

Editor's note: Reconsideration denied by Order dated Dec. 9, 1992; Petition for review by Director, OHA, denied -- see In the Matter of AMOCO Production, 9 OHA 223.

AMOCO PRODUCTION CO.

IBLA 90-508

Decided June 18, 1992

Appeal from a decision by the Minerals Management Service requiring a Federal gas lessee to prepare a royalty report. MMS 89-0275-OCS (OCS-G 2928).

Affirmed.

1. Federal Oil and Gas Royalty Management Act of 1982:
Royalties--Oil and Gas Leases: Royalties: Payments

MMS may properly require a Federal gas lessee to furnish a report derived from information in corporate records concerning royalty payments, even if some of the documents needed to produce the report are over 6 years old.

2. Federal Oil and Gas Royalty Management Act of 1982:
Royalties--Oil and Gas Leases: Royalties: Payments

Discovery of an anomaly in royalty reporting arising during refund proceedings on a Federal lease provided a reasonable foundation for an investigation into the possibility that other similar errors had also occurred.

3. Federal Oil and Gas Royalty Management Act of 1982:
Royalties--Oil and Gas Leases: Royalties: Payments

MMS may properly require a Federal gas lessee to furnish a report concerning identified payment errors to be prepared from corporate royalty payment records. If regulations currently in effect do not require a payor to research and analyze payment records and report specified reporting errors, special orders providing adequate guidance for reporting will provide a foundation that permits the required report to be completed.

APPEARANCES: Deborah Bahn Price, Esq., New Orleans, Louisiana, for Amoco Production Company; Howard W. Chalker, Esq., Office of the Solicitor, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE ARNESS

Amoco Production Company (Amoco) has appealed from a June 29, 1990, decision issued by the Director, Minerals Management Service (MMS), that required Amoco to prepare a report concerning whether it had erroneously claimed entitlement to refunds of royalties paid for lease OCS-G 2928 between October 1980 and September 1983. Amoco contends that MMS lacks authority to require such a report because, among other matters alleged, the order requires use of records that were more than 6 years old when the order to report was issued.

On August 22, 1989, the Dallas Compliance Office, MMS, ordered Amoco to review corporate royalty records and report concerning royalty payments made from October 1980 through September 1983 to determine whether royalty refunds were improperly paid during the period. The order was prompted by discovery of the fact that, in 1985, Amoco had obtained a refund of royalties overpaid from November 1981 through July 1982 to which it was not entitled. The refund error, sometimes referred to by the parties as a "recoupment," occurred as a result of confusion over whether royalties had been paid by Amoco pursuant to Federal Energy Regulatory Commission (FERC) Order Nos. 93 and 93A, which required gas to be measured according to "delivery conditions." See Interstate Natural Gas Association of America v. Federal Energy Regulatory Commission, 716 F.2d 1, 8 (D.C. Cir. 1983), cert. denied, 465 U.S. 1108 (1984). It appears that Amoco had not paid royalty at the higher rate required by the FERC rules, but that refund was sought and approved as though it had.

Amoco appealed the order issued August 22, 1989, to the Director, MMS. In the meantime, on October 10, 1989, Amoco replied to the inquiry by MMS that \$24,975.86 additional royalty was owed to MMS from November 1981 through July 1982. The report submitted on October 10, 1989, showed adjustments made to sales and royalty value for each month in the period.

The Director's decision here under review summarized and repeated the response required by the August 22 order, by

directing Amoco to (1) review all royalty calculations and payments made in connection with Federal Lease No. OCS-G 2928 for the period October 1980 through September 1983 to determine whether royalty was properly paid using the correct BTU factors, (2) pay any additional royalties found to be due, and (3) accompany such payments with a properly completed Report of Sales and Royalty Remittance (Form MMS-2014).

(Decision at 1).

Amoco contends that the MMS order here under review is contrary to the record retention provision of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), 30 U.S.C. § 1713 (1988), and that the order is unreasonable because rulemaking is required to establish standards for

reporting such as was required by the MMS orders here under review (Statement of Reasons (SOR) at 7, 11, 14, 17). In making these arguments, Amoco relies on an unreported United States District Court order, reversed on December 1, 1991, by Phillips Petroleum Co. v. Lujan (Phillips I), 951 F.2d 257 (10th Cir. 1991), subsequently affirmed by decisions in Phillips Petroleum Co. v. Lujan, No. 91-5071, and Atlantic Richfield Co. v. Lujan, No. 91-5072 (Phillips II) (10th Cir. May 13, 1992).

