POGO PRODUCING CO.

IBLA 90-305 Decided November 18, 1991

Appeal from a decision of the Deputy Associate Director for Budget and Appeals, Minerals Management Service, denying an appeal from an assessment of late payment charges for the underpayment of royalties on an offshore oil and gas lease. MMS 89-0303-OCS.

Affirmed in part and reversed in part.

1. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Oil and Gas Leases: Royalties: Interest--Oil and Gas Leases: Royalties: Payments--Outer Continental Shelf Lands Act: Refunds

An assessment of late payment charges for months in which a royalty payor underpaid royalties for natural gas produced and sold from an offshore oil and gas lease will be reversed where MMS approved a refund request for overpayments made during a specific time period including those months; the lease royalty account had a net surplus each month during the period; and the payments all occurred for a single lease.

APPEARANCES: Thomas J. Eastment, Esq., Lloyd C. Wantschek, Esq., Washington, D.C., and Janice J. Cleavinger, Esq., Houston, Texas, for Pogo Production Company; Peter J. Schaumberg, Esq., Geoffrey Heath, Esq., and Howard W. Chalker, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY DEPUTY CHIEF ADMINISTRATIVE JUDGE HARRIS

Pogo Production Company (Pogo) has appealed from a February 28, 1990, decision of the Deputy Associate Director for Budget and Appeals, Minerals Management Service (MMS), denying its appeal of a Royalty Management Program (RMP) assessment of $8,953.38 in late payment charges for the underpayment of royalties on offshore oil and gas lease No. 054-003975-0 for the sales months of January through May 1986 and November 1986 through February 1988.

By invoice No. 11800316, dated June 7, 1989, and an undated cover letter, RMP officials assessed Pogo $20,374.27 for the late payment of royalties on various leases. Pogo appealed only the $8,953.38 interest assessment for offshore oil and gas lease No. 054-003975-0 to the Director,

MMS. Pogo admitted that it had made underpayments but asserted that it had also submitted royalty overpayments for the lease during other months, and that MMS had erroneously failed to offset the overpayments and the underpayments in computing interest. Pogo argued that interest should only be computed on the basis of the net underpayment in existence during a particular month, and that since its royalties for the lease were always in an overpaid status, no interest should be assessed.

In its February 28, 1990, decision, MMS stated that it had received the balance of the royalties due for January through May 1986 and November 1986 through February 1988 on August 1, 1988, from 91 to 854 days late. MMS acknowledged that, in addition to Pogo's admitted royalty underpayments, Pogo had also overpaid royalties for other months on the same lease. Nevertheless, MMS rejected Pogo's arguments that these underpayments and overpayments should be offset to determine if the lease was in an underpaid status for any particular month and that interest should only be assessed for such underpaid months. MMS concluded that offsetting was permissible only in limited circumstances: "Offsets must occur on a single lease within the timeframes defined in a Government-initiated audit or a Government order to perform a restructured accounting" (MMS Decision at 3). In this case, although the overpayments and underpayments occurred within a single lease, MMS found no evidence that there had been a Government audit or a restructured accounting order, and noted that a "lessee cannot pick and choose a timeframe in order to maximize the use of offsetting to its benefit." Id.

MMS justified the need for an audit or restructured accounting on the ground that allowing a payor to unilaterally offset overpayments and underpayments would not provide adequate protection of the public interest. It indicated that its administrative and accounting burden would be unbearable if every late payment charge were subject to adjustment because of claimed offsetting overpayments. Accordingly, MMS denied Pogo's appeal.

In its notice of appeal, which includes a statement of reasons for appeal (SOR), Pogo explains that it sells 50 percent of its share of the natural gas produced from the lease to United Gas Pipe Line Company (United), and that, beginning January 1, 1985, this gas was no longer subject to price regulation. According to Pogo, during the course of negotiations over the impact of deregulation on the contract price of the gas, it paid royalties to MMS on the proceeds received from United, except for the 5 production months of June through October 1986 when, Pogo states, it paid royalties on more than gross proceeds based on its belief that it was entitled to a higher price than United was paying. As a result of its settlement of the pricing dispute with United, Pogo relates that it recalculated its gross proceeds and royalty payments for each month beginning with January 1985, and that the recalcuations revealed that royalty had been overpaid in some months and underpaid in others. By letter dated March 29, 1988 (Attachment C to SOR), Pogo submitted a refund request to MMS. 1/ By

