



**Gary E. Johnson**  
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**John J. Chavez**  
*Secretary*

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An Equal Opportunity Employer

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## Fax Cover Sheet

**DATE:** April 28, 1997      **TIME:** 4:31 PM  
**TO:** Mr. David S. Guzy, Chief      **PHONE:**  
Rules and Procedures      **FAX:** 303-231-3194  
**FROM:** Marilyn L. Hill      **PHONE:** 505-827-0900  
NM Taxation and Revenue      **FAX:** 505-827-0801  
**RE:** Response to Proposals

**Number of pages including cover sheet: 4**

**Message**



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CERTIFIED MAIL • RETURN RECEIPT REQUESTED

April 28, 1997



Mr. David S. Guzy, Chief  
Rules and Procedures  
Minerals Management Service  
P.O. Box 25165, MS 3101  
Denver, CO 80225-0165

Dear Mr. Guzy:

The New Mexico Taxation and Revenue Department with this letter is formally responding to the Notice of Proposed Ruling, dated January 24, 1997, which would modify the valuation procedures for crude oil transactions on federal lands.

MMS is to be commended for its new proposed oil valuation regulations, as it specifically applies to oil production not sold pursuant to arm's-length transactions. With few exceptions, we believe the proposed rule provides for a fair and certain valuation methodology that captures the true market value of oil in instances where producers dispose of oil in non-arm's length arrangements.

Nine years of recognizing posted prices in the benchmarks, as the base upon which the value is derived for non-arm's-length transactions, has resulted in the loss of millions of dollars to the State of New Mexico. As MMS is clearly aware of, there are numerous factors that prove posted prices represent a minimum by which to negotiate arm's-length contracts.

The following are the New Mexico Taxation and Revenue specific comments as it relates to MMS "requests for comment" and areas where we feel would simplify the proposal and clarify MMS's overall intent of assuring that fair market value is being received under non-arm's-length transactions.

Specific Comments

- Interim Rule and 6-month verification/Page 3743:  
To properly do any type of verification application, quality and location of leases must be identifiable because of pricing mechanisms and transportation cost differences. If that is identifiable, a comparison of 2014 lines (integrated majors) the following net-back calculation and recognizing a cents per barrel deviation should substantiate the validation of actual market value.

Net-Back Calculation:

Net-Back Price at Market Center

- Market Center-to-Major Aggregation Point differentials based on an average of representative published tariff
- Lease to Aggregation Point cost based on 3rd party valuation.
- = Lease Price

Note: If comparison shows "Lease Price" less than "Reported Price", MMS can be assured that "Fair Market Value" is being received.

• Alternative valuation techniques/Page 3746:

As stated previously, we feel that a net-back calculation, starting with NYMEX and subtracting differentials to the lease, is the only valid indicator of market value for integrated companies. The presentation by Bob Levin of NYMEX at the hearing on April 17, 1997, clearly dispelled all questions regarding the validity of using NYMEX to establish price. Any recognition of posted prices impairs the requirement to pay on market value when the transaction is non-arm's-length.

• Alternative differential recognition/Page 3747:

We recommend that MMS consider not requiring the Form 4415. Instead, MMS should publish a rate recognizing the lowest FERC tariff from which a significant amount of production moves from an aggregation point to the market center. Because New Mexico currently has a limited number of aggregation points, this determination would require little effort.

• Exchange agreement definition/Page 3751:

This definition is too narrow. Exchanges can include multiple parties or be part of an over-all net-out agreement. Also, it is unclear what is meant by "Exchange agreements do not include 'transportation agreements'...." Transportation agreements are a type of exchange agreement and the terms reflect the relative value differences in the crudes exchanged, but not the absolute value.

• Field definition/Page 3751:

This definition can be deleted because we find no place where it is referenced.

• Section 206.102 (a) (4)/Page 3752:

The requirement to use a NYMEX net-back if the production is subject to crude oil calls is far too restrictive. We recommend that: 1. The "call" application be deleted from this section; 2. MMS deal with the "call" issue in the definition of "gross proceeds" or "duty to market to the benefit of lessor". We also recommend that it only be questioned if the call is willfully and knowingly executed.

• Section 206.102 (a) (6)/Page 3753:

Even though we agree with your concerns regarding reciprocal dealings, MMS's proposal is too broad and most likely would move a significant number of payors to NYMEX pricing. We do not think this was the purpose or intent of the regulations. Other consideration problems can be dealt with in the "gross proceeds" definition and application. We do not think that what may be a small issue should harm the majority of this proposal.

• Section 206.105/Page 3754:

We agree with MMS that the index price should be adjusted for location and quality if it is part of the overall exchange agreement only. However, MMS needs to be consistent throughout the regulations when they discuss the differential. The regulations sometimes recognize a distinction between location and quality differentials and other places MMS combines the terminology.

• Section 206.105 (3)/Page 3755:

Based on reviewing the form, instructions and listening to comments concerning such, we have to agree that it is not clear on who is to file, what information is to be provided and how exactly it will be used by MMS to publish rates.

- Is it the intent to capture all exchange information regardless of where the exchange points are?

- Will traders be required to file this form?

- How is the information to be supplied on "over-all exchanges"?

- What are the penalties if they are not filed?

- What happens if the differential terms change in midyear?

It appears from the language in Section 206.105 (c)(1)(iii) that the published differential will be recognized between the aggregation point and market center. However, the instructions state that the form's purpose is to collect differential data, whether the exchange takes place at the lease or downstream of the lease.

We recommend that the information be limited to exchanges at the lease and market center. With this information, the lease can be accurately defined as well as the other contract and product qualities. If royalty payors use this differential, no actual cost calculations would be necessary between the lease, aggregation point and market center.

#### Other Costs

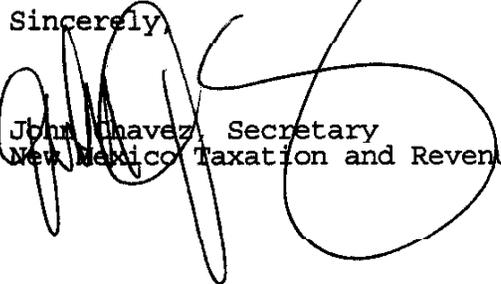
Industry, in their hearing comments, expressed concerns that the proposed regulations did not allow pipeline loss and terminal transfer costs within the net-back calculation. We feel that MMS should consider allowing these costs only if the recognized differentials between Cushing and the market center do not include them.

Industry also expressed concern that MMS was deleting Section 206.105(b), which allowed lessees to apply for an exception from the requirement that it compute actual costs of transportation and use a Federal Energy Regulatory Commission or State-approved tariff. We agree completely with the position that MMS has taken. The ultimate goal in this net-back calculation is to recognize actual costs to a market center if the production actually moves there. Anything less would limit MMS's ability to recognize market value for their production.

#### Conclusion

We appreciate the work MMS has done in drafting the proposed regulations. We agree with the net-back approach MMS is taking. Our comments and suggestions are intended to re-direct the focus of the regulations to major integrated companies, and to ensure that the regulations will be workable. We urge MMS to move forward on the proposed regulation.

Sincerely,

  
John Chavez, Secretary  
New Mexico Taxation and Revenue Department