

SUN EXPLORATION AND PRODUCTION CO.

IBLA 86-1502; IBLA 87-138

Decided January 5, 1989

Appeals from decisions of the Director, Minerals Management Service, denying credit for overpayment of royalties and assessing late payment charge. OCS-G 2327, OCS-G 2434, and OCS-G 2751.

Affirmed.

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

Allowance of setoff of royalty overpayments against royalty underpayments discovered by a Minerals Management Service audit made more than 2 years after the overpayment is confined to the individual lease under audit.

APPEARANCES: Thomas B. Deal, Esq., Dallas, Texas, for appellant; Cass Butler, Esq., Office of the Solicitor, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE ARNESS

Sun Exploration and Production Company (Sun) has appealed from a decision of the Director, Minerals Management Service (MMS), dated May 30, 1986, denying Sun a "credit" for its royalty overpayments against royalty underpayments. A second appeal has been filed by Sun to contest the Director's decision of July 16, 1986, affirming imposition of a late payment charge for the amounts involved in the Director's May 30 decision.

A "look back" audit performed by the Office of Inspector General for the period January 1, 1977, through August 31, 1981, concluded that Sun had underpaid royalties on lease OCS-G 2434 in the amount of \$1,702,000. As a result of the audit, MMS, by demand letter of September 11, 1985, directed Sun to pay this amount and informed Sun that late payment charges would be computed upon receipt of the royalty due. Sun filed an appeal to the Director, MMS, from this decision, contending that MMS failed to recognize credits totalling \$418,294 discovered "during, and as a result of, the Inspector

General Audit Report dated July 31, 1984." 1/ These credits, Sun stated, were attributable to royalty overpayments it had made on leases OCS-G 2327 and OCS-G 2751. 2/

The Director, MMS, affirmed the refusal of MMS below to recognize overpayments on OCS-G 2327 and OCS-G 2751 as an offset against Sun's underpayment on OCS-G 2434, but remanded the matter to the Royalty Management Program to determine whether Sun was entitled to a refund under section 10 of the Outer Continental Shelf Lands Act, 43 U.S.C. § 1339 (1982). In so holding, the Director relied on Shell Oil Co., 52 IBLA 74 (1981), and Mobil Oil Corp., 65 IBLA 295 (1982), two cases of this Board construing the refund provisions of section 10.

In its statement of reasons, Sun contends that MMS should credit Sun's overpayments against its underpayments because these payments were disclosed by a single audit conducted at the instigation of MMS, not Sun. The fact that multiple leases are involved in the present appeal should be irrelevant given the facts of this case, Sun argues. Appellant urges this Board to reject MMS' position that restricts offsets to overpayments and underpayments of royalties on a single lease.

Section 10 of the Outer Continental Shelf Lands Act, 43 U.S.C. § 1339 (1982), provides in part:

(a) Subject to the provisions of subsection (b) of this section, when it appears to the satisfaction of the Secretary that any person has made a payment to the United States in connection with any lease under this subchapter in excess of the amount he was lawfully required to pay, such excess shall be repaid without interest to such person or his legal representative, if a request for repayment of such excess is filed with the Secretary within two years after the making of the payment.

In Shell Oil Co., supra, the Board construed section 10 to permit Geological Survey (GS) 3/ to "offset" a royalty overpayment in November 1974 against a royalty underpayment in December 1974 where such payments had occurred on the same lease. The holding in Shell Oil Co., therefore, was predicated upon the principle that the purpose to be served by the audit review was to

1/ Notice of appeal to the Director, MMS, dated Oct. 10, 1985.

2/ Sun qualifies this statement slightly in its notice of appeal, stating that lease OCS-G 2751 was "inadvertently allocated" an overpayment made on lease OCS-G 2327. If this claim is true, an overpayment has occurred on only one lease, and the present controversy reduces to two leases, OCS-G 2434 and OCS-G 2327. Royalties on OCS-G 2434 are acknowledged by the parties to have been underpaid in the amount of \$1,702,000. Sun alleges, and MMS neither confirms nor denies, that royalty overpayments totalling \$418,294 were made on OCS-G 2327.

3/ The Conservation Division of GS has since been abolished and its functions have been assumed by MMS per Secretarial Order No. 3071. 47 FR 4751 (Feb. 2, 1982).

discover the amount owing on the lease under audit. The fundamental premise underlying that purpose was that the Department was obliged to fairly determine the amount actually owed, despite the fact that a reporting error in November 1974 had obscured the correct balance of the account.

