

INTERIOR BOARD OF LAND APPEALS

Taylor Energy Co.

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Editor's Note: Reconsideration denied by order dated May 27, 2003

TAYLOR ENERGY CO.

IBLA 94-828

Decided February 24, 1998

Appeal from a Decision of the Associate Director for Policy and Management Improvement, Minerals Management Service, denying the appeal of a decision by the Chief, Royalty Valuation and Standards Division. MMS-92-0524-OCS.

Affirmed.

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

A lessee of a Federal OCS oil and gas lease is obligated to pay royalty on the value of the gas. Creation and development of markets for production is the very essence of the lessee's implied obligation to prudently market production from the lease at the highest price obtainable for the mutual benefit of lessee and lessor. Federal lessees bear 100 percent of the costs of developing a market for gas. It is the lessee's duty to perform that service at no cost to the lessor. That means that the lessor's royalty is not reduced by the costs of finding a market for the gas. A contractual 3-percent deduction from the net-back price constitutes a marketing fee that cannot be deducted from the royalty basis of production where the contract expressly states that the purchaser acquires the gas from the lessee "for resale"; the lessee retained the responsibility to pay transportation costs to the purchaser's resale point; the contract fails to provide for a price for the gas in the absence of a sale by PSI; and the contract does not establish any definite quantity of gas or give PSI any right to take a specific volume.

APPEARANCES: Richard G. Morgan, Esq., Juliana Schulte O'Reilly, Esq., Washington, D.C., for Appellant; Peter J. Schaumberg, Esq., Howard W. Chalker, Esq., Office of the Solicitor, U.S. Department of the Interior, for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE HUGHES

Taylor Energy Company has appealed from the June 17, 1994, Decision of the Associate Director for Policy and Management Improvement, Minerals

Management Service (MMS or the Service), denying Taylor's appeal of a decision by the Chief, Royalty Valuation and Standards Division (RVSD).

The facts are undisputed that Taylor and PSI Gas Marketing, Inc. (PSI), entered into an August 1, 1990, "Gas Purchase Agreement" (Agreement), where PSI agreed to "purchase" gas produced by Taylor from its Federal oil and gas lease. PSI agreed to pay Taylor 97 percent "of the weighted average netback prices for the sales which [PSI] makes using [Taylor's] gas." See Agreement, para. 4.1.

The Service found that the contractual 3-percent deduction from the net-back price constituted a marketing fee. Accordingly, on September 16, 1992, RVSD directed Taylor to increase the gross proceeds it had reported by the amount of that 3-percent deduction for purposes of calculating the royalty due on the production. Taylor appealed that order to the Directorate, MMS. On June 17, 1994, the Associate Director issued the Decision under appeal here, affirming RVSD's previous determination that the 3-percent deduction was a marketing cost that could not be deducted from the value of production for the purposes of determining royalty. Taylor appealed. We affirm MMS.

[1] The present situation, as MMS argues in its Answer, amounts to a contractual agreement between Taylor and PSI under which PSI agreed to sell Taylor's production in return for a 3-percent commission. There is, of course, nothing preventing a lessee from engaging an agent to sell its production. However, a lessee is obligated to pay royalty on the value of the gas. It is established that the creation and development of markets for production is the very essence of the lessee's implied obligation to prudently market production from the lease at the highest price obtainable for the mutual benefit of lessee and lessor; traditionally, Federal lessees have borne 100 percent of the costs of developing a market for gas. ARCO Oil & Gas Co., 112 IBLA 8, 11 (1989); Walter Oil & Gas Corp., 111 IBLA 260, 265 (1989). It is the lessee's duty to perform that service at no cost to the lessor. That means that the lessor's royalty is not reduced by the costs of finding a market for the gas, in this case, the 3-percent payment to PSI.

Nor can Taylor avoid paying royalty on the cost of selling the gas because a third party (PSI) performed that duty. It is established that it is irrelevant who performs the necessary obligations of a lessee, or that title may have passed from the Federal lessee prior to undertaking an activity the lessee is obligated to perform. See Apache Corp., 127 IBLA 125, 134 (1993). The regulations require Taylor to increase the gross proceeds to the extent that they were reduced because PSI provided marketing services, as the costs of marketing services are Taylor's responsibility as part of its duty to market the gas. See 30 C.F.R. § 206.152(i).

Taylor argues that it actually sold the gas to PSI. As MMS points out in its Answer, the terms of the Agreement indicate otherwise. The Agreement expressly states that PSI "is purchasing the Gas for resale to [its] market and such Gas will ultimately be consumed by commercial, industrial, or residential users." See Agreement at VIII. Taylor retained the responsibility to pay transportation costs to PSI's resale point. See Agreement

at X. Further, the Agreement fails to provide for a price for the gas in the absence of a sale by PSI and does not establish any definite quantity of gas or give PSI any right to take a specific volume. See Agreement at IV. Instead, the Agreement simply requires Taylor to notify PSI in advance of how much production PSI will be marketing and any variations from that amount. See Agreement at II. Clearly, the parties contemplated that PSI would resell the gas.

The only feature of the Agreement that sets it apart from a commissioned sale is that PSI agreed to indemnify Taylor for any "pipeline imbalance penalty" on Taylor arising from PSI's failure "to take and receive a quantity of gas tendered by Seller." The fact that such penalty is imposed on Taylor, however, suggests that it is still regarded as the party in possession of the gas. Although Taylor can apparently penalize PSI for failing to timely sell the gas by reducing PSI's commission on the sale, we do not see this term as amounting to a sale of Taylor's production to PSI.

Taylor challenges MMS's ruling on transportation fees arguing that the 3-percent reduction is not for marketing services. Taylor now requests a hearing "on the grounds that there is a genuine issue of material fact regarding the type of contract it entered with PSI" and offers to produce evidence to show that it is "a contract for the purchase and sale of natural gas." (Request at 2.) Taylor contends the evidence will establish that the agreement is a sales contract, and consequently 30 C.F.R. § 206.152(i) does not apply.

Requests for assignment to an administrative law judge are granted in the discretion of the Board. 43 C.F.R. § 4.415. In most cases, the Board will decide factual issues based upon the record filed by the agency and documents submitted by the parties. A hearing is appropriate when a factual issue cannot be resolved from the record and additional documentation would not be an appropriate means of presenting evidence, such as when facts at issue depend upon an individual's actions, knowledge, or expertise. Based on our review of the record thus far, we conclude that no such issue is presented in this matter. The terms of the contract, which control our decision, are not in dispute. Accordingly, Appellant's request for hearing is properly denied.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the request for hearing is denied, and the Decision appealed from is affirmed.

David L. Hughes
Administrative Judge

I concur:

Gail M. Frazier
Administrative Judge