EIGHTY-EIGHT OIL CO.

IBLA 89-368 Decided August 16, 1990

Appeal from a decision of the Director, Minerals Management Service, assessing additional royalty. MMS 87-0213-O&G.

Affirmed as modified.

1. Oil and Gas Leases: Royalties: Generally--Regulations: Interpretation

Oil and gas lease royalty accounts are settled under rules in effect at the time charges at issue were incurred.

2. Oil and Gas Leases: Royalties: Generally--Regulations: Interpretation

Where a 1987 audit discovered a discrepancy between sales and production volumes from an oil and gas lease had occurred in March 1985, MMS properly required royalty rate to be calculated on actual production pursuant to provision of 30 CFR 202.101 (1984).

3. Oil and Gas Leases: Royalties: Generally--Regulations: Interpretation--Statutory Construction: Administrative Construction

An obligation to pay oil royalty for March 1985 using actual production to compute a royalty rate pursuant to 30 CFR 202.101 (1984) did not arise until 1987 when MMS ordered such payment to be made following audit of the 1985 account.

4. Estoppel--Federal Employees and Officers: Authority to Bind Government--Regulations: Interpretation

An alleged conflict between Departmental oil and gas regulations and a policy guideline used by MMS to govern royalty administration failed to establish a foundation for a claim of equitable estoppel where no factual or legal conflict was shown to exist between the regulations and the guideline so as to establish the claimed misrepresentation by Federal employees.

APPEARANCES: John J. Blomstrom, Esq., Casper, Wyoming, for appellant; Peter J. Schaumberg, Esq., Howard W. Chalker, Esq., Geoffrey Heath, Esq., George Fishman, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE ARNESS

Eighty-Eight Oil Company (Eighty-Eight) has appealed from so much of a January 27, 1989, decision of the Director, Minerals Management Service (MMS), as assessed $1,154.45 additional royalty on production during March 1985 from a Federal oil and gas lease issued to Sage Energy Company (Sage), effective December 1, 1984, pursuant to the Mineral Leasing Act for Acquired Lands of 1947, 30 U.S.C. §§ 351-359 (1982). Eighty-Eight purchases crude oil from the Sage lease and pays royalty due on the lease.

The Sage lease provides at section 2 that "royalty shall be computed in accordance with regulations on production removed or sold." Schedule B of the lease establishes that royalty shall be paid on "production removed or sold from the leased lands" using a sliding-rate scale ranging from 12.5 to 25 percent of average daily production of oil, calculated monthly. In 1987, the Sage lease was audited pursuant to section 205 of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), 30 U.S.C. § 1735 (1982). The audit reported two errors in royalty calculations made under the lease. It was first concluded that in March 1985 Eighty-Eight erroneously reported the number of production days. The audit also found that sales volume, rather than production volume, had been used in error to calculate the royalty rate. Royalty was assessed for actual March sales, not on oil produced but not then sold. MMS does not contend that a royalty was due on oil produced, but not sold in March 1985.

Eighty-Eight has conceded there was an error in the number of days used to calculate royalty; the only issue remaining to be decided, therefore, is whether the royalty rate should be calculated by using the volume of oil sold or the amount of oil produced. The resulting additional royalty claimed by MMS, $1,154.45, is the difference between royalty rate computed using the sales volume of 2,468.73 barrels (18 percent under the variable rate schedule) or the production volume of 3,017 barrels of oil (20 percent under the schedule). Subsidiary to this issue, MMS has also indicated that late payment charges will be assessed if the finding that additional royalty is owed is sustained on appeal.

On January 27, 1989, the Director, MMS, determined that production, rather than sales, should have been used to calculate the royalty rate for March 1985. Rejecting arguments advanced by Eighty-Eight that the U.S. Geological Survey Conservation Division Manual (CDM) Part 647 (1974) and 30 CFR 202.101 (1984) require that the royalty rate be calculated using sales, instead of production volume, the Director concluded that "[s]liding and step-scale royalties are based on the average daily production per well" (Decision at 2). Observing that in March 1985 production on the Sage lease exceeded sales by over 22 percent, he found:

> Where a disparity of this magnitude occurs, the policy that the production and sales figures may be deemed interchangeable, and that sales may be used in royalty-rate calculation as a matter of administrative convenience, is no longer applicable. Simply stated, it was not proper to substitute one figure (number of barrels sold) or another figure (number of barrels produced) as though they were the same when they were not the same.

(Decision at 3).

Eighty-Eight argues that the Director erred by failing to apply regulations in effect in March 1985, when determining the royalty rate for that month; that CDM requires that sales, not production, provide the measure for royalty-rate determination; and that MMS is estopped by policy guidance provided by CDM to deny that Eighty-Eight correctly determined the royalty rate, using sales rather than production figures.

