SUPERIOR OIL COMPANY

IBLA 76-659 Decided June 30, 1977

Appeal from decision GS-72-O&G of the Acting Director, Geological Survey, affirming the determination of value of production from offshore oil and gas leases OCS-0248 and OCS-0249.

Affirmed.

1. Contracts: Construction and Operation: Generally--Oil and Gas Leases: Royalties--Outer Continental Shelf Lands Act: State Leases: Generally

   The royalty provisions of a state lease validated under section 6 of the Outer Continental Shelf Lands Act will govern the determination of the royalty due to the United States.

2. Oil and Gas Leases: Royalties--Outer Continental Shelf Lands Act: State Leases: Generally

   The royalty provisions on a State of Louisiana 1942 lease form subsequently validated under section 6 of the Outer Continental Shelf Lands Act provide either for (1) delivery of royalty oil in kind to the lessor free of expense with delivery understood as being made when the oil has been received by the first purchaser or, (2) at the option of the lessee, payment of the value of the oil, with certain express disallowances, including no deduction for transportation charges. Constructive delivery of in-kind royalty must be authorized and accepted by the lessor to constitute a

> payment of royalty. The delivery-in-kind provision does not authorize the lessee to act as agent of the United States, and is not applicable where the lessee has not notified Geological Survey of any purported constructive delivery of oil to the first purchaser and Survey has not accepted such constructive delivery. Therefore, the second provision is applicable which expressly precludes deductions of transportation costs.

APPEARANCES: James N. Dunnam, Esq., for appellant; Karen A. Shaffer, Esq., Office of the Solicitor, for U.S. Geological Survey.

OPINION BY ADMINISTRATIVE JUDGE THOMPSON

The Superior Oil Company appeals from the April 27, 1976, decision of the Acting Director, United States Geological Survey (Survey), GS-72-O&G, which affirmed the determination of an Oil and Gas Supervisor regarding the value to be used in computing and paying royalty to the United States on condensate produced from offshore oil and gas leases OCS 0248 and 0249. These leases were issued by the State of Louisiana in 1946 and 1947 on its 1942 lease form. They were subsequently continued as federal leases when the Bureau of Land Management determined in 1954 that they met the requirements of section 6 of the Outer Continental Shelf Lands Act (OCS Act), 43 U.S.C. § 1335 (1970). 1/

In his original determination dated March 26, 1968, the Supervisor ruled that appellant's royalty payments for May 1966 through January 1967 were computed on an incorrect valuation of the condensate produced on the above leases. The Supervisor further ruled that by the terms of appellant's leases, transportation costs may not be deducted from the value of production. Appellant appealed this determination to the Director of Survey for two reasons: first, appellant argued that the Supervisor had no authority to make the determination; second, appellant argued in

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1/ Section 6 of the OCS Act authorizes the Secretary of the Interior to validate any State-issued mineral lease covering submerged lands of the Outer Continental Shelf that meets the requirements of that section. Section 8 of the Act, 43 U.S.C. § 1337 (1970), authorizes the Secretary to issue mineral leases for any submerged lands of the Outer Continental Shelf not covered by leases meeting the requirements of section 6.

the alternative that the determination does not represent a reasonable valuation for computing royalties. 2/

In the decision appealed from, the Acting Director upheld the authority of the Supervisor to compute royalties based on the "estimated reasonable value" of production from appellant's leases as provided in 30 CFR 250.64. The Board requested additional briefs on the issues from both Survey and appellant and heard oral argument on March 4, 1977.

The condensate, together with gas, is separated and measured at the offshore platform and then recombined for movement through the Transco pipeline system to the onshore East White Lake Scrubber Station, operated by Union Oil Company of California. At the scrubber station, Union samples and measures the condensate to determine the total amount of purchase price it will pay appellant at a previously agreed-upon rate. The condensate is then transported to Union's Forked Island Terminal where it is sold to Shell Oil Company.

Appellant states that when it initially determined that it would have condensate to market, it contacted possible purchasers who could arrange for transportation from the well-head site offshore to an onshore point of delivery. Appellant then entered into an agreement with Union whereby Union purchased the condensate with delivery at the scrubber station. The price per barrel was agreed upon in advance and was changed periodically either by agreement or by price posted by Union for several producing fields in the area.

