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MESSAGE TO: David S. Guzy, Chief, Rules and Publications Staff

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MESSAGE FROM: James C. Pruitt

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ADDITIONAL COMMENTS:

Comments for filing this date.



James C Pruitt
 Vice President
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Texaco

1050 17th Street NW
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April 27, 1999

Mr. David S. Guzy
 Chief, Rules and Publications Staff
 Minerals Management Service
 Royalty Management Program
 P.O. Box 25165
 MS 3021
 Denver, CO 80225-0165

Re: **Minerals Management Service Rulemaking on Valuation of Crude Oil**
64 FR 12267 (March 12, 1999)

Dear Mr. Guzy:

Texaco Inc. ("Texaco"), on behalf of itself and its affiliates, including Texaco Exploration and Production Inc., appreciates the opportunity to submit these comments in response to the Minerals Management Service ("MMS") reopening the comment period on its rulemaking on valuation of crude oil, 64 FR 12267 (March 12, 1999). These comments supplement and incorporate by reference those previously submitted in this rulemaking under letters dated May 27, 1997, April 6, 1998, and July 31, 1998.

Texaco references and adopts as its own the joint comments filed this date by the American Petroleum Institute, the Independent Petroleum Association of America, the Domestic Petroleum Council, and the United States Oil and Gas Association. Texaco participated in the formulation of those comments which demonstrate the strong unanimity of industry with regard to crude oil valuation.

Additionally, Texaco offers the following particular comments to augment the discussions at the workshops held on March 23 in Houston, March 24 in Albuquerque, and April 6-7 in Washington D.C.

Regarding industry's proposal on comparable sales, MMS expressed concern at the workshops that there may not be a true crude oil market at the lease -- that the market was "artificial" and that participation in the lease market was only for royalty purposes. MMS heard at the workshops that there was in fact an active lease market for crude oil. Tom White of Walter Oil and Gas, Keith Kosmin of Equiva Trading Company, and others spoke to the high level of competition for lease crude oil barrels. In addition, Texaco urges MMS to reexamine the body of comments already in the record that attest



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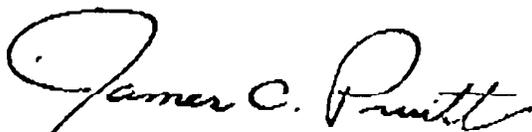
to the existence of an active, viable market at the lease. These comments have been filed by such diverse parties as large producers, independent producers, crude oil marketers, and economists. A compendium of such comments is attached as Exhibit "A". Even experts who have in the past been critical of industry's overall valuation practices have validated the lease market in trial testimony. Excerpts from one such expert's testimony can be found at Exhibit "B".

The best indicators of the market value of crude oil at the lease are arm's length sales and purchases. As was explained at the workshops, Texaco has considerable experience in competitively marketing at the lease. Texaco began its crude oil tendering program in August 1995 in the offshore Gulf. Texaco's tendering program, which is now employed across the country, has successfully captured the actual market value at the lease of Texaco's crude oil production. Texaco receives an average of 13 bids and as many as 17 bids for each bid package under its tendering program. Texaco awards the tendered barrels to the highest bidder and pays royalty on that basis. Equiva Trading Company (a midstream joint venture in which Texaco is a minority member) is then permitted to match the highest bid price for the remaining production. In some instances, Equiva Trading Company has declined to match the price, in which case the remaining production has been re-bid to third parties. Today, Texaco sells approximately 44% of its Gulf of Mexico crude oil production to third parties. Texaco's tendering program received favorable comments from representatives of the States of Louisiana and New Mexico at the recent workshops.

The bid process is an established, commercially acceptable practice used by industry to determine market value of both services and products. In fact, the federal government itself uses a bid process for all major purchases. Texaco is confident that its tendering program properly establishes the value of crude oil at the lease. This process is important to Texaco not just for royalty valuation purposes, but also because it accurately values the assets of the company so that appropriate business decisions can be made.

Should you have any questions regarding any of our comments or other points discussed during the recent workshops, please contact either Mr. Ronnie A. Martin at (713) 752-7793 or Ms. Wendy Daboval at (504) 680-1075.

Sincerely,



JCP:caa

Attachment

cc: Ms. Lucy Querques Denett
Associate Director, Minerals Management Service
United States Department of the Interior
1849 C Street, NW
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EXHIBIT A

The following comments filed by Texaco and others in response to MMS's crude oil valuation rulemaking demonstrate that there is an active, competitive market at the lease.

