

BEFORE THE HEARING OFFICER
OF THE TAXATION AND REVENUE DEPARTMENT
OF THE STATE OF NEW MEXICO

IN THE MATTER OF THE PROTEST OF
MERIDIAN OIL, INC.

NO. 95-09

DECISION AND ORDER

This matter came on for hearing on July 26, 1995 before Gerald B. Richardson, Hearing Officer. Meridian Oil, Inc. (hereinafter "Meridian") was represented by Michael B. Campbell, Esq. and Michael H. Feldewert, Esq. of Campbell, Carr & Berge, P.A. The Taxation and Revenue Department (hereinafter "Department") was represented by Margaret B. Alcock, Special Assistant Attorney General. After the hearing, the parties submitted written argument, with the last submittal being Meridian's reply, which was filed on August 28, 1995 and the matter was considered submitted for decision at that time. Prior to the formal hearing in this matter, this Hearing Officer entered a previous Decision and Order on October 31, 1994 which determined that there was jurisdiction, pursuant to Section 7-1-24 NMSA 1978, to decide Meridian's protest in this matter.

FINDINGS OF FACT

1. Meridian is a joint interest owner in thousands of oil and natural gas wells in the San Juan Basin in New Mexico. As an oil and gas owner and producer, Meridian reports and pays oil and gas production taxes to the Department on behalf of itself and other working interest owners of the oil and gas wells.

2. Pursuant to New Mexico's various oil and gas production taxes, the producer or owner of oil and natural gas is required to report and pay oil and gas production taxes to the state. Although, ultimately, the producer of the oil and gas production is the one legally responsible for the payment of oil and gas production taxes, the Department also allows the taxes to be paid by the purchaser and by the well operator.

3. Commencing in April of 1992, the Department and the State Land Office conducted a limited scope concurrent audit of Meridian to determine whether Meridian had properly paid New Mexico oil and gas production taxes and state royalties on behalf of itself, its affiliates and the other working interest owners for which it reported taxes during the designated audit period. The audit focused on the pricing policies of Meridian and its affiliates and how those pricing policies affected the determination of the value of the oil and gas production at the wellhead upon which the oil and gas production taxes are paid. The audit was of limited scope in that only designated production units were examined and only for designated reporting periods. The audit period covered the period from April, 1989 through August 1991.

4. From the outset of the audit, Meridian was concerned with protecting the confidentiality of information which it provided to the auditors which Meridian considered to be proprietary. At the outset of the audit Meridian prepared and the Department's audit manager signed a "Confidentiality Agreement" which acknowledges that pursuant to Section 7-1-8 NMSA 1978 it is unlawful to reveal information about Meridian acquired as a result of the audit "except as permitted in 7-1-8". The confidentiality agreement further provided that documents would be kept confidential pursuant to Section 19-1-2.1 NMSA 1978.

5. During the course of the concurrent audit, Meridian provided the auditors access to documents and information which it considered to be proprietary or confidential information. These documents included copies of contracts between Meridian and its affiliates which contain price and volume information which would reveal much about Meridian's oil and gas operations.

6. On September 30, 1993 the Department issued the Meridian Audit Report. The report is in two parts. First, there is a narrative which describes Meridian's operations, its accounting system, the audit procedures and audit findings. The second part consists of a number of schedules and attachments in support of the audit narrative.

7. The Meridian audit report concluded that Meridian had underpaid oil and gas

production taxes upon production owned by Meridian and its affiliates. The audit report found no under reporting of oil and gas production taxes by Meridian where such taxes were paid on behalf of other interest owners. A closing agreement was entered into between the Department and Meridian as a result of the audit report or the assessment issued as a result of the audit report in October, 1993. The closing agreement settled and resolved any and all issues between the Department and Meridian resulting from the Meridian audit report.

8. During the audit period, Cinco General Partnership (hereinafter "Cinco") owned a working interest share in the 30-06 production unit, which was one of the production units examined in the audit of Meridian. During the audit period, Meridian reported and paid oil and gas production taxes on behalf of Cinco. The audit did not result in any tax deficiencies being assessed for the oil and gas production attributable to Cinco's ownership interest in production unit 30-06.