Appellant computed the royalty payable to the United States based upon the price per barrel appellant received from Union at the scrubber station. This did not include any transportation allowance to the scrubber station. In the March 26, 1968, letter which began this proceeding, the Oil and Gas Supervisor informed appellant that the proper value of the condensate for royalty computation was the price per barrel paid by Shell to Union at the loading terminal. This ruling was upheld by the Acting Director of Survey in decision GS-72-O&G described above.

2/ In decision GS-50-O&G, dated October 27, 1972, the Director of Survey affirmed the decision of the Supervisor denying the deduction of transportation costs for appellant and three other companies. Subsequently, appellant requested that its appeal be separated from the others and considered only on the issues raised by appellant. This request was granted. Decision GS-50-O&G, which involved 1948 Louisiana lease forms different from appellant's leases, was reversed by the Board in Ocean Drilling & Exploration Company, 21 IBLA 137 (1975).

[1] Appellant argues that section 6(b) of the OCS Act, 43 U.S.C. § 1335(b) (1970), and regulation 30 CFR 250.100 allow it to pay royalty according to the terms of its leases. Section 6(b) of the OCS Act states in relevant part:

> Any person holding a mineral lease, which as determined by the Secretary meets the requirements of subsection (a) of this section, may continue to maintain such lease, and may conduct operations thereunder, in accordance with (1) its provisions * * *, subject to the provisions of paragraphs (8)-(10) of subsection (a) of this section, as to royalties * * *.

According to 30 CFR 250.100(a), the provisions of a section 6 lease with respect to the royalties payable under the lease "shall take precedence over the regulations in this part." Regulation 30 CFR 250.100(b) states that a section 6 lease "shall also be subject to the mineral leasing regulations applicable to the outer Continental Shelf * * * to the extent those regulations are not contrary to or inconsistent with the provisions of the lease relating to * * * the royalties payable, and the terms of the lease."

The royalty provisions of appellant's leases are set out in Article III of each lease as follows:

> Should sulphur, potash, oil, gas and/or other liquid hydro-carbon mineral be produced in paying quantitites on the premises hereunder, then the said lessee shall deliver to lessor as royalty, free of expense:
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> One-eighth (1/8) of all oil produced and saved, including distillate or other liquid hydro-carbons [and gas], delivery of said oil to be understood as made when same has been received by the first purchaser thereof. Or lessee may, in lieu of said oil delivery, and at its option, pay to lessor sums equal to the value thereof on the premises; provided no deductions or charges shall be made for gathering or transporting said oil to the purchaser thereof, or loading terminal, nor shall any deductions whatsoever be made chargeable to lessor; provided further, that the price paid lessor for said oil shall not be less than the average posted pipeline or loading terminal price then current for oil of like grade or quality.

Appellant asserts that it always computed its royalty payment on the basis of in-kind delivery to Union at the scrubber station. It argues that the language of Article III quoted above gives it the option to do so, and, in effect, authorizes it to act for the Secretary by delivering the royalty in kind to the first purchaser. According to appellant, the purpose of Article III is to avoid disagreement between lessee and lessor by insuring that the lessor will be treated exactly like the lessee in the sale to the first purchaser. It points out that once the sale to Union occurs at the scrubber station, it has no further interest in or title to the condensate. Further, it construes Article III to mean that the value basis for computing royalty is the price paid for the delivery at the first sales point to the first purchaser. Appellant concludes that because section 6 of the OSC Act and 30 CFR 250.100 allow payment of royalty according to the terms of the state-issued leases, Survey has no authority or discretion to make any other determination regarding the value of production.

Survey disputes appellant's interpretation of the statute, regulations and lease terms. First, Survey points to the language of section 6(b) that the royalty provisions of an approved lease are subject to section 6(a)(8) which requires a minimum royalty of 12-1/2 percent in "amount or value of production saved, removed, or sold" from the lease. Survey agrees that this language in section 6(a)(8) authorizes the Secretary of the Interior to receive royalty payments in kind for section 6 leases, but it does not agree that it authorized appellant to act in behalf of the Secretary. Survey notes that the Secretary had not exercised his authority to receive royalty payments in kind. It contends that, therefore, appellant cannot "deliver" in-kind royalty and accept payment for it from the first purchaser. Moreover, Survey continues, no employee of Survey approved or executed any division orders or sales agreements for the sale of royalty condensate from appellant's leases.