I. COMMENTS IN RESPONSE TO THE JANUARY 24, 1997 NOTICE OF PROPOSED RULEMAKING (62 FED. REG. 3742)

A. Texaco Inc.'s May 28, 1997 Comments Re: Proposed Rule for Establishing Oil Value for Royalty Due on Federal Leases

• Page 13:

A substantial bidding market exists at the lease level. TEPI is only one of many companies selling crude oil to third parties in the producing fields. In addition, TTTI purchased 200,000 barrels per day of crude oil from third parties at the lease in 1996. Leading crude oil marketers such as Scurlock Permian Corporation introduced evidence into the administrative record that fierce competition for the purchase of crude oil exists in virtually every major field in the United States. (Transcript of MMS Hearing in Houston, Tx., April 17, 1997, Attachment 1.) ...

By way of example, since the State of Texas maintains such records, we asked the firm of Soloman Associates, Inc. to review "First Purchasers" forms filled out by Texas crude oil lessees. These records show a "highly active, competitive market for crude oil at the lease." (Bossung Report at p. 1.) For just one representative month, December 1995, a conservative estimate showed 11,236 out of 12,227 entries (91.9%) involved arm's-length transactions at the lease level in Texas. (*Id.* at p.5.)

• Pages 33-35. In addition to demonstrating that there is an active market at the lease, Texaco's comments also note that MMS has failed to provide an adequate basis or reasoned explanation for rejecting arm's-length sales prices in the production field.

• Attached at Tab 4 to Texaco's comments is a May, 1997 report prepared by Robert B. Bossung of Solomon Associates, entitled, "Participants & Transactions in the Crude Oil Market at the Lease in Texas." The report analyses first

purchaser records maintained by the State of Texas which "show[] the existence of a highly active, competitive market for crude oil at the lease." (Bossung Report at p. 1.) The data examined by Mr. Bossung "show[ed] thousands of transactions each month involving hundreds of thousands of barrels sold each day in arm's-length transactions in arm's-length transactions between parties with opposing economic interests." (*Id.*) The report concludes that "[t]he data clearly show a viable market at the lease where there are thousands of examples of arm's-length lease transactions throughout the State which could serve as realistic indicators of market value at the lease." (*Id.* at p. 8.)

**B. Independent Petroleum Association of America's May 15, 1997
Comments Re: "Notice of Proposed Rulemaking, 62 Fed. Reg. 3742
9January 24, 1997)"**

• Page 9:

[T]he current lease market for federal lease oil is thriving. MMS knows this first hand, for it sells a portion of its royalty oil at or near the lease, not at Cushing, Empire, or St. James. But the same is true of oil sold by lessees. IPAA asked its members to estimate what percent of their sales are at arm's-length in the lease market. (By "lease market" we mean any first point of sale upstream of a market center, as MMS's proposal understands the market center concept.) Responses were in the 80 to 100 percent range. Smaller independents would likely fall in the high end of this range, the vast majority selling all their production at arm's-length. Purchasers have told MMS the same thing. Jack Blomstrom of Eighty-Eight Oil Company, a purchaser of federal crude oil, testified at the Denver hearing that his company buys the majority of its crude oil at the lease.... And Scurlock Permian Corporation, a purchaser testifying in Houston, stated that it "and many other companies compete fiercely to purchase crude oil at the lease."...

The rulemaking record MMS has assembled so far offers further proof of a flourishing lease market. An unidentified presentation stated that the "first point of sale for most domestic crude is at the lease," and that a "significant portion of activity is between [third] parties" Even the presentation by Micronomics, Inc., one of the consultants supporting plaintiffs' attorneys in suits against producers, did not claim that information from the lease market was unreliable. It simply argued that the value of crude oil at the lease can also be determined in a different way, using the method MMS adopted in the proposed rule.... And the presentation by Summit Resource Management, Inc., another plaintiffs'

consultant, explained that "independents commonly sell outright" and conceded that the proper value for "outright" arm's-length sales should continue to be the lessee's gross proceeds.

