FMP OPERATING CO.

IBLA 90-7 Decided December 13, 1991

Appeal from a decision of the Director, Minerals Management Service, denying consolidated appeals from eight demand letters of the Chief, Royalty Compliance Division, Royalty Management Program, Minerals Management Service, requiring payment of additional royalties. MMS-87-0091-O&G.

Affirmed in part, set aside in part, and remanded.

1. Oil and Gas Leases: Royalties: Generally

An operator and lessee have an affirmative duty to obtain the best possible price for the benefit of the royalty owner, consistent with reasonable business judgment. Therefore, when the contract under which the natural gas is being sold provides for payment at the highest obtainable ceiling price under the NGPA, 15 U.S.C. §§ 3301-3432 (1988), the operator or lessee has an affirmative duty to seek classification under the NGPA section affording the best possible price. If the operator or lessee fails to exercise due diligence in obtaining a classification affording a higher sales price, the royalty may properly be calculated as if the higher sales price had been paid.

2. Oil and Gas Leases: Royalties: Generally

MMS properly requires the payment of additional royalties where reimbursements for State production taxes made by the purchaser of natural gas produced from an onshore oil and gas lease were improperly excluded from the value of that gas for royalty computation purposes.

3. Oil and Gas Leases: Royalties: Generally

In an audit of royalties on natural gas produced from an onshore oil and gas lease, MMS need not consider offsetting underpayments with overpayments if there is no substantive evidence that overpayments occurred or the extent of the overpayments. MMS may not disallow an offset, however, when the basis for disallowing the offset is an unsupported assumption that an overpayment has already been recouped.

APPEARANCES: M. Julia Hook, Esq., Denver, Colorado, for appellant; Howard W. Chalker, Esq., Peter J. Schaumberg, Esq., and Geoffrey Heath, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE MULLEN

The FMP Operating Company (FMP) has appealed from a May 26, 1989, decision of the Director, Minerals Management Service (MMS), denying its consolidated appeals from eight demand letters directing FMP to pay additional royalties totalling $451,235.99.

The royalties in question accrued in the years 1979 through 1984 for natural gas produced from 14 Federal oil and gas leases and certain other Federal oil and gas leases committed to the Whitewater (14-08-001-014223-C) and Ashfield (14-08-001-013872-B) units, all in Phillips and Valley Counties, Montana. 1/ The gas was sold by Midlands Gas Corporation (Midlands) and other working interest owners, and purchased by the Kansas-Nebraska Natural Gas Company, Inc., now K N Energy, Inc. (hereafter referred to as Kansas-Nebraska), pursuant to various gas purchase agreements. FMP is successor-in-interest to Midlands and the operator of the leases, communitized areas, and units from which the gas was produced, and, thus, is responsible for any royalty deemed owing but unpaid by Midlands.

This action stems from an audit of Midlands' royalty payments by the Montana Department of Revenue (Montana DOR). The audit was conducted under delegated authority granted by MMS pursuant to section 205 of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), 30 U.S.C. § 1735 (1988). After its audit, Montana DOR concluded that Midlands had failed to value production at the highest obtainable ceiling price under the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. §§ 3301-3432 (1988), and failed to include the amounts that Kansas-Nebraska had reimbursed the sellers (based on Montana State production taxes paid by the sellers) as a part of the proceeds from the sale of natural gas. 2/ As a result, Montana DOR determined that Midlands had undervalued its production when calculating royalties. Based on Montana DOR's findings, the Chief, RCD, issued eight demand letters between January 12 and 30, 1987, directing FMP to pay additional royalties totalling $444,924.21. FMP filed timely appeals to the MMS Director, which were consolidated under docket number

1/ The individual leases are listed as follows: 053-016287, 053-015656-A, 053-008555, 053-015659-A, 053-015820, 053-015761, 053-015761-A, 053-015402, 053-009161, 053-030887-A, 053-015656-B, 053-030887-B, 053-011627, and 053-015890-A. Many of these leases are within communitized areas.

