MIAMI OIL PRODUCERS, INC.

IBLA 88-242 Decided October 30, 1990

Appeal from a decision of the Director, Minerals Management Service, denying appeal from order to pay additional royalty. MMS-87-0397-O&G.

Affirmed.

1. Minerals Management Service: Generally--Oil and Gas Leases: Royalties: Generally

Where natural gas produced from a Federal lease is sold under an arrangement where the buyer pays the maximum law-ful price allowed under the Natural Gas Policy Act of 1978 and also reimburses the producer for severance taxes it paid to the State of Montana, both the maximum Natural Gas Policy Act price and the severance tax reimbursement together constitute "gross proceeds" received for the gas from the lease. The Minerals Management Service properly includes such severance tax reimbursements when computing the value of gas for royalty purposes.

APPEARANCES: Susan N. H. Dixon, Esq., Julia Hook, Esq., Denver, Colorado, for appellant; Susan K. Hoven, Esq., Peter J. Schaumberg, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY CHIEF ADMINISTRATIVE JUDGE HORTON

Miami Oil Producers, Inc. (Miami), has appealed from a decision of the Director, Minerals Management Service (MMS), MMS-87-0397-O&G, dated December 17, 1987, denying an appeal from a September 15, 1987, order to pay additional royalty. The September 15, 1987, order assessed $581.03 additional royalty for failure to include, in the value of production, reimbursement for state severance taxes. The S & J Operating Company (S & J) produced and sold the natural gas during the period from January 1982 through December 1984. Miami succeeded S & J as the operator of the Fed 890-20 #1 Well (KN 2034) on lease 053-015890 in Phillips County, Montana.

The State of Montana imposes an ad valorem severance tax on the sale of gas produced within the State. The purchaser of gas from this lease agreed to pay the price allowed by the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. § 3301 (1988). In addition, the purchaser agreed to reimburse the producer for the severance tax, an arrangement permitted by the NGPA, 15 U.S.C. § 3320(a) (1988). MMS determined that the gross proceeds of the lease, to which the Federal Government's royalty is applied, included the severance tax reimbursement. Miami contends that severance tax reimbursement should be excluded from the gross proceeds against which royalty is charged.

[1] Federal oil and gas lessees must pay a royalty of "12-1/2 per centum in amount or value of the production removed or sold from the lease." 30 U.S.C. § 226 (1988). Royalty is calculated as 12-1/2 percent of the value of the production from the lease when royalty is not taken in kind. The Mineral Lands Leasing Act of 1920 (MLA), as amended, 30 U.S.C. § 181 (1988), reserves to the Department of the Interior the authority and responsibility to establish reasonable values for royalty purposes. Marathon Oil Co. v. United States, 604 F. Supp. 1375, 1381 (D. Alaska 1985), aff'd, 807 F.2d 759 (9th Cir.), cert. denied, 107A S. Ct. 1593 (1987); accord California Co. v. Udall, 296 F. 2d 384 (D.C. Cir. 1961); Continental Oil Co. v. United States, 184 F.2d 802 (9th Cir. 1950); United States v. Ohio Oil Co., 163 F.2d 633, 639-40 (10th Cir. 1947), cert. denied, 333 U.S. 833 (1948). For the period at issue, Departmental rules for determining value for royalty purposes were set forth at 30 CFR 206.103 (1987): 1/

> The value of production, for the purpose of computing royalty, shall be the estimated reasonable value of the product as determined by the Associate Director [of MMS] due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field, to the price received by the lessee, to posted prices, and to other relevant matters. Under no circumstances shall the value of production of any of said substances for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee from the sale thereof or less than the value computed on such reasonable unit value as shall have been determined by the Secretary. In the absence of good reason to the contrary, value computed on the basis of the highest price per barrel, thousand cubic feet, or gallon paid or offered at the time of production in a fair and open market for the major portion of like-quality oil, gas, or other products produced and sold from the field or area where the leased lands are situated will be considered to be a reasonable value. [Emphasis added.]

Miami asserts that a Federal oil or gas lessee should not be obligated to pay royalty on reimbursement of state severance taxes. Appellant points out that the Federal Government's one-eighth share (12-1/2 percent) was not subject to Montana severance tax; only the non-Federal share was subject to the tax. Because Miami was reimbursed for a tax levied on the non-Federal share only, Miami reasons that the Federal Government should not be entitled to share in a tax reimbursement that its share did not generate.