It is Survey's position that the delivery-in-kind provision is not applicable in this case because there was no acceptance of a delivery in kind by the Secretary. Thus, the second royalty provision regarding value of production is applicable and that provision clearly excludes deductions for transportation costs for the royalty computation. Alternatively, Survey contends that even if the delivery-in-kind provision were applicable, delivery had to be "free of expense" to the lessor. Therefore, the transportation costs may not be deducted by appellant because the fair value of the services provided by Union, including transportation to Union's loading terminal and handling, would have to be considered part of the value received by Superior for production from the leases.

In making these contentions, Survey refers to guidelines issued by the Louisiana State Mineral Board in 1965. 3/ Those guidelines are applicable to Louisiana's oil and gas leases for State-owned minerals. The guidelines state that delivery of in-kind royalty production is accomplished by delivery to a first purchaser for whom the State executes a division order of the State's in-kind royalty, or to whom production is sold by the lessee as an authorized agent of the State. The value basis for the in-kind royalty is the price fixed in the division order. Survey points out that the State Mineral Board's interpretation of determining value under the second method of royalty payment, i.e., payment for value on the premises, is similar to the value determination guideline set out in 30 CFR 250.64. Survey concludes from the State Board's interpretation that since no division order of the Government was executed or approved, the method of royalty payment should be determined according to the circumstances of the case. Since the State Board does not discuss guidelines for determination of value when no division order of in-kind royalty is executed, Survey argues that the guidelines in 30 CFR 250.64 should be utilized.

We agree with appellant that under the OCS Act and regulations the royalty provisions of the 1942 state lease form govern the computation of royalty owed to the United States. The royalty payment method which appellant claims to have utilized, i.e., constructive delivery of in-kind royalty, requires the royalty to be delivered "free of expense." Appellant argues that "free of expense" should be construed with regard to Louisiana precedent defining "market value." The 1942 Louisiana lease form makes no reference to "market value" as a standard for determining the value of production. Cf. Freeland v. Sun Oil Co., 277 F.2d 154, 157 (5th Cir. 1960). Appellant has cited no Louisiana court decisions construing the language of the 1942 lease form or similar lease provisions. The plain language of appellant's leases must stand in the absence of any conclusive contrary interpretation. Therefore, we agree with Survey that even if the delivery-in-kind provision were applicable, the transportation charges cannot be shifted to the lessor because the delivery to the first purchaser would not be "free of expense." In any event, we find that the delivery-in-kind provision is not applicable in the circumstances of this case to determine royalty.

3/ The Louisiana State Mineral Board is the state agency authorized to issue oil and gas leases for land owned by the state, to supervise all oil and gas leases on state land, and to review and approve all bonuses, rentals and royalties due from state leases. See Ocean Drilling & Exploration Co., 21 IBLA 137, 141 (1975).

[2] Under the terms of Article III quoted above, delivery of in-kind royalty to the lessor occurs with receipt of production by the first purchaser. The main issue here is how delivery of the in-kind royalty is made and whether there must be some indication of acceptance by the lessor, i.e., the United States, so that such constructive delivery may constitute a payment of royalty. For the reasons discussed below, we find that there must be an authorization of delivery and acceptance by the lessor and that the lack thereof renders the sale of the production subject to the second method of determining royalty.

Counsel for appellant at the oral argument suggested that it acted as the Secretary's "authorized agent" in the delivery and sale of the in-kind royalty. The only basis for this argument is an implied authorization by virtue of the lease terms. Other than this, appellant did not explain how it became an authorized agent of the United States. Appellant also argues that its failure to notify Survey of its sale of condensate to a first purchaser comports with standard industry practice. It offers nothing to support this bare assertion.