[1] The principal argument raised by Amoco on appeal concerns whether an investigation by MMS is controlled by the 6-year statute of limitations provided at 28 U.S.C. § 2415 (1988). If it is, this appeal can be decided without need to inquire further. Nevertheless, in Phillips I the U.S. Court of Appeals for the Tenth Circuit rejected arguments, such as those Amoco makes here, that the 6-year statute of limitations on actions for money damages brought by the United States was relevant to administration of royalty accounts by MMS. 951 F.2d at 260 n.5.

At issue in Phillips I was the propriety of a September 30, 1988, order, that required Phillips to provide company records from October 1980 through September 1986. The court determined that MMS could properly require such disclosure under the pertinent Federal lease agreement because:

The lease agreements require [Phillips] to permit [MMS] to inspect "all books, accounts, maps and records." The inspection clause of the agreement is not limited to records generated within the past six years. Indeed, the only limitation on the disclosure of records that [the parties] have formally agreed upon is that the records must be "relative to operations and surveys or investigations on the leased lands or under the lease." We will not read a limitation into a lease provision which was not part of the agreement between the parties.

951 F.2d at 260. The lease here at issue contains an identical provision. See Amoco lease, paragraph 3(e).

After citing the record retention provisions of FOGRMA and the implementing Departmental regulation, 30 CFR 212.51(c), as additional authority to support this holding, the court went on to observe, concerning the fact that the records search required by MMS involved documents more than 6 years old, that the "duty to disclose records is not limited to records which [Phillips] could have lawfully destroyed but, instead, has retained." Id. Focussing on the nature of the agency action under review, the court observed, concerning production of records in the possession of a lessee, regardless of age, that:

Administrative agencies vested with investigatory power have broad discretion to require the disclosure of information concerning matters within their jurisdiction. * * *
[Phillips'] attempt to distinguish orders by [MMS] premised on their investigatory power and orders by [MMS] premised on their power to audit is without

merit. [MMS'] investigatory power is their power to audit records maintained by lessees such as [Phillips]. [Emphasis in original.]

Id. The opinion concluded with the observation "that the statute of limitations, 28 U.S.C. § 2415, is irrelevant to [MMS'] authority to obtain the records." Id. at 261 n.7.

This reasoning is persuasive here. Accordingly, it is concluded that the 6-year statute of limitations on judicial actions relied upon by Amoco to bar use of records more than 6 years old at the time it was required to report is not relevant to the matter here under review and does not bar use of records in the possession of Amoco, regardless whether some of the records sought are more than 6 years old. Phillips I, supra; Phillips II, slip op. at 12, 14; see Marathon Oil Co., 119 IBLA 345, 351 (1991); Mobil Exploration & Producing U.S. Inc., 119 IBLA 76, 81, 98 I.D. 207, 210 (1991).

[2] Amoco argues that the law limits a lessee's responsibility to a passive duty to maintain certain records, which are subject to delivery to MMS on demand. In stating this argument, Amoco characterizes the required report as a "self-audit," and contends that there is no duty to report as required by MMS because there was no pattern of "erroneous recoupment by Amoco made pursuant to the Federal Energy Regulatory Commission (FERC) Order Nos. 93 and 93A," contrary to the finding by the Director that there had been such a pattern (SOR at 4, 5, 17; Reply at 2, 3).

This argument is not well taken. First, it misunderstands the nature of the report required: the report is to answer the question whether Amoco obtained other refunds similar to the refund obtained in 1985. The investigation to be made is limited to analysis of royalty calculations made during the period in question to determine if they were similarly flawed. If there were no similar errors from 1980 until 1983, the report could so state.

Concerning the nature of the error suspected, the Director found that "Amoco's use of an incorrect Btu factor in calculating royalties (and Amoco's erroneous recoupment based on that error) was a continuing problem that spanned many reporting months" (Decision at 4). Amoco argues that the error described by the Director was "only a one time error" (SOR at 3). Amoco explains this observation with the contention that

the error was not attributable to Amoco's use of incorrect Btu factors in calculating its royalties. Rather, Amoco made an error in the submission of a refund request for royalties that it thought had been overpaid (in fact the royalties had been paid correctly), the MMS audited the refund request but did not discover the error, the MMS approved the refund request, Congress approved the refund request, and Amoco recouped on the amount that the MMS expressly authorized it to recoup. This recoupment occurred in August 1985. [Emphasis in original.]

(SOR at 2, 3).

Amoco argues that, while a reporting error was ultimately discovered (despite the fact that all concerned had overlooked it throughout the refund process), "a pattern of violations" has not been established. Amoco contends that such a pattern must exist before MMS can order a lessee to "review its own records for the purpose of identifying and correcting alleged royalty underpayments" (SOR at 4, 17). This proposition seems to arise by reference to prior MMS practice in handling similar matters, since no other authority is cited to support it.