[1] Eighty-Eight is correct that regulations in effect at the time of the claimed underpayment should apply. See generally, Union Pacific Ry. Co., 38 L.D. 262 (1909), for the proposition that accounts are settled under rules in effect at the time fees are incurred. In this case the applicable oil and gas regulations in effect in 1985 are those published in 1984. The regulation governing royalty rates for production from variable rate leases for March 1985 provided, pertinently: "Sliding- and step-scale royalties are based on the average daily production per well * * *. The average daily production per well for a lease is computed on the basis of * * * gross production from the leasehold." 30 CFR 206.104 (1984). On its face, therefore, this regulation requires that MMS look to gross production when computing the average daily production for the royalty rate determination on a variable rate lease. See generally, Conoco, Inc., 113 IBLA 47 (1990). Supplementing this rule, however, the regulation governing monthly royalty reporting in March 1985 provided in relevant part that:

> For the convenience of the lessor and lessee, monthly statements of production and royalty shall be based in general on production recorded in pipeline runs or other shipments. When shipments are infrequent or do not approximate actual production, the Associate Director may require statements of production and royalty to be made on such other basis as he may prescribe, gains or losses in volume of storage being taken into account when appropriate.

30 CFR 202.101 (1984). The CDM provision in effect in 1985 provided, not inconsistently with the regulations quoted above, that "[i]n calculating the royalty rate, production and sales are generally considered to be the same thing with the sales figures being used to calculate all royalty rates even though the word 'production' may be used in this chapter." Id. at 647.13.3(A) (1974).

[2] The general rule allowing royalty administrators to use sales figures for convenience in calculating royalty rate was thus emphasized

by CDM, while the exception to the general practice was enunciated by the regulation at 30 CFR 202.101 (1984). Applying the regulations quoted above to the Sage lease, MMS concluded that because the oil and gas regulation required MMS to use gross production when determining average daily production for step-scale leases, Eighty-Eight was required to use gross production to determine royalty rates. This conclusion, however, is inconsistent with Sun Exploration & Production Co., 112 IBLA 373 (1990). That case also reviewed the relationship between provisions of CDM and 30 CFR 206.104. 1/ There, we determined that conflicting interpretations given to the royalty payment regulation by MMS and Sun were equally reasonable. Id. at 385, 388. We also, however, determined that 30 CFR 206.104 was permissive rather than directory, and found that, while Sun was not required to pay royalty on oil not sold because it was not previously required to do so in keeping with the general administrative practice described in CDM, that MMS could require such payment in the future, after giving notice that valuation was to be calculated using daily production rather than sales. Id. at 392. The Sun Exploration & Production Co. decision did not, however, deal with the issue before us here, where sales lag behind production.

When MMS has not ruled otherwise, royalty payments are accepted subject to audit and do not necessarily constitute payment in full. Supron Energy Corp., 55 IBLA 318, 321 (1981). In Supron Energy Corp. we found that this rule is realistic because exigencies of royalty administration require recognition of the fact that there is a gap between when actions occur at a lease and when MMS learns about them. We recognized that when Geological Survey, the predecessor of MMS, "receives a lessee's monthly statement of value, it cannot immediately know what the sales data for the entire field are, and it will necessarily take time to assemble this information and interpret it." Inaction during this time, we observed, "could reasonably indicate that the Department is considering whether to adopt these sales prices as adequate for 'value' or, instead, to impose its own determination thereof on the lessees." Supron Energy Corp., quoting from Supron Energy Corp., 46 IBLA 181, 190 (1980).

Similarly, here MMS could not realistically be expected to immediately know that there was a difference between production and sales volumes triggering application of 30 CFR 202.101 (1984). That regulation requires that, if shipments do not approximate production, a determination should be made whether royalty should be calculated using actual production instead of pipeline runs or shipments. The knowledge necessary to make such a determination was obtained by MMS in the course of audit in 1987, when a difference between March 1985 sales and production was discovered.

MMS was then required to determine, in the exercise of discretion conferred on the agency by 30 CFR 202.101 (1984), whether the royalty rate was

1/ Oil and gas operating regulations previously found at 30 CFR Part 221.43 and 30 CFR 221.49 were recodified at 30 CFR 202.101 and 30 CFR 206.104. 48 FR 35641 (Aug. 5, 1983).

to be computed using some measure other than recorded shipments from the Sage lease. The Director, MMS, in the decision under review, concluded that disparity discovered in excess of 22 percent between sales and production was sufficient to require a royalty rate using production rather than sales volume. There has been no showing that this finding was incorrect, and we find that it represented a proper exercise of the discretion conferred on MMS by 30 CFR 202.101 (1984). The United States, as owner of the oil produced, has an interest in receiving royalty using correct measurements. Both the lease and the oil and gas regulations, as previously explained, require that payment of royalty is to be made on "production removed or sold." And see 30 U.S.C. § 1702(14) (1982), defining "royalty" to mean "any payment based on the value or volume of production." While "production" may in most instances be shown by sales figures, the regulation recognizes that there are times when the two things, production and sales, are not the same. 2/ It is the policy of Departmental administrators of royalty collection to assume that production and sales will generally conform. CDM 647.13.3(A) (1974). It is the duty of MMS to determine when sales and production do not conform and to charge for "actual production" which is the measure of value for royalty purposes in that case. 30 CFR 202.101 (1984).