9. On January 6, 1994, Cinco requested of the Department, pursuant to the Inspection of Public Records Act, a copy of the Meridian audit report.

10. On January 14, 1994, the Department, by letter to Meridian's counsel, notified it of Cinco's request for the Meridian audit report. The letter further informed Meridian of the Department's position that Cinco, as a working interest owner, would be entitled to the audit report and that it had informed Cinco's representatives that the Department would make a copy of the audit report available to Cinco on February 1, 1994. The Department's letter stated that notice was being given to Meridian in order to give it the opportunity to seek judicial construction of the statutes involved.

11. On February 1, 1994, Meridian filed suit against the Department and the Attorney General seeking a declaratory judgment and a temporary restraining order and preliminary and permanent injunction prohibiting the Department from honoring Cinco's request.

12. On February 8, 1994, Meridian filed a protest with the Department, protesting the

Department's stated intention to release the audit report to Cinco on the basis that the Department is required to keep the audit report confidential by the provisions of Section 7-1-8(U) NMSA 1978.

13. The Department disputed that Meridian's February 8, 1994 letter constituted a valid protest pursuant to Section 7-1-24 NMSA and contested the jurisdiction of the Hearing Officer to determine Meridian's protest. This issue was bifurcated from the determination of the merits of Meridian's protest and was the subject of an earlier hearing in this matter. By Decision and Order dated October 31, 1994, it was concluded that Meridian's letter of February 8, 1994 constituted a valid protest pursuant to Section 7-1-24 NMSA 1978.

14. On June 1, 1994, the District Court entered a preliminary injunction which prohibits the Department from releasing the Meridian Audit Report to Cinco pending the determination of Meridian's protest herein concerning the confidentiality of the Meridian audit report under Section 7-1-8 NMSA 1978.

DISCUSSION

Cinco made its request of the Department for the Meridian audit report under the Inspection of Public Records Act, Sections 14-2-1 through 14-2-12 NMSA 1978. Section 14-2-1 provides that every person has a right to inspect any public records of the state and then sets forth exceptions to that general presumption of availability to the public. Subsection F of Section 14-2-1 is the exception which applies herein, because it provides an exception where it is "otherwise provided by law." Section 7-1-8 NMSA 1978 (1993 Repl. Pamp.), is the confidentiality provision of the Tax Administration Act which governs the confidentiality of information acquired by the Department about taxpayers. It is the provisions of this statute which must be construed to determine the issue presented herein, whether the Meridian audit report is required to be held confidential or whether it must be released to Cinco pursuant its request.

Section 7-1-8 provides for a general presumption of confidentiality of all information

contained in any tax returns filed with the Department as well as any other information about any taxpayers acquired by the Department's employees. However, there are then numerous exceptions to confidentiality which are specifically enumerated in the statute. Set forth below are the provisions of Section 7-1-8 which are pertinent to the resolution of the issue herein.

It is unlawful for any employee of the department or any former employee of the department to reveal to any individual other than another employee of the department any information contained in the return of any taxpayer made pursuant to any law subject to administration and enforcement under the provisions of the Tax Administration Act or any other information about any taxpayer acquired as a result of his employment by the department, except:

* * * * *

U. information with respect to the taxes or tax acts administered pursuant to Subsection B of Section 7-1-2, except that:

- (1) information for or relating to any period prior to July 1, 1985 with respect to Sections 7-25-1 through 7-25-9 and 7-26-1 through 7-26-9 NMSA 1978 may be released only to a committee of the legislature for a valid legislative purpose;
- (2) contracts and other agreements between the taxpayer and other parties and the proprietary information contained in such contracts and agreements shall not be released without the consent of all parties to the contract or agreement; and
- (3) audit workpapers and the proprietary information contained in such workpapers shall not be released except to a person having a legal interest in the property that is subject to the audit, to a purchaser of products severed from a property subject to the audit or to the authorized representative of either, but this paragraph does not prohibit the release of any proprietary information contained in the workpapers that is also available from returns or other sources not subject to the provisions of this section;

Subsection U creates an exception to confidentiality for information with respect to taxes administered pursuant to Section 7-1-2(B) NMSA 1978, which includes the oil and gas production taxes for which Meridian was audited. Paragraphs (2) and (3) modify the exception to confidentiality provided in subsection U, and it is to the language of these paragraphs that we turn to determine the confidentiality of the Meridian audit report.