C. Comments of Joseph P. Kalt, Harvard University and The Economics Resource Group, Inc. Before the United States of America Department of the Interior Minerals Management Service Re: Establishing Oil Value for Royalty Due on Federal Leases, and on Sale of Federal Royalty Oil (May 27, 1997)

- Page 3:

There is an active market at the lease (or 'wellhead') level. This market is highly competitive and involves major and minor integrated and non-integrated producers on the supply side, and numerous large and small integrated refiners and a very large number of independent marketers and brokers on the buying side.

D. Mobil Oil Corporation's May 27, 1997 Comments Re: "Proposed Rules Establishing Oil Value for Royalty Due on Federal Leases, and on Sale of Federal Royalty Oil," 62 F.R. 3742, January 24, 1997

- Page 2: "Vigorous lease markets exist and generate many arm's-length transactions or 'comparables" that are appropriate, primary references for royalty valuation."

- Pages 6-7:

Plaintiffs in the pending Engwall case [Engwall, et al. v. Amerada Hess Corp., et al., No. CV-95-322 (5th Dist., Chaves County, New Mexico) (filed Sept. 1, 1995)] private royalty lessors in New Mexico, rely on a netback methodology developed by one of MMS' retained consultants and conceptually similar to MMS' netback methodology. In response, Professor Joseph Kalt of Harvard University demonstrated that there are active lease markets for the purchase and sale of oil, and testified that the use of comparables from lease markets is the best measure of lease value. Testimony of Joseph P. Kalt, Ph.D., in Engwall v. Amerada Hess Corp. (hereinafter "Kalt Test.") at 1116-17, 11125-26, 1177 [attached to Mobil's comments]. Only "by looking at outright transactions at arm's-length for the comparable level of commerce and under comparable supply and demand conditions [can] one see what the market says" about the interplay of those forces. *Id.* at 1117. The Engwall court rejected the netback proposal of MMS' expert, which it deemed "novel" in the sense that it lacked "precedent," and relied on the "comparables" approach in denying class certification. (footnotes omitted)

**E. Rocky Mountain Oil & Gas Association's May 28, 1997 Comments
Re: Establishing Oil Value for Royalty Due on Federal Leases, and on
Sale of Federal Royalty Oil¹**

- Page 3: "... there is a viable and active market for oil at the wellhead."

**F. Scurlock Permian Corporation's April 17, 1997 Comments Re:
"Establishing Oil Value For Royalty Due on Federal Leases and on
Sale of Federal Royalty Oil"**

- Page 2:

A key point I wish to convey today is one that appears to be ignored, if not rejected outright, by the proposed rule. The point is that SPC and many other companies compete fiercely to purchase crude oil at the lease. Many willing buyers are active not just in the major fields, but also in the hundreds of out-of-the-way locations where crude oil is sold in truckload quantities and where our transportation costs of purchased crude are especially high.

**II. COMMENTS IN RESPONSE TO THE JULY 3, 1997
SUPPLEMENTARY NOTICE OF PROPOSED RULEMAKING (62
FED. REG. 3742)**

**A. Conoco, Inc.'s August 1, 1997 Comments Re: Supplementary
Proposed Rule for Establishing Oil Value for Royalty Due on Federal
Leases, and on Sale of Federal Royalty Oil, 30 C.F.R. Part 206 (62
Fed. Reg. 36030, July 3, 1997)**

- Pages 1-2. During the public meeting on April 17, 1997 in response to the original January 24, 1997 proposed rulemaking, Conoco offered as an alternative its competitive bidding program, which MMS ignored in the supplementary proposed rule published on July 3, 1997. To demonstrate that "Conoco's proposed alternative is superior to the MMS NYMEX netback method because it reflects the real market at the lease level," Conoco "compare[d] the results of its bid program values actually received versus the MMS NYMEX netback method values" Conoco's

¹ Please note that I have been unable to actually download a copy of the RMOGA's comments from MMS's web-site, and have therefore been unable to verify that this quote is accurate.

comments provided data showing that the values derived from its bid program for the second quarter of 1997 for certain offshore production exceeded the values that would be determined by the MMS NYMEX netback method, thus demonstrating that there is a valid, competitive market at the lease.