[3] Nonetheless, there was no obligation on Eight-Eight to compute royalty using gross production figures until May 12, 1987, when MMS directed that royalty for March 1985 be calculated on a basis "other than sales." 30 CFR 202.101 (1984). Cf. Sun Exploration & Production Co., supra. Until May 12, 1987, when MMS issued an order to Eighty-Eight assessing additional royalty for the Sage lease, Eighty-Eight had no obligation to account for royalty based on "actual production," because the regulation required agency action before the customary method of royalty rate calculation could be replaced with another method of computation. Before MMS issued the order of May 12, 1987, therefore, there was no requirement that royalty rate be calculated using actual production instead of sales. But once MMS found that March 1985 sales and production differed to a degree that made inexpedient the computation of the royalty rate using sales, Eighty-Eight was obliged to change the royalty rate calculation method used, unless it could show MMS had erred by applying the regulation.

[4] Eighty-Eight argues that provisions of CDM are contrary to 30 CFR 202.101 (1984), and that MMS is estopped to assess additional royalty by the terms of the policy guideline, which are in direct conflict with the regulation so as to amount to a misrepresentation by the agency of its own rules. Eighty-Eight argues in the statement of reasons in support of appeal (SOR) that:

> No one with Minerals Management Service has said, nor has [CDM] been revised to say, that if there is a difference, be it

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2/ Having exercised this discretion, it would also be proper for MMS to make a corresponding downward adjustment to the average daily production figure when determining the royalty rate for subsequent months when sales exceed production.

> significant or minimal, between sales and production, Eighty-Eight should use production. Eighty-Eight has relied on that fact. Now, Minerals Management Service alleges Eighty-Eight should not have used [CDM], should not have relied upon it.
> That is precisely the type of situation to which estoppel should apply.

(SOR at 8).

Examination of the CDM guideline, however, does not bear out this contention. The guidance provided by CDM is, in actuality, nearly identical to the guidance provided by the regulation. While the guideline stresses the administrator's usage in practice, and emphasizes that the general practice will be to use sales to approximate production for reasons of expediency in administration, this guidance in no way obscures the rule that there is an exception to this policy in cases where sales lag too far behind production.

Consistent with the general rule, a specific order is required, directed to the situation where "shipments are infrequent" or where they "do not approximate actual production" if the exception to the general rule is to be applied. The order dated May 12, 1987, was that order. Eighty-Eight does not contend that sales approximated actual production. Instead, it has argued that the administrative practice of allowing sales to represent production for royalty rate calculations may never be varied without a prior order to that effect. This approach has no support in either regulations or the policy guideline. Until there has been a divergence from the norm, so that sales and production do not match, there is no occasion for MMS to apply the provision of 30 CFR 202.101 to require use of actual production. In this case a divergence was detected by audit. When it became known, an order, issued under authority of 30 CFR 202.101 (1984) was issued. While it would be error for MMS to assess a late payment charge for such an assessment, because it was not due until the order issued, 3/ nonetheless, it has not been shown that the order itself was incorrect.

The policy guidance appearing in CDM, therefore, was not inconsistent with the provisions of 30 CFR 202.101 (1984). While the guideline repeated the regulatory provision allowing payment of royalty calculated on sales figures, this approach was not misleading since it did not deny the continued effect of the regulation. There is no conflict between 30 CFR 202.101 (1984) and the policy guideline published to supplement the regulation so as to establish the Federal employees misrepresented the meaning and effect of Departmental regulations in CDM in a fashion that should estop MMS from issuance of the May 12, 1987, order. See generally, Gulf States Petroleum, 113 IBLA 55 (1990), holding the estoppel must be in the form of a "crucial misstatement in an official decision." Id. at 58. No such misstatement has been shown to have been made here.

3/ This is not true, however, for the $1,731.67 deficiency resulting from using 31 days rather than 20 days when calculating average daily production. Interest would commence on the date this amount was first due.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed as modified.

Franklin D. Arness
Administrative Judge

I concur:

R. W. Mullen
Administrative Judge