

SUN EXPLORATION AND PRODUCTION CO.

IBLA 87-134, 87-139, 87-70

Decided September 9, 1988

Appeal from a decision of the Director, Minerals Management Service, affirming an order requiring payment of additional royalties on gas produced under Outer Continental Shelf oil and gas lease MMS-85-0314-OCS. Appeals from decisions of Director affirming orders assessing late payment charges. MMS-86-0099-OCS and MMS-85-0259-OCS.

Affirmed.

1. Oil and Gas Leases: Royalties--Outer Continental Shelf Lands Act: Oil and Gas Leases

The United States, as lessor of an oil and gas lease, is entitled to its royalty based on "the reasonable value" of the gas as set by the Secretary. Where a party challenges a determination as to the value of gas produced, the party must establish that the methodology used in the Government's computation is, in fact, erroneous.

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

30 CFR 218.54(a) authorizes the Minerals Management Service to impose a late payment interest charge where royalty payments for offshore oil and gas leases are untimely or improper. The imposition of late payment charges is appropriate to compensate the United States for loss of use of funds which it is due under an express royalty computation and payment program.

APPEARANCES: Thomas B. Deal, Esq., Dallas, Texas, for appellant; Peter J. Schaumberg, Esq., Geoffrey Heath, Esq., Howard W. Chalker, Esq., L. Poe Leggette, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE ARNESS

Sun Exploration and Production Company (Sun) appeals from a decision of the Director, Minerals Management Service (MMS), dated July 17, 1986 (MMS-85-0314-OCS), requiring it to pay additional royalties for gas produced under the Outer Continental Shelf Lands Act (OCSLA) lease OCS-G 1752. Sun

also appeals two other decisions of the Director dated August 6, 1986 (MMS-86-0099-OCS and MMS-85-0259-OCS), assessing late payment charges on leases OCS-G 1752 and OCS-G 2663.

The appeal in MMS-85-0314-OCS involves two audits conducted by the Office of Inspector General (OIG), Department of the Interior, of Sun's offshore lease OSC-G 1752. The first audit covered the period June 15, 1972, through May 31, 1978, and involves gas produced from Platform "A" on lease OSC-G 1752. A portion of the gas produced from Platform "A" was committed to and sold to Transcontinental Gas Company (Transco) pursuant to a contract dated September 1, 1970, between Sun and Transco. The remainder of the gas was the subject of a transportation agreement between Sun and Transco. The original agreement dated February 3, 1970, provides for the transportation of natural gas to Sun's Marcus Hook Refinery (Marcus Hook) and the Sun-Olin Area Plant (Sun-Olin) both located in Delaware County, Pennsylvania, for Sun's own use. This agreement was amended on June 9, 1972, to add the Block A-76 Field as a source of gas for transportation.

The audit found that Sun correctly valued the gas which it sold on the interstate market pursuant to its contract with Transco. The value was based on the actual prices charged Transco while the prices themselves were determined in accordance with Federal Power Commission (FPC), now the Federal Energy Regulatory Commission (FERC), Opinions No. 545 and No. 749. The audit did not agree with the value reported by Sun for the gas which Sun used at its own refineries. Sun valued this gas at the same prices it charged for gas sold to Transco under the gas purchase contract of September 1, 1970. According to the audit, the transportation agreement under which residue gas is transported for Sun cannot be used to value gas by an FPC opinion, *i.e.*, as if the gas were dedicated to a long-term gas sales contract. The audit found that this gas was not dedicated to a long-term gas sales contract. The audit determined that the correct value for the gas is the highest price Sun could have obtained on the interstate market if each month's production had been offered as a separate or new sale. The difference in valuation methods on gas transported to the refineries results in a royalty deficiency of \$540,641.09.

MMS required Sun to pay a royalty deficiency for the "A" gas on the basis of a value equal to the "Section 104 replacement/recompletion" price as set forth in the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. | 3314 (1982). This assessment was premised on a finding that if the "A" gas had not gone to Marcus Hook, Sun could have sold such gas to third parties on the open market at the maximum ceiling price for which such gas qualified.