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1/ In its refund request, Pogo noted that in January 1987, it had advised MMS of its overpayment of royalties and its intention to seek

letter dated July 20, 1988 (Attachment D to SOR), MMS notified Pogo that its refund request had been approved and it authorized Pogo to "recoup the $74,874.47 when you file your next regular monthly Report of Sales and Royalty Remittance, Form MMS-2014." Pogo acted according to those instructions in filing its next Form MMS-2014, i.e., its July 1988 Form MMS-2014, which MMS timely received on August 1, 1988, July 31, 1988, being a Sunday. See 30 CFR 218.50(a).

Referring to Table I (attached as Appendix A to this opinion), which was included in its appeal to the Director and shows a summary of monthly underpayments and overpayments from January 1985 through December 1987, Pogo emphasizes that the lease was never in an underpaid status for any month during that time period. 2/ It notes that, because most of its royalty overpayments occurred in the early months of its dispute with United, the lease account showed net overpayments at all relevant times. Pogo argues that MMS is not entitled to any interest because MMS has not incurred any damage in the form of lost time value of money, and that, in fact, due to the overpayments, MMS has actually enjoyed the time value of money to which it was not entitled.

Pogo complains that the MMS decision does not address any of the issues posed in this case in any meaningful manner. It notes that it brought the overpayments and underpayments at issue here to MMS' attention by requesting a refund of the net overpayments. It contends that MMS is attempting to dissect a single transaction relating to a single lease (the United settlement) into separate overpayments and underpayments in an attempt to create the appearance of a loss in the time value of money where there is no such loss. Pogo further argues that MMS has already effectively offset the underpayments and overpayments on the lease by granting Pogo's refund request for the net overpayment for the period beginning January 1, 1985. Pogo asserts that MMS cannot now separate the months in which underpayments occurred for the purpose of calculating interest simply because Pogo discovered the overpayments and underpayments without a Government audit.

Finally, Pogo challenges MMS' claim that Pogo's position would create an unbearable burden on MMS, noting that its refund request fully detailed

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fn. 1 (continued)
a refund. Under section 10 of the Outer Continental Shelf Lands Act, 43 U.S.C. § 1339 (1988), a request for a refund of an overpayment must be filed within 2 years of the making of the payment.
2/ The time period covered by the MMS decision extends beyond the period covered by Pogo's Table 1. Table 1 summarizes the overpayments and underpayments for the months January 1985 through December 1987 and the total overpayments reflected in that table ($74,874.48) are within one cent of the refund requested by Pogo ($74,874.47) and authorized by MMS. The MMS decision, however, also covered the months of January and February in 1988 for which late payment charges of $31.80 and $13.18, respectively, were sought by MMS.

the overpayments and underpayments and that MMS approved the refund reflecting the net overpayment. It argues that this same data demonstrates that the lease was not in an underpaid status during any relevant month, and concludes that MMS would have no additional burden in determining that Pogo does not owe MMS interest.

In its answer, MMS frames the issue on appeal as "whether Pogo may use royalty overpayments made for previous months as a `bank deposit' against which to draw to supplement royalty underpayments in later months"
(Answer at 1). MMS contends that in the absence of an audit, past overpayments cannot be used to offset underpayments to avoid late payment charges. It argues that Pogo's payments were clearly late, that MMS has the authority and responsibility to assess late payment charges on royalty payments not received by the due date and that Pogo cannot unilaterally offset royalty underpayments against royalty overpayments to avoid late payment charges. 3/

MMS asserts that it has been its longstanding position that past overpayments may not be used as credits for months in which royalty has been underpaid because MMS accounts for each production month separately. It analogizes this situation to one in which a payor has submitted an estimated payment, and suggests that the Board's holding in Yates Petroleum Corp., 104 IBLA 173, 177 (1988), that submission of an estimated payment does not establish a line of credit upon which a payor may draw any time a payment is late, supports its conclusion that previous overpayments cannot be used as a credit to draw upon to avoid interest charges.