Shell's underpayments and overpayments were revealed by a GS audit occurring some 4 years after the payments had been made and well beyond the 2-year period in which application to the Secretary to grant a refund is authorized. The Board stated:

Had Shell initiated a request in 1979 for a refund of its November 1974 overpayment, we believe Survey would have been correct in denying such request as untimely. In Phillips Petroleum Co., 39 IBLA 393 (1979), we so held. Where, however, Survey undertakes to audit a producer some 4 years after the payments at issue have been made, we hold that a sense of fundamental fairness requires Survey to recognize both a producer's underpayments and overpayments of royalty. We believe Survey should have properly offset Shell's underpayment by the amount of its overpayment. We do not believe that the 2-year period of limitations was established to give Survey a procedural advantage in computing royalty payments. The opinion of the Comptroller General of the United States involving an earlier royalty dispute is not inconsistent with the actions we take herein. Opinion B-156603, November 5, 1965.

Shell, *supra* at 78. The emphasis of the holding in Shell Oil Co. is not upon the fact that there was an audit, but upon the overall correctness of the lease account under review.

In a subsequent case, Mobil Oil Corp., 65 IBLA 295 (1982), the Board affirmed its position in Shell Oil Co. and directed GS to apply that holding to the facts present in Mobil's appeal. The concurring opinion in Mobil Oil Corp. contained the following passage applicable to Sun's appeal:

[O]ffsetting can be allowed only within the confines of each lease. If it is subsequently determined that excess overpayments exist for [the overpaid lease] such excess cannot be applied to cover any total underpayment which might be determined to exist for [the underpaid lease]. Leases are assessed royalty on an individual basis and any offsetting must be similarly limited.

Id. at 306. MMS asks the Board to apply this position in the present appeal.

[1] Our holding in Shell Oil Co. was based on the notion that it would be impermissible, in the course of an audit, to disregard the purpose for which the audit was being conducted: discovery of the amount of royalty actually owed on the lease. As the concurring opinion in Mobil Oil Corp. later pointed out, however, the fact that royalty audits are conducted by individual lease necessarily limits the application of our holding in Shell Oil Co. to individual leases within the audit.

The logic and necessity for this position becomes apparent when it is recognized that the royalty payor may be an operator who is the agent for a group of lessees. Ultimate liability for any underpayment of royalty, and credit for overpayment, remains with the lessees. The extent of the interest in an overpayment which the royalty payor or operator may be entitled to claim is not shown by the record before us. The record on appeal simply does not reveal how Sun would be entitled to setoff any overpayment on lease OCS-G 2327 or OCS-G 2751.

Further, it is more likely than not that lessees of a lease for which royalties are overpaid will be different in identity or percentage of lease ownership from the lessees of an underpaid lease. If the right of setoff were to be allowed in the uncritical fashion advocated by Sun, the rights of the lessees entitled to credit for overpayments could be infringed. Such lessees might then claim credit to setoff their overpayments against amounts owing for other lease accounts. Since Federal royalty revenue is not uniformly distributed ^{4/} allowance of such offsets would cause inequities for the recipients of such revenue.

We therefore affirm our decisions in Shell Oil Co. and Mobil Oil Co. We find that because leases are assessed royalty on an individual basis, any allowable offset must be discovered within the limits of an individual lease. Shell Oil Co., *supra*; Mobil Oil Corp., *supra*. While our decision in Shell Oil Co. establishes that the Department will recognize an offset on equitable grounds, it also requires that a party claiming an offset prove entitlement by showing that the interests claimed to be offsetting are so in fact. Given the circumstances of the Shell Oil Co. decision, it is clear that this holding limits any offset to the lease under review in any audit occurring more than 2 years following the royalty payments under examination.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decisions of the Director are affirmed.

Franklin D. Arness
Administrative Judge

We concur:

C. Randall Grant, Jr.
Administrative Judge

John H. Kelly
Administrative Judge

^{4/} Compare 43 U.S.C. § 1338 (1982) (Outer Continental Shelf royalties paid to U.S. Treasury) with 30 U.S.C. § 191 (1982) (50 percent of onshore oil and gas royalty paid to the state where the lease is located, except for Alaska, which receives 90 percent).