MMS, on the other hand, apparently regards each month that an error in reporting was repeated as a separate instance of error, and concludes, on the same facts, that there was a pattern of error in reporting. It is clear that the parties can never agree on this issue, since they define it differently. Nonetheless, the fact there was an irregularity remains, whether it is characterized as a pattern of error, or simply as an identifiable error. Clearly, there occurred an anomaly in making royalty payments during the period at issue. We find, therefore, that the circumstances described allowed investigation by MMS.

The information required to be produced is specific as to time and to the nature of the suspected error, which arose from the use of certain payment information. Whether there are more instances of similar reporting errors is the information required to be furnished. The existence of a "pattern" of errors is not a precondition to investigation of payor accounts by MMS. As FOGRMA establishes, royalty investigations should be conducted by MMS, which may, where "reasonably necessary * * * require by special or general order, any person to submit in writing such * * * answers to questions as [MMS] may reasonably prescribe." 30 U.S.C. § 1717(a)(1) (1988). The question to be answered is therefore whether the reporting requirement imposed on Amoco by the special order here under review was reasonable.

[3] Amoco contends that MMS may not require the reporting demanded because it compels Amoco to conduct a "self-audit" contrary to provisions of 30 U.S.C. § 1711(c)(1) (1988) that give authority to the Secretary to conduct royalty audits in the exercise of his inspection authority. Amoco argues generally that existing regulations do not permit MMS to require more of a Federal lessee than that it make corporate royalty records available, and that a detailed investigation into a specified area in order to prepare a report that is not currently in existence exceeds the scope of existing rules. Amoco argues that

FOGRMA authorizes the Secretary to delegate all or part of his auditing responsibilities to a State, but only if he promulgates standards and regulations pertaining to such audits. 30 U.S.C. § 1735(d). The reason for this requirement * * * is "to provide reasonable assurance that a uniform and effective royalty management system will prevail among the States." Id. Yet no such regulations have been promulgated.

Nor can a lessee look to regulations governing the MMS' own audits for guidance. In promulgating regulations to implement

the FOGRMA, the DOI recognized the need for such regulations, reserving Part 215 of Title 30 for "Accounting and Auditing Standards." 49 Fed. Reg. 37336 (Sept. 21, 1984). evertheless, Part 215 remains reserved, since no regulations have yet been promulgated. [Emphasis in original.]

(SOR at 14-15).

Amoco does not contend that the royalty information required by MMS is not within the jurisdiction of MMS to investigate. Rather, it is the position of Amoco that if MMS wants this information collected and reported in the form required, MMS auditors should perform any needed research and analysis without active help from employees of Amoco. If this procedure is not adopted, then it is contended that rulemaking is required to authorize such a procedure as MMS required of Amoco in this case.

MMS responds to the argument that regulations to implement the reporting provision of FOGRMA have not been issued by the Department by arguing that FOGRMA clothed the agency with broad investigatory power sufficient to require the disclosure of information concerning matters within the jurisdiction of MMS, citing 30 U.S.C. § 1711(c)(1) (1988) (MMS Answer at 6). MMS also argues that Amoco agreed to release the records here at issue while reserving any limitations defenses to which it might be entitled, and that there are consensual as well as regulatory reasons why Amoco should comply with the reporting order. MMS explains that:

Amoco's agreement to produce the records was in accordance with what both applicable regulations and the terms of its leases required it to do. Under section 3(e) of its lease, * * * Amoco is required to keep all books, accounts, and records regarding the lease open to inspection. Thus, the lease terms require Amoco to produce all of its records if equested. Moreover, 30 C.F.R. § 212.51(c) requires the lessee to keep records in its possession available for inspection. * * * It follows that * * * if MMS may examine documents in the essee's possession which are more than six years old, then MMS may require the lessee to recalculate royalties for the period for which MMS may examine those records.

(MMS Answer at 13, 14).

A provision of 30 U.S.C. § 1717(a)(1) (1988) authorizes the Secretary "to require by special or general order, any person to submit in writing * * * answers to questions as the Secretary may reasonably prescribe." This authority is provided in order to facilitate "any investigation or other inquiry." This authority establishes the broad investigatory authority of the Secretary (described in general terms by the opinion in Phillips I), that requires disclosure of any documents, without limitation, described in lease section 3(e). Id. at 260. Nonetheless, the argument that this authority also enables the Department to require the lessee to research and analyze past accounts and prepare reports concerning perceived suspected

payment problems does not explain the effect of the provision of FOGRMA that provides a lessee "shall * * * make any reports, and provide any information that the Secretary may, by rule, reasonably require." 30 U.S.C. § 1713(a) (1988) (emphasis supplied). Amoco reads this provision so as to limit the power of MMS to require records to be generated by the corporate lessee, unless regulations specifically provide for such investigation. Amoco articulates a reason for this argument as arising from due process considerations, as follows:

In the absence of articulated procedures and guidelines, a lessee, even when acting in complete good faith, might "knowingly or willfully" employ auditing standards in conducting a review of its records that the MMS later determines were insufficiently rigorous or that resulted in inaccurate information being provided to the MMS. In addition, in this case, the schedules that Amoco is being required to provide might not comply with the MMS' unarticulated expectations regarding those schedules. * * * [I]t is patently arbitrary, capricious, and an abuse of discretion to require a federal lessee to conduct an audit of its records for the purpose of identifying underpayments without first providing the lessee with guidance regarding the procedures to be followed and the standards to be employed. This, however, is exactly what the order attempts to do[.]

(SOR at 16, 17).

In the course of appeal by Amoco from the order issued by the Dallas Compliance Office to the Director, MMS, the Dallas office defended the order it had issued. In answer to Amoco's charge that it was improper to compel a "self-audit" because the order requiring such audit provided insufficient reporting guidance or accounting standards, MMS responded that it had historically used accepted commercial audit standards and relied on published Government Auditing Standards in general use. See Memorandum dated Feb. 14, 1990, MMS-DACO-T. On appeal, MMS has explained how the standards regularly and historically applied by MMS when auditing royalty payments are employed by the agency, stating that all audits by MMS are conducted "in accordance with generally accepted audit standards as adopted by the American Institute of Certified Public Accountants (AICPA) and the Government Auditing Standards (GAS). See General Accounting Office, Government Auditing Standards (1988)" (MMS Answer at 5). The reply filed by Amoco does not dispute that the use of these standards is provided and accepted in practice as claimed by MMS. Nonetheless, Amoco continues to argue that the schedules required to be prepared by the August 22 order "constitute records that Amoco was not previously required to maintain" and that such a report cannot be required by an order alone (Reply at 7). While Amoco contends that the special order issued by MMS on August 22, 1989, was not an adequate substitute for rulemaking, there has been no showing that the order was contrary to existing regulations or was otherwise unreasonable. See, e.g., Phillips Petroleum Co., 117 IBLA 255, 261 (1991).

Congress provided, at section 101 of FOGRMA, 30 U.S.C. § 1711(c)(1) (1988), that MMS "shall * * * take appropriate actions to make additional collections." Further, the statute provides that MMS may, in conducting "any investigation * * * require by special * * * order, any person to submit in writing such * * * answer to questions as [MMS] may reasonably prescribe." 30 U.S.C. § 1717(a)(1) (1988). The declared purpose of FOGRMA was to "clarify, reaffirm, expand, and define the authorities and responsibilities of the Secretary of the Interior to implement and maintain a royalty management system." 30 U.S.C. § 1701(b)(2) (1988). The purpose of the legislation was not, therefore, to limit the prior power exercised by the Secretary, acting through his designated agency, but to enhance and "expand" his investigatory powers, and, consequently those of the agency. The fact that regulations promulgated to implement the recordkeeping provision of the statute did not include a specific provision requiring special reports to be made to explain suspected errors in reporting does not, therefore, lead to the conclusion that such investigations may not be made. Nor does it preclude the continuation of past practices, which FOGRMA reaffirmed, that permitted MMS to perform audits using generally accepted auditing standards and to order reports concerning questioned royalty payment practices by a lessee. To limit the authority of MMS by requiring prior notice-and-comment rulemaking in such cases, especially where investigation of a perceived error is in progress, seems contrary to the grant of "broad enforcement authority" contemplated by Congress. See 1982 U.S. C.C.A.N. 4286.

In a related area of royalty management involving valuation of natural gas liquid products, we considered an argument concerning the need for rule-making similar to that raised in this case by Amoco. In Conoco Inc., 110 IBLA 232, 239 (1989), a lessee argued that MMS should have used rulemaking instead of an informal policy statement called a "procedure paper" to value production. There, it was alleged that the procedure paper was a mandatory directive that prescribed conduct and defined accounting standards. Id. at 238. It was argued, as it is argued here, that there should have been compliance with the notice and comment requirements of the Administrative Procedure Act, and that failure to observe those requirements voided the procedure paper. Id. at 239.

Rejecting the argument that rulemaking was mandatory, we instead evaluated use of the procedure paper for error or inconsistency with relevant regulations: to the extent that the procedure paper was found to conflict with existing regulations it was found to be invalid. Id. at 243, 244; see Phillips Petroleum Co., 117 IBLA at 261.