2/ The State production taxes included "Montana's Net Proceeds, Severance, Resource Indemnity Trust, and Conservation Taxes." See Letter from Chief, Royalty Compliance Division (RCD), Royalty Management Program, MMS, to FMP, dated Jan. 14, 1987, at 3.

MMS-87-0091-O&G. 3/ In his May 1989 decision, the Director addressed each of the issues raised by FMP and denied FMP's consolidated appeals. FMP then appealed to this Board.

On appeal, FMP again raises two principal issues it had raised before the Director. The first is whether MMS can set the value of the natural gas sold at the highest ceiling price which Midlands and others could have obtained at the time of sale. The second is whether reimbursements made by Kansas-Nebraska for Montana State production taxes paid by Midlands and others should be included as a part of the sales price of the natural gas for royalty computation purposes. FMP also questions the accuracy of the audit. We will address the principal issues first as they will have bearing on the royalty owed, regardless of the accuracy of the audit.

[1] The Director, MMS, held that MMS is entitled to compute the royalty due using the highest applicable NGPA ceiling price for the subject gas at the time of sale, even though Midlands and others had valued the gas at 100 percent of the NGPA maximum lawful price for which the gas had been certified at the time of sale. This dispute arises from the sellers' apparent failure to seek and receive a higher NGPA classification for the production sold to Kansas-Nebraska. To allow a more precise understanding of the issue, we will set out the relevant wording of the amended December 21, 1973, agreement between Midlands and Kansas-Nebraska:

> Should the Federal Power Commission [(FPC) (now the Federal Energy Regulatory Commission)], at any time hereafter, prescribe for the FPC pricing area in which [the] lands [involved here] * * * are located a just and reasonable rate which is higher * * * than the price herein provided and which rate shall be applicable to the purchase of gas of substantially the same quality and on comparable terms and conditions, then the price hereunder shall be increased * * * to equal such higher * * * rate as prescribed. [Emphasis added.]

(Statement of Reasons (SOR) at 50). This provision is apparently also found in the gas purchase agreements of the other working interest owners.

All of the parties had received NGPA certification for the gas sold to Kansas-Nebraska, and the price paid was the NGPA ceiling price assigned to the NGPA section under which the production had been certified at the time of sale. For example, from September 1982 through June 1983 the gas

3/ Following FMP's appeal to the Director, Montana DOR reviewed FMP's allegations of factual errors in Montana DOR's audit and concluded that certain of the amounts stated in MMS' January 1987 demand letters should be adjusted with the total royalty amount deemed owing revised to $451,235.99. In forwarding FMP's appeal to the Director, MMS recommended that its demand should similarly be altered. See Memorandum from the Chief, Office of State and Tribal Program Support (OSTPS), MMS, to the Chief, Division of Appeals, MMS, dated Sept. 30, 1987, at 2. MMS' recommendation was adopted by the Director in his May 1989 decision.

produced from lease No. 053-016287 was sold at the ceiling price under section 109. The production was certified under section 102 in July 1983 and the gas was subsequently sold at the section 102 ceiling price. Montana DOR recalculated the royalty for the period from September 1982 through June 1983 using the section 102 ceiling price, rather than the lower section 109 ceiling price used by Midlands. According to Montana DOR the section 102 NGPA ceiling price was used because Midlands could have obtained payment at the higher section 102 NGPA ceiling price from the beginning:

> Since Midlands did receive the NGPA Section 102 certification when it did apply, §102 pricing obviously constitutes reasonable value. In addition, it is the responsibility of the lessee to act prudently and promptly to obtain the full value of the product for the benefit of the royalty owner. Here, Midlands could have applied for and begun collecting the higher NGPA price at an earlier date but failed to do so. [FMP], not the government, must bear the consequences of its inaction.

(Memorandum to the Chief, OSTPS, from Montana DOR, dated July 10, 1987, at 9).