B. Koch Oil Company's July 29, 1997 Comments Re: Proposed Rules of the Department of the Interior, Minerals Management Service, 30 C.F.R. Parts 206 and 208, 62 FR 3742, "Establishing Oil Value for Royalty Due on Federal Leases and on Sale of Federal Royalty Oil," January 24, 1997, as Amended July 3, 1997

- Pages 2-4. Koch, an independent purchaser of crude oil, commented that the proposed rule would "seriously undermine the effectiveness of the United States crude oil markets," by replacing the current free market valuation of oil with an artificial market:

The proposed regulation is a step backward, making efficient allocation of resources less likely. Further, KOC believes that the MMS has overlooked the secondary effects of the proposed rule on the United States crude oil markets. . . . The proposed rule will act as a form of "price fixing," thus prompting inefficiencies in the market. . . . In short, the proposed regulations are an intrusion into the marketplace which will result in misallocation of this nation's crude oil resources.

C. Marathon Oil Company's August 1, 1997 Comments Re: Establishing Oil Value for Royalty Due on Federal Leases, and on Sale of Federal Royalty Oil Supplementary Proposed Rule (62 FR 36030, July 3, 1997)

- Page 3:

Although MMS contends that there is no market at the lease, in reality, independent and integrated refiners compete rather aggressively for lease crude oil for refinery supply; similarly, resellers compete for lease crude in order to utilize transportation assets effectively and efficiently. Arm's-length transactions at the lease cannot be ignored.

**III. COMMENTS IN RESPONSE TO THE SEPTEMBER 22, 1997
NOTICE OF REOPENING THE PUBLIC COMMENT PERIOD (62
FED. REG. 49460)**

**A. Union Pacific Resources Company's November 5, 1997 Comments
(filed by Sidley & Austin) Re: Establishing Oil Value for Royalty Due
on Federal Leases, Notice of Reopening of The Public Comment
Period, 62 Fed. Reg. 49460 (September 22, 1997)**

- Pages 3-4: "[A] flourishing market for production exists at the lease, and that market is affected by demand and supply factors that differ from the factors that affect prices in crude oil market centers." (footnote omitted)

**IV. COMMENTS IN RESPONSE TO THE FEBRUARY 6, 1998
SECOND SUPPLEMENTARY NOTICE OF PROPOSED
RULEMAKING (63 FED. REG. 6113)**

**A. Texaco Inc.'s April 6, 1998 Comments Re: Supplementary
Proposed Rule for Establishing Oil Value for Royalty Due on Federal
Leases**

- Page 2:

The costs and inefficiencies which would be imposed by the supplementary proposed rule are entirely unavoidable and unnecessary, because an active market exists for crude oil at the lease that allows a more straightforward, more accurate, more certain, and much less costly approach to valuation than that proposed by MMS. MMS has failed to consider these less burdensome and more reliable alternatives.

**B. Coastal Oil & Gas Corporation, *et al.*'s April 6, 1998 Comments
Re: Supplementary Proposed Rule for Establishing Oil Value for
Royalty Due on Federal Leases**

- Page 6:

The Government Continues to Ignore the Fact that There Is an
Active Market for Crude Oil At or Near the Lease.

If the government were to take some or all of its royalty share of oil production at the lease and market it, as the IPAA and the API have suggested, the government would learn first-hand that there is indeed a viable lease market for crude oil. In addition to refiners and lease crude oil purchasers, such as Coastal, there are non-affiliated companies whose

primary business is to purchase crude oil at the lease, such as Scurlock-Permian.

**C. Marathon Oil Company's April 7, 1998 Comments Re:
Establishing Oil Value for Royalty Due on Federal Leases (63 FR
6113, February 6, 1998)**

- Page 2:

Crude oil is regularly bought and sold at or near the lease throughout the United States. These sales transactions occur in all producing regions, not just in the Rocky Mountain Area. It is arbitrary to apply a benchmark system only in the Rocky Mountain Area. Again, the market dynamics which make benchmarks based on arm's-length sales feasible in the Rocky Mountain Area also make them feasible in all regions.

