



# Memorandum

To : Mr. Dick Johnson, MIC:64

Date: April 11, 1995

From : Eric Eisenlauer

Subject: Royalty Payments for Oil Property

This is in response to your memorandum of March 30, 1994 to Mr. Richard Ochsner in which you request our opinion with respect to the following procedure used by the staff in valuing oil producing property:

In estimating the economic life of an oil producing property staff deducts royalty payments from cash flow, along with other operating expenses. To arrive at value, however, staff includes royalty payments in the income stream to be capitalized over the remaining life estimate.

Since royalty payments are made pursuant to lease arrangements between the owner and operator of the oil producing property, such a procedure is contrary to Property Tax Rules 2(a) 8(c) and 8(d) which require that market value and the income indicator of market value not reflect the effects of private encumbrances such as leases for property tax purposes. Property Tax Rule 4 is to the same effect with respect to the comparative sales approach.

We recently noted the same problem with respect to the draft of the amended AH 560, Valuation of Mining Properties (Memorandum to Arnold Fong dated March 30, 1995, p.2).

In view of the requirements of the aforementioned property tax rules, we find no legal basis for the procedure used by the staff.

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cc: Mr. John Hagerty, MIC:62  
Ms. Jennifer Willis, MIC:70