

INTERIOR BOARD OF LAND APPEALS

Union Exploration Partners, Ltd.

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UNION EXPLORATION PARTNERS, LTD.

IBLA 89-226

Decided September 23, 1993

Appeal from a decision of the Director, Minerals Management Service, upholding an assessment for additional royalties. MMS-87-0175-OCS.

Affirmed.

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

The offsetting of royalty overpayments against underpayments from an offshore oil and gas lease may only take place after an official audit and within the royalty account of a single lease. Offsetting between leases is not permitted.

2. Administrative Procedure: Administrative Procedure Act--Oil and Gas Leases: Royalties--Outer Continental Shelf Lands Act: Refunds

Where a policy to restrict the offset of royalty overpayments against underpayments is the product of adjudication, the notice and comment procedures of 5 U.S.C. § 553 (1988) are not required.

APPEARANCES: Deborah K. Cornett, Esq., Dee H. Richardson, Esq., Houston, Texas, for appellant; Howard W. Chalker, Esq., Office of the Solicitor, Washington, D.C., for the Minerals Management Service.

OPINION BY CHIEF ADMINISTRATIVE JUDGE BYRNES

Union Exploration Partners, Ltd. (Union), has appealed from a decision of the Director, Minerals Management Service (MMS), dated November 2, 1988, upholding an order of the Regional Manager, Houston Regional Compliance Office, MMS. The Regional Manager's order, dated April 22, 1987, assessed Union \$26,714 in additional royalties because appellant had taken unauthorized transportation deductions on five offshore Federal leases <sup>1/</sup> during the period January 1978 through December 1981. Union's royalty underpayments were disclosed by a 6-year (1977-82) lookback audit conducted by KMG Main Hurdman for the Department's Office of Inspector General (OIG).

<sup>1/</sup> These leases are: 054-001031, 054-001036, 054-001329, 054-001529, and 055-000205.

Union acknowledges the underpayments at issue, but contends that due process requires MMS to recognize as well the overpayments Union made during the audit period. The record contains a document, dated August 22, 1985, wherein Union has set forth a number of leases whose overpayments during the audit period exceed the \$26,714 sum assessed by MMS. Appellant makes clear that it does not seek a refund of these overpayments under section 10 of the Outer Continental Shelf Lands Act, 43 U.S.C. § 1339 (1988). It asks rather that MMS recognize these time-barred overpayments as offsets to the underpayments revealed by audit.

Union points out that in Shell Oil Co., 52 IBLA 74 (1981), a fundamental sense of fairness was key to the Board's decision to require Geological Survey (MMS' predecessor) to recognize during audit a lessee's underpayments and overpayments of royalty on the same lease. Where, as here, Union's royalty overpayments occur on leases distinct from those on which it underpaid, Union contends that MMS cannot, consistent with principles of fundamental fairness, validly limit offsets to the same lease. It thus argues for cross-lease offsets.

In his decision of November 2, 1988, the Director denied cross-lease offsets because oil and gas leases are separate contracts, issued individually, and to treat each lease account as a single account for purposes of offsetting is consistent with the nature of the royalty obligation. The MMS accounting system, while payor oriented, is designed to account for an individual payor on a single lease, the Director found. To require MMS to alter its accounting system to one which would account on a company basis would be unmanageable and inefficient (Decision at 3). Moreover, a "multiple lease offset" rule could improperly deny Indian lessors and states their share of lease revenue if, for example, an underpayment on an Indian or onshore lease were to be offset against an overpayment on an offshore lease. Id.

In support of its view that fairness requires MMS to allow cross-lease offsets, Union looks to the bankruptcy code and, specifically, to the setoff provision at 11 U.S.C. § 553 (1988). This provision, Union states, allows a creditor to offset a mutual debt owing by such creditor to the debtor against a claim such creditor has against the debtor. Appellant similarly calls our attention to certain Internal Revenue Code provisions at 26 U.S.C. § 6402 (1988), which, it claims, authorize the offset of a net overpayment against any other Internal Revenue tax owed by a taxpayer.