Similar considerations are present here. While the notice and comment provisions of the Administrative Procedure Act were not made available when the order of August 22, 1989, was issued, nonetheless Amoco has been allowed to comment before MMS and this Board and to explain the position it urges on us now. While Amoco contends present practices that permit use of special orders to initiate investigations are inadequate, there has been no showing how the accounting practices used by MMS have denied Amoco any protection it might otherwise have obtained had there been prior rulemaking

concerning the type of reporting required. There is no allegation that the order issued by MMS on August 22, 1989, was in violation of any existing regulation of the Department, and we have found no such violation. Nor has Amoco shown that general rulemaking was required to permit MMS to continue to investigate into the circumstances of an admitted irregularity in royalty reporting or to require Amoco to report as it did. We therefore find that the special order issued by MMS on August 22, 1989, provided adequate standards to permit Amoco to provide the required report concerning use of the proper energy factor in making royalty refund requests for lease OCS-G 2928 from October 1980 until September 1983. 1/

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.

Franklin D. Arness
Administrative Judge

1/ Cf. Phillips II, slip op. at 13, where the court observed, concerning whether MMS could properly require amended royalty reporting by a lessee on the record presented for review in that case, that "MMS will ask Phillips and other lessees to make changes to correct repeated royalty underpayments caused by systemic deficiencies. Such a request falls squarely within the purposes of FOGRMA.

" ADMINISTRATIVE JUDGE HUGHES CONCURRING SEPARATELY:

I agree fully with Judge Arness' disposition of the necessity to produce documents that have been retained by a lessee, even if more than 6 years old.

My comments are addressed to the "self-audit" question, an issue of first impression that affects numerous appeals presently pending before the Board. I emphasize that the facts of the case reveal that there was no impermissible self-audit here.

The record reveals that for a period of 9 months, from November 1981 to and including July 1982, Amoco Production Company (Amoco) sold gas produced from lease OCS-G 2928. The purchaser (identified in the record only as "Trunkline") evidently paid for the gas as valued by the so-called "dry" or "in-place" method of determining its energy value, as mandated at that time by Orders 93 and 93A of the Federal Energy Regulatory Commission (FERC Orders 93/93A). However, Amoco evidently paid royalty to the Minerals Management Service (MMS) using an energy value calculated by the so-called "wet" or "saturated" method (MMS Field Report at 2; MMS Supplemental Response dated June 17, 1991, Attachment IV at 1). ^{1/} The "wet" method resulted in a lower British Thermal Unit (Btu) value than the "dry" method, so that using it to calculate royalty resulted in a lower royalty basis and, hence, lower royalty payments for those months. Thus, if the "dry" rule had remained in effect, it appears that Amoco would have underpaid royalty.

However, FERC Orders 93/93A were overturned by the U.S. Court of Appeals for the District of Columbia Circuit in Interstate Natural Gas Association of America v. FERC, 716 F.2d 1 (D.C. Cir. 1983), cert. denied, 465 U.S. 1108 (1984), and the "wet" rule was subsequently imposed retroactively for the period in question here. Replacing the "dry" method with the "wet" method resulted in a decrease in the amounts Amoco was entitled to receive for the gas from its purchasers, thus reducing the royalty basis and, as a result, the amount of royalty. As Amoco had earlier paid royalty to MMS on the basis of the "wet" rule, it turned out (apparently fortuitously) that its royalty payments were actually correct.

On December 28, 1984, Amoco requested a refund of \$1,115,715.83 for royalties that had assertedly been overpaid on various leases as a result of following FERC Orders 93/93A, including royalties paid on lease OCS-G 2928 for the 9 months from November 1981 to and including

^{1/} It appears that Amoco's use of the "wet" rule for royalty purposes resulted from its failure to make royalty payments when it received increased payments from its purchaser at the time FERC Orders 93/93A went into effect (MMS Supplemental Response dated June 17, 1991, Attachment IV at 3).

July 1982. On July 9, 1985, the MMS Royalty Management Program Office in Denver, Colorado, notified Amoco that its request had been audited and approved by the Tulsa Regional Compliance Office, and that the Congressional review requirement had been completed. MMS authorized Amoco to recoup that amount when it filed its next regular monthly report, Form MMS-2014.

It is now acknowledged that MMS' approval of Amoco's 1984 refund request was in error, as Amoco was not entitled to a refund for the 9-month period in question, since (as discussed above) Amoco had paid royalty on production for those months using the "wet" rule and had not followed FERC Orders 93/93A. That error was not recognized until after MMS conducted a second audit of Amoco's accounts, as described below.