By letter dated May 17, 1979, Sun informed Geological Survey (GS) that the payment of additional royalties on production from Platform "A" was made under protest and Sun reserved the legal right to recover the same. Sun explained that the conclusion reached by the auditors that Sun always had the option of selling residue gas to others than Transco is erroneous. Sun contended that all gas not taken for Sun's use had been and continued to be committed under the September 1, 1970, contract with Transco.

The second audit covered the period from January 1977 through December 1981. The gas in question was produced from Platform "B" of

lease OCS-G 1752 and transported to Marcus Hook where it was used by Sun as fuel or feedstock. For royalty computation purposes, Sun valued the "B" gas at the "replacement/recompletion price" as determined under section 104 of NGPA, 15 U.S.C. | 3314 (1982). However, the audit determined that under NGPA, such gas qualified for a "Section 104 post-1974 price." By order dated November 1, 1985, the Tulsa Regional Compliance Office (Tulsa) required Sun to value the "B" gas at the "Section 104 post-1974 price." As a result of the valuation at a higher price, Tulsa determined that Sun underpaid royalties by \$385,922. The remainder of Sun's share in the production from the lease was sold to Transco. The Transco contract also provided for a "Section 104 post-1974 price" with respect to gas produced on Platform "B."

On December 4, 1985, Sun filed its notice of appeal from Tulsa's decision. Sun asserts that MMS and GS are in error in requiring Sun to value gas delivered to the refinery in inconsistent manners from two platforms on the same lease. Sun explains its position with regard to the gas from the two platforms as follows:

(1) Platform A Sun's position, with regard to Platform A, is that the USGS, now MMS, wrongfully required Sun to value production delivered to Marcus Hook Refinery from this Platform at a price equal to the Section 104 replacement/recompletion price. The reason for this position is that the USGS required Sun to value the gas at a price that it could not receive under its contract with Transcontinental Pipeline Corporation (Transco). Under that contract, Sun reserved quantities from sales under the contract up to a certain amount per day to be delivered to its Marcus Hook Refinery. The contract is an interstate contract in which the gas is dedicated to interstate commerce. Consequently, those amounts of gas reserved but not delivered to the Marcus Hook Refinery could not be sold on the open market to third parties. Rather, it had to be sold to Transco at Transco's price under the contract. That price, during the relevant periods of time for production from Platform A was the Section 104 old flowing gas price. During the relevant times there was a significant price difference between the price Sun was required to value the gas for purposes of royalty to the MMS (Section 104 replacement/recompletion price) and the Transco contract price (Section 104 old flowing gas price). The Section 104 old flowing gas price was approximately 30¢ to 40¢ less per MMBTU than the Section 104 replacement/recompletion price. At no time, during all relevant periods, could Sun ever collect the Section 104 replacement/recompletion price (the higher of the two prices) because the gas under the contract was dedicated to interstate commerce and could only be sold to Transco if the production did not go to Marcus Hook Refinery. [Emphasis in original.]

(Sun Response dated Apr. 11, 1986, at 2).

Sun further asserts that the gas reserved to Sun for delivery to Marcus Hook, but not taken, would not be free of the Transco contract, but subject to it. Citing Getty Oil Co., 51 IBLA 47 (1980), Sun contends that MMS cannot

ignore the terms of a contract between Sun and Transco. Sun asserts that it has overpaid royalty due to this required valuation in the amount of \$540,641.09 and is entitled to a credit plus all applicable interest paid.

