathon") entered into these leases with the Eastern Shoshone and Northern Arapaho Tribes of the Wind River Reservation in Wyoming in 1996 and 2000, respectively. Aplt. App. Vol. III at A-595; Vol. IV at A-640. On behalf of the Secretary, the Bureau of Indian Affairs approved and agreed to the leases. Aplt. App. Vol. III at A-629; Vol. IV at A-679. Merit acquired the leases from Marathon in 2016. Aplt. App. Vol. III at A-420, Declaration of Chad Brister, ¶ 3. Since that time, Merit has operated the leases and remits royalty payments to the Office of Natural Resources Revenue ("ONRR"), which acts for the Secretary on royalty collection. *Id.*

Section 6 of the leases contains the royalty provision, which gives the Secretary the discretion to calculate royalty based on the highest price paid or offered for the "major portion" of the oil. This major portion provision states:

> "Value" may, in the discretion of the Secretary, be calculated on the basis of the highest price paid or offered . . . at the time of production for the major portion of the oil of the same gravity, and gas, and/or natural gasoline, and/or all other hydrocarbon substances produced, sold, and saved from the area where the Leased Premises are situated[.]

Aplt. App. Vol. III at A-607; Vol. IV at A-651. The current royalty rate for the Circle Ridge lease is 29%; for the Steamboat Butte lease, it is 20%. *See* Aplt. App. Vol. III at A-606; Vol. IV at A-651. The "Leased Premises" are defined as "tracts of land situated in the Reservation." Aplt. App. Vol. III at A-603; Vol. IV at A-647.

Section 23 of the leases provides that the lessee agrees to comply with applicable regulations "now or hereafter in force relative to this lease." Aplt. App. Vol. III at A-624; Vol. IV at A-673. But it states that no regulations which become effective after the date of approval of the lease "shall operate to effect (sic) the duration of this lease, rate of royalty, rental, or acreage unless agreed to in writing by all parties to this lease." *Id*.

II. The Secretary's Historic Calculation Of "Major Portion" Prices.

For many decades, the Secretary has included "major portion" provisions in oil and gas leases on Indian and allottee leases.[1] As indicated by the preamble to the Secretary's comprehensive royalty regulations adopted in 1988, the purpose of the major portion provision is to ensure that royalty is paid on the market price for the majority of like quality production from the leased area. *See* 53 Fed. Reg. 1,184, 1,197 (Jan. 15, 1988) (explaining that major portion will be "determined using like-quality oil sold under arm's-length contracts because non-arm's-length contracts may not reflect market value"). The major portion calculation thus ensures that the Tribes receive royalty on the market price paid or offered for the majority of production, not a lower price paid for a smaller portion of the production.

For 75 years, the Secretary calculated major portion prices based on an analysis of prices actually paid or offered for like quality oil at the time of production within the area where the leases are located. *See* 53 Fed. Reg. at 1,197 (noting in 1988 that "[t]he major portion analysis has been a part of valuation

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[1] Not all leases on Tribal lands contain a major portion provision. Merit has a third lease on the Wind River Reservation called the Maverick Springs lease. That lease does not contain a major portion provision, as the Secretary has acknowledged. Aplt. App. Vol. I at A-75 n.5.

procedures for at least 45 years"). Until 2015, the Secretary's major portion regulation provided:

> [M]ajor portion means the *highest price paid or offered at the time of production* for the major portion of oil production *from the same field*. The major portion will be calculated using like-quality oil *sold under arm's-length contracts from the same field* (or, if necessary to obtain a reasonable sample, from the same area) *for each month*. All such oil production will be arrayed from highest price to lowest price (at the bottom). *The major portion is that price at which 50 percent by volume plus one barrel of oil (starting from the bottom) is sold.*

30 C.F.R. § 1206.54(b) (2014) (emphases added); *see also* 53 Fed. Reg. at 1,220 ("The major portion is that price at which 50 percent (by volume) plus 1 barrel of the oil (starting from the bottom) is sold.").

The administrative record contains descriptions of how major portion prices were calculated from the 1940s to 2015, all of which correspond to the language in Merit's leases. *See* Aplt. App. Vol. II at A-257, ONRR PowerPoint (May 2, 2012) ("Major Portion Means [t]he highest price paid or offered at the time of production for the major portion of oil production from the same field. The major portion will be calculated using like-quality oil sold under arm's-length contracts from the same field . . . for each month."); Aplt. App. Vol. II at A-282, "Traditional ONRR-Calculated Major Portion Methodology" (August 21, 2012) (describing methodology); Aplt. App. Vol. II at A-331, ONRR "New Indian Oil Rule" (under "Oil Major Portion (the old way) . . . [m]ajor portion was calculated using <u>like-</u>

quantity oil sold under arm's-length contracts from the same field or area" (emphasis in original)).

III. The Secretary's 2015 Regulations Adopting The Index-Based Major Portion Price Formula.

In 2015, the Secretary adopted regulations changing the way in which major portion would be calculated. *See* 80 Fed. Reg. 24,794 (May 1, 2015). The Secretary adopted the IBMP formula that starts with NYMEX prices for light sweet crude oil delivered to Cushing, Oklahoma, and then purports to adjust those prices using the LCTD. 30 C.F.R. § 1206.54. However, as discussed below, the LCTD adjustment to the NYMEX prices for light sweet crude oil does not result in a price representative of market prices for the Wyoming asphaltic sour crude oil produced and sold from Merit's leases on the Wind River Reservation.

The 2015 regulations state that, if there is an inconsistency between the regulations and an express provision in an oil and gas lease, the lease provision controls:

> If the regulations in this subpart are inconsistent with: . . . (4) An express provision of an oil and gas lease subject to this subpart then the . . . lease provision will govern to the extent of the inconsistency.

30 C.F.R. § 1206.50(c)(4). One of the other changes the Secretary made in 2015 to the calculation of major portion was to change the percentage for the major portion price from the top 50% plus 1 barrel to the top 75% plus 1 barrel. 80 Fed. Reg. at

24,797. Merit did not challenge the Secretary's change in the definition of "major portion" from 50% to 75%. Merit agrees that this change is not inconsistent with an express provision of its leases. However, Merit challenges application of the IBMP formula to its Wind River leases because other aspects of the IBMP formula (such as the use of NYMEX prices and an ineffectual LCTD adjustment) fail to result in a major portion price that is consistent with the major portion provision in Merit's leases.

IV. The Secretary's IBMP Prices For Asphaltic Crude.

Even though the regulations were finalized in 2015, the Secretary did not publish IBMP prices for asphaltic crude produced on the Wind River Reservation until May 2019. Aplt. App. Vol. I at A-230. When the Secretary did so, these prices were published retroactively to April 2017, and Merit (along with other producers on the Reservation) was instructed to pay royalty based on the IBMP prices when those prices are higher than its gross proceeds. *Id*. Since then, the Secretary, through ONRR, has continued to publish IBMP prices for asphaltic crude oil on the Wind River Reservation (called "PC 63") on a monthly basis. *Id.*; *see also* Aplt. App. Vol. II at A-362–79 (IBMP prices for Wind River PC 63 for June 2019 through February 2020).

When Merit reviewed the IBMP prices published in May 2019, it determined that those prices were dramatically higher than the prices it received for Wyoming asphaltic sour crude for many months during April 2017 to May 2019. *See* Aplt. App. Vol. III at A-421–22 ¶¶ 8–9. It therefore contacted ONRR to discuss the disconnect between the published IBMP prices and what it believed to be true market prices for Wyoming asphaltic sour crude. *Id.* at A-422 ¶ 10; *see also* Aplt. App. Vol. I at A-231–44 (materials Merit provided to ONRR in August 2019).

After many months of discussion between Merit and ONRR, on February 13, 2020, ONRR issued an Order to Report and Pay demanding that Merit pay approximately $3.5 million in additional royalty for April 2017 through December 2019. *See* Aplt. App. Vol. III at A-572–94. Merit filed a timely administrative appeal of ONRR's Order and posted a bond for the amount ONRR claimed was due under this Order for these past royalty periods, thus suspending compliance with the Order. *See id.* at A-423 ¶ 14; *see also id.* at A-573 and 30 C.F.R. Part 1243 (ONRR's bonding regulations). Merit's petition before the district court did not involve the period covered by ONRR's Order and Merit's administrative appeal.[2]

Instead, Merit's action related to the Secretary's requirement that Merit pay royalty for current and future production (due on or after January 2020) based on

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[2] Merit's administrative appeal is still pending.

the IBMP formula. *See* Aplt. App. Vol. I at A-14–15. Merit had attempted to pay royalty in the fall of 2019 based on its gross proceeds, but because the IBMP was higher, ONRR's accounting system rejected the payment. *See* Aplt. App. Vol. III at A-422 ¶¶ 12–13. Merit requested that ONRR allow it to report and pay royalty based on the terms of its leases while Merit pursued its administrative appeal from the Order. *Id.* ONRR rejected Merit's request, stating that it is bound by, and must enforce, 30 C.F.R. § 1206.54(b), which states that a lessee "must submit a monthly Form ONRR-2014 using the higher of the IBMP value . . . or [the lessee's] gross proceeds under § 1206.52 or § 1206.53." *Id*.

ONRR's position left Merit with a Hobson's choice: either (i) pay royalty on a price that is contrary to the terms of Merit's leases, one that is frequently far in excess of the market price Merit can obtain for the oil, or (ii) don't pay royalty at all, which could subject Merit to civil penalties, interest, or other consequences. *See* 30 C.F.R. § 1241.60(b) (authorizing penalty of up to $25,780 per day, with no prior notice or opportunity to correct, for failure to pay royalty).

V. Asphaltic Sour Crude Oil Is Sold Based On The WCS Index, Not NYMEX.

The type of oil produced by Merit and other lessees from the Wind River Reservation is called Wyoming asphaltic sour crude oil. Aplt. App. Vol. III at A-420 ¶ 4; *see also* Vol. IV at A-811–15. This type of oil is sold by Merit and other producers in the area by reference to published prices in Canada called the WCS

Index. Aplt. App. Vol. III at A-420 ¶ 5; Vol. IV at A-814. The reason that buyers and sellers of Wyoming asphaltic sour crude oil use the WCS Index is that heavy oil in Canada is the market benchmark for this type of oil.[3] Aplt. App. Vol. III at A-420 ¶ 5; Vol. IV at A-814 (ONRR report in April 2019 stating, "Asphaltic crude is priced closely to Western Canada Select (WCS) . . . .").

In contrast, NYMEX Index prices do not represent a benchmark for Wyoming asphaltic sour crude oil produced on the Wind River Reservation, but instead represent a typical benchmark for *sweet* crude oil produced in other regions of the United States. Aplt. App. Vol. III at A-420 ¶ 5. Further, the LCTD adjustment does not result in prices actually paid or offered for Wyoming asphaltic sour crude oil on the Wind River Reservation. For example, a comparison of Merit's received prices for the Steamboat Butte lease and the IBMP prices for January–May 2020, which Merit presented to the district court, is as follows:

[3] Merit occasionally uses spot contracts to sell oil at known market prices in one-off transactions for near-term delivery, usually for a period of one month. When Merit enters into a spot contract, it knows the WCS prevailing futures price, which trades one month in advance of the delivery month. Aplt. App. Vol. III at A-559 ¶¶ 7–8. Thus, some of these spot contracts do not explicitly reference the WCS Index, but they nonetheless contain a dollar differential calculated to achieve a price that is equivalent to the WCS price for the contract month plus a small bonus to account for the location (closer to large markets in the United States) and the quality of oil Merit produces (slightly better than asphaltic crude oil produced in Canada). *Id.*

Month	Gross Proceeds Price per bbl	IBMP Price per bbl	Percentage Difference
January	$43.00	$51.03	19%
February	$33.81	$44.26	31%
March	$18.00	$26.29	46%
April	$7.63	$14.19	86%
May	$15.45	$23.81	54%

See Aplt. App. Vol. III at A-423–24 ¶ 17.[4] By being forced to pay royalty on the higher IBMP prices during January–May 2020, Merit had to pay about $1.1 million in additional royalty, a 44% increase as compared to royalty on actual sale

[4] The chart comparing Merit's prices with IBMP prices for January-May 2020 contains information not in the administrative record. The record contains IBMP prices for January and February 2020, Aplt. App. Vol. II at A-376–77, but not March–May 2020; those prices, however, are on ONRR's website. *See* https://www.onrr.gov/Valuation/IndianOilIBMP.htm (last visited, Oct. 19, 2021). Merit's prices for 2020 are not in the record because, when the IBMP is higher than Merit's prices, Merit is required to report the IBMP price and, thus, ONRR does not accept data on Merit's gross proceeds. A court may go outside the administrative record "where necessary for background information or for determining whether the agency considered all relevant factors including evidence contrary to the agency's position." *Franklin Sav. Ass'n v. Dir., Off. of Thrift Supervision*, 934 F.2d 1127, 1137 (10th Cir. 1991). The district court considered this information. *See* Aplt. App. Vol. I at A-210 (evaluating Merit's "comparison of actual prices for asphaltic sour crude oil and the IBMP value"). Thus, this chart comparing prices provides necessary background information and evidence contrary to the agency's position.

prices. *Id.* at A-424 ¶ 18. As described in the Argument below, Merit explained to the district court the dramatic difference in prices and why the IBMP formula does not work for Wyoming asphaltic sour crude oil produced from Merit's leases.

There is no indication in the administrative record that, when the 2015 IBMP regulations were adopted, the Secretary considered whether the formula would work for Wyoming asphaltic sour crude oil sold by reference to an entirely different index price. The only discussion in the record concerning application of the formula to asphaltic sour crude oil occurred in April 2019, four years after the regulations were adopted, and in that report ONRR acknowledged the disconnect between NYMEX and WCS prices. Aplt. App. Vol. IV at A-811–15.

