

INTERIOR BOARD OF LAND APPEALS

Estoril Producing Co.

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ESTORIL PRODUCING CO.

IBLA 97-95

Decided October 12, 2000

Appeal from a decision of the Acting Deputy Commissioner of Indian Affairs, Bureau of Indian Affairs, denying appeals from an order to pay additional royalties and perform a restructured accounting. MMS-93-0220-IND, MMS-93-0221-IND.

Affirmed.

1. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Indians: Mineral Resources: Oil and Gas: Royalties--Oil and Gas Leases: Royalties: Payments

Where payor information forms and division orders specify that the purchaser of gas is to distribute gas sales proceeds and has assumed the lessee's legal obligation to pay royalties, the obligation to perform a restructured accounting and to pay any additional royalty found to be due rests with the purchaser. If the purchaser does not perform the accounting or pay the royalty, it is the lessee's obligation to do so.

APPEARANCES: James M. Peters, Esq., and Sarah H. Stuhr, Esq., Oklahoma City, Oklahoma, for Appellant; Peter J. Schaumberg, Esq., Howard W. Chalker, 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 IRWIN

Estoril Producing Company (Estoril) is the lessee of oil and gas mining leases issued by the Bureau of Indian Affairs in 1980 on individual Indian allottee lands in Oklahoma. In 1987, Estoril entered into contracts with Bethel Gas Company (Bethel) in which Bethel agreed to purchase the gas produced from the Skinner formation underlying the leases. At the request of the operator of the leases, Bethel made disbursement of the royalties to MMS.

As a result of an audit of Bethel's payments for 12 sample months between April 1, 1987, and March 31, 1992, the Royalty Compliance Division, Minerals Management Service (MMS), sent Bethel an issue letter on September 21, 1992, requesting comments on MMS' preliminary findings of Bethel's underpayments of royalties. MMS' letter stated that Bethel's apparent errors were due to the use of unauthorized measurement points and improper deductions of compressor fuel, resulting in incorrect production volumes, and to the use of nonallowable exclusions, resulting in improper decreases of values for royalty purposes, and set forth the applicable regulations.

Bethel responded that it was not the lessee of the leases, it was the first purchaser of the gas. The calculation of the payment to the lessee was based on the contract with the lessee, Bethel stated, and it used the same basis to calculate the payment of the Indian royalties. "The operator did not inform Bethel Gas that the Indian royalty was to be calculated differently from the other payment. The rules you state in your [September 21] letter were never given to us by the operator or lessee. \* \* \* We did not agree to bear the cost of compression, fuel and other deductions of the Indian's share," Bethel wrote. "If the MMS has decided that the Indians should not bear any of these costs, then the lessee will owe this money and not Bethel Gas Company." (October 19, 1992, letter from Bethel to MMS.)

In response, MMS issued an order letter to Bethel dated May 13, 1993, stating that Bethel had submitted Payor Information Forms (PIF's) indicating an intent to remit royalties on behalf of the lessee and that, in MMS' view, a designated payor was obligated to pay royalties in accordance with lease terms and applicable regulations and would be the responsible party if royalty payments were in error. "Nevertheless," MMS wrote, "in the event Bethel's position is upheld, the lessee(s) \* \* \* will ultimately be held responsible."

MMS directed Bethel to submit \$11,329.17 additional royalty for the 12 sample months; to identify all leases for which it had payor responsibility during the period covered by the audit; to recalculate royalties due from April 1987 through May 13, 1993, on those leases in accordance with the regulations discussed in the letter; and, if additional royalties were due, to pay them. MMS sent identical letters to Estoril and other lessees.

Both Estoril and Bethel filed appeals with the Deputy Commissioner of Indian Affairs under 30 C.F.R. Part 290. In September 1993, Estoril paid the \$11,329.17 "in order to avoid protracted litigation." Estoril stated its payment was being made under protest and "shall not be considered an admission of liability with respect to this audit or in connection with any other audit." With that payment, Estoril believed its contingent liability was extinguished. (Response to Field Report at 3; Notice of Appeal at 3 and 8 n.7.)

On April 4, 1996, MMS sent the Field Report it prepared in response to the appeals to Estoril and Bethel. See 30 C.F.R. § 290.3(b). In its response, Estoril disagreed with the statement that it had paid the royalties "but ha[d] not complied with the performance requirements of the [May 13, 1993] order." (Field Report at 2.) Estoril argued that there were no performance requirements directed to it in the order; only Bethel had been directed to identify leases and recalculate royalties. (Response to Field Report at 6-7.) Estoril stated that it was only one of several lessees and that "[i]f and when the MMS elects to audit the lessees under these leases, each should be audited only for its own proportionate share of the production under each Lease," citing Phillips Petroleum Co. & Phillips 66 Natural Gas Co., 121 IBLA 278 (1992). Id. at 7. Estoril also questioned MMS' authority to require a party to identify leases and recalculate royalties and objected to the application of regulations that were not effective until March 1, 1988, to production before that date. Id. at 7, 9.