Regarding Platform "B," Sun stated:

(2) Platform B During a period of time covered by these audits, Sun delivered to the Marcus Hook Refinery certain volumes of gas from Platform B. During this period, Sun valued this gas at what the USGS had required it value the gas from Platform A, e.g. the Section 104 replacement/recompletion price. These wells were drilled at a later time than the wells on Platform A, and under the Natural Gas Policy Act of 1978 they could qualify for a Section 104 post-1974 price. The contract with Transco allowed such a price for the Platform B wells. Sun does concede that the price that it could have obtained, had the gas not been taken by Sun's refinery, was the contract price equal to the Section 104 post-1974 price. As a result of its valuation equal to the Section 104 replacement/recompletion price, Sun undervalued the gas on which it paid royalties to the MMS. Sun has paid under protest an amount equal to \$303,870 being the difference between the Section 104 replacement/recompletion price and the Section 104 post-1974 price. The MMS is correct in its position regarding gas delivered to the Marcus Hook Refinery from Platform B.

(Sun Response dated Apr. 11, 1986, at 4).

Sun urged that MMS be consistent and require it to pay royalties on the price it could receive under the Transco contract for all production from the lease. If MMS took this position, Sun claimed it would be due a credit of \$540,641.09 for overpayment of royalties.

In his decision dated July 17, 1986, the Director, MMS, affirmed Tulsa's deficiency assessment for Platform "B" gas. The Director denied Sun a credit of \$540,641.09 based on alleged overpayments for Platform "A" gas, because the Director found that the record indicates there is no overpayment. The Director based his determination on 30 CFR 250.64 (1979) which provides that the value of production for the purposes of computing royalty shall be the estimated reasonable value of the product as determined by the supervisor. The Director explained that the focus of 30 CFR 250.64 (1979) is on the "estimated reasonable value" of the gas as determined by the supervisor rather than the contract price as urged by Sun.

According to the Director, the "A" gas was not committed to the Transco sales contract and, in fact, was not sold at all. The Director found that Sun's use of the gas at Marcus Hook did not constitute an arm's-length sale to an unrelated party. The Director concluded that the supervisor properly valued the "A" gas at the highest available FPC rate for which such gas would have qualified had it been sold by Sun in the interstate market.

Finally, the Director found that there is no indication in the record that Sun appealed the "A" gas assessment within the time provided by 30 CFR

290.3(a) (1979) and therefore concluded that Sun's challenge based on the "A" gas assessment is barred.

In its statement of reasons, Sun reiterates its contention that it could never have sold the gas to third parties because the gas was reserved from commencement under the Transco contract. According to Sun, any gas not taken by Marcus Hook remained under the contract and was required to be sold to Transco under the section 104 old flowing gas price. Sun requests that the Board overturn the decision of the Director and allow it to recoup the excess royalties which resulted from MMS' requirement to value the gas at a price Sun could never have received.

In response, MMS asserts that Sun did not file a timely appeal with the Director in regard to the alleged overpayment of royalties on the Platform "A" gas. MMS refers to 30 CFR 290.3 (1979) which requires that orders must be appealed within 30 days. MMS admits that the file does not include a copy of the order assessing additional royalties on Platform "A" gas. However, MMS points out that there was no question that GS required Sun to pay additional royalties because Sun did, in fact, pay. BLM contends that Sun knew or should have known that it was required to appeal within 30 days, but did not file an appeal regarding royalty obligations on lease OCS-G 1752 until December 4, 1985. MMS asserts that even if Sun is not barred from filing an appeal by 30 CFR 290.3 (1979), it is barred by the doctrine of laches.

MMS contends that Sun's refund request must be denied because it has not met the requirements of section 10 of OCSLA, 43 U.S.C. | 1339 (1982). Under section 10, a request for a refund must be filed within 2 years after making the payment. MMS explains that Sun paid the additional royalties from Platform "A" gas in 1979 but did not submit its request for a refund until December 3, 1985. MMS asserts that this is 4\ years after the expiration of the 2-year period set by section 10. MMS notes that offsetting has been permitted after the 2-year period has expired when an overpayment and underpayment are made within the same audit period. MMS points out that the alleged overpayments and underpayments were identified by separate audits covering separate audit periods. MMS explains that even if it could offset, Sun would not be entitled to an offset of \$540,641.09. If the time period in which the overpayments were made is outside the 2-year time period set forth in section 10, the overpayment may only be offset by the amount of the underpayment and refund of any additional overpayment must be denied.