Meridian relies on Section 7-1-8 (U)(2), which prohibits the release of contracts and other agreements between a taxpayer and a second party and the proprietary information contained in such contracts unless all parties to the contract or agreement agree to the release of such information. Meridian produced substantial evidence that the Meridian audit report is replete with proprietary information concerning pricing, costs and even profit margins which was derived from contracts provided the Department auditors and that this information is spread pretty much throughout the audit report. Meridian claims that subsection U(2) operates as an absolute bar to the release of the audit report because contractual and proprietary information is integrated throughout the audit report. If subsection U(2) were the only provision to be construed with respect to determining confidentiality, this case would be easily decided, since that section clearly would prohibit the release of the Meridian audit report.

Subsection U(3) specifically addresses the treatment of audit workpapers. With respect to audit workpapers and the proprietary information contained in them, they may not be released "except to a person having a legal interest in the property that is subject to the audit," The first question to be addressed is whether subsection U(3) creates an exception to subsection U(2). Meridian contends that it does not, and that subsection U(2) deals with contractual proprietary information and that subsection U(3) deals with non-contractual proprietary information. This reading is too strained. It requires reading the word, "non-contractual" into subsection U(3). Courts will not read into a statute language which is not there, particularly if the statute makes sense as written. *State ex rel. Barela v. New Mexico State Board of Education*, 80 N.M. 220, 453 P.2d 583 (1969). Meridian's construction also does not make much sense in the context of the administration of the oil and gas production taxes which were audited. Those taxes are imposed on the value of oil and gas production at the wellhead. Section 7-29-4.1 NMSA 1978. Determining this value is the critical factor in determining the amount of tax due. Wellhead value can be determined by examining contracts for sale of production where the operator and the

purchaser are not affiliated. Where the production is not sold at the wellhead, contracts are often examined to determine the costs of processing, transportation, etc., to determine the value at the wellhead. In other words, contractual information is often extremely important in determining whether a taxpayer is properly reporting oil and gas production taxes when the taxpayer is audited by the Department. It is simply not realistic that audit workpapers would not contain contractual information relative to the valuation of the oil and gas production. Under these circumstances, subsection U(3) is more reasonably construed as an exception to the prohibition against releasing contractual information found in subsection U(2). This construction is also supported by another principal of statutory construction that the legislature will not be presumed to have enacted useless statutes or amendments. *Southard v. Fox*, 113 N.M. 774, 833 P.2d 251 (Ct. App. 1992). Clearly, subsection U(3) allows the disclosure of audit workpapers and the proprietary information contained therein to certain qualifying requestors. Given the ubiquity of proprietary contractual information in audit workpapers because of the nature of the taxes being audited, there would be no point to subsection U(3) if it were not intended to be an exception to subsection U(2).

The next matter to be determined is what is meant by a "legal interest" in the property subject to audit under Subsection U(3) and whether Cinco such a person. Meridian argues that "legal interest" should be construed to mean standing, as in a person who is threatened with a real risk of injury as a result of the proceeding. Meridian argues that Cinco would not meet that test since no taxes were assessed as a result of the audit of Meridian with respect to how the taxes were reported on the production of which Cinco owns a working interest. The Department argues that "legal interest" should be equated with the definition of "interest owner" contained in New Mexico's oil and gas tax statutes. Sections 7-29-2(J), 7-30-2(I), 7-31-2(I) and 7-32-2(I) NMSA 1978 (1993 Repl. Pamp.) define "interest owner" to mean:
a person owning an entire or fractional interest of whatsoever kind of nature in the products at the time of severance from a production unit, or who has a right to monetary payment that is determined by the value of such products.

