

UNION OIL COMPANY OF CALIFORNIA

IBLA 87-759

Decided July 20, 1989

Appeal from a decision of the Director, Minerals Management Service, denying credit for overpayment against underpayment of royalties due on Federal offshore oil and gas leases OCS-G 1228 and OCS-G 1230 and OCS 0827.

Affirmed.

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

Crediting within an audit of overpayments against underpayments of royalty on oil and gas leases is properly limited to individual lease accounts. Credits may not be allowed (offset) between unrelated lease accounts because oil and gas leases are individually assessed for royalty due.

APPEARANCES: Dennis E. Butler, Esq., Houston, Texas, for appellant; Howard W. Chalker, Esq., Office of the Solicitor, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE ARNESS

Union Oil Company of California (Union) has appealed from a decision of the Director, Minerals Management Service (MMS), dated June 29, 1987, refusing to allow Union to credit claimed overpayments of Federal oil and gas royalty against underpayments. On April 21, 1986, Union was directed to pay additional royalties following an audit of royalty payments made by Union for liquid petroleum products produced from three offshore oil and gas leases and processed by the North Terrebonne Gas Plant from January 1, 1977, through December 31, 1982. While admitting additional royalty in the amount of \$87,014.52 was owed, Union sought to "offset" claimed overpayments of royalty against the underpayments among the three leases here under review. Union complained on appeal to the Director, MMS, that "billing Union for individual issues which arose out of the office of Inspector General's Six Year Lookback Audit \* \* \* destroys Union's ability to offset royalty overpayments which were paid on production from the federal leases which the OIG audited" (Union notice of appeal dated May 22, 1986, at 1).

Union has not identified the source of the claimed overpayments of royalty in the statement of reasons (SOR) filed on appeal. On appeal to the Director, MMS, dated May 22, 1986, however, Union refers to a "letter

dated August 22, 1985, [in which] Union requested numerous offsets against the federal leases involved in the Lookback Audit." MMS identifies these claimed offsets as a "refund [request] in the amount of \$173,230.66 in connection with Lease Nos. OCS-0827 and OCS-G 1228" (MMS Decision at 2). According to the MMS decision, the last of these claimed overpayments occurred in December 1970, prior to the 6-year audit which discovered the shortage in payments. *Id.* This claim, according to MMS, was rejected on May 20, 1985, because prohibited by the limitation on refunds established by 43 U.S.C. | 1339 (1982). *Id.* Except for the above-quoted reference in the Union letter of August 22, 1985, there is no explanation provided by Union concerning the source of the claimed overpayments which it seeks to offset against the admitted underpayment of royalty.

Union's SOR argues that "due process requires the MMS to recognize all overpayments made during the audit period for offset purposes" (SOR at 2). Union therefore sees the issue on appeal as whether MMS properly limited credits (offsets) within each individual lease.

First relying upon principles of bankruptcy law, Union argues "[f]undamental fairness dictates that all overpayments made during the same period be treated in the same manner; Union should be afforded co-extensive offset rights" (SOR at 4). Pursuing this argument further, Union argues "MMS was not simply examining one lease; \* \* \* MMS was verifying all royalty accounts between the parties" (SOR at 5). Union concludes that MMS "was requiring an accounting on a company basis in having the [Office of the Inspector General] engage in the Six-Year Lookback Audit. The MMS cannot conduct a company-wide audit and then claim it would be unmanageable and inefficient to require an accounting on a company-wide basis" (SOR at 6).

[1] In considering appellant's claim for an offset, we must begin by recognizing that section 10(a) of the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. | 1339(a) (1982), requires that any request for a refund of overpayments be filed within 2 years of the payment. The Board has held that this statute limits the authority to refund overpayments to those requests filed with MMS within 2 years of the overpayment. Shell Offshore, Inc., 96 IBLA 149, 94 I.D. 69 (1987); Phillips Petroleum Co., 39 IBLA 393 (1979). A legislative purpose to "require lessees to promptly verify their accounts and ascertain the correctness of payments made within the time provided" has been recognized. Phillips Petroleum Co., *supra* at 398. It is true as appellant points out that a limited exception to this rigid statutory limitation has been recognized in the context of an audit. Noting that the statutory 2-year period was not designed to give the Department a procedural advantage in computing royalty payments, we have held that where the Department undertakes to audit a producer more than 2 years after the payments at issue have been made, fundamental principles of fairness require the Department to recognize both the producer's underpayments and overpayments of royalty and to offset the underpayment by the amount of the overpayment. Shell Oil Co., 52 IBLA 74, 78 (1981). The Board has limited this exception to the offsetting of overpayments on a given lease against underpayments on that lease. Sun Exploration & Production Co., 106 IBLA 300 (1989). In Sun Exploration & Production Co., *supra*, we considered several of the ways in which one lease account may differ significantly from another

lease account and, thus, render cross-lease offsets both unfeasible and inequitable to adversely affected third parties (particularly parties with an interest in lease royalties). 106 IBLA at 303. Restriction of offsets to a single lease account is consistent with the statutory purpose and distinguishable from allowing a credit for an overpayment which the Department has no authority to refund against an underpayment on a different lease. Thus, prior Board decisions establish that offsetting of overpayments against underpayments may only take place after audit and within the royalty account of a single lease. Offsetting between leases is not permitted, because Federal oil and gas leases are individually assessed royalty and prudential considerations prevent crediting between leases. Mesa Petroleum Co., 108 IBLA 149 (1989); Sun Exploration & Production Co., *supra*.

