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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

Released-sec file

B-156603

JUL 8 1974

The Honorable Henry M. Jackson, Chairman
Committee on Interior and Insular Affairs
United States Senate

Dear Mr. Chairman:

This is in response to your request that we review the matters outlined in the report of March 1, 1974, from the Under Secretary of the Interior to the President of the Senate concerning the application submitted to the Department of the Interior (Interior) by Union Oil Company of California (Union) for credit against future royalty payments. Your request also anticipated our review of the Acting Secretary's response to the additional questions raised by you concerning the basis for Interior's determination that Union was entitled to credit totaling $799,747.86 for overpayment on certain Outer Continental Shelf (OCS) leases.

The claimed overpayments allegedly represented excess royalty payments that Union made on certain specified OCS leases during the period from July 1, 1966, to December 3, 1972. Prior to approval of the Unit Agreement on November 15, 1973, the Federal and State leases were credited with approximately 98 percent and 2 percent respectively of the total gas produced, whereas the Unit Agreement provides for an allocation of 96.5032 percent to six Federal OCS leases and 3.4968 percent to four Louisiana State leases retroactive to July 1, 1966. Consequently, Interior determined that Union is entitled to credit for overpayments made to the United States on the basis of the original allocation, although Union's initial request for a refund of $852,197.61 was recalculated by Interior and reduced to the present sum of $799,747.86.

As stated in the Under Secretary's letter of March 1, 1974, section 10(a) of the Outer Continental Shelf Lands Act, approved August 7, 1953, ch. 345, 67 Stat. 469, 43 U.S.C. 1339(a), authorizes the Secretary to repay amounts paid in connection with a lease issued under the Act when he determines such payment to have been in excess of the amount the lessee was lawfully required to pay, provided that the request for refund is filed within two years of the date of payment. Although the latter proviso might seem to bar allowance of that portion of Union's claim relating to payments made more than two years prior to July 27, 1973, the date Union applied for the refund credit, our decision of November 5, 1965, B-156603, supports a contrary result.

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In that case the Interior Department had determined that several oil companies were entitled to refunds on account of excess royalty payments made under certain OCS oil leases. The claimed refunds related to royalty payments made by the companies under protest against administrative determinations that no deductions for barging costs from the lessor's royalty interest would be permitted in computing the royalty that was due. Thereafter, the Interior Department concluded that reasonable barging costs could, in certain circumstances, be considered for purposes of computing royalties due the United States. Within two years thereafter one of the companies submitted a claim for the refund of the resulting excess royalty payments, although these payments were originally made more than two years prior to submission of the claim. In that decision we said the following in regard to the two-year limitation:

> "The only other aspect of the Phillips claim which bears further comment is the fact that it was not submitted until January 26, 1965, covering excessive royalty payments during the period October 1956 to April 1960. As you know, subsection 10(a) of the act requires requests for repayment of excessive royalty payments made to be filed within two years after making the payment. While it thus might be suggested that the claim is barred by the statutory two year limitation we would not be inclined to question the refund, since the initial payments to which it relates were paid over a number of years under protest and the claim was, in fact, filed within two years from the date of the departmental determination under which it became allowable. Moreover, we understand that the royalty payments subject to protest on the barging cost question were held in suspense by the Department and not treated as earned during the lengthy period taken for ultimate resolution of the matter."

The primary basis for the conclusion reached in our decision of November 5, 1965, thus was the fact that the claim was filed within two years of the date upon which it could first be determined that excess royalty payments had, in fact, been made. Similarly, in the instant case Union's application was filed within two years of the date the Unit Agreement was approved, and it was only at this time that the amount or, for that matter, even the existence of an overpayment became known.

Consequently, in view of the information contained in the Under Secretary's letter of March 1, 1974, we see no objection to the Under Secretary's determination that Union is entitled to $779,747.86 as credit against future royalty payments.

As regards our review of the Acting Secretary's response to the four questions subsequently directed to him, we have informally been advised that both you and your Committee are interested only in our analysis of the legal issues involved, as opposed to a full review which would include our independent verification of the actual dollar amounts as well. Therefore, our analysis is limited to the Acting Secretary's response to question 2 which is stated in your letter of March 13, 1974, as follows:

> "What is the authority for making the allocation change retroactive? Why did you decide to apply the change retroactively?"

Although the Acting Secretary's response thereto treats the question as having two distinct parts requiring two separate answers, our analysis of the legal issues involved considers the matter as a whole, since the basis for the decision to apply the change retroactively is closely related to and dependent upon the legal authority for doing so.

Section 5 of the Outer Continental Shelf Lands Act, 43 U.S.C. 1334, states the following in regard to unit agreements and the reduction of rentals or royalties:

> "Without limiting the generality of the foregoing provisions of this section, the rules and regulations prescribed by the Secretary thereunder may provide for the assignment or relinquishment of leases, for the sale of royalty oil and gas accruing or reserved to the United States at not less than market value, and, in the interest of conservation, for unitization, pooling, drilling agreements, suspension of operations or production, reduction of rentals or royalties, compensatory royalty agreements, subsurface storage of oil or gas in any of said submerged lands, and drilling or other easements necessary for operations or production."

Also, as stated in the Acting Secretary's response, 30 C.F.R. 250.50 provides as follows in regard to unitization, pooling, and drilling agreements:

> "Such agreements may be initiated by lessees or where in the interest of conservation they are deemed necessary they may be required by the Director."

The Acting Secretary's response to question 2 also contained the following excerpts from the memorandum dated May 25, 1972, that was written by the Assistant Solicitor, Minerals Division of Public Land, in regard to the Unit Agreement in question:

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"In his letter of March 29, 1967, the Supervisor acted responsibly in the interest of conservation. As indicated in the Union-Pan American letter of February 10, 1967, * * * the problem of allocating production equitably between two operators in the same field with multiple reservoirs selling gas to two transmission companies with different capacity requirements, and with two governments involved with the royalty, had reached impossible proportions. Although the reservoirs involved extended onto the state leases, * * * there was very little production from state lease wells until 1966; where as one former state lease had been producing continuously since 1960. To avoid a continued inequity to the state leases with additional Federal leases coming on stream (July 1, 1966), and to avoid the drilling of unnecessary wells on the State leases, the State of Louisiana agreed in principle to unitization and to the retroactive provision.

"A procedure of allocation was set-up in 1967 to proportionately equate the lease ownerships through reservoirs and sales under the State's allowable system, but the procedure could not take into account the problems of State-Federal equity caused by competitive reservoirs and commingled measurement. Very basically, the reason for unitization was to provide equity among the participants with minimum costs and the reason for the retroactive feature was to correct the gross inequity which began when large amounts of new Federal lease production came on stream July 1, 1966, and could not be prorated without affixing the same unitization date."

In view of the broad statutory authority the Secretary possesses with respect to the approval of unit agreements, and considering the above-stated justification for the decision to approve the Vermilion Block 14 Unit Agreement retroactive to July 1, 1966, we would not question the validity of the Unit Agreement or its retroactive provision.

Sincerely yours,

SIGNED ELMER B. STAATS

Comptroller General
of the United States

OIL AND GAS
Outer Continental Shelf
Royalty payments
Approval

OIL AND GAS
Outer Continental Shelf
Royalty payments
Unit agreements
Retroactive

OIL LEASEHOLDS
Outer Continental Shelf
Royalty payments
Statute of limitations