MMS recognizes that in certain circumstances it does offset royalty overpayments and underpayments and assess interest only on net underpayments, but, it contends, such offsetting is permissible only within the confines of a single lease and after an official audit or review. MMS argues that, because it did not conduct an audit here, it does not know if the overpayments actually were overpayments or if other underpayments occurred in months prior to January 1985, and that, therefore, it cannot offset the asserted overpayments against the underpayments on the lease.

MMS contends that accepting Pogo's arguments would place the lessee, not MMS, in the position of determining the timing, frequency, and subject of an audit. MMS asserts that it must maintain control of its audit program in order to promptly and properly collect and disburse royalties. MMS argues that accepting Pogo's arguments would enable lessees to pick and choose timeframes to maximize the benefits of offsetting, and without an audit covering at least a period prior to the lessee-identified overpayments, MMS would be unable to determine if earlier, additional underpayments had occurred. MMS concludes that its policy of permitting offsets only within MMS selected scope and time periods is necessary for

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3/ In neither the Deputy Associate Director's decision nor its answer does MMS acknowledge that it approved Pogo's refund request for this lease.

the efficient administration of the royalty management program, and that its interest assessment in this case was proper.

In reply, Pogo reiterates that MMS has already accepted, subject to future audit, the existence and amount of the royalty overpayments by allowing the refund of the net overpayment. Pogo notes that, although MMS asserts that it received the late royalty payment in August 1988, Pogo made no additional royalty payment at that time; rather, Pogo filed its amended Form MMS-2014 in August 1988. Pogo stresses that MMS has not explained how it suffered a loss of the time value of money during a period in which it owed Pogo a refund.

Pogo considers Yates Petroleum Corp., supra, inapposite because the Yates payments were estimated royalty payments, while Pogo's payments were excess actual royalty payments which resulted in the lease royalty account always containing a surplus. Pogo suggests that its position does not frustrate MMS' reasonable interests in administering its audit operations since MMS retains the right to audit the lease, as well as the refund it received. Pogo concludes that neither the factual record nor MMS' reasonable policy interest in the administration of its audit functions warrants the late payment charges assessed here.

[1] Consistent with 30 CFR 218.50(a), the terms of onshore and offshore Federal oil and gas leases provide that royalty payments are due at the end of the month following the month during which the oil and gas is produced and sold. Section 111(a) of the Federal Oil and Gas Royalty Management Act of 1982, 30 U.S.C. § 1721(a) (1988), specifically provides that "where royalty payments are not received by the Secretary on the date that such payments are due, or are less than the amount due, the Secretary shall charge interest on such late payments or underpayments * * *." The regulations implementing this statutory provision also require the assessment of interest on late payments or underpayments. 30 CFR 218.54; 30 CFR 218.150(b). Additionally, the Board has held that the Government has the authority, independent of any specific grant thereof, to make a unilateral determination of interest owed. See, e.g., Yates Petroleum Corp., supra at 176; Peabody Coal Co., 72 IBLA 337, 348 (1983); Atlantic Richfield Co., 21 IBLA 98, 111, 82 I.D. 316, 322 (1975).

However, Pogo does not challenge MMS' authority to assess interest for late payments; rather, it argues that because the net royalties paid for the subject lease royalty account were always greater than the amount of royalties actually due, no interest should be assessed, given MMS' approval of its refund request.

The essence of Pogo's position is that its earlier royalty overpayments should be offset against its later underpayments to determine if a net underpayment existed in a given month, and that interest should be assessed only if such a net underpayment occurred. As MMS correctly notes, the offsetting of overpayments of royalty on natural gas production from

an offshore oil and gas lease against underpayments of royalty generally has been permitted only within the royalty account of a single lease after an official audit. See, e.g., Chevron U.S.A. Inc., 111 IBLA 92, 94-95 (1989); Union Oil Company of California, 110 IBLA 62, 64 (1989), and cases cited therein. Here, the royalty overpayments and underpayments occurred within the confines of a single offshore lease. In addition, the question whether Pogo may offset its overpayments against its underpayments on this lease, in the absence of an official audit or review, has been answered by MMS. By letter dated July 20, 1988, MMS approved the refund request and authorized Pogo to recoup the overpayment on its July 1988 Form MMS-2014. See Attachment D to SOR. Clearly, MMS' charge in its answer that Pogo cannot unilaterally offset royalty underpayments against royalty overpayments has a hollow ring where by approving the refund request, MMS in essence accepted Pogo's offsetting of the royalty overpayments against the underpayments during the period of the price dispute (subject to audit), and, thus, implicitly accepted that timeframe as proper. 4/