We are not persuaded by FMP's argument that Montana DOR "disregarded" the NGPA ceiling prices applicable under the gas purchase agreements when it selected higher NGPA ceiling prices. There is no reason to dispute FMP's contention that the royalties paid were based upon the amounts actually paid by Kansas-Nebraska under the terms of the contracts. However, in this case, the proper basis for determining the royalty due and owing the Federal Government is the highest price that could have been received under the various contracts with Kansas-Nebraska, had the sellers been diligent in seeking NGPA reclassification of its production. It matters not that Kansas-Nebraska properly paid a lower price for the gas sold, based on the NGPA classification in effect at the time of sale.

Regulated ceiling prices and the prices received by lessees are both relevant factors when considering the value of production for royalty purposes under 30 CFR 206.103 (1985) (formerly 30 CFR 221.47 (1978) and 30 CFR 221.110 (47 FR 47774 (Oct. 27, 1982))), the regulation in effect at the time of production. See Phillips Petroleum Co., 117 IBLA 230, 233 (1990) (offshore leases); Mobil Oil Corp., 115 IBLA 304, 310 n.7 (1990) (offshore leases). The regulated ceiling prices assume an even greater importance in this case because they are incorporated into the gas purchase agreements as a material basis for establishing the sales price for the natural gas produced and sold. At all times during the audit period, Midlands and the other working interest owners had the ability to seek and, if warranted, gain certification of the production from the leases in question under the various NGPA sections. When a classification change was sought and obtained, the price paid by Kansas-Nebraska became the new NGPA ceiling price under the applicable section, without action on the part of Kansas-Nebraska.

The concept key to resolution of this issue is set out in Transco Exploration Co., 110 IBLA 282, 96 I.D. 317 (1989). An operator and a lessee have an affirmative duty to obtain the best possible sales price for the benefit of the royalty owner, consistent with reasonable business judgment. When the operator or lessee fails to carry out this responsibility it is proper for the royalty owner to seek payment based upon the higher sales price. Id. at 326-27, 96 I.D. at 384; Phillips Petroleum Co., supra at 236. If Midlands was selling gas subject to a royalty and was paid the ceiling price under section 109 of NGPA, when it became eligible for classification under section 102 of NGPA, it would be obligated to seek section 102 certification or show why remaining certified under section 109 was consistent with reasonable business judgement. If it did not seek recertification under section 102 and could show no reasonable business basis for maintaining certification under section 109, it would be liable for royalties that would have accrued as if it had been certified under section 102.

Montana DOR calculated and MMS assessed royalties at the higher rates when they determined that Midlands and the others could have applied for and been granted certification under NGPA sections having higher ceiling rates, which would have automatically resulted in an increase in the amount paid under the Kansas-Nebraska agreements. Midlands and the other working interest holders had the duty to obtain the best possible price for the benefit of the royalty owner, consistent with reasonable business judgment, and when they did not they breached their duty to the royalty owner. FMP has provided no evidence to the contrary. In particular, FMP offers no proof that Midlands and the other working interest owners would have been unable to obtain reclassification under an NGPA section having a higher maximum allowable gas price or that remaining certified under a section with a lower ceiling price was consistent with reasonable business judgment. Thus, MMS properly assessed royalty based on the highest applicable NGPA ceiling prices. See Phillips Petroleum Co., supra at 236.

[2] We next address the issue of whether MMS is entitled to compute royalty on the basis of the value of production, including reimbursements for State production taxes. During the entire audit period, 30 CFR 206.103 (1985) provided, in relevant part, that "[u]nder no circumstances shall the value of production * * * for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee from the sale thereof." We have long held that this regulation requires the Department to include tax reimbursements paid by the purchaser of gas produced from a Federal lease in the value of production for royalty computation purposes, when the reimbursements constitute part of "gross proceeds." 4/

4/ We find no contrary language in the Mineral Leasing Act, as amended, 30 U.S.C. §§ 181-287 (1988), and have held that Congress endorsed this proposition where the Notice to Lessees Numbered 5 Gas Royalty Act of 1987 (NTL-5 Act), P.L. 100-234, 101 Stat. 1719 (1988), "effectively ratified" the Notice to Lessees and Operators of Federal and Indian Onshore Oil and Gas Leases Numbered 5 (NTL-5) (42 FR 22610 (May 4, 1977)) valuation of gas for royalty computation purposes based on gross receipts from the purchaser, including reimbursements for state taxes. See Tricentrol United States, Inc., 105 IBLA 392, 395 (1988).