By letter dated March 18, 1988, the Dallas Area Compliance Office, MMS, notified Amoco that it was auditing the propriety of the royalty payments made by Amoco for the period October 1, 1980, through September 30, 1986, on various leases, including OCS-G 2928. The audit was to be conducted by the MMS audit staff at the Amoco offices in Tulsa. On September 30, 1988, MMS notified Amoco that it had divided the audit period into separate segments, and that the first segment would cover the period October 1, 1980, through September 30, 1982. 2/ The second segment would cover the period from October 1, 1982, through September 30, 1983.

In its September 30, 1988, letter, MMS directed Amoco to make available "all necessary supporting records" by October 31, 1988. MMS directed Amoco to provide "the documents and supporting information identified in the enclosures * * * to the MMS resident audit staff." Enclosure 1 stated as follows: "Required are all records and documents, in whatever form, establishing the history of the lease, lease operations and the procedures applicable to accounting for production, sales, revenues, costs, and royalties associated with the lease." In Enclosure 2, MMS notified Amoco that certain leases and sample months had been selected for audit of royalty payments for the period October 1, 1980, through September 30, 1982. The following sample months were selected for lease OCS-G 2928: May 1981, June 1981, February 1982, and September 1982. Other test months were selected for other leases.

The audit went forward. 3/ On June 9, 1989, MMS wrote to Amoco to advise that the audit had disclosed that royalty had been underpaid and

2/ At one point, the order refers to the first segment as extending through Sept. 30, 1983, but that appears to be a typographical error, as the order elsewhere refers to that date as Sept. 30, 1982.

3/ Amoco did appeal the audit letter, but, pursuant to a settlement agreement, withdrew the appeal without prejudice to its right to later challenge the legality of the audit methods adopted by MMS.

to afford it an opportunity to comment or provide any additional documentation that would refute that determination. Specifically, MMS advised that

[o]ur review indicates that during the sample month February 1982, Amoco underpaid royalties by (a) failure to properly adjust royalties in accordance with the manufacturing allowance approved for the period June 1, 1981, through March 31, 1982; (b) failure to pay on gross proceeds since the purchaser paid for gas at a higher Btu factor than Amoco used in its royalty calculation; and (c) other unidentified reasons. [Emphasis supplied.]

MMS advised Amoco that it had "calculated an underpayment of gas royalties for Lease [OCS-G 2928] for sample month February 1982 of \$6,966.99." MMS also advised that, even if Amoco concurred with MMS' preliminary findings, it would be requested to review its records to determine if other leases and/or months were underpaid due to the same circumstances.

Thus, in June 1989, MMS had discovered only that there was a discrepancy between the energy value used by the purchaser to pay for the gas (apparently calculated using the "dry" rule) and the energy value used by Amoco in its royalty calculations (apparently calculated by the "wet" rule).

By letter dated June 30, 1989, Amoco responded, concurring in MMS' finding concerning the manufacturing allowance, but not with the findings on the Btu value. Amoco challenged MMS' June 9 letter, which it characterized as a "self-audit procedure," asserting that it was unauthorized by law. 4/

On August 22, 1989, MMS issued the letter that is the subject of the present dispute. In that letter, MMS advised Amoco that its audit of the first two "segments" had revealed that Amoco had erroneously recouped royalties because an improper refund had been requested for one of the test months checked by the audit:

[MMS] has reviewed royalties paid by [Amoco] for natural gas produced from Lease OCS-G 2928 * * * during the period October 1, 1980 through September 30, 1983. Our review disclosed royalties were underpaid by \$2,277.18 for the test month of February 1982 due to Amoco erroneously recouping royalties pursuant to [FERC] Orders 93/93A. * * * Subsequently, Amoco representatives orally agreed February 1982 royalty was underpaid due to erroneous recoupment of royalties on FERC 93/93A corrections. They stated this occurred because a refund was requested based on the dry analysis, although royalties were calculated and paid using the

4/ Amoco also asserted that the period/payment in question falls outside the applicable 6-year statute of limitations.

saturated Btu analysis. They also indicated other months could have been similarly affected. [5/]

Therefore, to correct the royalty deficiencies, Amoco is directed to:

1. Review all royalty calculations and payments applicable to Lease OCS-G 2928 for the period October 1980 through September 1983 to identify the appropriate Btu factors based on the saturated Btu measurement and to determine whether the royalty was properly paid using these Btu factors after consideration of all royalty payment and recoupment activities.

2. Pay additional royalties within 60 days of receipt of this letter. * * * Late payment charges * * * will be computed and billed to Amoco upon receipt of payment of the additional royalties due.

