UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

OXY USA Inc. v. United States Department of the Interior

No. 21-2011, United States Court of Appeals for the Tenth Circuit (May 2, 2022)

SUMMARY

OXY USA v. DOI, 10th Cir. 2022, addresses royalty valuation for carbon dioxide (CO2) produced from federal oil and gas leases under the Mineral Leasing Act. The court upheld the Department of the Interior's Office of Natural Resources Revenue (ONRR) determination that the lessee's use of a "Unit Average" valuation method was properly rejected because it was unverifiable and included non-arm's-length transactions. The court also affirmed ONRR's denial of compression and dehydration costs as a transportation allowance, holding those costs were necessary to place CO2 in marketable condition for enhanced oil recovery and thus not deductible under 30 C.F.R. § 206.157(f)(9). The decision confirms ONRR's authority to establish minimum royalty values using alternative benchmarks, including the Smithson formula from a private arbitration, when arm's-length sales are lacking.

CASE DETAILS

COURT	United States Court of Appeals for the Tenth Circuit
WRITING FOR THE COURT	BRISCOE; HOLMES; MORITZ
JURISDICTION	Federal
DECIDED	May 2, 2022
DOCKET	21-2011
DISPOSITION	affirmed
PROCEDURAL POSTURE	Appeal from the United States District Court for the District of New Mexico
STANDARD OF REVIEW	Under the APA, we may set aside agency action only if it is arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law. 5 U.S.C. § 706(2)(A). We review the district court's decision de novo. We ask whether the agency's interpretation was based on an examination of the relevant evidence and if the agency articulated a rational connection between the facts found and the decision made.
PRECEDENTIAL VALUE	Published

PARTIES	OXY USA INC. v. UNITED STATES DEPARTMENT OF THE INTERIOR; OFFICE OF NATURAL RESOURCES REVENUE; GREGORY GOULD

TOPICS

administrative law · oil and gas · minerals · appellate procedure · standard of review

PRACTICE AREAS

Administrative Law · Energy Law · Oil and Gas Law

QUESTIONS PRESENTED

1. Whether ONRR's valuation of CO_2 royalties was arbitrary and capricious under the APA
2. Whether ONRR properly rejected the Unit Average valuation method
3. Whether ONRR properly applied the second regulatory benchmark
4. Whether ONRR correctly determined that compression and dehydration costs were not deductible as a transportation allowance

HOLDINGS

1. ONRR's valuation was reasonable and not arbitrary or capricious.
2. ONRR's rejection of the Unit Average was not arbitrary or capricious.
3. The Director's interpretation and application of the marketable-condition rule was not plainly erroneous or inconsistent with the regulations.

KEY QUOTATIONS

> *"Under the APA, we may set aside agency action only if it is 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.' 5 U.S.C. § 706(2)(A)."* (at 22)

> *"Supplemental costs for compression, dehydration, and treatment of gas . . . only if such services [1] are required for transportation and [2] exceed the services necessary to place production into marketable condition."* (at 37)

> *"lease products which are sufficiently free from impurities and otherwise in a condition that they will be accepted by a purchaser under a sales contract typical for the field or area."* (at 37)

FACTUAL BACKGROUND

Hess produced CO_2 from federal leases in the Bravo Dome Unit. Hess used almost all of the CO_2 for its own enhanced oil recovery operations rather than sale. Hess paid royalties based on the 'Unit Average' valuation method. ONRR audited and rejected that method, establishing its own valuation using a weighted average and the Smithson formula. ONRR also disallowed Hess's claimed compression and dehydration costs as a transportation allowance because those costs were necessary to place the CO_2 in marketable condition.

PROCEDURAL HISTORY

OXY appealed the decision of ONRR ordering it to pay additional royalties. The district court affirmed ONRR's decision. OXY now appeals to the Tenth Circuit.

DISPOSITION

affirmed

CASES CITED

- N.M. Cattle Growers Ass'n v. Fish & Wildlife Serv., 248 F.3d 1277, 1281 (10th Cir. 2001)
- Utah Env't Cong. v. Troyer, 479 F.3d 1269, 1280 (10th Cir. 2007)
- Hillsdale Env't Loss Prevention, Inc. v. U.S. Army Corps of Eng'rs, 702 F.3d 1156, 1165 (10th Cir. 2012)
- Payton v. U.S. Dep't of Agric., 337 F.3d 1163, 1168 (10th Cir. 2003)
- Biodiversity Conservation All. v. Jiron, 762 F.3d 1036, 1060 (10th Cir. 2014)
- Forest Guardians v. U.S. Fish & Wildlife Serv., 611 F.3d 692, 704 (10th Cir. 2010)
- Pennaco Energy, Inc. v. U.S. Dep't of the Interior, 377 F.3d 1147, 1156 (10th Cir. 2004)
- Wyo. Farm Bureau Fed'n v. Babbitt, 199 F.3d 1224, 1231 (10th Cir. 2000)
- Devon Energy Corp. v. Kempthorne, 551 F.3d 1030, 1036-40 (D.C. Cir. 2008)
- Amoco Prod. Co. v. Watson, 410 F.3d 722, 729-31 (D.C. Cir. 2005)
- BP Am. Prod. Co. v. Burton, 549 U.S. 84 (2006)
- Amerada Hess Corp. v. Dep't of the Interior, 170 F.3d 1032, 1036-37 (10th Cir. 1999)
- Mesa Operating Ltd P'ship v. Dep't of the Interior, 931 F.2d 318, 323-27 (5th Cir. 1991)