See Miami Oil Producers, Inc., 116 IBLA 345, 347 (1990); CIG Exploration, Inc., 113 IBLA 99, 103 (1990), appeal filed, CIG Exploration, Inc. v. Lujan, No. H-90-1564 (S.D. Texas May 11, 1990). Tax reimbursements are to be included even though the reimbursements are limited to taxes assessed against the share of production allocated to the working interest owners, excluding production attributable to the Government's share, because the reimbursements are a part of the negotiated purchase price for all of the production. See Enron Corp., 106 IBLA 394, 397-98 (1989).

Under the terms of the agreements reviewed during the course of the audit, Kansas-Nebraska reimbursed Midlands and the other working interest owners for State production taxes they paid. The amounts reimbursed were received in accordance with the provisions of the gas sales contracts. We, therefore, affirm the Director's May 1989 finding that it was proper to include State production tax reimbursements as a part of the value of production for royalty computation purposes.

[3] FMP also asserts that the Montana DOR audit was "so inconsistent and problematic" that when MMS accepted the audit MMS failed to fulfill its responsibility to properly audit and reconcile lease accounts under section 101(c) of FOGRMA, 30 U.S.C. § 1711(c) (1988) (SOR at 12). FMP lists what it considers to be specific examples of inconsistencies and problems found during FMP's review of the Montana DOR audit of the relevant royalty payments and refers to an April 1, 1987, affidavit of Thomas P. Jirkovsky, an independent oil and gas consultant hired by FMP, for an analysis of that audit. See SOR at 12. Most of the alleged deficiencies noted by FMP pertain to Montana DOR's purported failure to "offset" royalty underpayments with rental and minimum and advance royalty overpayments, i.e., "lease maintenance payments." E.g., id. at 17. FMP states that these overpayments created credit balances which were either outstanding at the beginning of the audit period or accrued sometime during that period. In many cases, FMP specifies the exact credit balance and the leases to which it applies. In other cases, FMP simply asserts that credit balances exist and identifies the leases or units involved.

Each of the purported failures to offset royalty underpayments was reviewed by Montana DOR. See Memorandum from Montana DOR to the Chief, OSTPS, dated July 10, 1987, at 7-8, 10-11, 12, 14. Montana DOR and the Department jointly attempted to determine whether any credit balances existed for particular leases and units but were unable to confirm the existence of the balances because FMP was unable to provide "enough specific information" to allow Montana DOR to "track the payments." Id. at 14. Montana DOR concluded that, given the number of leases involved (over 130), it was "virtually impossible" to determine whether any overpayments had occurred as a result of payments made "in error [or] * * * booked to the wrong lease," and that FMP was "in the best position to know what payments have been made and which have been recouped, refunded, or otherwise adjusted." Id.

MMS accepted Montana DOR's analysis, concluding that FMP failed to substantiate its claim to offsets against royalty underpayments. See Memorandum to the Chief, Division of Appeals, from the Chief, OSTPS, dated Sept. 30, 1987; Memorandum to the Chief, Division of Appeals, from the Chief, RCD, dated Apr. 4, 1988. The Director also concluded that FMP had failed to submit "full and sufficient documentation" supporting its claims, after an "extended opportunity [to do so] throughout this proceeding" (Decision at 5). On appeal to this Board, FMP reiterates its allegations of Montana DOR's purported failure to offset royalty underpayments, contending that, when MMS claims that the responsibility for demonstrating entitlement is with the operator, MMS is shirking the responsibility imposed upon it by FOGRMA.