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1/ Product valuation standards were rewritten after the issuance of the MMS decision on appeal here. See 53 FR 1218-21 (Jan. 15, 1988).

However, the value of Federal royalty gas can be no less per unit than the value of other gas of the same quality from the field. 30 CFR 206.103 (1987). This requirement prevents the producer from assigning a lower value to the Federal royalty gas than to other gas having the same characteristics. The value of a unit of gas is what a buyer is willing to pay. Because Miami's customer is willing to pay both the NGPA price and the severance tax amount, the true value to Miami's customer for each unit of gas is the sum of both the NGPA price and the severance tax reimbursement. See Enron Corp., 106 IBLA 394, 397 (1989). The total compensation received for gas from this lease consists of the maximum lawful NGPA price plus the severance tax reimbursement. Thus, as we have previously held in similar cases, the reimbursement was appropriately included in "gross proceeds." Tricentrol United States, Inc., 105 IBLA 392 (1988); Amoco Production Co., 29 IBLA 234, 235 (1977); Wheless Drilling Co., 13 IBLA 21, 80 I.D. 599 (1973); see also Hoover & Bracken Energies, Inc., 52 IBLA 27, 88 I.D. 7 (1981), aff'd, Hoover & Bracken Energies, Inc., v. U.S. Department of the Interior, 723 F.2d 1488 (10th Cir. 1983), cert. denied, 469 U.S. 821 (1984). 2/ In Wheless, the Board explained why gross proceeds include the gas purchase price plus the reimbursed severance tax:

> [T]he buyer is paying to the seller an amount greater than the established field price for the natural gas it purchases from the * * * well. It follows, therefore, that it is reasonable to compute the Federal royalty of the natural gas taken from this well on a unit value consisting of the field price established by FPC [3/] plus the amount of the severance tax reim-bursed by the buyer. Within the context of 30 CFR 221.47, "gross proceeds" means the established field price for the natural gas plus any additional sums paid by the purchaser of the gas to the unit operator as consideration for the purchase of gas from the unit of which the federal lease is a part.

Wheless, 13 IBLA at 30-31, 80 I.D. at 603. Thus, it is not arbitrary, capricious, or an abuse of discretion to include tax reimbursements in gross proceeds.

After Wheless, MMS explicitly incorporated this longstanding princi-ple of inclusion of tax reimbursements in gross proceeds into the Notice to Lessees and Operators of Federal Onshore Oil and Gas Lessees-1 (NTL-1), 42 FR 4546, 4548 (Jan. 25, 1977) and NTL-5, 42 FR 22610, 22611 (May 4, 1977). Based on a 1988 rule change, "gross proceeds" are now expressly defined to include tax reimbursements. 30 CFR 206.151, 53 FR 1230, 1273 (Jan. 15, 1988).

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2/ The situation in Hoover & Bracken Energies, Inc., supra, differed from this case in that the buyer paid Oklahoma the State severance tax. In Hoover, we held that the buyer's willingness to pay the severance tax in addition to the maximum NGPA price established a value for the gas equal to the actual cost to the buyer, i.e., the NGPA price plus the severance tax. 3/ The Federal Power Commission set gas prices in that case.

Appellant argues that Congress did not intend this result when, in 1920, it enacted the MLA, 30 U.S.C. § 181 (1988). However, Congress enacted the Notice to Lessees Numbered 5 Gas Royalty Act of 1987, P.L. 100-234, 101 Stat. 1719 (approved Jan. 6, 1988), which modified one por-tion of NTL-5, 4/ but left intact and effectively ratified the inclusion of tax reimbursements in gross proceeds.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision of the Director, Minerals Management Service, is affirmed.

Wm. Philip Horton
Chief Administrative Judge

I concur:

John H. Kelly
Administrative Judge

4/ This statute affected certain wells from 1982 through 1986, but the changed provision does not apply to this appeal. Under NTL-5, the base value for royalty purposes was either the actual price received or the ceiling price, whichever was higher. Although actual gas prices in many areas declined below the ceiling price after 1982, lessees were still required to base royalty on the ceiling price. The new statute allowed the value of production for certain leases between 1982 and 1986 to be based on actual price received.