

Appeal from a decision of the Director, Minerals Management Service, denying an appeal from a decision denying a request for refund of royalties paid on Federal Energy Regulatory Commission Order No. 94 reimbursements. MMS 86-0479-OCS.

Affirmed.

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

Federal Energy Regulatory Commission Order No. 94 reimbursements paid to a lessee by a pipeline purchaser of gas from Outer Continental Shelf oil and gas leases for certain production-related expenses, not included in the ceiling price for delivered gas, may be considered part of the lessee's gross proceeds for purposes of calculation of royalties. A request for a refund of royalties paid on such reimbursements may be properly denied.

APPEARANCES: Thomas J. Eastment, Esq., Stephen L. Teichler, Esq., Drew J. Fossom, Esq., Washington, D.C., Paul Van Wagenen, Esq., 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 June 12, 1987, decision of the Director, Minerals Management Service (MMS), denying its appeal of a September 15, 1986, decision of the Houston Compliance Office, MMS, denying Pogo's request for refund of royalties in the amount of \$125,834.50. That sum constituted the amount of royalties Pogo had paid to MMS for production months January through April 1985 on cost reimbursements that pipeline company purchasers had paid to Pogo in accordance with section 110(a)(2) of the Natural Gas Policy Act of 1982 (NGPA), 15 U.S.C. § 3320(a)(2) (1988), and the Federal Energy Regulatory Commission's implementing Order No. 94 and supplemental orders (FERC Order No. 94). ^{1/}

^{1/} Through its orders, FERC provided that a first sale of natural gas would not be considered to exceed the maximum lawful price if that first sale price exceeded the maximum lawful price by an amount necessary to

The issue presented in this case is whether royalties were properly collected by MMS for the period in question on the amounts received by Pogo as FERC Order No. 94 reimbursements from pipeline purchasers of Pogo's gas from certain Outer Continental Shelf (OCS) leases.

In its statement of reasons filed in August 1987, Pogo argues that royalties are not due on FERC Order No. 94 reimbursements because such reimbursements cannot be considered part of the gross proceeds for the sale of the gas. Pogo claims such reimbursements are for post-production services. Further, Pogo contends that since a royalty interest attaches to the value of gas at the wellhead, reimbursements for post-production services are not royalty bearing. Thereafter, MMS filed a motion to stay consideration of this appeal, as well as others involving FERC Order No. 94 reimbursements, pending the final outcome of certain Federal court litigation. The Board grant the first of a series of stay orders on June 7, 1988.

In 1991, the United States Court of Appeals for the Fifth Circuit issued a decision in Mesa Operating Limited Partnership v. United States Department of the Interior, 931 F.2d 318 (1991), cert. denied, 112 S. Ct. 934 (1992). Therein, the court upheld the Department's position that FERC Order No. 94 reimbursements are royalty bearing. In doing so, it characterized that position, as follows, at page 323:

Royalties are due on the gross proceeds accruing to the lessee; the term "gross proceeds" includes payments for the costs of treatment including measuring, gathering, compressing, sweetening, and dehydrating "where such services are necessary to place gas in marketable condition," [2/] whether the costs are absorbed in the price the purchaser pays pursuant to the set NGPA ceiling or are ultimately borne by the purchaser under § 110; accordingly, where the purchaser reimburses the lessee for treatment costs in accordance with § 110 and the Order 94 regulations, these payments become part of the value of production (gross proceeds) subject to royalty.

The court recognized that the Department had for decades interpreted the marketable condition rule as requiring that marketing costs could not be deducted from gross proceeds before royalty is calculated. The court then stated at page 325:

fn.1 (continued)

recover production-related costs. 18 CFR 271.1104(a)(1). The term "Production-related costs" is defined to include "costs other than production costs that are incurred: (i) To deliver, compress, treat, liquify, or condition natural gas * * *." 18 CFR 271.1104(c)(7)(i).

[2/ The regulations at 30 CFR 250.42 (1985) set out the marketable condition rule governing OCS leases. It stated: "The lessee shall put into marketable condition, if commercially feasible, all products produced from the leased land. In calculating the royalty payment, the lessee may not deduct the costs of treatment."

As the Interior Board of Land Appeals stated in Arco Oil & Gas Co. [115 IBLA 393 (1990)], only such marketing allowances "as have been expressly recognized may properly be deducted from value [of production] for royalty purposes." As did the D.C. Circuit in California Co., [296 F.2d 384 (D.C. Cir. 1961)], in the context of this case we define "production" in the phrase "amount of production" as meaning "gas conditioned for market."

* * * * *

* * * The DOI-lessor simply obtains a flat percentage of all "gross proceeds" whether they be within the ceiling price or exceed it under § 110, obtaining more royalty where the lessee obtains a greater price, including costs reimbursements, from the pipeline purchaser. [Footnotes omitted.]

Following denial of certiorari by the Supreme Court, MMS filed an answer in this case arguing that based on earlier Board precedents and the court's decision in Mesa, we should affirm the Director's decision. Pogo has made no further filing.

[1] The applicable regulation for the period in question provides that in determining the value basis for computing royalty, "[u]nder no circumstances shall the value of production be less than the gross proceeds accruing to the lessee from the disposition of the produced substances * * *." 30 CFR 206.150 (1985). The gas sold in this case was subject to the ceiling prices established by the NGPA. However, Pogo was authorized by section 110 of the NGPA, 15 U.S.C. § 3320 (1988), and FERC Order No. 94 to collect more than the ceiling price from pipeline producers in order to recoup certain production-related expenses. The court's decision in Mesa clearly held that MMS may properly collect royalty on such FERC Order No. 94 payments.

Although Pogo asserts that the FERC Order No. 94 payments in this case were for "transportation services," there is nothing in the present record to support such a claim. Nor has Pogo come forward to distinguish the production-related expenses in this case from those involved in the Mesa case. Under such circumstances, we conclude that MMS properly denied Pogo's request for refund. 3/

3/ In its answer, MMS notes that for the time period in question it has allowed retroactive transportation allowances for the actual costs of transportation. It then states that "[i]f some or all these FERC Order No. 94 reimbursements were for actual transportation costs incurred by Pogo, it should file an application with MMS for a transportation allowance. MMS will consider such a request and issue a decision" (Answer at 5 n.2). Accordingly, our affirmation of the Director's decision in this case is not a bar to Pogo seeking a transportation allowance.

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.

Bruce R. Harris
Deputy Chief Administrative Judge

I concur:

David L. Hughes
Administrative Judge