Clearly, MMS is responsible for determining in the first instance whether an overpayment had occurred and whether to allow an offset. See Mobil Oil Corp., 65 IBLA 295, 304 (1982). MMS made this determination based upon the audit and subsequent findings of its delegate, Montana DOR, and held that no overpayments warranting offsets had been made. On appeal FMP must demonstrate error in the MMS determination, i.e., it must show that MMS should have allowed an offset. See Sun Exploration & Production Co., 106 IBLA 300, 303 (1989).

FMP did not substantiate its claim of unrefunded or uncredited overpayments, and thus was unable to show that an offset should have been allowed. With one possible exception, it has thus failed to carry its burden of proof on this point. 5/ This failure is perhaps explained by the fact that FMP's records, inherited from Midlands, are "less than complete" (Letters to Montana DOR from FMP, dated June 20 and July 24, 1986, at 4). However, the state of the records it received from its predecessor-in-interest will not excuse FMP from satisfying its burden of proof.

Having found that FMP did not substantiate its entire claim to offsets, we also find that MMS should have allowed an offset for certain of the overpayments. Montana DOR initially allowed FMP to offset verifiable overpayments under lease Nos. 053-015402 and 053-009161. 6/ FMP substantiated the existence of overpayments to the extent offsets were initially allowed. However, Montana DOR then rejected the offsets based on its "assum[ption] that [FMP] may have already recouped the minimum royalty payment(s) since MMS advance approval to recoup overpayments on Federal

5/ FMP has submitted no cancelled checks or other evidence of overpayments or when overpayment might have occurred, in order that the payments might be tracked. The lone exception is a copy of a July 27, 1982, check, which FMP purports to be overpayment of minimum royalties for lease No. 053-016287 for the period Sept. 1, 1981, to Aug. 31, 1982. See Exh. Q, Letter to the Director from FMP, dated Nov. 28, 1987. On remand, MMS should consider FMP's argument that the "Remittance Advice" attached to the check, which states that the check is payment of minimum royalties for the period starting Sept. 1, 1982, is "in error" (SOR at 19).

6/ Montana DOR initially allowed FMP an offset in the amount of $639 and $440, respectively, in the case of lease Nos. 053-015402 and 053-009161, with respect to minimum royalty payments. See Memorandum to the Chief, OSTPS, from Montana DOR, dated July 10, 1987, at 10-11, 12.

Onshore leases is not required" (Memorandum to the Chief, OSTPS, from Montana DOR, dated July 10, 1987, at 11, 12). The Director ultimately affirmed rejection of those offsets.

Notwithstanding the fact that MMS need not approve recoupment in advance, FMP correctly argues at page 27 of its SOR that there must be "evidence of a recoupment" for MMS to disallow an offset because an overpayment has already been recouped. MMS cannot simply assume recoupment when there is no evidence of one in the record. 7/ To the extent that the Director's May 1989 decision affirmed Montana DOR's disallowance of offsets for lease Nos. 053-015402 and 053-009161, it is set aside. It is important to note, however, that the offsets available to FMP are limited to the amount of the verifiable overpayments. We therefore find it appropriate to remand this case to MMS to allow it to determine the verified overpayments, allow the appropriate offsets and recalculate the royalty due after making necessary adjustments.

In the text of this decision above we found it proper for MMS to recompute royalties based on the highest applicable NGPA ceiling price. However, questions remain as to whether MMS used the correct ceiling prices in every instance. Our concern is based upon discrepancies.