The Acting Deputy Commissioner's July 25, 1996, decision on the appeals by Estoril and Bethel stated that because the additional royalties had been paid "[t]he only issue remaining to be resolved \* \* \* is whether Bethel, as the payor, is responsible to perform the restructured accounting, or whether the lessees are primarily responsible." (Decision at 3.)

Referring to our decision in Mesa Operating Partnership (On Reconsideration), 128 IBLA 174, 100 I.D. 8 (1994), the Acting Deputy Commissioner stated that, although Bethel filed PIF's with MMS establishing its status as royalty payor for the leases at issue, "a document such as a division order evidencing the person's agreement to accept this responsibility [to pay royalties] is necessary." (Decision at 4.) "According to the record," the Acting Deputy Commissioner continued:

[D]ivision orders exist for the 4 leases at issue, all addressed to Bethel, and instructing Bethel, as purchaser, to distribute gas sale proceeds to the specified interests. Therefore, I conclude that Bethel had assumed the lessee's legal obligation to pay royalties and MMS was correct in looking to Bethel for compliance with the order. This part of Bethel's appeal is denied. Also, Bethel is responsible to perform the restructured accounting.

Id., emphasis supplied. Concluding the decision, the Deputy Commissioner repeated: "Bethel is responsible to pay the royalty and perform a restructured accounting on any lease that Bethel serves as the payor, has filed a PIF, and is responsible under a division order or other contractual agreement whereby Bethel agreed to serve as the payor and report the royalties due on that lease." (Decision at 7-8.)

Turning to Estoril's reasons for appeal, the Acting Deputy Commissioner noted at page 5 that MMS "sent Estoril a copy of the May 13, 1993, order since Estoril, as a lessee, is responsible for any royalty underpayment that is not corrected by Bethel," quoting Jerry Chambers Exploration

Co., 107 IBLA 161, 163 (1989). 1/ The Acting Deputy Commissioner went on to state: "If the payor does not perform the restructured accounting, each lessee will be ultimately responsible to perform restructured accounting for its respective interest in the leases on which it is a lessee." Id. at 5, emphasis added. "Estoril's appeal challenging the responsibility to perform the restructured accounting is denied as to the leases for which Estoril is a lessee and Bethel does not perform the restructured accounting," the Acting Deputy Commissioner concluded. Id. at 8, emphasis added.

In response to Estoril's argument that if and when MMS decides to audit lessees under the leases, each lessee should be liable only for its own proportionate share of production under each lease, the Acting Deputy Commissioner agreed that "[a]ny future royalty payment issues and orders regarding the subject leases should be handled in accordance with" Phillips Petroleum Co., supra. Id. at 7, emphasis added.

The Acting Deputy Commissioner cited 30 U.S.C. § 1717(a)(1) (1994) as authority to require a restructured accounting, noting that because Bethel was the payor for several leases, some of which might not involve Estoril, it was in the best position to comply with the restructured accounting portion of the order. Id. Finally, the Acting Deputy Commissioner observed that other regulations governing royalty valuation were in place before those that became effective on March 1, 1988. Id. at 8.

Only Estoril has appealed the Acting Deputy Commissioner's July 25, 1996, decision. We understand that as of July 13, 1999, Bethel had not complied with that decision. 2/

Estoril states, with reference to the May 13, 1993, order, that its payment of the "alleged underpaid royalty resolved the only pending matter insofar as Estoril was concerned" and that "[n]othing in the 1993 Order required Estoril to do anything further." (Notice of Appeal at 3 and 4, n.3.) Estoril repeats that the 1993 Order "was directed to Bethel, not Estoril," and the order stated only that in the event Bethel had no obligation to pay additional royalties, "then the lessees (such as Estoril) would

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1/ "The lessee of a Federal oil and gas lease is obligated pursuant to the terms of the lease contract to pay the United States a royalty \* \* \* on oil and gas removed from the leased lands. See 30 CFR 218.100(a). A lessee may designate an operator to act for the lessee in matters relating to lease operations, but this does not relieve the lessee from ultimate responsibility for compliance with the lease terms. 43 CFR 3162.3(a); Supron Energy Corp., 46 IBLA 181, 192 (1990)."