Appellant also challenges a number of conclusions by the Director in his decision of November 2, 1988. In response to the Director's holding that a lessee's royalty obligation is based on a separate contract that is issued individually, Union states that OIG's audit was a general review of Union's overall royalty status with MMS. The agency cannot be heard now to disallow overpayments as offsets on the basis that the leases upon which overpayments were made are somehow not cognizable since each lease stands on its own (Statement of Reasons (SOR), Jan. 11, 1989, at 6). Replying to the Director's statement that to require MMS to account on a company basis would be unmanageable and inefficient, appellant argues that MMS cannot conduct a company-wide audit and then claim that it would be unmanageable and inefficient to require an accounting on a company-wide basis. Finally, with

regard to the Director's finding that the multiple offset rule would prejudice the rights of certain beneficiaries of royalty payments, Union contends that a lessor's obligations to others should not be a basis for denying a lessee's substantive rights. MMS can easily avoid any possible reduction in royalties to third-party beneficiaries by keeping such parties whole. Id. Alternatively, appellant states, it is willing to limit its offset rights

to those Outer Continental Shelf leases other than section 8(g) leases 2/ in order to eliminate any "prejudice" to Indian lessors or the states.

Lastly, Union notes that MMS' restrictive offset policy has never been promulgated in accordance with the notice and comment provisions of the Administrative Procedure Act (APA), 5 U.S.C. § 553 (1988). As a result, appellant argues, this policy cannot be used to deny legitimate offset rights. In support of its argument, appellant calls our attention to the discussion of APA formalities in Chrysler Corp. v. Brown, 441 U.S. 281 (1979).

[1] Shell Oil Co., supra, held that considerations of fundamental fairness required the Department to recognize during audit both the royalty underpayments and overpayments of a lessee on a single offshore lease. Thereafter in Sun Exploration & Production Co., 106 IBLA 300, 302 (1989), the right of a lessee to take a cross-lease offset was expressly denied.

Our decision in Sun rested on two bases, the first of which was legal in nature and traceable to the concurring opinion in Mobil Oil Corp., 65 IBLA 295, 306 (1982). The concurring opinion stated in part:

[O]ffsetting can be allowed only within the confines of each lease. If it is subsequently determined that excess overpayments exist for OCS-G 2041 such excess cannot be applied to cover any total underpayment which might be determined to exist for lease OCS-G 2051. Leases are assessed royalty on an individual basis and any offsetting must be similarly limited.

On this basis alone, the Director's decision of November 2, 1988, must be affirmed.

The second basis for the Sun decision focused on equitable and practical considerations not present in Shell. If a cross-lease offset were approved, a real possibility exists that a state or Indian lessor entitled to a share of royalty revenues on the underpaid lease would be prejudiced. 106 IBLA at 303. Such a condition did not exist in Shell and requires that we confine our holding there to the facts then at hand. Sun also addressed the possibility that lessees of a lease for which royalty is overpaid will

2/ Section 8(g) of the Outer Continental Shelf Lands Act, 43 U.S.C. § 1337(g) (1988), addresses leases, issued after Sept. 18, 1978, which lie wholly or partly within three nautical miles of the seaward boundary of any coastal state. Royalties from these leases are shared by the United States with the coastal state.

be different in identity or percentage of lease ownership from lessees of an underpaid lease. If setoff were to occur in an uncritical fashion, the rights of lessees of the overpaid lease could be infringed. <sup>3/</sup> This factor of lease ownership was also absent in Shell and distinguishes the instant facts from those entering the fairness equation in Shell.

The principles set forth in Sun dispose of appellant's arguments addressing issues of fairness and accounting efficiencies. Arguments similar to those made here have been previously answered by the Board in Union Exploration Partners, Ltd., 113 IBLA 186 (1990), and Union Oil Company of California, 110 IBLA 62 (1989).

[2] Union's remaining argument, as noted above, charges that MMS' restrictive offset policy has not been properly promulgated under the APA and cannot, therefore, be used to deny legitimate offset rights. Our discussion above of Shell, Mobil, and Sun makes clear that MMS' single lease offset policy is the product of adjudication and, therefore, is not subject to the APA's notice and comment provisions. Sonat Exploration Co., 105 IBLA 97, 119 (1988). In Union Exploration Partners, Ltd., supra at 188, we considered this identical argument and rejected it.

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

James L. Byrnes  
Chief Administrative Judge

I concur:

John H. Kelly  
Administrative Judge

<sup>3/</sup> See Texaco, Inc., 112 IBLA 174 (1989), for an example of the complexity resulting from common ownership of an oil and gas lease.