VI. Relevant Procedural History.

In February 2020, Merit petitioned the U.S. District Court in Wyoming to set aside the Secretary's application of the IBMP formula to Merit's leases for the period beginning in January 2020 and continuing thereafter—the time frame not covered by Merit's administrative appeal. Aplt. App. Vol. I at A-14–15.

A. The District Court Denied Preliminary Injunctive Relief.

Because the Secretary's royalty calculation in violation of the lease terms would force Merit to pay millions in additional royalty during the course of the litigation—without an adequate remedy to recover those losses later—Merit first sought a preliminary injunction against application of the IBMP formula to its leases. *See id.* at A-18–39. The Secretary opposed the motion, primarily arguing that application of the IBMP formula was not inconsistent with Merit's leases. *Id.* at A-61–92. The court denied an injunction. *Id.* at A-133–59. Among other reasons, the court held that based on evidence available at the time (*i.e.*, before ONRR filed a complete administrative record), the Secretary's application of the IBMP formula to Merit's leases appeared reasonable. *Id.* at A-155–57.

B. On The Merits, The District Court Ruled That Royalty Value Must Be Tethered To Prices "At The Time Of Production" But Nonetheless Affirmed Application Of The IBMP Formula.

Subsequently, in March 2021, the district court issued a judgment in Merit's favor, affording Merit some, but not all of, the relief requested.[5] The court held that to be consistent with the terms of Merit's leases, ONRR's royalty valuation must be based on prices paid for the major portion of comparable oil at the time of production. According to the court, although the Secretary has the discretion to valuate royalty using a different method than gross proceeds, the Secretary's

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[5] As a threshold matter, the district court agreed with Merit that the Secretary's action requiring Merit to pay royalty on Wyoming asphaltic sour crude oil based on the IBMP prices (going forward from December 2019) constituted final agency action and was ripe for judicial review. *See* Aplt. App. Vol. I at A-200–06. The court found that (1) ONRR's position was "definitive and known," (2) ONRR ordered Merit to pay royalty on the IBMP formula without exceptions, (3) ONRR's position was not appealable, and (4) there was no procedure available for Merit to seek a stay of ONRR's mandate. *See id.* at A-203–06; *see also* Aplt. App. Vol. III at A-395–400, 486–90.

valuation needs to fall within the paraments delineated in the major portion provision of the Wind River leases: "'value' as calculated by the Secretary must be on the basis of (not grounded upon) the highest prices paid or offered at the time of production for the major portion of (not all or only) the oil of the same quality and gravity from the area where the Leased Premises are situated." Aplt. App. Vol. I at A-208–09.

However, the district court determined that given "the intent of major portion provisions is to ensure Tribes receive royalty on the market price paid for like-quality oil under arm's length contracts, the IBMP formula . . . falls within the parameters" of the major portion provision above. *Id.* at A-209. The court stated that the "highest price paid or offered" does not "require a value calculation derived solely from prices *actually* paid or offered . . . as opposed to adjusted Index prices." *Id.* (emphasis in order). The court acknowledged that the "IBMP formula is, in itself, incapable of replicating market prices for Wyoming asphaltic sour crude oil at the time of production, thus necessitating the LCTD adjustment." *Id.* at A-211. But it held that because the "LCTD factor adjusts these prices using data from actual sales of Wyoming Asphaltic Sour Crude Oil on the Wind River Reservation to account for the differential in oil type and location," the application of the IBMP formula was not inconsistent with the terms of Merit's leases. *Id.* at A-209.

Nonetheless, the court ruled that ONRR's application of the LCTD adjustment to the NYMEX prices does not adequately address the requirement that the major portion price be a price "at the time of production." *Id.* at A-210–13. In particular, the court focused on the 10 percent cap on any adjustments to the LCTD and concluded the cap was "problematic." *Id.* at A-210. Because market prices vary from month-to-month, the court held that a "10 percent cap is arbitrary and inconsistent with the lease requirement that value be based on prices *at the time of production*." *Id.* at A-211 (emphasis in order). It also noted that ONRR's rationale for the cap—to avoid volatility in royalty payments—cannot "justify ignoring lease provisions[,]" and that the cap "untethers 'value' from the 'highest price paid or offered . . . *at the time of production*,' as required by Merit's leases." *Id.* at A-212–13 (emphasis in order).

Accordingly, although the court upheld the Secretary's application of the IBMP formula, it ordered ONRR to "make appropriate adjustments to the LCTD, without limitation from any 10 percent cap, so that 'value' under the leases more accurately reflects a major portion price for Wind River asphaltic sour crude oil at the time of production." *Id.* at A-213.

C. The District Court Denied Merit's Motion To Amend The Judgment.

Merely invalidating the arbitrary 10 percent cap did not fix the problem with the Secretary's IBMP formula. Therefore, Merit filed a motion to amend the judgment identifying the limitations of the district court's order. *See* Aplt. App. Vol. III at A-499–507. Merit highlighted that removing the 10 percent cap alone would not make the IBMP formula comply with the leases' terms because another defect in ONRR's calculations—besides the 10 percent cap—generates an LCTD adjustment that does not achieve prices "at the time of production," as required by the leases. *Id.* at A-504–06. Specifically, ONRR uses months-old pricing data to adjust the LCTD.

In opposing Merit's motion for preliminary injunction, ONRR explained in a declaration that it uses price data "from two months ago" to adjust the LCTD for any given month of production. Aplt. App. Vol. I at A-121–22 ¶ 11; *see also* 30 C.F.R. § 1206.54(c)(2) (ONRR "will monitor the LCTD using data reported . . . for the month ending two months before the current production month."). But when subsequently opposing Merit's motion to amend the judgment, ONRR argued that "the Secretary promulgated an interpretation [of the major portion provision] that necessarily applied a definition of 'at the time' that included a *three-month period* to adjust differentials." Aplt. App. Vol. III at A-529 (emphasis added). ONRR did not cite to any authority in the regulations or support in the administrative record for its ability to use three-month old pricing data to determine the LCTD adjustment.

In any event, Merit's motion to amend the judgment demonstrated that ONRR's reliance on prices that are months old at the time of production fails to comply with the leases' terms for determining a major portion price. *Id.* at A-504. As the district court acknowledged, "It is common knowledge that market prices can shift dramatically from month-to-month, as shown by ONRR's own chart." Aplt. App. Vol. I at A-211. Obviously, prices that are two months old are not prices "at the time of production," and they simply cannot capture price changes in a rapidly changing market. *See*, *e.g.*, Aplt. App. Vol. III at A-393 (Merit's opening brief, showing the wide range of actual and index-based prices for oil subject to the leases over a five-month period in early 2020). Thus, to ensure that ONRR determines an accurate IBMP price "at the time of production," Merit asked the court to amend its order to also require—in addition to removal of the 10 percent cap—that ONRR use the current month's prices to calculate the LCTD adjustment for each month of production. *Id.* at A-505–06.

The district court denied Merit's motion to amend the judgment. Aplt. App. Vol. I at A-218–28. The court held that considering "the leases do not define 'at the time of production,'. . . the Secretary's interpretation that necessarily applies a definition including a *three-month* period to adjust differentials is not unreasonable." *Id.* at A-226. (emphasis added).

SUMMARY OF THE ARGUMENT

The Secretary's application of the IBMP formula to Merit's Circle Ridge and Steamboat Butte leases is arbitrary, capricious, and contrary to law, and also directly contravenes the unambiguous and controlling terms of those leases, because the IBMP formula requires Merit to pay royalties on prices that are wholly disconnected from the actual market prices "*paid or offered . . . at the time of production* for the major portion of the oil . . . produced, sold, and saved *from the area where the Leased Premises are situated*"—*i.e.*, the Wind River Reservation.

The district court erred in concluding that application of the index-based formula to Merit's leases was a reasonable exercise of the Secretary's discretionary authority to determine value under the major portion provision. Rather, the index-based formula is directly contrary to Merit's leases, which means that the lease language—requiring the Secretary to determine value based on *actual* prices received for Wyoming asphaltic crude oil sold on the Wind River Reservation—must control. Merely removing the 10 percent cap on the LCTD adjustment fails to remedy the conflict. The IBMP formula still does not comply with the terms of Merit's leases that require royalty to be based on the value "at the time of production," because the Secretary uses sales data "from two months ago" to adjust the LCTD for any given month of production.

Thus, the Court should require the Secretary to calculate royalty in accordance with the terms of the "major portion" provision of Merit's leases, instead of the IBMP formula. Alternatively, if the Court upholds application of the IBMP formula, then the Court should require the Secretary to determine the monthly LCTD based on prices in effect during the month of production, without limitation from any 10 percent cap, so that the Secretary's royalty calculation more accurately reflects oil prices "at the time of production," as required by the leases.

STANDARD OF REVIEW

Courts review agency action under the standards set forth in 5 U.S.C. § 706 of the APA, which require reviewing courts to engage in a "substantial inquiry." *Olenhouse v. Commodity Credit Corp.*, 42 F.3d 1560, 1573–74 (10th Cir. 1994). The essential function of judicial review is to determine "(1) whether the agency acted within the scope of its authority, (2) whether the agency complied with prescribed procedures, and (3) whether the action is otherwise arbitrary, capricious or an abuse of discretion." *Id.*

This Court will set aside agency action if the agency failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, failed to base its decision on consideration of relevant factors, or made a clear error of judgment. *Cherokee Nation v. Bernhardt*, 936 F.3d 1142, 1153 (10th Cir. 2019). Although an agency's decision is entitled to a presumption of regularity, "that presumption is not to shield [the agency's] action from a thorough, probing, in-depth review." *Olenhouse*, 42 F.3d at 1574. A court's review must "be searching and careful" and cannot accept "appellate counsel's post-hoc rationalizations for agency action." *Biodiversity Conservation All. v. Jiron*, 762 F.3d 1036, 1060 (10th Cir. 2014). Courts play an "important role in ensuring that agencies have engaged in reasoned decisionmaking." *Judulang v. Holder*, 565 U.S. 42, 43 (2011). "That task involves examining the reasons for agency decisions, or the absence of such reasons." *Id.*

This Court reviews de novo a district court's decision in an APA case, and considers "the administrative record directly." *N.M. Health Connections v. United States HHS*, 946 F.3d 1138, 1161 (10th Cir. 2019) (citations omitted). "In reviewing the agency action, [this Court] must render an independent decision using the same standard of review applicable to the District Court's review." *Id.* (citation omitted). It "owe[s] no deference to the district court's decision." *N.M. Cattle Growers Ass'n v. U.S. Fish & Wildlife Serv.*, 248 F.3d 1277, 1281 (10th Cir. 2001) (citation omitted).

ARGUMENT AND AUTHORITIES

I. The Secretary's Application Of A Regulatory Index-Based Major Portion Price Formula To Merit's Leases Is Arbitrary, Capricious, An Abuse Of Discretion, And Otherwise Not In Accordance With Law.

A. When Regulations And Unambiguous Lease Terms Conflict, The Lease Terms Control.

Although Merit's leases are subject to valuation regulations adopted by the Secretary (whether existing at the time the leases were executed or newly promulgated), there is no dispute that where there is conflict, the regulations must yield to Merit's express lease language. *See* Aplt. App. Vol. III at A-624; Vol. IV at A-673; Vol. I at A-66 ("Merit is correct that [the IBMP regulations] cannot apply to the extent inconsistent with an express provision in an oil and gas lease . . . ."); *see also Monahan v. U.S. Dep't of Interior*, No. 05-8068, 2007 U.S. App. LEXIS 24211, at *16 (10th Cir. Oct. 15, 2007) ("Federal and Indian oil and gas leases are subject to future regulations *except to the extent such regulations are inconsistent with express lease provisions or the rights granted in the lease*." (emphasis added) (quoting 66 Fed. Reg. 1,883, 1,884 (Jan. 10, 2001))); *Pauley Petrol. Inc. v. United States*, 591 F.2d 1308, 1325 n.28 (Ct. Cl. 1979) (where "a new regulation would be inconsistent with the lease . . . , then the new regulation would be unenforceable against [the lessee] and the latter could defend against claims based on the new regulation"). Recognizing this principle, the IBMP regulations specifically provide that if there is an inconsistency between the IBMP regulations and an express provision in an oil and gas lease, the lease provision controls. 30 C.F.R. § 1206.50(c)(4).

The Department of the Interior has followed this principle in a variety of situations, including with respect to major portion calculations for Indian oil and gas leases. *See Marathon Oil Co.,* MMS-95-0265-IND, 1997 WL 34844654, *3 (July 28, 1997) ("to the extent that the regulatory provision specifying the use of arm's-length prices in the major portion calculation is inconsistent with carrying out the intent of the lease terms, *then the lease term governs*." (emphasis added)); *see also Robert L. Bayless*, MMS-95-0287-IND, 1997 WL 34844656, at *5 (July 10, 1997); *Meridian Oil, Inc*., MMS-96-0139-IND, 1998 WL 35416992, at *4 (June 16, 1998). ONRR also applies this principle in evaluating general royalty valuation disputes. *See Citation Oil & Gas Corp*., MMS-09-0103-IND, 2013 WL 3156128, at *3–*4 (March 1, 2013) ("When provisions of any oil and gas lease are inconsistent with Federal regulations, the lease shall govern to the extent of that inconsistency.").

Further, the Federal Circuit has previously rejected use of a methodology to calculate a major portion price that conflicts with the lease terms. In *Pawnee v. United States*, 830 F.2d 187, 191–92 (Fed. Cir. 1987), the court reviewed a major portion provision like the one in Merit's leases. Indian allottees argued that the Secretary had breached his fiduciary duty by not calculating royalty based on the average of the three highest prices in the county where the gas was produced. *Id.* The court rejected the allottees' position because the three highest prices in the *county* were not the prices for the "major portion" of the gas produced and sold from the *field* where the leases were located, as required by the lease terms. *Id*. The court explained that, under the leases, the "reference to highest prices [was] always *linked to 'the major portion' of the gas in the field*." *Id.* at 191 (emphasis added). A desire to maximize revenues for the allottees, as part of the Secretary's fiduciary duty to the allottees, could not trump the lease terms.