D. Mobil Oil Corporation's April 7, 1998 Comments (filed by Hogan & Hartson L.L.P.) Re: "Establishing Oil Value for Royalty Due on Federal Leases," Department of the Interior Minerals Management Service, 63 Fed. Reg. 6113, February 6, 1997 [sic]

- Pages 5-6:

In its Original Comments, Mobil noted that MMS has failed, as a threshold matter, to justify its move away from lease market benchmarks for valuation of crude oil. *See* Original Comments at 14-17. Nothing in the current proposal addresses that fundamental point. It has been and is Mobil's consistent position that comparable transactions *at the lease* are the proper primary determinant of royalty value. *See, e.g., id* at 6-10. The Supplemental Notice, however, proposes to use gross proceeds from a downstream sale as the starting point for royalty valuation, regardless of whether the sale is of crude similar to federal royalty oil or of a vastly different crude. . . . MMS' conclusion that there are few lease-level transactions is not supported by the rulemaking record. In fact, there are thousands of lease-level transactions that could be used to determine market value based on comparable sales of similar crude oil in the field, the valuation method traditionally favored by the courts and used by MMS. *Id.*

**E. Oryx Energy Company's April 3, 1998 Comments Re:
Establishing Oil Value for Royalty Due on Federal Leases**

Page 2: "Oryx still believes there is a viable lease market for most federal production."

F. Transcript of Public Hearing Held in Houston, Texas on February 18, 1998

- Page 60 (John Haley, Director of Upstream Affairs and Special Projects for Conoco's Crude Oil Supply and Trading Group)

[T]he MMS essentially ignores that a market exists at the lease other than in the Rockies or when oil is sold out-right at the lease. Conoco's proposed competitive bid program was offered as a fair and reasonable method for all lessees, including integrated oil companies, to fairly establish market value at the lease. The MMS has chosen to ignore Conoco's program that Harvard professor Dr. Joseph P. [Kalt], a leading petroleum economist, has found to be quote, "clearly meet the economic criteria of achieving third [party] market value," end quote.

V. COMMENTS IN RESPONSE TO THE JULY 16, 1998 FURTHER SUPPLEMENTARY NOTICE OF PROPOSED RULEMAKING (63 FED. REG. 28355)

A. The Barents Group L.L.C.'s July 31, 1998 Comments (filed by Gardere & Wynne, L.L.P.) Re: Analysis of the Department of Interior, Minerals Management Service's Second Further Supplementary Proposed Rule Establishing Oil Value for Royalty Due on Federal Leases

- Page 25:

The costs and inefficiencies that would be imposed on lessees by the further supplementary proposed rule are entirely avoidable and unnecessary because an active market exists for oil at the lease that would allow a more straightforward and less costly approach to royalty valuation.

- Attached to the Barents' report is a January 5, 1998 letter from Dr. Joseph P. Kalt to Conoco, Inc., evaluating Conoco's bid-out program:

Basis economic reasoning leads to the conclusion that the best indication of fair market value is outright cash transactions between reasonably informed, unrelated parties with adverse interests in the transaction. Based on my understanding of the design and operation of Conoco's bid-out program, the bid prices revealed will generate a reliable measure of the fair market value of Conoco's crude at the lease or in the field.

B. Conoco, Inc.'s July 30, 1998 Comments Re: MMS Further Supplementary Proposed Rule for Establishing Oil Value for Royalty Due on Federal Leases, 63 Fed. Reg. 38355 (July 16, 1998)

- Page 4:

The MMS seems to recognize that a competitive bid program will reveal value at the lease inasmuch as they have incorporated this lease value method (albeit flawed) for the Rocky Mountain region... However, the MMS rejects competitive bidding outside of the Rocky Mountain region because they believe that their indexing scheme is a better indicator of market value. Conoco and many others have commented in over 4,000 pages of comments why this belief is misguided. However, the MMS appears unmoved by these copious comments and seemingly chooses to ignore the fact that a *real and active market* exists *at the lease*. (emphasis in original)

- Page 6. Conoco also responded to MMS's concerns about tendering, including, in particular, MMS's assertion that there is not an active, competitive market at the lease.

MMS Concern #1.

"Tendering is an artificially-created market for the purpose of paying royalties. It does not represent how companies actually market their production and accordingly cannot represent market value. If there truly were an active, transparent, and competitive market at the lease, there would be no reason to establish a tendering program."

Conoco's Response: This concern of the MMS illustrates our point. The MMS does not know this part of our industry and the MMS is completely wrong. Tendering is not an "artificially-created" market. It is a means to determine what the true arm's-length market value truly is at the lease. If two or more non-affiliated bidders bid on lease crude then those bids are true representations of that lease oil market value. Tendering discloses the transparent and true market value at the lease. Without question an audit would easily disclose this fact. What the MMS is really saying is that lease market values are not publicly reported which is true. But that does not mean that a lease market does not exist. Nor does it mean that lease values are somehow disguised from the MMS. Rather they are available and transparent to any observer of a bid opening process or subsequent audit. Indeed Professor Joseph P. Kalt in his study (described in his comments of May 26, 1997) found a very active and competitive market at the lease.