On the other hand, Survey has submitted the guidelines of the State of Louisiana Mineral Board to show how the State has administered the leases still owned by the State which would be on the same 1942 State lease form. These guidelines are, therefore, the only probative evidence of the practices of the industry and of practical interpretations of the lease forms by the lessees and lessors, as reflected by their own conduct. While resolutions of the Louisiana State Mineral Board do not carry the force of law, as appellant contends, they do reflect the policy, practice and interpretation of that body which administers the State leases. In interpreting state-issued OCS leases, adopted by the United States under section 6(a) of the OCS Act, this Department has looked to decisions of state courts, opinions of state attorney generals, or other statements by appropriate state officials for guidance. C & K Petroleum, 27 IBLA 15 (1976); Ocean Drilling & Exploration Co., 21 IBLA 137 (1975). The 1965 State guidelines have relevance in interpreting the 1942 State lease form even though they were issued some 11 years after these particular leases were adopted by the United States. Obviously, the State guidelines are the only relevant evidence in this record of the industry practices to which appellant alludes. They also reflect an interpretation by the State which issued the lease form involved here indicating how that State expects its lessees to operate under that lease form. When the United States assumed the position of the State as lessor, it assumed the same rights that the State had as lessor. It may properly look to the State's guidelines for the operation of similar leases remaining under State control.

The State Mineral Board describes the procedure for payment of in-kind royalty under the 1942 lease form at section 1.3(a) of its resolution: "(a) By delivery of production into the hands of a first purchaser for whom the State executes a division order or to whom production is being sold by the State's lessee as authorized agent." Appellant has not described any different procedure that it or other lessees may have followed when paying royalty to the State of Louisiana under other leases issued on the 1942 form. Apparently, appellant did not begin production on the leases involved here until after they came under the jurisdiction of the United States. The alleged payment of in-kind royalty, therefore, was accomplished solely according to appellant's interpretation of the lease terms without consultation with Survey. Superior did not show it has leases on the 1942 form where the State remains as lessor and, if so, that the computation of royalty would be different from what Survey is prescribing.

The importance of the State's execution of a division order is evident from the method used by the State Mineral Board to determine the value basis for royalty set out in section 2.2(a) of the guidelines:

> (a) Under normal conditions, when oil royalties are delivered in kind according to Subsection 1.3(a), the value basis for oil royalties should be the purchase price fixed according to the division order. If a third party purchaser performs functions which are customarily performed by producers, the fair value of such services should be considered to constitute a part of the purchase price. Similarly, if a purchaser pays charges which are normally borne by the producer, such amounts shall be considered to constitute a part of the purchase price.

Obviously, the State Mineral Board intended to exercise control over determination of the value basis for computing royalty by requiring advance notification, or approval through execution of a division order, of the proposed sale to a first purchaser.

As to these federal leases on the State form, no division orders were issued by the United States, nor, indeed, is it apparent that appellant ever notified Survey prior to the various sales that it was purporting to exercise its option by making a constructive delivery of the royalty oil or gas. The State of Louisiana presumably would not accept constructive delivery in kind without issuing a division order. Likewise, we see no basis for holding that the United States is bound by any constructive delivery here. Further, appellant had no authority to effect and accept a constructive delivery for the United States by its sale to Union without express authorization from Survey. The lease provision by itself did not authorize the lessee to be the lessor's agent in this regard. Whether or not appellant would have been entitled to pay royalty according to the constructive delivery method set out in its lease prior to promulgation of regulations by the Secretary need not be decided here because appellant did not notify Survey it was purporting to exercise its option. 4/

We conclude, therefore, that the first method for computing royalty based on a constructive delivery in kind to the first purchaser is not applicable here. This leaves the second method provided by the lease, the value of the oil on the premises. The lease term itself expressly precludes deductions or charges for "gathering or transporting said oil to the purchaser thereof, or loading terminal, nor shall any deductions whatsoever be made chargeable to lessor." Clearly then, the cost of the transportation of the oil from the platform to the loading terminal cannot be deducted from the royalty. 5/

For the above reasons, it was proper for Survey to require appellant to recompute its royalty.

4/ Had such notification and a request for a division order been made, a decision by Survey could have been promulgated. We note that no regulations providing for the sale of royalty oil were issued until 1972 when provision was made for sale of royalty oil and gas to refineries who qualify as a small-business concern under the rules of the Small Business Administration. 30 CFR Part 225a. Survey contends that the Oil and Gas Supervisor could not accept or approve in-kind royalty payments in the absence of authorization from the Secretary. The OCS Act allows the Secretary in his discretion to issue regulations concerning the sale of royalty oil and gas. 43 U.S.C. § 1334 (1970). As indicated in the text above, we need not decide the authority issue. The lack of regulations and other prescribed procedures for accepting delivery of royalty oil, actually or constructively, however, does tend to suggest that delivery in kind was not a recognized practice.