MMS asserts that the value of the gas used by Sun was higher than the price it received from Transco and therefore GS was correct in assessing royalties on a higher value. MMS refers to 30 CFR 250.64 (1979) which provides that the value of production for royalty purposes shall be the estimated reasonable value of the product as determined by the Supervisor.

Even assuming Sun's allegation were true, MMS asserts that it was a reasonable exercise of MMS' authority under the lease and regulations to establish a higher value than the contract price.

In reply Sun asserts that it should be able to raise the issue of the assessment of royalties on the Platform "A" gas in the appeal filed December 4, 1985. Sun explains that this should be allowed because the time frames established by these two audits, covering the same lease, overlapped and because MMS' position in the latter audit supported Sun's position in the former audit as to valuation at the Transco contract price.

[1] A threshold issue for consideration is whether Sun timely filed its appeal to the Director from the GS order assessing additional royalties for the Platform "A" gas. We find that it did.

The applicable regulation, 30 CFR 290.3 (1979), reads as follows:

(a) An appeal to the Director, Geological Survey, may be taken by filing a notice of appeal in the office of the official issuing the order or decision within 30 days from service of the order or decision. The notice of appeal shall incorporate or be accompanied by such written showing and argument on the facts and laws as the appellant may deem adequate to justify reversal or modification of the order or decision. Within the same 30-day period, the appellant will be permitted to file in the office of the official issuing the order or decision additional statements of reasons and written arguments or briefs.

The file does not include a copy of GS' demand letter for additional royalties for Platform "A" gas. We can assume that Sun received this letter because it paid the additional royalties and noted such payment in its letters dated May 17 and June 1, 1979. What we do not know is the date on which Sun received GS' demand letter. This fact is crucial to a determination of timely filing. In considering whether appeals to the Board are timely filed, the Board will not dismiss an appeal as untimely if the record transmitted with the appeal fails to establish that the decision from which the appeal is taken was served upon appellant in accordance with the regulations more than 30 days prior to the filing of the notice of appeal. Mobil Oil Exploration & Producing Southeast Inc., 90 IBLA 173 (1986). We find this holding applicable to the case in issue. There is no evidence in the casefile such as a return receipt card to verify the date on which Sun received GS' decision.

Furthermore, 30 CFR 290.2 (1979) provides in general that any party to a case adversely affected by a final order or decision of an officer of the Conservation Division, GS, shall have the right to appeal to the Director. The file does not include a copy of the demand letter. Therefore, we do not know whether GS' demand letter was a final decision or order within the meaning of 30 CFR 290.2 (1979) or whether Sun was informed of its appeal rights. See Inexco Oil Co., 45 IBLA 377 (1980).

We find that Sun's letter of May 17, 1979, meets the requirements of 30 CFR 290.3 (1979). We can safely assume that the addressee in Sun's letter, Oil and Gas Supervisor AC-5, GS, is the office which demanded the additional royalties because this is the office to which Sun made payment. Sun's letter states:

The payment of additional royalty on production emanating from the subject Block A-76 is made under protest, and Sun Oil Company (Delaware) through its Division Sun Gas Company, hereby reserves all of its legal rights to recover same.

The conclusion reached by the auditors that Sun Oil Company (Delaware) always had the option of selling residue gas to others than Transcontinental Gas Company is erroneous. All gas not taken for Sun Oil Company (Delaware) use had been and still is committed under the September 1, 1970 contract with Transcontinental Gas Company.

We find that Sun sufficiently established its reasons for appealing. Although Sun characterized this document as a protest, the characterization of a submission as a "protest" or as an "appeal" is not determinative whether it is an appeal. This determination can only be made by reference to the nature of the submission. Buck Wilson, 89 IBLA 143, 145 (1985); Duncan Miller (On Reconsideration), 39 IBLA 312, 315-16 (1979).