Here, the Secretary's IBMP formula, which the district court upheld, conflicts even more starkly with the lease language than the methodology urged by the Indian allottees in *Pawnee*. In *Pawnee*, at least the prices the allottees wanted to use were actual prices paid for some portion of the production in the same county. The IBMP formula, by contrast, does not represent *any* prices paid for even one barrel of Wyoming asphaltic sour crude oil on the Reservation, in the same county, or in the same State. Under Merit's leases, the Secretary has discretion to require royalty to be paid by following the terms of the major portion provision. But as explained in *Pawnee*, the Secretary does not have discretion to calculate a "major portion" value untethered to the lease terms, in order to "maximize revenues" for the Tribes. The Secretary's decision to enforce application of the IBMP formula, despite its clear conflict with the Merit's lease terms, violates 30 C.F.R. § 1206.50(c)(4) and, therefore, is arbitrary, capricious, an abuse of discretion, and otherwise not in accordance with law.

B. The IBMP Price Formula Is Inconsistent With Merit's Leases And, Thus, Cannot Apply.

The language of the major portion provision in the Circle Ridge and Steamboat Butte leases is not ambiguous or susceptible to an interpretation that supports the Secretary's use of the IBMP formula. The key terms are (i) the "highest price paid or offered," (ii) "at the time of production," (iii) for the "major portion of the oil of the same quality and gravity," (iv) sold from the "area where the Leased Premises are situated[.]" Aplt. App. Vol. III at A-607, § 6.3.2; Vol. IV at A-651, § 6.3.

The term "highest price paid or offered" is self-explanatory; it is the highest price actually paid or offered by a third party. *See* 53 Fed. Reg. at 1,197; Aplt. App. Vol. II at A-258. Thus, under the major portion provision, the Secretary must rely on real sales prices paid or offered to determine the major portion price.

The "time of production" is the month of production, which is how ONRR has always computed royalty and performed major portion calculations. *See* 30 C.F.R § 1206.54(b) (2014) (providing for major portion calculation to be performed based on sales prices "for each month"); 30 C.F.R. § 1206.54(c) ("monthly" major portion calculations); Aplt. App. Vol. II at A-257 ("each month"); A-283 ("monthly major portion values"). "Production," as that term is used in the oil and gas industry, means the act of removing oil and gas from the ground. *See* Patrick H. Martin and Bruce M. Kramer, Williams & Meyers, *Oil & Gas Law*, "P Terms" (2021); *State of Wyo. v. Pennzoil Co.*, 752 P.2d 975, 979 (Wyo. 1988) (equating "production" with "physical extraction of the gas from the ground and its removal"). Thus, the phrase "at the time of production" means the time when the oil is extracted and sold. That must be the month of production. The "same quality and gravity" and the "area where the Leased Premises are situated" clearly refer to comparing prices for the same type of oil on the Wind River Reservation. The "Leased Premises" are defined in the leases as "tracts of land situated in the Reservation." Aplt. App. Vol. III at A-603; Vol. IV at A-647.

The Secretary's arbitrary and capricious application of the IBMP formula to Merit's leases disregards each of these key terms. First, the use of NYMEX Index prices obtained for sweet crude oil in Cushing, Oklahoma as a starting point for the IBMP formula fails to comply with the leases' requirement that the major portion price be based on the "highest price paid or offered" for oil sold "from the area where the Leased Premises are situated." Second, the IBMP formula's LCTD differential fails to adjust the NYMEX prices to approximate prices obtained "at the time of production" because the LCTD contains an arbitrary 10 percent cap on the monthly adjustment and is based on months-old sales data.

1. The IBMP Formula Is Divorced From Prices "Paid Or Offered" For Like Quality Oil Sold "From The Area Where The Leased Premises Are Situated."

For 75 years before adopting the IBMP regulations, the Secretary interpreted the "paid or offered" lease language to require calculation of a major portion price based on *actual* prices paid or offered for the same type of oil on the same Reservation, at the time of production. 53 Fed. Reg. at 1,197 (noting 45 years of major portion analysis as of 1988). Given the clear and unambiguous terms in the major portion provision of the leases, there is no room for a formula as a more convenient short-cut to calculating a major portion price, or to "maximize revenues" for the Tribes, where that formula does not use actual prices paid or offered at the time of production for the same type of oil on the Reservation. *See Carlisle v. United Prod. Co.*, 278 F.2d 893, 895 (10th Cir. 1960) ("Where the instrument, viewed in its entirety, is unambiguous, the intention of the parties is to be determined from its language.").

Defying the express language in § 6.3 of the leases that the major portion price be based on the "highest price paid or offered" for oil sold in the area of the "Leased Premises" (*i.e.*, the Wind River Reservation), the IBMP price is a formula based on the NYMEX index "prices for light sweet oil delivered at Cushing, Oklahoma[.]" *See* 30 C.F.R. § 1206.54; *see also id.* § 1206.51. The Secretary's use of index prices for oil in Cushing, Oklahoma renders meaningless the provisions of the leases tying royalty value to the prices paid or offered for the major portion of production from the "Leased Premises." *See Praetorian Ins. Co. v. Axia Contracting, LLC*, 794 F. App'x 791, 793 (10th Cir. 2019) (courts read contract provisions as a whole so that all provisions are harmonious, and none is rendered meaningless); *cf. Shoshone Indian Tribe of the Wind River Rsrv., Wyo. v. United States*, 56 Fed. Cl. 639, 649 (2003) (rejecting Secretary's argument of possessing full discretion to calculate royalty under the "estimated reasonable value" provision, because that position "would render the balance of the regulation . . . meaningless, a result to be avoided in statutory interpretation").

Significantly, as Merit pointed out to the district court, the record relating to the Secretary's promulgation of the IBMP regulations contains no indication that ONRR considered potential problems with applying a NYMEX Index formula price to leases that produce Wyoming asphaltic sour crude oil. There is no mention that ONRR was even aware that asphaltic crude oil produced on the Wind River Reservation is sold by reference to a different index, the WCS. Nor is there any discussion on whether the LCTD adjustment could account for huge variations in pricing between sweet crude oil and Wyoming asphaltic sour crude oil. The lack of any consideration of these issues when the Secretary adopted the 2015 regulations is evidence that ONRR "entirely failed to consider an important aspect of the problem," which itself is the hallmark of arbitrary and capricious action. *See*

Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983).

It appears that the first time ONRR considered the difference between NYMEX prices for sweet crude and WCS prices for asphaltic sour crude was in April 2019, four years after it adopted the IBMP regulations. Aplt. App. Vol. I at A-229; Vol. IV at A-811. ONRR's discussion of NYMEX vs. WCS prices was in connection with ONRR's initial calculation and publication of IBMP prices in May 2019 for asphaltic crude oil. In this report, ONRR identified two periods "where asphaltic crude movements differed from the NYMEX CMA prices[.]" Aplt. App. Vol. IV at A-814. ONRR circled the months of December 2017 through April 2018, and September 2018 through December 2018 as when the markets diverged. These two time periods comprised almost one-half of the production months that ONRR reviewed—nine out of 20 months. *Id*. For these 20 months in question, ONRR estimated that additional royalty of $3.7 million would be owed by producers of asphaltic crude on the Wind River Reservation. *Id.* at A-815.[6] ONRR stated: "The largest months of additional royalties were from the periods

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[6] Because Merit produces more than 75% of the asphaltic crude oil on the Reservation (*see* chart at Aplt. App. Vol. IV at A-811), most of the additional royalty ONRR estimated would be due is owed by Merit. This is confirmed by ONRR's Order requiring Merit to pay $3.5 million in additional royalty. Aplt. App. Vol. III at A-572.

which the NYMEX CMA price and the reported price of asphaltic moved separately." *Id.*

In other words, before publishing its IBMP prices for asphaltic crude oil on the Wind River Reservation, ONRR was aware of the disconnect between the IBMP formula and WCS index prices, but made no attempt to consider whether there was a problem with applying the formula to asphaltic sour crude oil. It simply proceeded to publish the IBMP prices in May 2019, retroactively to April 2017, and instructed Merit to pay on the higher IBMP prices. Aplt. App. Vol. I at A-230.

During this litigation, the Secretary claimed, and the district court noted, that over a 15-year period stretching back to 2005, there was a high (95%) correlation between NYMEX and WCS prices. *See* Aplt. App. Vol. I at A-84; A-123–24 ¶ 18; A-210. But nothing in the administrative record shows that ONRR ever considered such a correlation. Moreover, during the relevant time for this case—the period for which ONRR has published IBMP prices for asphaltic crude oil (April 2017 to February 2020)—the correlation was only 60%. *See* Aplt. App. Vol. III at A-424 ¶ 19. This means that NYMEX and WCS prices are not correlated and they often diverge from each other. *Id.*

Even if, averaged over many years, the correlation was 95%, that would not render the formula an acceptable substitute for true sales prices. Because the formula is a one-way street, *i.e.*, Merit must pay royalty on the higher of gross proceeds or the IBMP price, averaging the periods when NYMEX and WCS diverge merely obscures the problem. When sales prices are higher than IBMP, Merit pays royalty on the sales price. When sales prices are less than IBMP, which will typically be the case when the NYMEX and WCS indices diverge, Merit must pay royalty on the IBMP. Compiling an average correlation over decades produces a misleading statistic.

The Secretary tried to diminish the significance of the price divergence by describing the months of November and December 2018 as a "historic disconnect" and an "anomalous" situation. Aplt. App. Vol. I at A-84. The district court also called this divergence an "anomaly." *Id.* at A-210. But as Merit pointed out, the disconnect did not occur in only those two months. ONRR's own report identified two such periods covering nine of the 20 months from April 2017 to December 2018: the first one extended from December 2017 to April 2018, and the second from September 2018 to December 2018. *Id.* at A-229; Aplt. App. Vol. IV at A-814–15. A third period of disconnect began in the fall of 2019 and extended through May 2020. *See* Aplt. App. Vol. III at A-423–24 ¶ 17 (disconnect January-May 2020); *see also* Aplt. App. Vol. I at A-44–45 ¶¶ 12, 14, and A-60 (disconnect started in fall 2019). In 2020, the difference between sales prices and IBMP reached 86%, second only to the "historic disconnect" of 200% at the end of 2018.

These periods of disconnect cannot be dismissed as "anomalous," but even if they could, that would not defeat the point that the IBMP price formula conflicts with the plain language of Merit's leases requiring royalty on the "highest price paid or offered" for production on the Wind River Reservation. If the Secretary calculated major portion by following the lease terms, then there would not be periods when the major portion price is more than *double* real sale prices, forcing Merit to pay millions of dollars in additional royalty.

Thus, the district court erred in holding that "[t]he language 'highest price paid or offered' is not so restrictive as to require a value calculation derived solely from prices *actually* paid or offered … as opposed to adjusted Index prices." *See* Aplt. App. Vol. I at A-209. Such a reading arbitrarily disregards the conflicting lease language in violation of 30 C.F.R. § 1206.50(c)(4) and the well-settled principle that newly promulgated regulations cannot apply if they conflict with express lease language.

2. The IBMP Formula Does Not Rely On Prices Obtained At The "Time Of Production."

Merit's leases plainly require value to be calculated based on prices "*at the time of production*." Aplt. App. Vol. III at A-607 § 6.3.2; Vol. IV at A-651 § 6.3 (emphasis added). The reason for this limitation is obvious. If ONRR is going to require a lessee to pay additional royalty because the upper range of market prices is higher than the prices the lessee received, it only makes sense to compare prices available during the same time. That market prices might have been higher in *other* months in the past does not mean Merit's sale prices at the time of production were below market. As the district court acknowledged, "[i]t is common knowledge that market prices can shift dramatically from month-to-month." Aplt. App. Vol. I at A-211. This is shown by ONRR's own chart in the record. Aplt. App. Vol. IV at A-811–15.

The IBMP formula is incapable of replicating market prices for Wyoming asphaltic sour crude oil "at the time of production." By starting with NYMEX prices for sweet crude oil at Cushing, Oklahoma, the formula already begins with a price that has little to do with Wyoming asphaltic sour crude oil that is produced at the Wind River Reservation. The flaw in the approach is then exacerbated by the way in which ONRR calculates the LCTD adjustment. And the district court's decision to eliminate the arbitrary 10 percent cap on the LCTD adjustment fails to remedy the IBMP formula's defects. *See infra* Section II.

The LCTD purports to account for "the difference in value between the NYMEX Calendar Monthly Average (CMA) and the value that approximates the monthly Major Portion Price for any given month, designated area [designated reservation], and crude oil type." *See* 30 C.F.R. §1206.51. The way ONRR calculates the LCTD adjustment is explained in a PowerPoint presentation in the record. Aplt. App. Vol. II at A-328. The initial LCTD value, which is ultimately expressed as a percentage, is calculated by taking the average NYMEX Index calendar month price for the prior 12 months, less the average monthly major portion price for actual sales from the Reservation for the prior 12 months. *Id*. at A-340. The example given in the PowerPoint results in an initial LCTD of 14.30%. *Id*. at A-342. For the next production month, the IBMP will be the NYMEX Index price for that month, less 14.30% of that price. *Id*. at A-343. If the NYMEX Index price for that month is $100.32, the IBMP price will be $85.97. *Id*. This is regardless of actual prices for Wyoming asphaltic sour crude oil in that month.