For lease No. 053-009161, Montana DOR found an underpayment for the period from September 1979 to March 1980 because Midlands had sold the gas at NGPA section 104 ceiling prices which was less than the royalty using NGPA section 103 ceiling prices. See SOR at 25-26. For this lease, the NGPA ceiling prices and time periods cited by FMP do not match the reports in the original issues letter prepared by Montana DOR on March 11, 1986. In that letter Montana DOR states that well # 3415-1 on lease No. 053-009161 was certified under NGPA section 103 until May 1983, when it was recerti-fied under NGPA section 108. Conflicting statements in the July 10, 1987, Montana DOR memorandum to the Director, MMS, make this conclusion questionable. Conflicting statements in consecutive sentences at page 5 indicating first, that well # 3415-1 was a section 103 well until April 1980 and then that certification as a section 108 well was obtained in May 1983. At page 11 of the same memorandum, Montana DOR asserts that the gas was properly valued under NGPA section 103 from September 1979 to December 1984 despite the fact Midland was paid under NGPA section 104 from September 1979 to March 1980. The spreadsheet reflecting the calculation of royalties due for well # 3415-1 attached as an exhibit to the July 10, 1987, memorandum reflects use of an NGPA section 103(c) price until May 1983 and an NGPA

7/ The portion of MMS' "Oil and Gas Payor Handbook" (Sept. 30, 1986), found in the record, states in section 4.4.5 that a payor "recoups an overpayment on a Federal onshore lease by entering two lines on Form MMS-2014. The first line reverses the overpayment entry. The second line records the correct quantities and (or) values for the sales month in which the overpayment was made." The record before us contains no MMS-2014 forms showing recoupment of minimum royalty overpayments by either Midlands or FMP. Jirkovsky's Nov. 25, 1987, affidavit states that FMP did not seek recoupment of overpayments for lease Nos. 053-015402 and 053-009161.

section 108(b) price thereafter. No explanation for these discrepancies can be found in the record.

All of this leads us to question whether either FMP or Montana DOR is simply incorrect with respect to the particular NGPA section actually relied upon to value production and that, in any case, the correct section was used or whether the wrong NGPA section was chosen because the relevant well would not have qualified for that certification. Since we have deemed it appropriate to set aside the Director's May 1989 decision in part and remand the case to MMS for further consideration, we also deem it appropriate for MMS to consider whether the correct NGPA ceiling price was used for lease No. 053-009161 during the entire audit period. To the extent that FMP is able to identify discrepancies between the applicable NGPA ceiling prices and those used by Montana DOR appropriate adjustments to the royalty amount owing should be made. 8/

FMP contends MMS erred in yet another respect when adopting Montana DOR's audit. According to FMP, Montana DOR failed to consider whether gas was sold by non-operating working interest holders and a prior operator (for some time in the case of lease No. 053-008555) based upon the same terms as the gas purchase agreement between Midlands and Kansas-Nebraska when Montana DOR calculated the value of the gas sold. In particular, FMP states that Montana DOR did not examine the other contracts to determine whether they also provided for payment according to the NGPA ceiling price and reimbursements of State production taxes.

In its assessment of FMP's charges, Montana DOR asserted that it had "requested, received, and reviewed the applicable gas purchase contracts between K N Energy, Inc. (Purchaser) and [FMP] and other third parties (Sellers). During the [Montana DOR] audit period all of the contracts provided for the applicable NGPA price and 100% tax reimbursements to be paid to the [Sellers]" (Memorandum to the Chief, OSTPS, from Montana DOR, dated July 10, 1987, at 14; emphasis added). This assertion was confirmed by MMS (see Memorandum to the Chief, Division of Appeals, from the Chief, RCD, dated Apr. 4, 1988, at 2) and adopted by the Director (see Decision at 4). FMP has presented no evidence to the contrary. 9/ Accordingly, we

8/ FMP also challenges Montana DOR's use of NGPA section 108 ceiling prices to value production from lease No. 053-008555 between September and November 1982. FMP claims that the applicable wells had "lost their § 108 status" because production then exceeded a particular limit (SOR at 21). According to Montana DOR, the wells did not lose section 108 status because the NGPA provided for retention of that status when the increased production results from applying recognized enhanced recovery techniques (see 15 U.S.C. § 3318(b) (1988)). See Memorandum to the Chief, OSTPS, from Montana DOR, dated July 10, 1987, at 9-10.