We shall next consider the substantive issue on appeal, that is, whether Sun undervalued its Platform "A" gas for royalty purposes by using the price it received under its contract with Transco rather than the "section 104 replacement/recompletion price," as determined by the supervisor to be the estimated reasonable value of the gas.

The Secretary of the Interior is authorized to lease tracts of the Outer Continental Shelf under OCSLA for the exploration and development of mineral resources, including oil and gas. 43 U.S.C. | 1337 (1982). In passing the Outer Continental Shelf Lands Act, Congress committed the Government to the goal of obtaining fair market value for Outer Continental Shelf (offshore) oil and gas resources. Watt v. Energy Action Educational Foundation, 454 U.S. 151, 162 (1981); Amoco Production Co., 78 IBLA 93 (1983), aff'd, Amoco Production Co. v. Hodel, 627 F. Supp. 1375 (W.D. La. 1986), vacated and remanded, 815 F.2d 325 (5th Cir. 1987). Computing the royalties payable for offshore gas production involves: (1) a determination of the amount of production on which royalties are to be paid; (2) a determination of the value of the gas produced; (3) a determination of the deductions to be allowed; and (4) application of the rate of royalty provided for in the lease. Id. at 96.

The Secretary of the Interior possesses considerable discretion for determining what is the "value" of production. The exercise of the Secretary's statutory discretion is found in the promulgation of 30 CFR 206.150, formerly 30 CFR 250.64 (1979), which establishes the factors to be considered when determining value for royalty computations.

30 CFR 250.64 (1979) provides:

The value of production, for the purpose of computing royalty, shall be the estimated reasonable value of the product as determined by the supervisor, due consideration being given to the highest price paid for a part or for a majority of production of

like quality in the same field or area, to the price received by the lessee, to posted prices, and to other relevant matters. Under no circumstances shall the value of production of any of said substances for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee from the sale thereof or less than the value computed on such reasonable unit value as shall have been determined by the Secretary. In the absence of good reason to the contrary, value computed on the basis of the highest price paid or offered at the time of production in a fair and open market for the major portion of like-quality products produced and sold from the field or area where the leased lands are situated will be considered to be a reasonable value.

Sun contends that the gas used at its refineries should be valued at the contract price because any gas not taken by the refinery would remain under contract to Transco. Sun explains that it could not be sold to third parties without abandonment of part of the reserves which are dedicated to interstate commerce. Information included in the audit report does not support Sun's theory. The audit report notes that Transco received a Certificate of Public Convenience and Necessity from FPC authorizing the transportation of gas from Block A-76 Field to the refineries. The certificate did not require that the gas be used in Sun's facilities. FERC informed the auditors that, barring unusual problems, a request by Sun to sell this gas on the open market would have been approved. Therefore, according to the audit, Sun always had the option of selling the residue gas on the interstate market.

The audit also points out that although the transportation agreement allowed the refinery to take deliveries of up to 60,000 Mcf of gas per day, Sun's records showed that the refinery did not always do so. The audit refers to Sun's 6-month update of the transportation agreement which shows that during the period July 1977 through December 1977, the refinery took deliveries averaging 50,200 Mcf of gas per day. The 6-month update also stated that "gas not needed by the refinery has continued to be sold under short term agreements."

Also in a letter agreement dated January 20, 1977, between Sun and Transco, Sun agreed to an emergency sale of gas normally utilized by Sun at Marcus Hook through the transportation agreement.

The information from the audit report shows that Sun had the option of selling the residue gas on the interstate market. Even if we were convinced by Sun's argument that the gas in issue were not available for interstate sale, MMS would not necessarily be bound by the contract price in determining the royalty. In Amoco Production Co. v. Hodel, *supra*, the court held that even when gas from a Federal lease is sold under an arm's-length contract, that contract price does not necessarily establish the royalty value of the gas. Sun cites Getty Oil Co., 51 IBLA 47 (1980), to support its contention that MMS cannot ignore the terms of the contract between Sun and Transco. While the Board in Getty did recognize the contract between Getty and its subsidiary, the Board also found that the contract price represented the fair market value of the gas. Therefore, under 30 CFR 250.64 (1979), MMS is not bound by Sun's contract.