2/ MMS states that on September 23, 1997, it issued a Notice of Noncompliance to Bethel under 30 U.S.C. § 1719 (1994) for failure to comply with the Deputy Commissioner's July 25, 1996, decision. As of April 15, 1998, Bethel had not complied "and Estoril has not consented to extend the briefing schedule while MMS seeks Bethel's compliance." (MMS Answer at 2.) In response to a June 30, 1999, inquiry, MMS informed us that as of July 13, 1999, Bethel had still not complied. (MMS Response to Order of June 30, 1999.)

be obligated to make that payment." Id. at 6. Bethel was held liable for the underpayments, Estoril observes, and Estoril was never ordered to conduct additional audits. Id. Even now, Estoril writes, "the [Acting Deputy Commissioner's] Decision presents merely a contingency, i.e., if Bethel does not complete additional audits then lessees such as Estoril may be required to." Id. "MMS should be required to enforce Bethel's duty and should not be permitted to change the 1993 Order and impose on Estoril an obligation to audit in the event Bethel does not do so. It should not be Estoril's responsibility to undertake the heavy burden and expense of determining whether Bethel properly paid royalties." (Notice of Appeal at 7.) The Acting Deputy Commissioner's reliance on Jerry Chambers Exploration Co., supra, is misplaced, Estoril argues: the royalty underpayment has been paid, so liability for additional royalty is not an issue. "Imposing liability for an underpayment is different from ordering Estoril to investigate and determine whether Bethel underpaid royalties in other instances." Id. at 8. Even assuming MMS had ordered it to conduct an audit, Estoril argues, MMS does not have authority to do so. Id. at 8-9. Finally, Estoril iterates its objection to a "retroactive application of specific royalty valuation regulations." Id. at 9-10.

MMS answers that the May 13, 1993, order "put Estoril on notice that if Bethel did not perform its obligations, Estoril would be responsible." (Answer at 3.) "[T]he basic fact [is] that the lessee bears the ultimate responsibility for compliance with lease terms." The Acting Deputy Commissioner's decision "correctly stated that MMS' order required Estoril to comply if Bethel did not," MMS argues (Answer at 4), reciting the statement preceding the quotation from Jerry Chambers Exploration Co. in the decision that "MMS sent Estoril a copy of the May 13, 1993, order since Estoril, as a lessee, is responsible for any royalty underpayment that is not corrected by Bethel." (Decision at 5.) "Estoril cannot escape its duty as lessee because MMS' order did not address all possible situations under which Bethel's non-compliance would trigger Estoril's obligations as a lessee." (Answer at 4.) There is ample precedent supporting MMS' authority to require a lessee to carry out a restructured accounting, MMS argues. Id. at 5-6. MMS did not intend to apply the regulations that became effective March 1, 1988, to production before that date; the lease terms and regulations effective before then would apply to Estoril's duty as a lessee to conduct a restructured accounting and pay royalties for that period. Id. at 7.

Estoril filed a reply stating that it did "not deny that as a lessee it has certain obligations, or that if it has particular records it may be necessary to produce them to Bethel or MMS. Estoril does, however, dispute that it has ever been given notice of a 'performance requirement' with which it has 'failed to comply.'" (Reply at 3.)

[1] We think focussing on the Acting Deputy Commissioner's July 25, 1996, decision, as distinct from the "failed to comply" language in the Field Report to which Estoril objects, makes clear that Estoril's arguments primarily address the contingent aspects of the Acting Deputy Commissioner's decision. Estoril acknowledges that the Acting Deputy Commissioner decided that "Bethel is responsible to perform the

restructured accounting." (Decision at 4; see Reply at 2.) The Acting Deputy Commissioner properly concluded that Bethel is responsible in the first instance for both the restructured accounting and for the payment of any royalties found to be underpaid. The record includes copies of gas division orders authorizing Bethel to receive the gas "in accordance with the following specification of interests":

<u>Credit To</u>	<u>Division of Interest</u>
Estoril Producing Corp.	80.0% less production taxes * * *
Dept. Of Interior, MMS for BIA Shawnee Agency (Allotted)	20.00%.

These percentages are for one of the leases (14-20-0208-3948); they vary somewhat for the other leases involved. The division orders state that they are executed subject to a contract between Estoril and Bethel. As the Acting Deputy Commissioner held, the division orders indicate that the obligation to pay royalty had been assumed by Bethel. See GPM Gas Corp., 147 IBLA 314, 315 (1999); Mesa Operating Limited Partnership (On Reconsideration), supra.

As noted above, supra note 2, MMS has initiated proceedings to enforce the Acting Deputy Commissioner's decision. Only if and when Bethel does not perform the restructured accounting or pay any royalties found to be underpaid will MMS order the lessees to account for and pay their proportionate shares. As Estoril puts it: "Even now, the Decision presents merely a contingency, i.e., if Bethel does not complete additional audits then lessees such as Estoril may be required to." (Notice of Appeal at 6.) Ultimately, of course, as a lessee, Estoril would be responsible for fulfilling its obligations under the leases. Its argument that MMS has no authority to require a lessee to perform a restructured accounting must be rejected. Union Texas Petroleum Energy Corp., 153 IBLA 170, 179 (2000).

Therefore, pursuant to the authority delegated to the Interior Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the Deputy Commissioner's July 25, 1996, decision is affirmed.

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Will A. Irwin  
Administrative Judge

I concur:

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Bruce R. Harris  
Deputy Chief Administrative Judge