Thus, the real question presented by this appeal is whether MMS can assess late payment charges for royalty payments made during a period of time for which it has authorized the refund of overpayments. Under the facts of this case, the answer is no. The record demonstrates that the lease royalty account consistently maintained a net royalty overpayment during the period approved for refund. This Board has repeatedly recognized that interest charges are designed to compensate the Government for the time value of money, not to penalize payors. Coastal Oil & Gas Corp., 108 IBLA 62, 67 (1989); Cities Service Oil & Gas Corp., 104 IBLA 291, 295 (1988); Peabody Coal Co., supra. We agree with Pogo that MMS has suffered no loss of the time value of money for the subject lease since that lease royalty account always had more than enough funds to satisfy the royalties due. 5/ Therefore, we conclude that, under the circumstances present here, late payment charges are not warranted for the period approved for refund. 6/ However, in footnote 2, supra, we indicated

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4/ In this case, Pogo did not choose an arbitrary time period in order to maximize the use of offsetting. Pogo asserts, and MMS does not deny, that the timeframe defined by Pogo coincides with the period of its dispute with its gas purchaser over the proper price for the deregulated gas produced from the lease.

5/ We also agree with Pogo that MMS' analogy to estimated payments is inapposite. Estimated payments are designed to afford a payor an additional month in which to make actual royalty payments which will be considered timely; they are not credits against which a payor may draw, and they roll forward when actual payments are made. Yates Petroleum Corp., supra at 177. The overpayments made here were excess actual payments based on Pogo's good faith belief as to the appropriate price for the gas sold. MMS allows payors to recoup such overpayments in appropriate circumstances. See 2 MMS Oil and Gas Payor Handbook § 4.4.2. In fact, by approving Pogo's refund request, MMS authorized just such a recoupment in this case.

6/ Since the refund was approved subject to audit, MMS may at any time audit Pogo's lease to verify the royalty payments.

that the MMS decision assessing late payment charges included an assessement for two months beyond the refund period. Based on the record before us, for those months, assessment of late payment charges was appropriate.

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 in part and reversed in part.

Bruce R. Harris
Deputy Chief Administrative Judge

I concur:

David L. Hughes
Administrative Judge

APPENDIX A

TABLE 1

Production Month	Monthly (Underpayment) Overpayment	Net (Underpayment) Overpayment
1/85	652.46	652.46
2/85	709.67	1,362.13
3/85	643.67	2,005.80
4/85	9,473.97	11,479.77
5/85	9,372.31	20,852.08
6/85	7,337.46	28,189.54
7/85	5,706.49	33,896.03
8/85	5,633.66	39,529.69
9/85	8,796.03	48,325.72
10/85	8,314.25	56,639.97
11/85	7,645.97	64,285.94
12/85	8,121.20	72,407.14
1/86	(1,971.41)	70,435.73
2/86	(2,056.52)	68,379.21
3/86	(2,291.02)	66,088.19
4/86	(2,535.25)	63,552.94
5/86	(22,408.37)	41,144.57
6/86	9,660.91	50,805.48
7/86	10,347.59	61,153.07
8/86	10,015.35	71,168.42
9/86	9,066.91	80,235.33
10/86	9,316.82	89,552.15
11/86	(3.854.09)	85,698.06
12/86	(4,104.18)	81,593.88
1/87	(4,368.85)	77,225.03
2/87	(1,785.68)	75,439.35
3/87	(46.31)	75,393.04
4/87	(46.67)	75,346.37
5/87	(50.91)	75,295.46
6/87	(51.52)	75,243.94
7/87	(55.92)	75,188.02
8/87	(58.60)	75,129.42
9/87	(59.13)	75,070.29
10/87	(63.89)	75,006.40
11/87	(63.89)	74,942.51
12/87	(68.03)	74,874.48