Then, for each succeeding month, ONRR will review royalty reports to see the extent to which producers in the area are reporting arm's-length gross proceeds that are higher than the published IBMP prices. If the total volume of oil reported on gross proceeds rather than IBMP prices is approximately 25% (+/- 3%) of the total production volumes in the area, then the LCTD remains the same. *Id*. at A-346. If, however, the total volume of production reported using gross proceeds falls above or below approximately 25% of the total volume of production, then the LCTD may be adjusted up or down by 10 percent. *Id.; see also* A-347–49.

As the district court acknowledged, a fundamental problem with the LCTD adjustment, as applied to Wyoming asphaltic sour crude oil, is that the change in percentage of the LCTD—the percentage by which the IBMP will be set below

NYMEX Index prices—has nothing to do with the actual prices paid for Wyoming asphaltic sour crude oil. Aplt. App. Vol. I at A-211. Thus, in ONRR's PowerPoint presentation explaining how the IBMP formula works, if the IBMP price for a month exceeds all of the reported prices by $1 per barrel or $10 per barrel or $30 per barrel, the LCTD will be increased by the same 10 percent and the resulting IBMP will be the same under each scenario, regardless of the actual market prices for Wyoming asphaltic sour crude oil. Aplt. App. Vol. II at A-347. Indeed, in this scenario—which is the very scenario discussed by ONRR in the report at Aplt. App. Vol. IV at A-814, where WCS prices diverged significantly from NYMEX—ONRR will not even know what the market prices for Wyoming asphaltic sour crude are. That is because ONRR forces all the producers to report and pay royalty on an IBMP price when that price is higher than the sales price. 30 C.F.R. § 1206.54(b).

It is readily apparent that when market prices for Wyoming asphaltic sour crude fall below the IBMP, ONRR merely makes a minor and arbitrary 10 percent monthly increase to the LCTD percentage. That minor adjustment (*e.g.*, increasing the LCTD percentage from 14.3% to 15.73%) fails to result in a "major portion" price that is remotely representative of market prices. If, for example, the NYMEX Index price is $50 per barrel, increasing the LCTD from 14.3% to 15.73% will only reduce the IBMP from $42.85 ($50 less $7.15) to $42.13 ($50 less \$7.87), a small adjustment. ONRR will keep making a 10 percent adjustment each month until—many months later—the LCTD adjustment results (hopefully) in a price in the ballpark. *See* Aplt. App. Vol. I at A-122–23 ¶ 15. But for all the months where the IBMP exceeds market prices, the producers will owe royalty on an amount greater—sometimes far greater—than they can receive selling the oil. That is exactly what ONRR describes in its April 2019 report. Aplt. App. Vol. IV at A-811–15.

ONRR explained that, by limiting changes in the LCTD to 10 percent each month, the IBMP formula reduces the impact on royalty payments during times of "drastic market volatility." Aplt. App. Vol. I at A-122 ¶ 14. ONRR's desire to avoid fluctuations in royalty payments is, however, a one-way street. When market prices for Wyoming asphaltic sour crude oil fall in relation to NYMEX Index pricing, Merit must pay royalty on a higher-than-market IBMP price to reduce volatility in royalty payments to ONRR (and ultimately the Tribes). But when market prices for Wyoming asphaltic sour crude oil rise in relation to NYMEX Index prices, Merit must pay royalty on the *actual* higher prices. That is because Merit must pay royalty on the higher of the IBMP or its gross proceeds. 30 C.F.R. § 1206.54(b). When the IBMP is too low, Merit does not receive any benefit and there is no "averaging" of the effect of the IBMP.

The desire to avoid volatility on *decreasing* royalty (but not on increasing royalty) cannot justify rewriting express lease provisions. As the district court correctly acknowledged, there is no provision of the leases that allows the Secretary to take that approach, nor can it be excused by the Secretary's fiduciary duty. Aplt. App. Vol. I at A-212; *see also Pawnee*, 830 F.2d at 191 (rejecting interpretation of major portion provision that would have increased royalty to Indian allottees, because it would render lease provisions meaningless). Thus, notwithstanding the district court's erroneous decision to allow application of the IBMP formula to Merit's leases, the district court was correct in concluding that the Secretary's use of a 10 percent cap on the LCTD adjustment is arbitrary and capricious.

II. The District Court Erred By Allowing The Secretary To Use Months-Old Sales Data In Calculating The Formula's Location and Crude Type Differential.

Even if the IBMP formula could apply to Merit's leases (which it cannot), the district court's decision to *disallow* the arbitrary 10 percent cap on the LCTD adjustment but *allow* use of months-old sales data in determining the LCTD was wrong. Allowing ONRR to use month-old sales data not only conflicts with the lease language requiring that the major portion price be based on the "highest price paid or offered . . . *at the time of production*" but also conflicts with the district court's conclusion that ONRR must determine royalty "value" under Merit's two leases in a way that "more accurately reflects a major portion price for Wind River asphaltic sour crude oil *at the time of production*." Aplt. App. Vol. I at A-213 (emphasis added).

The regulation provides that ONRR "will monitor the LCTD using data reported . . . for the month ending two months before the current production month." 30 C.F.R. § 1206.54(d)(2); *see also* Aplt. App. Vol. II at A-345 ("Remember that the IBMP price is calculated using a differential based on MP [major portion] values from prior months[.]" (emphasis in original)); Aplt. App. Vol. I at A-121–22 ¶ 11 (explaining ONRR uses sales data "from two months ago" to adjust the LCTD for any given month of production); *id.* at A-209–11 (Court Order, citing ONRR's Sudar Declaration).[7]

When ONRR uses sales data that is two-months old, its IBMP major portion prices do not reflect prices paid or offered "at the time of production." To illustrate the effect of removing the 10 percent cap to the LCTD adjustment but leaving intact ONRR's use of sales data that is two months old, Merit presented to the district court the Declaration of Alan Simpson, the outside consultant who was

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[7] ONRR's argument that it may use a "definition of 'at the time' that include[s] a three-month period to adjust differentials[,]" *see* Aplt. App. Vol. III at A-529, and the district court's apparent acceptance of a three-month time period, *see* Aplt. App. Vol. I at A-226, appears inconsistent with the two-month language of 30 C.F.R. § 1206.54(c)(2). In any event, whether ONRR uses sales data that is two months or three months old, the prices used are not at the "time of production."

allowed to review ONRR's pricing data. *See* Aplt. App. Vol. III at A-508–12. Based on the NYMEX and IBMP prices available on ONRR's website[8] and market prices obtained for production from Merit's Circle Ridge lease, Mr. Simpson showed the inescapable conclusion that removing the 10 percent LCTD cap, while still using two-months old prices, does not result in prices comparable to those received "at the time of production." *Id.*

In denying Merit's request that the district court require ONRR to use current month's prices to calculate the LCTD adjustment for each month of production, the court erroneously adopted the Secretary's argument that, because "ONRR does not immediately have the production data for any given month," "there is no feasible way to assign a mean value of like quality oil at the 75th percentile price in this way and [requiring ONRR to use current month's prices] would improperly limit the agency's discretion." Aplt. App. Vol. I at A-226. But ONRR's contention that using prices from the time of production "would make it impossible for the agency to implement index-based pricing or to exercise any level of discretion[,]" Aplt. App. Vol. III at A-517, is disingenuous and overblown.

ONRR can easily publish the IBMP prices after the month in which the royalty is paid, and the producers can retroactively adjust royalty payments if

[8] *See* https://www.onrr.gov/valuation/IndianOilIBMP.htm (last visited, Oct. 19, 2021).

needed. Rather than being burdensome, such an approach would be consistent with the language of the leases and with what producers did for decades before ONRR adopted the IBMP formula. *See* Aplt. App. Vol. I at A-191–92. Indeed, in other contexts, ONRR accepts estimated royalty payments, which are later adjusted if needed. *See* 30 U.S.C. § 1721(h); ONRR's Mineral Revenue Reporter Handbook, Release 4.0, Ch. 4.2.1 (June 4, 2020).[9]

More importantly, the Secretary cannot leverage use of a faulty formula for the sake of convenience into a requirement that a lessee pay millions of dollars more in royalty each year. The oil and gas leases are contracts governing how the major portion calculation must be done. As the district court emphasized, the alleged "benefit to industry" cannot "justify ignoring lease provisions" that require value to reflect major portion prices at the time of production. Aplt. App. Vol. I at A-212–13. In any event, the financial penalty from the Secretary's use of the formula far outweighs any claimed administrative benefit to Merit. *See id.* at A-211–13; Aplt. App. Vol. III at A-414–15, A-510–11 ¶¶ 3–6.

CONCLUSION

The Secretary's determination that Merit must pay royalty based on the IBMP formula prices is contrary to the terms of Merit's leases. It should therefore

[9] Available online at https://www.onrr.gov/ReportPay/Handbooks/revenue-handbook/pdfS/RRM-Chapter.4.pdf#page=18 (last visited, Oct. 19, 2021).

be set aside under 5 U.S.C. § 706(2)(A) as arbitrary, capricious, an abuse of discretion, and otherwise not in accordance with law. The Court should instruct the Secretary to calculate royalty on Merit's Wind River leases in accordance with the terms of the "major portion" provision of the leases, instead of the IBMP formula.

Alternatively, if this Court upholds the district court's analysis that the application of the IBMP formula is consistent with the terms of Merit's leases, then the Court should require the Secretary to determine the monthly LCTD based on prices in effect during the month of production, without limitation by any 10 percent cap, so that "value" under the leases more accurately reflects a major portion price for Wind River asphaltic sour crude oil at the time of production.

The relief Merit seeks is limited to the Steamboat Butte and Circle Ridge leases at issue in this action, and to calculating the "major portion" royalty value of Wyoming asphaltic sour crude oil produced from those leases. As the District Court noted, there are other oil and gas leases on Indian lands that contain major portion provisions, but this action is based on unique facts concerning calculation of a major portion price for a type of oil that is sold by reference to WCS Index prices, not NYMEX Index prices.

STATEMENT CONCERNING ORAL ARGUMENT

Merit respectfully requests oral argument in order to assist in explaining any important points that remain unclear after briefing.

Dated this 27th day of October, 2021.

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CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(g), I hereby certify as follows:

1. This document complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B)(i). Excluding the parts of the document exempted by Fed. R. App. P. 32(f) and 10th Cir. R. 32(B), the brief contains 10,794 words.

2. This document complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6). It has been prepared in a proportionally spaced typeface using Microsoft Word in 14-point Times New Roman (with the exception of the cover page, which was reduced in font size in order to accommodate the case caption).

Date: October 27, 2021

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CERTIFICATE REGARDING PRIVACY REDACTIONS AND DIGITAL SUBMISSIONS

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I hereby certify that the seven (7) copies of the pleading required to be submitted to the clerk's office will be exact copies of the ECF filing.

Date: October 27, 2021

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CERTIFICATE OF SERVICE

I hereby certify that on October 27, 2021, I electronically filed the foregoing Opening Brief of Appellants using the court's CM/ECF system which will send notification of such filing to the following:

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ATTACHMENT 1

Order on Petition for Review of Agency Action (March 4, 2021)

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF WYOMING

MERIT ENERGY COMPANY, LLC, and MERIT ENERGY OPERATIONS I, LLC

Petitioner,

vs.

DAVID BERNHARDT, in his official capacity as Secretary of the Interior U.S. Department of the Interior, and the U.S. OFFICE OF NATURAL RESOURCES REVENUE,

Respondents.

Case No. 20-CV-032-SWS

ORDER ON PETITION FOR REVIEW OF AGENCY ACTION

This matter is before the Court on the *Petition for Review of Final Agency Action* filed by Merit Energy Company, LLC and Merit Energy Operations I, LLC ("MEOI") (ECF No. 1), challenging the calculation of royalties owed on oil produced from two of Petitioners' oil and gas leases on the Wind River Reservation in Wyoming. The Court, having considered the briefs and materials submitted in support of the petition and the government's response thereto, having reviewed the Administrative Record ("AR") and being otherwise fully advised, FINDS and ORDERS as follows:

BACKGROUND

Petitioners Merit Energy Company, LLC and MEOI (collectively, "Merit") are the successors in interest of two oil and gas leases covering lands on the Wind River

Reservation in northwestern Wyoming.[1] *See* Pet. at 3; AR 170-206, 254-97. Marathon Oil Company ("Marathon") and the Eastern Shoshone and Northern Arapaho Tribes originally executed these leases, known as the "Steamboat Butte" lease and the "Circle Ridge" lease, in 1996 and 2000, respectively. *See id.* MEOI acquired the leases from Marathon in 2016 and, since that time, Merit Energy Company, LLC has operated the leases and remits royalty payments to the Office of Natural Resources Revenue ("ONRR") on behalf of MEOI.

Pursuant to the terms of the lease agreements, Merit is required to pay royalties on all the oil it produces, saves, or sells from the leased premises based upon a percentage of the "value" of that oil. (Steamboat Butte Lease § 6.3, AR 265; Circle Ridge Lease § 6.3.2, AR 182.) The leases do not define how "value" is calculated, but provide they are subject to "any and all applicable federal and tribal laws and regulations now or hereafter in force relative to this lease," including those governing royalty calculations. AR 199, 287; *see also* 30 C.F.R. Part 1200. Merit pays these royalties to the ONRR, which is a subset of the U.S. Department of Interior that is statutorily tasked with collecting, verifying, and then disbursing the revenues associated with the production of natural resources on Indian lands. *See* 30 U.S.C. § 1711(a). Once ONRR receives Merit's payments, it distributes the royalties owed to the Eastern Shoshone and Northern Arapaho Tribes.