5/ We note the State guideline interpretations of the lease provisions generally provide that transportation costs are not deductible under the 1942 lease form. We note that the State Mineral Board in 1959 passed a resolution stating that transportation costs could not be deducted under any Louisiana lease.

Therefore, 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.

Joan B. Thompson
Administrative Judge

I concur:

Douglas E. Henriques
Administrative Judge

ADMINISTRATIVE JUDGE FISHMAN CONCURRING IN THE RESULT:

The Louisiana 1942 lease form was employed by that State for what were denominated subsequently OCS 0248 and 0249. The Louisiana leases were validated by decisions of December 23, 1954, pursuant to section 6(a) of the OCS Act, 43 U.S.C. § 1335(a) (1970).

Article III of each lease, pertaining to royalty reads in applicable portion as follows:

> Should sulphur, potash, oil, gas and/or other liquid hydro-carbon mineral be produced in paying quantities on the premises hereunder, then the said lessee shall deliver to lessor as royalty, free of expense:
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> One-eighth (1/8) of all oil produced and saved, including distillate or other liquid hydrocarbons [and gas], delivery of said oil to be understood as made when same has been received by the first purchaser thereof. Or lessee may, in lieu of said oil delivery, and at its option, pay to lessor sums equal to the value thereof on the premises; provided no deductions or charges shall be made for gathering or transporting said oil to the purchaser thereof, or loading terminal, nor shall any deductions whatsoever be made chargeable to lessor; provided further, that the price paid lessor for said oil shall not be less than the average posted pipe-line or loading terminal price then current for oil of like grade or quality.

43 U.S.C. § 1335(b) provides that State leases validated under section 6(a) of the OCS Act, supra, may continue "subject to the provisions of paragraph (8)-(10) of subsection (a) of this section, as to royalties * * *."

Paragraph (8) requires a royalty of not less than 12-1/2 percent on oil and gas "in amount or value of the production saved, removed, or sold from the lease * * *." Paragraph (9) requires payment of royalty on a base which includes severance, gross production or occupation taxes. Paragraph (10) pertains to the duration of the lease.

30 CFR 250.100 explicitly recognizes that the regulations of the Department have no impact on "the royalties payable under the lease (subject to the provisions of section 6(a)(8) and 6(a)(9) of the Act) * * *." Such regulation provides further that royalties payable under the lease "shall continue in effect and in the event

of any conflict or inconsistency, shall take precedence over the regulations." It necessarily follows that the provisions of the leases in issue establish the proper predicate for determining appellant's claim for relief.

I regard as anomalous the suggestion made in the majority opinion that the 1965 guidelines issued by the Louisiana State Mineral Board control the construction of leases under federal aegis since 1954. It is difficult to understand how the interpretation of a contract by one of the contracting parties some 11 years after it was divorced therefrom has controlling impact. There is no interpretation of the leases by Louisiana and appellant during the period that Louisiana was the lessor. Cf. Superior Oil Co., 12 IBLA 212 (1973). The leases were nonproducing during the time the State of Louisiana was the lessor.

Therefore, the reference to the necessity of advance approval of a sale or through execution of a division order is irrelevant.

30 CFR 250.64, authorizing the Geological Survey to fix the lease for royalty, is inapplicable by virtue of 30 CFR 250.100.

The first mode of paying royalty, set forth in Article III of the leases, mandates delivery in kind, i.e., one-eighth of the oil.

The lessee has the option, in lieu of the first mode, of paying to the lessor "sums equal to the value thereof [of the oil] on the premises" subject to certain qualifications. I find appellant's contention that it opted for and paid royalty under the first mode constructively, to be unconvincing. No responsible federal authority designated appellant as its agent to sell the royalty oil. The second mode clearly prescribes "value" payments, i.e., money. It seems obvious that a dichotomy was intended and effectuated and that appellant operated under the second mode of payment of royalty.

The second mode of payment provided for in the contract envisages that "the price paid lessor for said oil shall not be less than the average posted pipe-line or loading terminal price then current of like grade and quantity." I assume that the price paid by Shell to Union at the loading terminal was not less than the posted price. In addition, the language relating to the second mode of payment is clear that no deductions shall be made for transporting oil to the purchaser.

Therefore, I concur in the result reached in the main opinion.

Frederick Fishman
Administrative Judge