C. Hunt Oil Company's July 23, 1998 Comments Re: Additional Changes to Second Supplementary Proposed Rulemaking Establishing Oil Value for Royalty Due on Federal Leases, 30 CFR Part 206

- Hunt Oil Company, an independent producer that markets its entire crude oil production under arm's-length sales contracts, expressed its concern with the changes in the proposed rule regarding the duty to market, and sought assurance from MMS that the open market value MMS would use to evaluate royalty valuation would be the price obtained at the lease:

If the MMS is going to continue to oversee the marketing decisions made by individual producers, which Hunt does not advocate, it urges the MMS to clarify that the open market it will use to value is the true market value at the lease or in the field where the crude oil is produced. . . . Hunt urges at a minimum that the MMS clarify that the "open market" value that it will use is the price obtained at the field in arm's-length transactions. (emphasis in original)

D. Marathon Oil Company's July 31, 1998 Comments Re: Establishing Oil Value for Royalty Due on Federal Leases (63 FR 38355, July 16, 1998)

- Page 4. In its comments, Marathon responded to MMS's assertions regarding industry's recommended improvements, including in particular tendering and comparable arm's-length transactions.

Tendering

Marathon disagrees with the assertions made by MMS concerning the legitimacy of values derived through a tendering program.

MMS claims that a tendering program would create an "artificial market." This is simply not the case. Regardless of whether a lessee chooses to retain its share of lease production for its own use, this choice does not diminish the fact that there is an active and competitive market at the lease. However, if a lessee were to elect to institute a tendering program in locations outside of the Rocky Mountain Area, the resulting price would be anything but "artificial." To the contrary, a price resulting from the interaction of competitive forces at the lease is the purest measure of fair market value. In denying this fact, MMS is in effect disregarding the basic tenet of the free market system; that is, the

forces of market supply and market demand, if left alone, will interact to establish a fair market price....

Comparable Arm's-Length Transactions

MMS' response to industry's proposal to use comparable arm's-length transactions as a non-arm's-length benchmark includes a claim that its audits have turned up little evidence of arm's-length transactions. Marathon disagrees with this assertion. In our comments submitted in response to MMS' January 24, 1997 proposed oil valuation rule, Marathon cited a study conducted by Professor Joseph P. Kalt of the Harvard University Kennedy School of Government. As a result of his study, Professor Kalt was able to compile a database representing over 850,000 arm's-length transactions at lease markets during 1990-1996 in just New Mexico, Texas, and Oklahoma. Furthermore, numerous tendering programs have been implemented in the last couple of years, and MMS' audits may not have extended into this time period yet. In addition, the vast majority of Marathon's transactions are currently at arm's-length. MMS' statement regarding its audit findings is likely based mostly on market activity from time periods as far back as the 1980's. If MMS has evidence which supports its claim that very little Federal oil is currently sold at arm's-length, it should present this data and offer industry an opportunity to respond.

EXHIBIT B

During the class certification hearing held in a private lease crude oil royalty case, an expert named by the plaintiffs has been questioned about the nature of competition at the wellhead. This expert, who may or may not also have advised MMS, has admitted that true competition to purchase crude oil exists at the wellhead market.

Transcript of Proceedings before the Fifth Judicial District court, County of Chaves, State of New Mexico, Engwall et al. v. Amerada Hess Corporation et al., Case Number CV-95-322, Vol. 2, Testimony of J. Benjamin Johnson.

At pages 431-433:

Q. And you do agree with me, sir, that there is, in fact, a market for the purchase and sale of crude oil at the lease; right?

A. That certainly is one method, yes.

Q. And you explained that there are advantages to selling crude oil outright at the lease, right?

A. Sure.

Q. And you also explained in your materials that many independent oil companies commonly sell oil outright at the lease?

A. That's correct.

Q. These companies are in the business of buying crude oil at the lease, transporting it to a market center, and then selling it?

A. That's correct. That's what they do.

Q. And you agree with me, sir, that the lease market is a competitive market?

A. From the standpoint of being able to purchase crude oil at the lease, there certainly is competition.

I believe I've testified several times that, for example, on these buy-sell agreements, the differential negotiated in that is extremely competitive.