In some instances, the price paid for the oil produced does not accurately reflect market value because the oil is not sold pursuant to an arm's-length transaction. To ensure

[1] Merit also has a third lease on the Wind River reservation that is not at issue in this litigation.

the Tribes and other Indian lessors receive full royalties in such instances, many (but not all) Indian leases, including those at issue here, contain a standard provision which gives the Secretary discretion to calculate an alternative "value" for royalty purposes. Specifically referred to as the "major portion provision," the leases state:

> "Value" may, in the discretion of the Secretary, be calculated on the basis of the highest price paid or offered . . . at the time of production for the major portion of the oil of the same quality and gravity, and gas, and/or natural gasoline, and/or all other hydrocarbon substances produced, sold, and saved from the area where the Leased Premises are situated, and the actual volume of the marketable product less the content of foreign substances as determined by the Authorized Officer. . . .

(Steamboat Butte Lease § 6.3, AR 265; Circle Ridge Lease § 6.3.2, AR 182). The major portion calculation thus ensures the Tribes receive royalty on the market price paid or offered for the majority of production, not a lower price paid for a smaller portion of the production. *See* 53 Fed. Reg. 1,184, 1,197 (Jan. 15, 1988) (explaining the major portion "will be determined using like-quality oil sold under arm's-length contracts because non-arm's-length contracts may not reflect market value").

Under its delegated rulemaking authority, ONRR has promulgated regulations for purposes of calculating "value" under those Indian leases with a major portion provision. *See id.* (noting in 1988 that "the major portion analysis has been a part of valuation procedures for at least 45 years"). Prior to 2015, the Secretary's major portion regulation provided:

> [M]ajor portion means the *highest price paid or offered at the time of production* for the major portion of oil production *from the same field*. The major portion will be calculated using *like-quality oil* sold under arm's-length contracts from the same field (or, if necessary to obtain a reasonable sample, from the same area) for each month. All such oil production will be

> arrayed from highest price to lowest price (at the bottom). *The major portion is that price at which 50 percent by volume plus one barrel of oil (starting from the bottom) is sold.*

30 C.F.R. § 1206.54(b) (2012) (emphasis added). This regulation, as well as administrative descriptions of how major portion prices were historically calculated, correspond to the language in Merit's leases. *See* AR 610, ONRR PowerPoint (May 1, 2012) ("Major Portion Means [t]he highest price paid or offered at the time of production for the major portion of oil production from the same field. The major portion will be calculated using like-quality oil sold under arm's-length contracts from the same field (or if necessary to obtain a reasonable sample, from the same area) for each month."); AR 740-46, "Traditional ONRR-Calculated Major Portion Methodology" (Aug. 21, 2012) ("In order to ensure that the ONRR-calculated major portion values are for like-quality oil, ONRR would need to collect API gravity and crude oil type information by lease or make a determination that all of the oil from a field or area is of the same API gravity and crude oil type."); AR 837, 840, ONRR "New Indian Oil Rule" (under "the old way," "major portion was calculated using like-quality oil sold under arm's-length contracts from the same field or area") (emphasis in original).

In 2011, the Secretary of the Interior established the "Indian Oil Valuation Negotiated Rulemaking Committee" to advise ONRR "on a rulemaking to address Indian oil valuation, as it relates to the major portion requirement in Indian oil leases." AR 772-73, Final Committee Report. The Committee as formed included representatives from American Indian Tribes (including the Shoshone and Arapaho Tribes), ONRR, the Bureau of Indian Affairs, Indian mineral owners, and the oil and gas industry. *Id.* at 773. The

Committee's stated objectives were to "ensure that Indian lessors receive maximum revenues from their mineral resources, as required by statute and the trust responsibility of the United States, while also developing regulations that offer greater simplicity, certainty, clarity and consistency in production valuation for mineral revenue recipients and mineral lessees." *Id.* at 774. The scope of the Committee was limited to the major portion calculation for oil produced from Indian leases. *Id.* at 772. The Committee met several times and ultimately reached a consensus on a proposal to value Indian oil royalties on the higher of (1) gross proceeds, or (2) an index-based formula intended to capture the "major portion price." *Id.* at 774-75. Though the Secretary is authorized to promulgate regulations to administer the statutes under which Indian oil and gas leases are permitted and supervised, the Committee acknowledged the Secretary "may not, either directly or indirectly, change any terms in existing leases in accordance with 30 C.F.R. 1206.50(b) (2011)." *Id.* at 774.

Following the Committee's recommendations, ONRR published a Proposed Rule to amend the Indian Oil valuation regulations on June 19, 2014. *See* 79 Fed. Reg. 53102 (June 19, 2014). ONRR received fifteen written comments on its Proposed Rule, and thereafter issued a Final Rule with amendments on May 1, 2015. *See* 80 Fed. Reg. 24,794 (May 1, 2015) ("Indian Oil Valuation Amendments"). As promulgated, the amended regulations determine "value" for purposes of calculating royalties as "the higher of either the [Index Based Major Portion or "IBMP"] value . . . or [ ] gross proceeds,"[2] in accordance

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[2] Gross proceeds are generally defined by the regulations as "the total monies and other consideration accruing for the disposition of oil produced." 30 C.F.R. § 1206.51.

with the consensus reached by the Committee members. 30 C.F.R. § 1206.54(a) (2015). They also define the "major portion price" for Indian oil as "the highest price paid or offered at the time of production for the major portion of oil produced from the same designated area for the same crude oil type," 30 C.F.R. § 1206.51, consistent with Merit's lease terms.

The IBMP value, as calculated in the regulations, is derived from a formula that begins with the average monthly price for crude oil published on the New York Mercantile Exchange ("NYMEX"). 30 C.F.R. § 1206.54. Because NYMEX only lists "prices for light sweet oil delivered at Cushing, Oklahoma," the regulation then adjusts these prices to purportedly account for differences in crude oil type and location. 30 C.F.R. § 1206.51 (defining NYMEX Calendar Month Average Price"); § 1206.54 (identifying the IBMP calculation). Specifically, this adjustment is made through a calculation called the "Location and Crude Type Differential" or "LCTD."[3] To develop the LCTD, ONRR imposed a requirement that all Indian lessees report their crude oil type (sweet, sour, asphaltic, black wax, yellow wax, or condensate) using a new product code, then designated and published certain "areas" based on location and type of crude oil produced. *See* 80 Fed. Reg. at 24,802; 30 C.F.R. § 1210.61; 30 C.F.R. § 1206.51 (defining "designated area" as "an area that ONRR designates for purposes of calculating Location and Crude Type Differentials applied to an IBMP value").

[3] LCTD is specifically defined by the regulations as "the difference in value between the NYMEX Calendar Monthly Average (CMA) and the value that approximates the monthly Major Portion Price for any given month, designated area, and crude oil type." 30 C.F.R. § 1206.51.

Using this information, ONRR establishes an initial differential value for each type of crude oil from each designated area based on sales data from the past twelve months.[4] 30 C.F.R. § 1206.54(d). This differential uses the "major portion price" of the oil, meaning each barrel of oil sold is valued at the price that reflects roughly the 75th percentile of oil received in a month (by volume). 30 C.F.R. § 1206.54(d)(1)(i). The differential is then applied to the NYMEX index price to determine the IBMP value, and then adjusted on a monthly basis if the royalties reported above the IBMP prices compared to the royalties reported at or below the IBMP price diverge from the 75th percentile by plus or minus three percent. *Id.* § 1206.54(c)(2) & (d)(2). Until the IBMP price is back within the acceptable percentile range, the regulations provide for a 10% adjustment to the LCTD per month. 30 C.F.R. § 1206.54(d)(2)(iii). The overall monthly IBMP values for each designated area and crude oil type are calculated and published by ONRR on its website. *See id.* § 1206.54(c).

In other words, the initial LCTD ultimately represents the average price difference over twelve months between the (1) NYMEX sweet oil price and (2) the Major Portion Price of crude oil from a designated area and of a particular type. For example, a differential of 0.3 means the major portion of a specified oil type from a designated area sold for 30% less than the NYMEX Price, on average, over the previous twelve months.

[4] To calculate the initial LCTD for a specific crude oil type and designated area, ONRR arrayed the reported prices for that oil, net of transportation, for each month, from highest to lowest price. The major portion price for each month is that price at which 25 percent plus 1 barrel of the oil (by volume) is sold (starting from the highest price in the array). 30 C.F.R. § 1206.54(d)(1)(i). These major portion prices are then averaged over a 12-month period. *See id.* § 1206.54(d)(1)(ii). ONRR also determines the calendar month average (CMA) of the daily NYMEX prices for each of the same twelve months, then averages those prices. *Id.* § 1206.51 (explaining how NYMEX CMA is calculated). ONRR subtracts the 12-month average major portion price from the 12-month average NYMEX CMA price, then divides the remainder by the 12-month average NYMEX price. *Id.* § 1206.54(d).

After determining the LCTD, ONRR averages the NYMEX Price paid for oil each day of the next month and then reduces that price by the LCTD. *See* 30 C.F.R. § 1206.54(c)(2). Using the foregoing example, if the average NYMEX Price was $100, then ONRR would reduce that price by 30%, resulting in an IBMP valuation of $70. When the split between royalties reported above the IBMP price compared to royalties reported at or below the IBMP price diverges from the 75th percentile by +/- 3%, the amended regulations provide for adjustment of the LCTD by 10% per month until equalized. *Id.* § 1206.54(d)(2)(iii).

Merit produces Wyoming asphaltic sour crude oil from its leases on the Wind River Reservation. *See* AR 1445-49. This type of oil is sold by reference to published prices in Canada called the WCS (Western Canadian Select) Index. AR 1445 at 4. Though the amended regulations were finalized in 2015, the Secretary did not publish IBMP prices for Wind River Asphaltic Crude until May 2019. AR 048. The Wind River publications were initially delayed because there were not enough royalty reporters in that designated area reporting asphaltic crude oil when the 2015 amendments first went into effect for ONRR to calculate the initial LCTD value. *See* AR 1445. However, by March 2017, ONRR reported that at least three payors in this area had continuously reported royalties on asphaltic crude oil, which ONRR confirmed were of the same API gravity. *Id.* ONRR then used this data to calculate and publish IBMP prices for the Wind River area dating retroactively back to April 2017. *Id.* In the April 2019 report discussing the calculation of IBMP prices for Wind River asphaltic crude oil, ONRR acknowledged the disconnect between NYMEX prices and WCS prices and noted the mechanism provided in the valuation regulations to adjust the LCTD in such circumstances ("capped at 10 percent per month until prices come back into a major portion equilibrium"). *Id.* at 4-5.

When ONRR finally began publishing the IBMP prices for Wind River asphaltic crude, it instructed Merit (and other producers) to pay royalty based on the IBMP prices when those prices are higher than its gross proceeds.[5] AR 048. When Merit reviewed the IBMP prices published in May 2019, it determined those prices were dramatically higher than the prices it received for Wyoming asphaltic sour crude for many months between April 2017 and May 2019. (*See* Brister Decl. ¶¶ 8-9, Pet'rs' Ex. A, ECF No. 34-1.) Merit therefore contacted ONRR to discuss the apparent disconnect between the published IBMP prices and what it believed to be true market prices for Wyoming asphaltic sour crude. *Id.* ¶ 10; *see also* AR 049-62 (materials Merit provided to ONRR in August 2019). Ultimately, on February 13, 2020, ONRR issued an Order to Report and Pay ("ONRR's Order") demanding Merit pay approximately $3.5 million in additional royalties on the Steamboat Butte and Circle Ridge leases for the period April 2017 through December 2019, based upon Merit's failure to report and pay on the higher of gross proceeds or IBMP. *See* AR 11-33. Merit timely filed an administrative appeal of ONRR's Order on March 11, 2020 and posted a surety bond for the amount ONRR claims is due under the Order for these *past* royalty periods. (Brister Decl. ¶ 14.) Merit represents this action does not involve the period covered by ONRR's Order and Merit's pending administrative appeal.

[5] Since then, ONRR has continued to publish IBMP prices for Wind River asphaltic crude oil (called "PC 63") on a monthly basis. AR 048; *see also* AR 965-82 (IBMP prices for Wind River PC 63 for June 2019 through February 2020).

In this action, Merit challenges the Secretary's requirement that it pay royalties for *current and future* production based on the IBMP value. *See* 30 C.F.R. § 1206.54(b) ("You must submit a monthly Form ONRR–2014 using the higher of the IBMP value determined under this section or your gross proceeds under § 1206.52 or § 1206.53."). Merit attempted to pay royalty in the fall of 2019 based on its gross proceeds, but because the IBMP value was higher, ONRR's accounting system rejected the payment. (Brister Decl. ¶¶ 12-13.) Merit requested that ONRR allow it to report and pay royalties based on the terms of its leases while Merit pursued its legal challenge. *Id.* ONRR rejected Merit's request, requiring Merit to pay royalties in accordance with § 1206.54(b) (2015) regardless of Merit's position regarding the IBMP values. *Id.* Merit contends it is thus left "with a Hobson's choice: either (i) pay royalty on a price [it believes] is contrary to the terms of [its] leases, one that is frequently far in excess of the market price Merit can obtain for the oil, or (ii) don't pay royalty at all, which could subject [it] to civil penalties, interest, or other consequences." (Merit Opening Br. at 7-8, ECF No. 34.)

Merit's Petition before this Court seeks judicial review of the Secretary's action requiring Merit to pay royalties based on the IBMP formula price and requests the following relief:

> A. An order finding that the Federal Respondents' regulation requiring Merit to pay royalties using the IBMP prices, instead of the prices as determined by their leases, is arbitrary and capricious, an abuse of discretion, and otherwise not in accordance with law;
>
> B. A declaration that the Federal Respondents cannot impose their 2015 IBMP regulations to determine the major portion price of asphaltic crude oil sold from Merit's leases, because the regulations conflict with the terms of Merit's Steamboat Butte and Circle Ridge leases; and

> C. A declaration that the major portion price for asphaltic crude oil sold from Merit's leases must be based on prices actually paid or offered for "oil of the same quality and gravity . . . produced, sold, and saved from the area where the Leased Premises are situation," as the leases provide.