Nonetheless, Union argues, citing our opinion in Shell Offshore, Inc., *supra*, that the rule announced in our decisions cited above should have been the subject of formal rulemaking pursuant to the Administrative Procedure Act. Failing such action, "Union maintains that this restrictive interpretative policy cannot be used by the MMS to deny legitimate offset rights" (SOR at 8).

This argument misconstrues our opinion in Shell Offshore, Inc., in a most peculiar manner. In Shell Offshore, Inc., we were confronted with arguments seeking to characterize notices published by MMS in the Federal Register as either "interpretive" or "substantive" rules. Looking to Chrysler Corp. v. Brown, 441 U.S. 281 (1979), for guidance, we determined that such characterization was unhelpful and unnecessary, and found that

there is no need to determine whether MMS' notices constitute such rules and regulations within the authority of [the Outer Continental Shelf Lands Act] or to delve into the complexities of the differences between substantive and interpretive rules and concomitant questions about substantial impact. If a rule is substantive, it must be promulgated in accordance with the APA in order to have the "force and effect of law." Nothing in the notices issued by MMS indicates that they were published pursuant to the notice and comment rulemaking procedures described by 5 U.S.C. | 553 (1982). Thus, they cannot have the force and effect of law. The same is true if, on the other hand, the notices are interpretive rules. [Citations omitted; emphasis in original.]

Shell Offshore, Inc., 96 IBLA at 171-72, 94 I.D. at 82. Similarly here, the characterization of the decisionmaking by MMS as either interpretive or substantive is unhelpful to a determination whether the agency had the authority to proceed as it did, by refusing to allow credit for overpayment between individual lease accounts. Characterization of the issue as interpretive or substantive does not further the inquiry concerning whether the MMS audit of each individual lease, which is the issue in this appeal, was correct.

To keep this matter in perspective, it should perhaps be observed, as it was in Sun Exploration & Production Co., *supra*, that section 10 of OCSLA, 43 U.S.C. | 1339 (1982), limits repayment of excess payments to cases where

a request for repayment is received by the Secretary within 2 years of the time payment was made. In this appeal we are dealing with a contention that credit should be allowed for transactions which occurred over 2 years prior to Union's claim that it be allowed a credit. Union concedes that it cannot claim a refund under section 10 when it states that "Union is not claiming a royalty refund right under Section 10" (SOR at 2). The issue before us is, therefore, very narrow, concerning as it does only whether Union should be allowed to offset overpayments between leases in an audit covering a 6-year period running from 1977 through 1982.

MMS concedes that it has not issued regulations dealing with questions concerning how credits might be set off against underpayments of royalty. This subject area has developed in decisionmaking within the Department. We explained the development of the "rule" that an "offset" might be permitted in certain cases of royalty audit accounting in Sun Exploration & Production Co.:

In Shell Oil Co., [52 IBLA 74 (1981)], the Board construed [43 U.S.C. | 1339 (1982)] to permit [the predecessor of MMS] 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 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. [Emphasis in original.]

Id. at 301. The same principle applies here. The purpose of the audit of each individual lease, which is at the bottom of the issue before us on appeal, concerns the correctness of royalty payments made upon the individual leases under audit within the audit period. It is not fundamentally unfair to so limit the audit in scope of review; but it is essential to proper lease administration to do so. Significantly, Union has not complained about the 6-year audit practice itself, nor questioned directly the authority of MMS to conduct such audits. We adhere to our prior decisions limiting crediting of overpayments against underpayments to each individual lease regardless whether other leases may also be subject to audit at the same time. Sun Exploration & Production Co., supra.

An appeal to fundamental fairness, as MMS points out in its answer, must also consider the effect that offsetting of accounts might have upon MMS, and leads to a conclusion that "limiting the offsetting required under Shell Oil Company, supra, to a single lease is a fair manner in which to administer these separate leases and to balance equities between both parties to the [lease] agreement" (MMS Answer at 5). There can be no doubt that MMS has the power, under OCSLA, 43 U.S.C. || 1301-1356 (1982), to determine the amount of royalty owed on leases governed by and maintained pursuant to the Act. Union has failed to show that, within the audit period, MMS has not accurately accounted for the royalty owed within each individual lease account, considered separately.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the MMS decision is affirmed.

Franklin D. Arness  
Administrative Judge

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I concur:

C. Randall Grant, Jr.  
Administrative Judge