.....

Q. Go ahead.

A. You've asked me about the competitive market at the lease. There are certainly locations where parties have the ability to purchase the crude oil themselves and to transport it and there is competition there; however, there are many other situations where the purchase of the crude oil is made through some other means o[th]er than an outright sale.

So from the standpoint of it being competitive, the marketplace there can be competitive; whereas, the price reported for that may not be the result of the competitive negotiations.

FIFTH JUDICIAL DISTRICT COURT
COUNTY OF CHAVEZ
STATE OF NEW MEXICO
Case Number CV-93-322

CARL ENGWALL, as Co-Trustee of the
Carl and Ruth Engwall Living Trust
et al.,

Plaintiffs,

v.s.

AMERACA MESS CORPORATION, et al.,

Defendants.

TRANSCRIPT OF PROCEEDINGS

Volume 2

On the 14th day of January, 1997, at 9:00 AM,
this matter came on for hearing before the MONCRABLE
ALVIN F. JONES, Judge of the Fifth Judicial District,
State of New Mexico, Division II in Roswell, New
Mexico.

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evidence, and I would object to any more inquiry into this subject with this witness.

MR. ZOTT: Your Honor, I'm not sure if that was an objection or what, but -

MR. EAVES: It is an objection.

MR. ZOTT: Okay. We can certainly address Professor Kalk's database now. I would prefer just to go on with my cross, though.

THE COURT: I would rather deal with the database when we get to the point that we're involved in Professor Kalk's testimony.

MR. ZOTT: Thank you.

Q. (BY MR. ZOTT) Just to be clear, Mr. Johnson, when we left - I want to make sure, you're not suggesting - strike that.

You're in no position to tell this Court that these defendants don't engage in outright arm's length deals of a lease, right?

A. That's correct.

Q. And do you agree with me, sir, that there is, in fact, a market for the purchase and sale of crude oil at the lease?

A. There certainly is a series of buys and sells in a market where people sell lease crude oil on an outright arm's length basis.

Q. In fact, in your teaching materials, you explained that there is one common method of marketing crude oil, to sell outright at the lease, right?

A. That certainly is one method, yes.

Q. And you explained that there are advantages to selling crude oil outright at the lease, right?

A. Sure.

Q. And you also explained in your materials that many independent oil companies commonly sell oil outright at the lease?

A. That's correct.

Q. And that includes both large and small independents?

A. Sure.

Q. And you agree that companies are also actively involved in buying crude oil outright at the lease?

A. Sure.

Q. And that includes the resellers you mentioned earlier like Keen and Seavock?

A. That's correct.

Q. These companies are in the business of buying crude oil at the lease, transporting it to a market center, and then selling it?

A. That's correct. That's what they do.

Q. And you agree with me, sir, that the lease market is a competitive market?

A. From the standpoint of being able to purchase crude oil at the lease, there certainly is competition.

I believe I've testified several times that for example, on these buy-sell agreements, the differential negotiated in that is extremely competitive.

Q. Okay. My question is very narrow, and I want to be clear we all agree, okay?

Do you agree that the market for crude oil at the lease is a competitive market?

A. I would hate to generalize that to say in all situations that it is.

C. Okay.

A. The -

Q. I'm sorry.

A. Can I -

Q. Go ahead.

A. - finish?

Q. Go ahead.

A. You've asked me about the competitive market at the lease. There are certainly locations where parties have the ability to purchase the crude oil

themselves and to transport it and there is competition there; however, there are many other situations where the purchase of the crude oil is made through some other means other than an outright sale.

So from the standpoint of it being competitive, the marketplace there can be competitive; whereas, the price reported for that may not be the result of the competitive negotiations.

Q. Can you please turn to page 400 of your deposition, beginning at line 167?

We were talking about the way that these Kochs and Seavocks of the world go around the lease and buy crude oil, right? That's what we were talking about here, right?

Then I asked you at line 16. "Q. Would you expect that if that incremental value that they - these resellers - were able to generate, was above a competitive rate - would you expect that other resellers would come into the market and bid them down and get that - which is this margin that we'll talk about later - from \$2.70 to \$2.50 or \$2.50 or whatever the case might be?"

There is an objection, and then there is an answer, "This is a competitive market."

Were you asked that question, sir, and did