(Pet. at 6-7.)

STANDARD OF REVIEW

Judicial review of agency action is governed by the standards set forth in § 706 of the Administrative Procedure Act ("APA"),[6] requiring the reviewing court to engage in a "substantial inquiry." *Olenhouse v. Commodity Credit Corp.*, 42 F.3d 1560, 1573-74 (10th Cir. 1994) (citing *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402 (1971)). While an agency's decision is entitled to a "presumption of regularity," the presumption does not shield the agency from a "thorough, probing, in-depth review." *Id.* at 1574. "[T]he essential function of judicial review is a determination of (1) whether the agency acted within the scope of its authority, (2) whether the agency complied with prescribed procedures, and (3) whether the action is otherwise arbitrary, capricious or an abuse of discretion." *Id.*

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[6] The APA's scope of review provisions relevant here are:

> To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall--
> * * *
> (2) hold unlawful and set aside agency action, findings, and conclusions found to be--
> (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;
> * * *
> In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error."

5 U.S.C. § 706.

"An action is arbitrary and capricious if the agency (1) entirely failed to consider an important aspect of the problem, (2) offered an explanation for its decision that runs counter to the evidence before the agency . . ., (3) failed to base its decision on consideration of the relevant factors, or (4) made a clear error of judgment." *Cherokee Nation v. Bernhardt*, 936 F.3d 1142, 1153 (10th Cir. 2019) (internal quotation and citation omitted). Although deferential, a court's review must be "searching and careful" and counsel's post-hoc rationalizations for agency action will not be accepted. *Biodiversity Conservation Alliance v. Jiron*, 762 F.3d 1036, 1060 (10th Cir. 2014). An agency's action will be upheld, however, "if it has articulated a rational basis for the decision and has considered relevant factors." *Cherokee Nation*, 936 F.3d at 1153. The scope of review under the "arbitrary and capricious" standard is narrow, and the court is not to substitute its judgment for that of the agency. *Colorado Wild, Heartwood v. U.S.F.S.*, 435 F.3d 1204, 1213 (10th Cir. 2006) (citing *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)).

DISCUSSION

As a threshold matter, the Court will address the ripeness of this action for judicial review – an issue the Court raised *sua sponte* at the preliminary injunction stage of this litigation but did not finally resolve. (*See Order Denying Preliminary Injunction* at 9-13, ECF No. 22.)

A. Ripeness

The doctrine of prudential ripeness recognizes there are "instances when the exercise of Article III jurisdiction is unwise." *Wyoming v. Zinke*, 871 F.3d 1133, 1141 (10th

Cir. 2017). This doctrine is specifically "'designed 'to prevent the courts, through avoidance of premature adjudication, from entangling themselves in abstract disagreements over administrative policies, and also to protect the agencies from judicial interference until an administrative decision has been formalized and its effects felt in a concrete way by the challenging parties.''" *Id.* (quoting *Nat'l Park Hosp. Ass'n v. DOI*, 538 U.S. 803, 807–08 (2003)). Courts analyze prudential ripeness by examining "'both the fitness of the issues for judicial decision and the hardship to the parties of withholding court consideration.'" *Id.* (quoting *Abbott Labs. v. Gardner*, 387 U.S. 136, 149 (1967) (abrogated on other grounds by *Califano v. Sanders*, 430 U.S. 99, 97 (1977))).

In determining whether an action is fit for judicial review, the Court considers, among other factors,[7] "whether the agency decision in dispute was final," and "whether judicial intervention would inappropriately interfere with further administrative action." *Id.* (internal quotations and citation omitted). "The APA defines 'agency action' as an 'agency rule, order, license, sanction, relief, or the equivalent or denial thereof, or failure to act.'" *Colorado Farm Bureau Fed'n v. U.S. Forest Serv.*, 220 F.3d 1171, 1173 (10th Cir. 2000) (quoting 5 U.S.C. § 551(13)). An agency's action is final if it "mark[s] the consummation of the agency's decisionmaking process," and is one by which "rights or obligations have been determined, or from which legal consequences will flow." *Bennett v. Spear*, 520 U.S. 154, 178 (1997). In other words, "the finality of an administrative action

[7] The remaining factors ("whether the issue is a purely legal one," "whether further factual development would significantly advance our ability to deal with the legal issues presented," and "whether courts would benefit from further factual development of the issues presented") weigh in Merit's favor and are not cause for concern. *See Zinke*, 871 F.3d at 1141–42. The Court therefore focuses its attentions on those factors listed above.

depends on whether the action impose[s] an obligation, den[ies] a right or fix[es] some legal relationship as a consummation of the administrative process." *Mobil Expl. & Producing U.S., Inc. v. Dep't of Interior*, 180 F.3d 1192, 1197 (10th Cir. 1999) (internal quotations and citation omitted).

Merit's action here is essentially an "as-applied" challenge to 30 C.F.R. § 1206.54. Merit contends the Secretary's requirement that Merit pay royalties on the Steamboat Butte and Circle Ridge leases based on the IBMP value is inconsistent with the plain and express language of the leases. Although ONRR issued an "Order and Report to Pay" after determining Merit's leases were, in fact, subject to these provisions, Merit asserts its "current and future production" is not at issue in the underlying administrative appeal (which only audited the sales period of April 2017 to December 2019). The Court is satisfied the Secretary's action requiring Merit to pay royalties on Wyoming asphaltic sour crude oil based on IBMP prices (going forward from December 2019) constitutes final agency action and is thus ripe for judicial review.

While "an action of 'a merely tentative or interlocutory nature' does not mark the consummation of an agency action," when "a definitive agency position" becomes known and has immediate "legal force or practical effect," it may be considered a final consummation of the agency's decision making. *Mobil Expl.*, 180 F.3d at 1198 (quoting *Bennett*, 520 U.S. at 178, and citing *FTC v. Standard Oil Co. of Cal.*, 449 U.S. 232). In *Mobil*, the Tenth Circuit Court of Appeals addressed whether a document request letter and administrative subpoena issued to an oil and gas lessee were final and ripe for judicial review. 180 F.3d at 1195. The court held the letter did not consummate the agency's decisionmaking process because it "merely asked [the lessee] to keep its records for the audit period . . . and notified [the lessee] that the MMS intended to initiate an audit." *Id.* at 1198. The court reasoned that "[a]t best, the letter served only to initiate further proceedings by which the MMS could determine whether Plaintiffs owed royalties." *Id.* By contrast, the court explained, "[u]nder FOGRMA, we think such definitive decisionmaking processes would include, for example, enforcing an order or subpoena for records or determining royalties owed as a result of an audit and requiring [the lessee] to pay such royalties[.]" *Id.* at 1199.

The Secretary's determination concerning Merit falls within the type of action the *Mobil* court recognized would constitute definitive decisionmaking – requiring the lessee to pay additional royalties. First, the 2015 IBMP regulations are final, providing that Merit "*must* submit a monthly Form ONRR–2014 using the higher of the IBMP value determined under this section or [its] gross proceeds[.]" 30 C.F.R. 1206.54(b) (emphasis added). Second, in May 2019, ONRR specifically instructed Merit that, if its leases contain a major portion provision, it "must" pay royalty on the higher of its gross proceeds or the IBMP price. AR 048. This notice stated it was not an appealable decision and, as noted above, ONRR's accounting system rejects any royalty payments that are less than the IBMP. Moreover, the Secretary has made the Department's position patently clear in this litigation, maintaining that applying the IBMP formula to Merit's leases is consistent with the lease terms. Thus, the agency's position is definitive and known.

The Secretary's determination also carries legal obligations and consequences for Merit. *Mobil Expl.*, 180 F.3d at 1199 (citing *Bennett*, 520 U.S. at 177). As mentioned above, the amended regulations and ONRR's May 2019 notice require Merit to pay royalties on current and future production based on the greater of IBMP value or gross proceeds received. Only if ONRR issues an Order, Notice of Noncompliance, or a Civil Penalty Notice, can Merit file an appeal; in other words, there is no procedure available to seek a stay of the requirement to pay royalties based on the IBMP price, except through appeal of an order. *See* AR 048; 30 C.F.R. § 1243.4 (a) ("If you timely appeal an order . . . and you want to suspend compliance *with that order*, you must post a bond . . . .") (emphasis added). Though Merit has appealed the February 2020 ONRR Order to Report and Pay, the administrative suspension of the that order extends only to the *historical* requirement to pay additional royalties for the period April 2017-December 2019; it does not apply to the *ongoing monthly* requirement to pay *current and future* royalties based on the greater of IBMP and gross proceeds received beginning January 2020 and continuing thereafter. And because ONRR"s accounting system will not accept Merit's current and future royalty payments if they are less than the IBMP price, Merit must either pay royalties on an IBMP price that is significantly higher than the prices it actually received, or not pay royalties at all, which could subject Merit to substantial civil penalties or other consequences. *See* 30 C.F.R. 1241.60(b). The legal consequences of not paying the IBMP price meet the finality test for judicial review. *See Frozen Food Express v. U.S.*, 351 U.S. 40, 44 (1956) (although Interstate Commerce Commission's order would have effect only if and when a particular action was brought against a particular carrier, it was nonetheless immediately reviewable because it "warn[ed] every carrier who does not have authority from the Commission to transport those commodities, that it does so at the risk of incurring criminal penalties"); *U.S. Army Corps of Eng'rs v. Hawkes Co., Inc.*, 136 S. Ct. 1807, 1815 (2016) (finding Army Corps' jurisdictional determination that deprived mining companies of five-year safe harbor from liability and "warn[ed] that if they discharge pollutants onto their property without obtaining a permit from the Corps, they do so at the risk of significant criminal and civil penalties" was final agency action).

"Even if final, an agency action is reviewable under the APA only if there are no *adequate* alternatives to APA review in court." *Hawkes Co.*, 136 S. Ct. at 1815 (citing 5 U.S.C. § 704) (emphasis added). Merit argues it lacks adequate alternatives and pursuing further administrative proceedings would be futile. *See Randolph-Sheppard Vendors of Am. V. Weinberger*, 795 F.2d 90, 107 (D.C. Cir. 1986) ("Resort to the administrative process is futile if the agency will almost certainly deny any relief [] because it has a preconceived position on . . . the matter."). The Court agrees.

The Federal Respondents argue Merit's challenge is not ripe for review because the regulation has not yet been applied to Merit's royalty payments from January 2020 going forward. However, the regulation has been applied in that Merit must either pay royalties based on the published IBMP price for Wind River asphaltic crude or not pay royalties at all. And the only way Merit can trigger an administrative appeal (and request suspension of an order) is by failing to pay royalties, thus potentially exposing itself to substantial penalties. *See Hawkes Co.,* 136 S. Ct. at 1815 (parties need not await enforcement proceedings before challenging final agency action where such proceedings carry the risk of serious civil penalties). Neither is it an adequate alternative for Merit to wait for the outcome of its pending administrative appeal of the Order to Report and Pay for April

2017-December 2019, a process that will likely take years to complete.[8] An "arduous, expensive, and long" process that will last several years and lacks the likelihood of addressing Merit's requested remedy is not adequate. *See id.* at 1815-16.

Particularly in these circumstances, where the Secretary has made the Department's position clear, there is no reason to defer judicial review. *See San Francisco Herring Ass'n v. Dep't of the Interior*, 946 F.3d 564, 579 (9th Cir. 2019) (final agency action requirement not meant "to require regulated parties to keep knocking at the agency's door when the agency has already made its position clear"). Therefore, the Court finds the matter ripe for review.

B. Merits

The primary regulation at issue, 30 C.F.R. § 1206.54, applies "to any Indian leases that contain a major portion provision for determining value for royalty purposes" or "any Indian leases that provide that the Secretary may establish value for royalty purposes." *Id.* § 1206.54(a). By its petition for judicial review, Merit challenges the Federal Respondents' requirement that it pay current and future royalties on its two Wind River leases at issue using IBMP prices when higher than gross proceeds. In particular, Merit argues this requirement is arbitrary, capricious, and not otherwise in accordance with law because the "IBMP prices are not the prices paid or offered for 'oil of the same quality and gravity . . . produced, sold, and saved from the area where the Leased Premises are situated,'" as required by the provisions of its lease agreements. (Pet. for Review at 6, ECF No. 1.)

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[8] The IBLA's docket as of September 30, 2020 shows royalty cases "under review" that were filed in 2016. *See* https://www.doi.gov/sites/doi.gov/files/fy20-pending-cases-september-2020.pdf.

Though both lease agreements are subject to the amended provisions of the Indian oil valuation rules where applicable (*see* AR 199, 287), Merit contends the valuation calculations contained in the regulations for the major portion of like-quality oil as applied are inconsistent with an express provision of its two leases. The valuation rules provide: "If the regulations in this subpart are inconsistent with . . . [a]n express provision of an oil and gas lease subject to this subpart then the statute, settlement agreement, written agreement, or *lease provision will govern to the extent of the inconsistency*." 30 C.F.R. § 1206.50(c)(4) (emphasis added); *see also Citation Oil & Gas Corp. Appellant*, 2013 WL 3156128 at *4, MMS-09-0103-IND (Mar. 1, 2013) ("When provisions of any oil and gas lease are inconsistent with Federal regulations, the lease shall govern to the extent of that inconsistency."); *Pauley Petroleum Inc. v. United States*, 591 F.2d 1308, 1325 n.28 (Ct. Cl. 1979) (where "a new regulation would be inconsistent with the lease . . ., then the new regulation would be unenforceable against [the lessee] and the latter could defend against claims based on the new regulation").