Copies of payments, related green MMS-2014 forms and supporting schedules should be sent to the address shown below. The schedules should include at a minimum the following information: Lease number, sales month, lease volumes, Btu factors, unit price, gross value, royalty due, royalty paid, and additional royalty due. All documentation supporting compliance with this order should be retained until MMS completes its follow-up compliance testing. [Emphasis supplied.]

Thus, at this time, MMS had determined that the error had occurred in 1985 when MMS approved Amoco's request for a refund to which it was not entitled.

Although Amoco appealed the August 22, 1989, demand letter, it also complied with MMS' demands. On October 10, 1989, it filed a response indicating that a total of \$24,975.86 in additional royalty was due to MMS for the period November 1981 through July 1982, which (it admitted) "was erroneously recouped in 1985." The Forms MMS-2014 attached to the response indicated that adjustments to the sales value and royalty value for each month from November 1981 through July 1982 were necessary to account for additional amounts erroneously recouped in 1985 following the improper request for and approval of Amoco's request for refund for those months (MMS Position Statement dated Feb. 14, 1990, Att. 3, Exh. A).

In reviewing this matter, it is essential to remember that, in section 101(a) of FOGRMA, Congress directed the Department to establish "a comprehensive inspection, collection and fiscal and production accounting and auditing system to provide the capability to accurately determine oil and gas royalties, interest, fines, penalties, fees, deposits, and other payments owed, and to collect and account for such amounts in a timely manner." 30 U.S.C. § 1711(a) (1988). Further, in section 101(c)(1),

5/ This statement is supported by notes of an MMS employee concerning a meeting held on Aug. 2, 1989, between Amoco and MMS auditors (MMS Supplemental Response dated June 17, 1991, Attachment IV).

Congress directed the Department to "audit and reconcile, to the extent practicable, all current and past lease accounts for leases of oil or gas and take appropriate actions to make additional collections or refunds as warranted." The Secretary "may also audit accounts and records of selected lessees and operators." 30 U.S.C. § 1711(c)(1) (1988). Administrative agencies vested with investigatory power have broad discretion to require the disclosure of information concerning matters within their jurisdiction. Phillips Petroleum Co. v. Lujan, 951 F.2d 257, 260 (10th Cir. 1991).

Clearly, MMS' auditing of this lease account to accurately determine the gas royalty and to make additional collections is consistent with MMS' established procedures. Under 30 CFR 212.51(a), "[e]ach lessee is required to make and retain accurate and complete records necessary to demonstrate that payments of * * * royalties * * * related to offshore and onshore Federal and Indian oil and gas leases are in compliance with lease terms, regulations, and orders." Under 30 CFR 212.51(c),

[t]he lessee, operator, revenue payor, or other person required to keep records shall be responsible for making the records available for inspection. Records shall be provided at a business location of the lessee, operator, revenue payor, or other person during normal business hours upon the request of any officer, employee or other party authorized by the Secretary. Lessees, operators, revenue payors, and other persons will be given a reasonable period of time to produce historical records.

There is no doubt that MMS' procedures in initiating the audit, including the March 18 and September 30, 1988, letters, complied fully with that regulation. The U.S. Court of Appeals for the Tenth Circuit recently affirmed the propriety of MMS' issuance of similar letters to Phillips Petroleum Company and Atlantic Richfield Company. Phillips Petroleum Co. v. Lujan (Phillips II), No. 91-5071 (10th Cir. May 18, 1992). MMS directed Amoco to make available to MMS' in-house auditor information to be reviewed, a procedure plainly proper under 30 CFR 212.51(c).

The audit disclosed that there had been an irregularity in a test month. Only then did MMS place the burden of correcting that error, as well as determining whether there were additional similar errors, on Amoco. Amoco challenges this procedure as a "self-audit," which (it argues) is impermissible under 30 U.S.C. § 1711(c)(2) (1988) without regulations specifically authorizing it. MMS defends this procedure:

When the Royalty Compliance Division (RCD) issues an order directing correction of specific noncompliance to a lessee it audited, it is not ordering the lessee to perform an audit. At that time, RCD has already performed the audit and, finding patterns of noncompliance, is ordering the appellant to take corrective action (i.e. reconstructed accounting) to remedy the irregularities found. Though the lessee claims it is being ordered to do a self-audit, the corrective actions it must take

to be in compliance with laws, regulations and lease terms do not represent an audit * * *, but are only efforts to locate accounting transactions having specified conditions and make corrections.

(MMS' Feb. 14, 1990, Response to Statement of Reasons before the Director at 4). I agree with that assessment.