In Amoco Production Co., 78 IBLA at 100, the Board held that "[w]here a party challenges a determination as to the value of gas or other hydrocarbons produced from a lease with the United States, the party must establish that the methodology used is, in fact, erroneous. Supron Energy Corp., 55 IBLA 318, 322 (1981), appeal pending, Atlantic Richfield v. Watt, Civ. No. 81-0615 (D.N.M. filed July 29, 1981)." Sun has not shown that MMS' methodology was erroneous.

Sun also appeals from two other decisions of the Director dated August 6, 1986. In MMS-86-0099-OCS the Director denied appeal from an order by the Regional Manager, Tulsa Regional Compliance Office, assessing late payment charges of \$262,382.23 for delinquent royalty payments on lease OCS-G 1752. In MMS-85-0259-OCS the Director denied an appeal from a Tulsa order (MMS-85-0259-OCS) assessing late payment charges of \$171,413.63 for delinquent royalty payments on lease OCS-G 2663. Sun contests this assessment to the extent of \$154,719.

In MMS-86-0099-OCS, Sun asserts that the assessment of additional royalties on lease OCS-G 1752 has been appealed (MMS-85-0314-OCS). Sun contends that in the event it is successful in this appeal, it should not be required to pay late payment charges.

In MMS-85-0259-OCS, Sun contends that it overpaid royalties in the amount of approximately \$540,000 on lease OCS-G 1752 and in the event it is successful in its appeal involving lease OCS-G 1752 it should not be charged interest of \$154,719 on lease OCS-G 2663. In other words, Sun contests the assessment of interest charges on one lease when Sun is in an overpaid status on another lease in the same audit.

In response, MMS contends that the late payment charges are proper. According to MMS, late payment charges on one lease cannot be offset against overpayments on another lease.

The regulation dealing with late payment charges, 30 CFR 218.150(b) states that "[t]he failure to make timely or proper payments of any monies due pursuant to leases \* \* \* subject to these regulations will result in the collection of the amount past due plus a late payment charge."

The time that royalty payments are due is set forth at 30 CFR 218.50(a):

Royalty payments are due at the end of the month following the month during which the oil and gas is produced and sold except when the last day of the month falls on a weekend or holiday. In such cases, payments are due on the first business day of the succeeding month. Rental payments are due as specified by the lease terms.

Under 30 CFR 218.150(b), the failure to make timely or proper payment of monies due under the lease will result in a late payment charge. The language of this regulation is clear. Since Sun did not pay a portion of its royalties within the time specified in the regulations, its payment was not "timely" and MMS properly assessed a late charge. The Board has

recognized that the United States should be compensated for the loss of the use of the funds due it under an express royalty computation and payment program. Amoco Production Co., 78 IBLA at 100. 1/

In light of the fact that we found no overpayments on the Platform "A" gas from lease OCS-G 1752, it is not necessary to discuss the offset issue raised by Sun. Also, the fact that the assessment of additional royalties for lease OCS-G 1752 was pending during this appeal is irrelevant to the assessment of late charges. 30 CFR 218.50(c) provides that "[a]ll payments to MMS are due as specified and are not deferred or suspended by reason of an appeal having been filed unless such deferral or suspension is approved in writing by an authorized MMS official." Since royalty payments are not suspended during appeal in the absence of MMS' approval, late payment charges must also be made, notwithstanding the fact that the royalty assessment is appealed.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, the decisions appealed from are affirmed.

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Franklin D. Arness  
Administrative Judge

I concur:

John H. Kelly  
Administrative Judge

1/ See also Peabody Coal Co., 72 IBLA 337 (1983), a decision involving a coal lease, in which the Board upheld the imposition of a late charge under a regulation similar to the one in issue.