The Department of Interior has followed this principle in a variety of situations, including with respect to major portion calculations for Indian oil and gas leases. *See Marathon Oil Co.,* MMS-95-0265-IND, 1997 WL 34844654, *3 (July 28, 1997) ("to the extent that the regulatory provision specifying the use of arm's-length prices in the major portion calculation is inconsistent with carrying out the intent of the lease terms, *then the lease term governs*") (emphasis added); *Robert L. Bayless*, MMS-95-0287-IND, 1997 WL 34844656, at *5 (July 10, 1997); *Meridian Oil, Inc.,* MMS-96-0139-IND, 1998 WL 35416992, at *4 (June 16, 1998). Thus, the primary question before this Court is whether the major portion provision contained in Merit's lease agreements is in fact inconsistent with the value calculations provided in the regulations.

Looking at the terms of the lease, Merit is required to pay a percentage royalty rate on "the value of all Oil and Gas produced, sold, or saved from the Leased Premises." (Steamboat Butte Lease § 6.3, AR 265; Circle Ridge Lease § 6.3.2, AR 182.) Merit concedes the lease agreements do not define how "value" is calculated. Therefore, the "value" of the oil sold under an arm's-length contract is generally calculated as gross proceeds less applicable allowances under the regulations. *See* 30 C.F.R. § 1206.52(a). However, the leases also provide:

> "Value" may, *in the discretion of the Secretary*, be calculated on the basis of *the highest price paid or offered . . . at the time of production* for the major portion of the oil *of the same quality and gravity . . . from the area where the Leased Premises are situated. . . .*

(Steamboat Butte Lease § 6.3; Circle Ridge Lease § 6.3.2) (emphasis added). Merit contends this language "means that, if the Secretary exercises his/her discretion to require payment of royalty under the major portion provision, the royalty must be based on prices paid or offered at the time of production for Wyoming asphaltic sour crude oil sold from the Wind River Reservation." (Opening Br. at 18.) By contrast, Federal Respondents argue the highlighted terms are undefined, and were reasonably interpreted by the Secretary in his discretion under the regulations.

While the major portion provision in the leases reserves to the Secretary discretion to calculate royalty using a different method than gross proceeds, the plain language of the provision also expressly delineates the parameters of the different method. Stated differently, "value" as calculated by the Secretary must be on the basis of (not grounded upon) the highest prices paid or offered at the time of production for the major portion of (not all or only) the oil of the same quality and gravity from the area where the Leased Premises are situated. The language "highest price paid or offered" is not so restrictive as to require a value calculation derived solely from prices *actually* paid or offered (as argued by Merit) as opposed to adjusted Index prices. Merit's argument would allow manipulation of the "major portion" price, particularly where a single entity produces and sells the majority of the oil from a given area.[9]

Considering the intent of major portion provisions is to ensure Tribes receive royalty on the market price paid for like-quality oil under arm's length contracts, the IBMP formula developed for the amended regulations falls within the parameters outlined in the major portion provision of Merit's leases. Although the calculation begins with the NYMEX "prices for light sweet oil delivered at Cushing, Oklahoma," the LCTD factor adjusts these prices using data from actual sales of Wyoming Asphaltic Sour Crude Oil on the Wind River Reservation to account for the differential in oil type and location. (Sudar Decl. ¶¶ 6-8, ECF No. 20-2; AR 1445-49.) ONRR monitors and adjusts the LCTD factor on a monthly basis so it "reflect[s] the changing markets and maintain[s] a price for like crude Indian oil at the major portion 75th percentile." *Id.* ¶ 10; AR 1449. Accordingly, the ultimate IBMP value is calculated on the basis of a major portion of prices for oil of the

[9] Indeed, Merit produces more than 75% of the asphaltic crude oil on the Wind River Reservation. (*See* chart at AR 1445; Merit Opening Br. at 22.)

same quality and gravity produced, sold, and saved from the area where the leased premises are situated.

Merit maintains the IBMP value under this formula is "divorced from" actual sales prices, as evidenced by a comparison of actual prices for asphaltic sour crude oil and the IBMP value. However, the comparisons provided appear to use Merit's gross proceeds for each month, which is not an informative contrast to an IBMP price that is the mean value of like-quality oil at the 75th percentile price and is intended to reflect the highest average prices. Moreover, aside from the anomaly in late 2018, the NYMEX Index prices and the WCS Index prices, by which Merit calculates its gross proceeds, appear to have a high degree of correlation. (*See* Sudar Decl. Ex. 1, ECF No. 20-2 (spreadsheet comparison and correlation of WCS to NYMEX).) And, as previously noted, the LCTD calculation takes into account the potential for individual market volatility and adjusts accordingly. Thus, application of the index-based formula to determine "value" for purposes of the major portion provision in Merit's leases is a reasonable exercise of the Secretary's discretion "to ensure Indian lessors receive maximum revenues from their mineral resources" and "offer greater simplicity, certainty, clarity and consistency in production valuation for mineral revenue recipients and mineral lessees." AR 774.

More problematic, however, is the 10 percent limitation on any adjustments to the LCTD percentage. The Federal Respondents offer little record support for the adjustment limitation, simply asserting the cap is intended "to limit the impact on mineral revenue to Indian Tribes and Indian Allottees during times of drastic market volatility." (Sudar Decl. ¶ 14.) Though arguably an effort to fulfill the Secretary's trust responsibility to Indian lessors, the Court agrees with Merit that the 10 percent cap is arbitrary and inconsistent with the lease requirement that value be based on prices *at the time of production*.

The Secretary does not explain how such a cap on adjustments can produce a representative "major portion" price, or how it is consistent with Merit's leases. That market prices might have been higher in *other* months in the past does not mean Merit's sale prices at the time of production were below market. It is common knowledge that market prices can shift dramatically from month-to-month, as shown by ONRR's own chart. *See* AR 1445-49. The IBMP formula is, in itself, incapable of replicating market prices for Wyoming asphaltic sour crude oil at the time of production, thus necessitating the LCTD adjustment. A fundamental problem with the LCTD adjustment is that the capped change in the LCTD percentage – the percentage by which the IBMP value will be set below NYMEX Index prices – has little to do with the actual prices paid or offered for Wyoming asphaltic sour crude oil. When market prices for Wyoming asphaltic sour crude fall even drastically below the IBMP – which is the scenario discussed by ONRR in its April 2019 report (AR 1445) – all ONRR does is make a minor and arbitrary 10% monthly increase to the LCTD percentage. ONRR will keep making a 10% adjustment each month until – perhaps many months later – the LCTD adjustment results in the "desired 75-25% volume target." (*See* Sudar Decl. ¶ 15.) But for all of the months where the IBMP exceeds market prices, Merit will owe royalty on an amount greater – sometimes far greater – than they can receive selling the oil at the time of production.

The Secretary defends the IBMP formula by pointing out there are months where the IMBP is also lower than the real major portion price based on actual sales. (Resp. Br.

at 23.) What the Secretary's chart of these prices shows is that the IBMP is often a poor substitute for actual prices, in part a function of the arbitrary 10% cap on adjustments. In a handful of months, the IBMP is relatively close, but in most months the IBMP is too high or too low by a significant amount. (*See id.*; Simpson Decl. Ex. C, ECF No. 34-2.) And contrary to the Secretary's suggestion, it doesn't appear Merit receives any benefit when the IBMP is too low because it must pay royalty on the higher of its gross proceeds or the IBMP;[10] thus, ONRR's desire to avoid fluctuations in royalty payments is a one-way street. When market prices for Wind River asphaltic sour crude oil fall in relation to NYMEX Index pricing, Merit must pay royalty on a higher-than-market price to reduce volatility in royalty payments to ONRR (and ultimately the Tribes). But when market prices for Wind River asphaltic crude rise in relation to NYMEX Index prices, Merit must pay royalty on the higher prices.

The desire to avoid volatility is insufficient justification for ignoring inconsistent lease provisions. There is no provision in the leases that allows the Secretary to take that approach, nor can it be excused by the Secretary's fiduciary duty. Neither does the asserted benefit to industry – that producers will not have to wait one to two years to receive ONRR's major portion calculations, saving them from possibly having to adjust reports

[10] The Secretary asserts Merit receives a benefit because Merit has paid royalty in some months in an amount less than the major portion price. However, an outside consultant allowed to review confidential pricing data reported that, for the period during which ONRR has published IBMP prices through the last month in which full sales price information was available (April 2017 through May 2019), Merit's price was almost always the highest reported monthly price for asphaltic sour crude oil on the Reservation. (Simpson Decl. ¶ 7.) Also, for all of those months, based on the methodology ONRR historically used to calculate the major portion price (using actual prices and volumes reported to ONRR), Merit's sale prices from one of its leases was always the major portion price for asphaltic sour crude on the Reservation. *Id.* ¶ 8. And, for the months in which the IBMP price was higher than Merit's sale prices, the IBMP price was also higher than any price received by all other producers on the Wind River Reservation. *Id.* ¶ 9.

and royalty payments retroactively (*see* Barder Decl. ¶ 7) – justify ignoring lease provisions. While this supposed benefit to industry might support the Secretary's discretion to use an index-based approach in determining value for purposes of a major portion provision, generally, the arbitrary imposition of a 10% cap on LCTD adjustments undermines the adjustment's purported purpose of accounting for differences in crude oil type and location and further untethers "value" from the "highest price paid or offered . . . *at the time of production*," as required by Merit's leases.

CONCLUSION

Though the IBMP value implemented by the regulations is reasonably calculated on the basis of the highest prices paid or offered for the major portion of like-quality and gravity oil from the area where the leased premises are situated, the arbitrary 10% cap on LCTD adjustments results in IBMP prices that are not tethered to prices *at the time of production*. To that extent, then, the IBMP value is inconsistent with the major portion provision of Merit's Steamboat Butte and Circle Ridge lease agreements. On remand, the ONRR must make appropriate adjustments to the LCTD, without limitation from any 10% cap, so that "value" under these two leases more accurately reflects a major portion price for Wind River asphaltic sour crude oil at the time of production.

THEREFORE, it is hereby

ORDERED that this matter is REMANDED for further action consistent with the Court's findings and conclusions herein.

Dated this 4th day of March, 2021.

Scott W. Skavdahl
United States District Judge

ATTACHMENT 2

Judgment (March 9, 2021)

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF WYOMING

MERIT ENERGY COMPANY, LLC, and
MERIT ENERGY OPERATIONS I, LLC,

Petitioners,

vs.

DAVID BERNHARDT, in his official capacity as Secretary of the Interior U.S. Department of the Interior, and the U.S. OFFICE OF NATURAL RESOURCES REVENUE,

Respondents.

Case No. 20-CV-032-SWS

JUDGMENT

This matter having come before the Court on the *Petition for Review of Final Agency Action*, and the Court having considered the issues and rendered a decision remanding the matter for further action (*see* ECF No. 39),

IT IS HEREBY ORDERED AND ADJUGED that Judgment is entered in favor of Petitioners.

Dated this 8th day of March, 2021.

Scott W. Skavdahl
United States District Judge

ATTACHMENT 3

Order on Post-Judgment Motions (May 25, 2021)

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF WYOMING

MERIT ENERGY COMPANY, LLC, and MERIT ENERGY OPERATIONS I, LLC

Petitioner,

vs.

DAVID BERNHARDT, in his official capacity as Secretary of the Interior U.S. Department of the Interior, and the U.S. OFFICE OF NATURAL RESOURCES REVENUE,

Respondents.

Case No. 2:20-CV-032-SWS

ORDER ON POST-JUDGMENT MOTIONS

This matter is before the Court on *Merit's Rule 59(e) Motion to Amend Judgment* (ECF No. 42) and the Federal Respondents' *Cross-Motion for Relief from Judgment Under Rule 60(b)* (ECF No. 46). These motions follow the Court's *Order on Petition for Review of Agency Action* (ECF No. 39), which ultimately held that, to the extent Respondents employ an arbitrary 10% cap on adjustments to its royalty calculations, the value as implemented by the challenged regulations is inconsistent with the provisions of Merit's lease agreements. *Id.* at 25. The Court, having considered the briefs and materials submitted in support of the parties' respective post-judgment motions and the responses thereto, and being otherwise fully advised, FINDS and ORDERS as follows:

BACKGROUND[1]

Petitioners Merit Energy Company, LLC and MEOI (collectively, "Merit") are the successors in interest of two oil and gas leases covering lands on the Wind River Reservation in northwestern Wyoming. *See* Pet. at 3; AR 170-206, 254-97. Marathon Oil Company ("Marathon") and the Eastern Shoshone and Northern Arapaho Tribes originally executed these leases, known as the "Steamboat Butte" lease and the "Circle Ridge" lease, in 1996 and 2000, respectively. *See id.* MEOI acquired the leases from Marathon in 2016 and, since that time, Merit Energy Company, LLC has operated the leases and remits royalty payments to the Office of Natural Resources Revenue ("ONRR") on behalf of MEOI.

Pursuant to the terms of the lease agreements, Merit is required to pay royalties on all the oil it produces, saves, or sells from the leased premises based upon a percentage of the "value" of that oil. (Steamboat Butte Lease § 6.3, AR 265; Circle Ridge Lease § 6.3.2, AR 182.) The leases do not define how "value" is calculated, but provide they are subject to "any and all applicable federal and tribal laws and regulations now or hereafter in force relative to this lease," including those governing royalty calculations. AR 199, 287; *see also* 30 C.F.R. Part 1200. Merit pays these royalties to the ONRR, which is a subset of the U.S. Department of Interior that is statutorily tasked with collecting, verifying, and then disbursing the revenues associated with the production of natural resources on Indian lands.

[1] The Court incorporates by reference the more complete background set forth in its Order on the merits. (*See* ECF No. 39 at 1-10.)

See 30 U.S.C. § 1711(a). Once ONRR receives Merit's payments, it distributes the royalties owed to the Eastern Shoshone and Northern Arapaho Tribes.