Under this definition, anyone with any ownership interest as well as anyone entitled to royalties from production would be considered to be an interest owner. It makes some sense to equate "interest owner" under the oil and gas tax acts with persons with a "legal interest" under the confidentiality provision of the Tax Administration Act which applies to the oil and gas tax acts, since those statutes are in *pari materia*. Even if this approach is not followed, however, I have little doubt that Cinco qualifies as a holder of a "legal interest." Words in statutes are to be given their ordinary and usual meaning unless a different intent is clearly indicated. *State ex rel. Duran v. Anaya*, 102 N.M. 609, 698 P.2d 882 (1985). It is beyond cavil that an ownership interest in property is a legal interest in property. Ownership is the most common type of interest in property which the law recognizes and protects. The other problem with Meridian's equation of standing and legal interest is that it is not supported by a reading of the language of the statute. If the legislature had intended to equate the two terms it could have only permitted the release of audit workpapers to those with a "legal interest in the outcome of the audit" or some other language limiting release to those who would have a potential tax liability as a result of the audit. Instead, it chose to write the statute much more broadly, permitting the release of audit workpapers to those with a "legal interest *in the property that is subject to the audit*" (emphasis added).

Meridian makes an additional argument that the only "property that [was] subject to the audit" was Meridian's "net revenue interest" by which it means Meridian's own working interest in the nine natural gas production units which were audited by the Department. This argument is completely without merit. In the first place, under its agreements with the various working interest owners, which included Cinco, Meridian reported and paid taxes on their behalf on the production from the units which were audited. There was nothing in the manner by which the Department handled the audit to support Meridian's narrow interpretation of what was audited. In fact, in the course of the audit, the Department asked for and was provided by Meridian

documents which related specifically to how Meridian was reporting on behalf of other interest owners. Department's Exhibit A. The audit report states that its purpose was "to establish Meridian's pricing tax and royalty *payment* methodology" (emphasis added). Meridian audit report, Exhibit 6, p. 1. Since Meridian admittedly made payment of taxes on behalf of others, a review of that payment methodology was clearly contemplated in the Department's audit, and in fact, was reviewed as shown by the evidence presented. The fact that no liability was established as a result of that review does not negate the fact that it was reviewed as part of the Department's audit.

Based upon the foregoing discussion, it is concluded that Section 7-1-8(U)(3) operates as an exception to the confidentiality the audit workpapers which would otherwise apply under Section 7-1-8, and that the Department is not prohibited from releasing those workpapers to Cinco under its request made pursuant to the Public Records Act. In arriving at this conclusion I am mindful of the policy arguments made by Meridian concerning the chilling effect the release of the audit report may have upon the willingness of oil and gas taxpayers to make their proprietary information available to the Department upon audit. Meridian provided ample evidence that the information contained in the audit report exposes its entire business operations to the scrutiny of Cinco and of other working interest owners, who may also be competitors in the gas production business. Meridian's concerns with the release of the audit papers are amply justified, and I share many of the same concerns with the impact of the release of this information upon taxpayer compliance in the audit process. It is the province of the legislature to establish the policy of the state with respect to the confidentiality of tax information in the hands of the Department, however. The legislature has expressed itself rather clearly with respect to the information at issue in this matter and there is no room for this decision maker to substitute his judgment for that of the legislature in htis matter.

CONCLUSIONS OF LAW

1. Pursuant to Section 7-1-24 NMSA 1978, Meridian filed a timely, written protest to the Department's proposed application of Section 7-1-8 NMSA 1978 to allow the release of the Meridian audit report to Cinco.

2. Section 7-1-8(U)(3) NMSA 1978 operates as an exception to the prohibition in Section 7-1-8(U)(2) to the release of contractual information and proprietary information found in contracts pertaining to the New Mexico's oil and gas production taxes.

3. As a working interest owner in the property which was subject to the Department's audit of Meridian, Cinco holds a "legal interest" in the property which was subject to the Department's audit, pursuant to Section 7-1-8(U)(3).

4. The Department's audit covered Meridian's method of calculating, reporting and paying taxes on the enumerated production units both for itself and for the other working interest owners, including Cinco, for whom Meridian reported and paid taxes.

5. The Department is not prohibited from releasing the Meridian audit report to Cinco under the provisions of Section 7-1-8 NMSA 1978 (1993 Repl. Pamp.).

For the foregoing reasons, Meridian's protest **IS HEREBY DENIED.**

DONE, this 21st day of September, 1995.