9/ We note that the Apr. 1, 1987, Jirkovsky affidavit, upon which FMP's allegation was based, merely states that the "Montana auditors do not appear to have examined or relied on the gas purchase contract[s of the non-operators]." Id. at 1, 2, 3, 4 (emphasis added). We are unable to give much weight to this equivocal assertion.

are persuaded that Montana DOR considered the terms of all of the appli-cable gas sales contracts with Kansas-Nebraska during the audit period, and MMS committed no error in this respect when adopting Montana DOR's audit.

FMP also contends that MMS acted contrary to section 205(b) of FOGRMA, 30 U.S.C. § 1735(b) (1988), when it improperly delegated its authority to audit royalty payments for production from the Whitewater Unit allocated to Federal leases because the delegation imposed an unreasonable burden on the Federal leases by subjecting them to a separate "duplicative" audit by MMS (SOR at 17). The Whitewater unit contains both Federal and Indian leases. Montana DOR has no authority under section 205(a) of FOGRMA, 30 U.S.C. § 1735(a) (1988), to audit production allocated to the Indian leases without the consent of the Indian tribes involved and it apparently has not received that authorization. Thus, FMP argues that it is subject to an additional MMS audit of the Whitewater Unit when MMS audits production from Indian leases in that unit.

We cannot conclude that MMS violated this statutory provision when delegating its audit authority to the State. Under section 205(b) of FOGRMA, the Secretary is authorized to delegate audit responsibilities under that Act if the "delegation will not create an unreasonable burden on any lessee." 30 U.S.C. § 1735(b)(3) (1988). Undoubtedly, there may be some overlap in the audits of royalty payments when a unit contains both Federal and Indian leases, but we are not persuaded by FMP's arguments that this is unreasonably burdensome.

Next, FMP points to two errors in the Montana DOR audit, which were corrected by Montana DOR after they were noted by FMP. FMP claims that these errors raise doubts about the accuracy of the audit. 10/ See SOR at 14, 17-18. We cannot assume that the State audit is fatally flawed by being fraught with inaccuracy on the basis of two errors that Montana DOR recognized and corrected in response to FMP's suggestion.

Finally, FMP renews its allegation that use of NTL-5 as the basis for valuing production at the highest obtainable NGPA ceiling price plus the State production tax reimbursements. Noting that the subject Federal oil and gas leases were issued between June 1, 1968, and September 1, 1970, and NTL-5 was promulgated effective June 1, 1977, it argues that NTL-5 is not binding on FMP because it is an instruction rather than a regulation and may not be applied retroactively to previously issued leases.

The status of NTL-5 was answered by Congress when it enacted the NTL-5 Act on January 6, 1988. That Act provided that NTL-5 "was a duly promulgated rule of the Department." 101 Stat. 1719 (1988). Also, by its terms, NTL-5 applies to any production after June 1, 1977, regardless of whether

10/ These errors were the failure to use the proper participation factors for the Whitewater Unit and the failure to audit acquired lands leases in the case of the Ashfield Unit. See SOR at 13, 17.

such production is from a lease issued before that date, and is thus applicable to leases issued prior to its promulgation. Its application to production after the date of promulgation is clearly prospective and not retroactive.

In any case, MMS correctly contends that during the entire audit period it had authority under 30 CFR 206.103 (1985), independent of NTL-5, to value production for royalty purposes considering various factors (including regulated prices), but at not less than the gross proceeds accruing to the lessee. We agree. See Marathon Oil Co. v. United States, 604 F. Supp. 1375, 1382 (D. Alaska 1985), aff'd, 807 F.2d 759 (9th Cir. 1986), cert. denied, 480 U.S. 940 (1987). As discussed above, this independent authority is the basis for valuing the natural gas production in this case, taking into consideration the obligation of the operator and lessee to obtain the best possible price for the benefit of the royalty owner, consistent with reasonable business judgment.

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 in part and set aside in part and the case is remanded to MMS for further action consistent herewith.

R. W. Mullen
Administrative Judge

I concur:

C. Randall Grant, Jr.
Administrative Judge