In some instances, the price paid for the oil produced does not accurately reflect market value because the oil is not sold pursuant to an arm's-length transaction. To ensure the Tribes and other Indian lessors receive full royalties in such instances, many (but not all) Indian leases, including those at issue here, contain a standard provision which gives the Secretary discretion to calculate an alternative "value" for royalty purposes. Specifically referred to as the "major portion provision," the leases state:

> "Value" may, in the discretion of the Secretary, be calculated on the basis of the highest price paid or offered . . . at the time of production for the major portion of the oil of the same quality and gravity, and gas, and/or natural gasoline, and/or all other hydrocarbon substances produced, sold, and saved from the area where the Leased Premises are situated, and the actual volume of the marketable product less the content of foreign substances as determined by the Authorized Officer. . . .

(Steamboat Butte Lease § 6.3, AR 265; Circle Ridge Lease § 6.3.2, AR 182). The major portion calculation thus ensures the Tribes receive royalty on the market price paid or offered for the majority of production, not a lower price paid for a smaller portion of the production. *See* 53 Fed. Reg. 1,184, 1,197 (Jan. 15, 1988) (explaining the major portion "will be determined using like-quality oil sold under arm's-length contracts because non-arm's-length contracts may not reflect market value").

Under its delegated rulemaking authority, ONRR has promulgated regulations for purposes of calculating "value" under those Indian leases with a major portion provision. *See id.* (noting in 1988 that "the major portion analysis has been a part of valuation procedures for at least 45 years"). ONRR published a Proposed Rule to amend the Indian

Oil valuation regulations on June 19, 2014. *See* 79 Fed. Reg. 53102 (June 19, 2014), and thereafter issued a Final Rule with amendments on May 1, 2015. *See* 80 Fed. Reg. 24,794 (May 1, 2015) ("Indian Oil Valuation Amendments"). As promulgated, the amended regulations determine "value" for purposes of calculating royalties as "the higher of either the [Index Based Major Portion or "IBMP"] value . . . or [ ] gross proceeds," in accordance with the consensus reached by the Committee members. 30 C.F.R. § 1206.54(a) (2015). They also define the "major portion price" for Indian oil as "the highest price paid or offered at the time of production for the major portion of oil produced from the same designated area for the same crude oil type," 30 C.F.R. § 1206.51, consistent with Merit's lease terms.

The IBMP value, as calculated in the regulations, is derived from a formula that begins with the average monthly price for crude oil published on the New York Mercantile Exchange ("NYMEX"). 30 C.F.R. § 1206.54. Because NYMEX only lists "prices for light sweet oil delivered at Cushing, Oklahoma," the regulation then adjusts these prices to purportedly account for differences in crude oil type and location. 30 C.F.R. § 1206.51 (defining NYMEX Calendar Month Average Price"); § 1206.54 (identifying the IBMP calculation). Specifically, this adjustment is made through a calculation called the "Location and Crude Type Differential" or "LCTD."[2] To develop the LCTD, ONRR imposed a requirement that all Indian lessees report their crude oil type (sweet, sour, asphaltic, black wax, yellow wax, or condensate) using a new product code, then

[2] LCTD is specifically defined by the regulations as "the difference in value between the NYMEX Calendar Monthly Average (CMA) and the value that approximates the monthly Major Portion Price for any given month, designated area, and crude oil type." 30 C.F.R. § 1206.51.

designated and published certain "areas" based on location and type of crude oil produced. *See* 80 Fed. Reg. at 24,802; 30 C.F.R. § 1210.61; 30 C.F.R. § 1206.51 (defining "designated area" as "an area that ONRR designates for purposes of calculating Location and Crude Type Differentials applied to an IBMP value").

Using this information, ONRR establishes an initial differential value for each type of crude oil from each designated area based on sales data from the past twelve months.[3] 30 C.F.R. § 1206.54(d). This differential uses the "major portion price" of the oil, meaning each barrel of oil sold is valued at the price that reflects roughly the 75th percentile of oil received in a month (by volume). 30 C.F.R. § 1206.54(d)(1)(i). The differential is then applied to the NYMEX index price to determine the IBMP value, and then adjusted on a monthly basis if the royalties reported above the IBMP prices compared to the royalties reported at or below the IBMP price diverge from the 75th percentile by plus or minus three percent. *Id.* § 1206.54(c)(2) & (d)(2). Until the IBMP price is back within the acceptable percentile range, the regulations provide for a 10% adjustment to the LCTD per month. 30 C.F.R. § 1206.54(d)(2)(iii).

In other words, the initial LCTD ultimately represents the average price difference over twelve months between the (1) NYMEX sweet oil price and (2) the Major Portion Price of crude oil from a designated area and of a particular type. After determining the

[3] To calculate the initial LCTD for a specific crude oil type and designated area, ONRR arrayed the reported prices for that oil, net of transportation, for each month, from highest to lowest price. The major portion price for each month is that price at which 25 percent plus 1 barrel of the oil (by volume) is sold (starting from the highest price in the array). 30 C.F.R. § 1206.54(d)(1)(i). These major portion prices are then averaged over a 12-month period. *See id.* § 1206.54(d)(1)(ii). ONRR also determines the calendar month average (CMA) of the daily NYMEX prices for each of the same twelve months, then averages those prices. *Id.* § 1206.51 (explaining how NYMEX CMA is calculated). ONRR subtracts the 12-month average major portion price from the 12-month average NYMEX CMA price, then divides the remainder by the 12-month average NYMEX price. *Id.* § 1206.54(d).

LCTD, ONRR averages the NYMEX Price paid for oil each day of the next month and then reduces that price by the LCTD. *See* 30 C.F.R. § 1206.54(c)(2). When the split between royalties reported above the IBMP price compared to royalties reported at or below the IBMP price diverges from the 75th percentile by +/- 3%, the amended regulations provide for adjustment of the LCTD by 10% per month until equalized. *Id.* § 1206.54(d)(2)(iii).

Merit produces Wyoming asphaltic sour crude oil from its leases on the Wind River Reservation. *See* AR 1445-49. This type of oil is sold by reference to published prices in Canada called the WCS (Western Canadian Select) Index. AR 1445 at 4. In an April 2019 report discussing the calculation of IBMP prices for Wind River asphaltic crude oil, ONRR acknowledged the disconnect between NYMEX prices and WCS prices and noted the mechanism provided in the valuation regulations to adjust the LCTD in such circumstances ("capped at 10 percent per month until prices come back into a major portion equilibrium"). *Id.* at 4-5. In this action, Merit challenged the Secretary's requirement that it pay royalties for *current and future* production based on the IBMP value.

Merit's Petition before this Court sought judicial review of the Secretary's action requiring Merit to pay royalties based on the IBMP formula price and requested the following relief:

> A. An order finding that the Federal Respondents' regulation requiring Merit to pay royalties using the IBMP prices, instead of the prices as determined by their leases, is arbitrary and capricious, an abuse of discretion, and otherwise not in accordance with law;
>
> B. A declaration that the Federal Respondents cannot impose their 2015 IBMP regulations to determine the major portion price of asphaltic crude oil sold

> from Merit's leases, because the regulations conflict with the terms of Merit's Steamboat Butte and Circle Ridge leases; and
>
> C. A declaration that the major portion price for asphaltic crude oil sold from Merit's leases must be based on prices actually paid or offered for "oil of the same quality and gravity . . . produced, sold, and saved from the area where the Leased Premises are situation," as the leases provide.

(Pet. at 6-7.)

Upon review and consideration of the administrative record and Merit's challenges to the regulations as applied to the two leases in question, this Court ultimately concluded:

> Though the IBMP value implemented by the regulations is reasonably calculated on the basis of the highest prices paid or offered for the major portion of like-quality and gravity oil from the area where the leased premises are situated, the arbitrary 10% cap on LCTD adjustments results in IBMP prices that are not tethered to prices at the time of production. To that extent, then, the IBMP value is inconsistent with the major portion provision of Merit's Steamboat Butte and Circle Ridge lease agreements. On remand, the ONRR must make appropriate adjustments to the LCTD so that "value" under these two leases *more accurately reflects* a major portion price for Wind River asphaltic sour crude oil at the time of production.

(*Order*, ECF No. 39 at 25) (emphasis added). The matter was thus remanded for further action consistent with the Court's findings. The parties then filed the present motions.

STANDARD OF REVIEW

> Grounds warranting a motion to reconsider [under Rule 59(e)] include (1) an intervening change in the controlling law, (2) new evidence previously unavailable, and (3) the need to correct clear error or prevent manifest injustice. *See Brumark Corp. v. Samson Resources Corp.*, 57 F.3d 941, 948 (10th Cir. 1995). Thus, a motion for reconsideration is appropriate where the court has misapprehended the facts, a party's position, or the controlling law. *Cf.* Fed.R.App.P. 40(a)(2) (grounds for rehearing). **It is not appropriate to revisit issues already addressed or advance arguments that could have been raised in prior briefing.** *See Van Skiver v. United States*, 952 F.2d 1241, 1243 (10th Cir. 1991).

Servants of Paraclete v. Does, 204 F.3d 1005, 1012 (10th Cir. 2000) (emphasis added).

Rule 60(b) of the Federal Rules of Civil Procedure provides:

> (b) **Grounds for Relief from a Final Judgment, Order, or Proceeding**. On motion and just terms, the court may relieve a party or its legal representative from a final judgment, order, or proceeding for the following reasons:
>
> ***
> (2) newly discovered evidence that, with reasonable diligence, could not have been discovered in time to move for a new trial under Rule 59(b);
> (3) fraud (whether previously called intrinsic or extrinsic), misrepresentation, or misconduct by an opposing party;
> (4) the judgment is void; [or]
> ***
> (6) any other reason that justifies relief.

"Rule 60(b) relief is extraordinary and may only be granted in exceptional circumstances." *Lebahn v. Owens*, 813 F.3d 1300, 1306 (10th Cir. 2016).

DISCUSSION

Merit bases its Rule 59 motion on the third ground supporting reconsideration: to correct a possible error in the Court's understanding of the facts and to prevent manifest injustice. The Federal Respondents' Rule 60 cross-motion for relief from the Judgment is based on an alleged misrepresentation by Merit as to its ability to receive NYMEX-based prices for its oil. Both motions lack any legal or evidentiary support and simply seek to reargue positions this Court has already considered and rejected.

A. Merit's Motion to Amend Judgment

Merit argues amendment is necessary to specifically address the fact that the ONRR uses prices which are two months old to calculate the LCTD adjustment for the month of production, which Merit contends is inconsistent with the lease provisions requiring ONRR to calculate the major portion price "at the time of production." However, Merit is simply reconstructing arguments already considered and rejected. The Court understood Merit's argument to include its underlying position that the leases require value to be calculated based on prices from the month of production. But the relief Merit now, more specifically, requests ignores the reality that there is no feasible way to assign a mean value of like-quality oil at the 75th percentile price in this way and would improperly limit the agency's discretion. This Court found "application of the index-based formula to determine 'value' for purposes of the major portion provision in Merit's leases is a reasonable exercise of the Secretary's discretion . . . ." *Order* at 22. ONRR does not immediately have the production data for any given month. Moreover, the leases do not define "at the time of production," and the Secretary's interpretation that necessarily applies a definition including a three-month period to adjust differentials is not unreasonable.

Nevertheless, the Court did find the 10 percent limitation on any adjustments to the LCTD percentage arbitrary and inconsistent with the lease requirement that value be based on prices "at the time of production." *Id.* at 22-23. But this finding was based on a determination that a *capped* adjustment has "little to do with the actual prices paid or offered for Wyoming asphaltic sour crude oil" – not on use of "two-month old" data. *Id.* at 23. While the purported benefit to industry in not having to wait months or years for ONRR's major portion calculations "might support the Secretary's discretion to use an index-based approach in determining value for purposes of a major portion provision, generally, the arbitrary imposition of a 10% cap on LCTD adjustments undermines the adjustment's purported purpose of accounting for differences in crude oil type and location and <u>further untethers</u> 'value' from the 'highest price paid or offered . . . *at the time of* *production*,' as required by Merit's leases." *Order* at 25 (underlined emphasis added). So long as the monthly LCTD adjustment is consistently calculated without any cap or limitation, "value" will be reasonably tethered to the highest price paid or offered at the time of production for the major portion of the oil of the same quality and gravity. Accordingly, the Court sees no need to correct any error or prevent manifest injustice.

B. Federal Respondents' Motion for Relief from Judgment

Neither is the Court persuaded by the Federal Respondents' argument that there is a need for further factual development based on Merit's alleged misrepresentation regarding its ability to receive NYMEX-based prices in its sale of sour crude oil. Regardless whether Merit actually made such a misrepresentation, the Court's determination that this matter is ripe for review had nothing to do with divergences between the WCS Index and the NYMEX Index or whether such divergences will cause similar divergences between Merit's proceeds and the regulation's royalty valuation. (*See Order* at 12-18.) Moreover, the agency itself acknowledged the disconnect between NYMEX prices and WCS prices and noted the mechanism provided in the valuation regulations to adjust the LCTD in such circumstances. *See id.* at 8-9. Finally, ONRR's proffered "new evidence" is immaterial. This Court already ruled the NYMEX-based IBMP formula is consistent with Merit's leases and within its discretion to implement (absent the 10 percent limitation on any adjustments to the LCTD percentage). This legal conclusion is not affected by the pricing formula in one of Merit's contracts which is not and was not at issue here. Accordingly, the Federal Respondents have not shown exceptional circumstances warranting extraordinary relief under Rule 60(b).

THEREFORE, it is hereby

ORDERED that *Merit's Rule 59(e) Motion to Amend Judgment* (ECF No. 42) and the Federal Respondents' *Cross-Motion for Relief from Judgment Under Rule 60(b)* (ECF No. 46) are DENIED.

Dated this 25th day of May, 2021.

Scott W. Skavdahl
United States District Judge