In Phillips II, the Tenth Circuit reviewed the identical procedure used by MMS here, concluding that it did not amount to a self-audit:

Phillips further contends that the MMS' company-wide audit procedure will require Phillips to perform a self-audit -- a requirement that Phillips claims exceeds the scope of the MMS' authority. Phillips offered only the following statement in the Affidavit of Donald Sant, Deputy Associate Director for Valuation and Audit of the MMS Royalty Management Program, to support this contention:

13. If the auditors' review reveals an error in payment of royalty, MMS generally will send an "issue letter" notifying the lessee of a preliminary determination of underpayment. The issue letter also may notify the lessee of a preliminary determination that a systemic deficiency may exist affecting several leases or royalty payments.

14. The lessee may respond to the issue letter and explain or demonstrate any reasons why it believes the MMS may be in error and that no underpayment exists.

15. If the lessee does not provide evidence to demonstrate that the MMS is in error, the MMS will issue an order to pay the additional royalties due. In the event of a systemic deficiency, the order may require the lessee to revise its accounting accordingly and recalculate its royalties for the relevant periods, leases, or payments.

Phillips II, supra. It should be noted that these three steps describe almost exactly what transpired in the case under review: Step 13 corresponds to MMS' June 9, 1989, letter; step 14 to Amoco's June 30, 1989, response; and step 15 to MMS' August 22, 1989, letter to Amoco. The Court observed as follows concerning that procedure:

This statement simply does not substantiate Phillips' claim that the MMS "will require Phillips and other royalty payors to audit their own records once an accounting procedure has been deemed erroneous" in contravention of FOGRMA's requirement that an independent audit be performed. See 30 U.S.C. § 1711(c)(2). Read in

the context of the remainder of the affidavit, Mr. Sant's statement does not contemplate that the MMS will require a lessee to substitute a "self-audit" for an independent audit. Instead, the statement clearly indicates that the MMS will ask Phillips and other lessees to make changes to correct repeated royalty underpayments caused by systemic deficiencies. [Emphasis supplied.]

Phillips II, supra. Thus, the Tenth Circuit has ruled that the same procedure used in the case under appeal does not amount to an impermissible "self-audit." 6/

Even apart from this commentary, it is clear that MMS had authority under FOGRMA to issue the August 22, 1989, letter, notwithstanding that no regulations expressly dealing with such procedure have been promulgated. Section 107(a) of FOGRMA states as follows:

In carrying out his duties under this Act the Secretary may conduct any investigation or other inquiry necessary and appropriate and may conduct, after notice, any hearing or audit necessary and appropriate to carrying out his duties under this Act. In connection with any such hearings, inquiry, investigation, or audit, the Secretary is also authorized where reasonably necessary--

(1) to require by special or general order, any person to submit in writing such affidavits and answers to questions as the Secretary may reasonably prescribe, which submission shall be made within such reasonable period and under oath or otherwise, as may be necessary.

30 U.S.C. § 1717(a)(1) (1988). The August 22, 1989, letter from MMS to Amoco is properly considered to be a special order, issued in connection

6/ The statement appears to be dictum, however. The decision in Phillips II deals with three separate requests by MMS for information, each dealing with the initiation of the audit: (1) the Sept. 19, 1989, notice of audit; (2) Request No. 89-23, dated Nov. 3, 1989, a handwritten request to Phillips identifying a list of sample leases to be audited and requesting information concerning overpayments; and (3) Request No. 90.A, directing Arco to provide "all records and documents, in whatever form, which address or reflect the accounting or reporting of production, sales, revenues, costs and royalties associated with" 38 different leases. In the present case, this information was requested from Amoco in MMS' Mar. 18 and Sept. 30, 1988, letters. By contrast, the procedures described by Sant take place only after the completion of the audit. They do not appear to have been under review in Phillips II.

Nevertheless, the situation presented in the case under appeal is squarely on all fours with that addressed by the Court. I therefore regard the statement as significant.

with previous audit, requiring Amoco to answer MMS' reasonable questions concerning possible impermissible refunds of royalty. MMS' questions were reasonable, as the audit had disclosed that Amoco had been improperly granted a refund for a test month, and as Amoco had expressly acknowledged in a meeting with MMS on August 2, 1989, that other months could also be affected.

Judge Arness states that "[t]he existence of a 'pattern' of errors is not a precondition to investigation of payor accounts by MMS." I stress that there must be, at a minimum, some evidence of irregularity to justify the type of demand for information that is under attack in this appeal. Further, that irregularity should be one that is capable of having been repeated. As noted above, there is such evidence here. In these circumstances, MMS' special order demanding answers was "reasonably necessary" under 30 U.S.C. § 1717(a)(1) (1988). I would not, however, rule out the possibility that circumstances in other cases would not justify the type of demand made here. In some cases, the failure to establish a pattern of errors may render the demand for information unreasonable.

David L. Hughes
Administrative Judge