

**BEFORE THE STATE BOARD OF EQUALIZATION**

**FOR THE STATE OF WYOMING**

IN THE MATTER OF THE REQUEST            )  
FOR EXAMINATION BY                        )     Docket No. **2010-141**  
**MERIT ENERGY COMPANY**                )

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**EXAMINATION REPORT**

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**THIS MATTER** came before the State Board of Equalization (Board) pursuant to a request by Merit Energy Company (Merit) for an examination in accordance with Wyo. Stat. Ann. § 39-11-102.1(c)(x) and Chapter 4 of the State Board of Equalization Rules. Merit alleged the Department of Revenue (Department) was improperly utilizing the volume of gas reported by the operator when there were discrepancies between the volumes reported by the operator and a take-in-kind (TIK) interest owner. Merit was represented by Randall B. Reed of Dray, Dyekman, Reed & Healey. The Department was represented by Martin L. Hardsocg, Senior Assistant Attorney General. The Board, consisting of Chairman Steven D. Olmstead, Vice Chairman Deborah J. Smith, and Board Member Paul Thomas Glause, reviewed the entire file, independently examined all information provided in this matter, and states the following:

1. The Board’s jurisdiction in this matter is invoked pursuant to Wyo. Stat. Ann. § 39-11-102.1(c)(x) which states the Board shall:

Carefully examine into all cases wherein it is alleged that property subject to taxation has not been assessed or has been fraudulently, improperly, or unequally assessed, or the law in any manner evaded or violated, and cause to be instituted proceedings which will remedy improper or negligent administration of the tax laws of the state.<sup>1</sup>

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<sup>1</sup>Before recodification the statute was numbered Wyo. Stat. Ann. § 39-1-304(a)(xiv) (Michie 1997). The language did not change until July 2001 when the following sentence was added: “Except for allegations based in fraud, any request for relief under this paragraph shall be filed within five (5) years from the date the taxes were paid or should have been paid[.]”

2. A Verified Petition for Board Examination was filed by Merit Energy Company on November 24, 2010. Merit requested the Board examine the Department's practice of utilizing volumes reported by operators to resolve the difference between volumes reported by TIK interest owners. The Board has jurisdiction to conduct such examination both statutorily and pursuant to the Wyoming Supreme Court's decision in *Exxon Corporation v. Board of County Commissioners, Sublette County*, 987 P.2d 158 (Wyo. 1999).

3. Merit also requested the Board hold a contested case hearing to consider whether it had paid the proper amount of severance and ad valorem tax on its 2006 production. Merit requested the Board direct the Department to consider the actual taxable value reported by the TIK taxpayer instead of relying on the gas volumes reported by the operator when there was a discrepancy in the volumes reported by the operator and the TIK interest owner. By an Order dated February 18, 2010, the Board declined to conduct a contested case hearing.

The plain language of Wyo. Stat. Ann. 39-1-304 (a)(xiv) makes it clear, when read in the context of the entire statute, that the legislature did not therein impose a "clear, certain, and indisputable" duty to utilize a contested case proceeding in "carefully examining" Section 14 petitions, although the Board may choose to do so. We cannot legislate such a duty. Neither can we say that due process so clearly requires a contested case proceeding for Section 14 petitions that a writ of mandamus should have issued to that effect. Rather, we conclude that Section 14 does not require a "trial type" hearing and the district court did not abuse its discretion in denying the writ of mandamus.

*In re Board of County Com'rs, Sublette County*, 33 P.3d 107,114 (Wyo. 2001)

4. In order to thoroughly evaluate Merit's allegations, it is necessary to review the history of this matter.

5. On March 17, 2008, the Department issued an assessment letter notice to Merit which increased the 2006 production year value by a total of \$15,671,697 for natural gas attributed to Merit from numerous wells in Lincoln, Sweetwater and Uinta Counties.

6. The Department issued two additional assessment letter notices to Merit dated November 24, 2008, which further increased, by a total of \$22,191, the 2006 production year natural gas value attributed to Merit in Lincoln County.

7. Each assessment letter notice stated it was a final administrative decision by the Department, and set forth the requirements for taking exception to the decision by filing an

appeal with the Board. Merit did not appeal the assessment letter notices dated March 17, 2008, or the assessment letter dated November 24, 2008.

8. On June 29, 2010, the Department issued a Notice of Valuation Change (NOVC) to Lincoln, Sweetwater, and Uinta Counties which notified each county of the increase in the value of the 2006 natural gas production for the wells and groups identified in the March 17, 2008, and November 24, 2008, assessment letter notices.

9. Merit did not file an amended ad valorem return within the three-year time frame allowed by Wyo. Stat. Ann. § 39-14-208(b)(iii) for its 2006 natural gas production. However, on July 16, 2010, Merit filed with the Board a Case Notice for Review/Notice of Appeal (Docket No. 2010-106) referencing the June 29, 2010, NOVC. The Board found the Case Notice for Review/Notice of Appeal filed by Merit referencing the June 29, 2010, NOVC, was not a timely appeal of the March 17, 2008, and November 24, 2008, Department assessment letter notices and dismissed the appeal.<sup>2</sup> [*Order of Dismissal With Prejudice* dated December 6, 2010, State Board of Equalization Docket No. 2010-106.]

10. The Department urged the Board to summarily dismiss Merit's Petition For Board Examination in accordance with Chapter 4, Section 3(b) of the Rules of the State Board of Equalization. In so doing, the Department argued that "Merit glosses over the actual reason it now challenges the Department's historic reliance upon operator returns - its failure to timely appeal or simply file amended returns to address the volumetric discrepancies at issue." The Board does not dismiss this argument lightly. However, the Board is mindful of the Wyoming Supreme Court's decision in *Exxon Corp. V. Board of County Com'rs, Sublette County*, 987 P.2d 158 (Wyo. 1999), "that the Board's power to 'carefully examine' alleged taxation improprieties under Section 14 is 'in addition to' the Board's duty to hear appeals from the Department of Revenue decisions." *Id.* at 164. In a case with a procedural history similar to the one at hand, this issue was revisited by the Court in 2001.

Wyo. Stat. Ann. § 39-11-102.1(c)(x) mandates careful examination of specified allegations and this examination is in addition to the review available by a contested case hearing. Assuming without deciding that the Board can reject a petition when a contested case is pending, in this case, Wyodak's petition for examination may provide review of subsection (x) issues other than that potentially available through a contested case proceeding. The Board

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<sup>2</sup>On January 5, 2011, Merit filed a Petition For Review of Administrative Action in the District Court for the Third Judicial District, Sweetwater County, Wyoming, Civil Action No. C-11-6-J challenging the decision of the Board in Docket No. 2010-106.

is mandated to perform a subsection (x) examination that may provide an additional avenue to a petitioner seeking relief for an improper assessment, and it may not summarily dismiss without examining the petition's merits sufficiently for judicial review.

*Wyodak Resources Development Corporation v. State Board of Equalization*, 32 P.3d 1056, 1060-1061 (Wyo. 2001).

11. In its Examination Order dated February 18, 2011, the Board requested the parties to responded to certain questions through designated representatives.

12. During the Examination Hearing held before the Board on March 22, 2011, the Department provided an overview of the TIK volume reporting and reconciliation process through Craig Grenvik. Mr. Grenvik has been the Administrator of the Mineral Tax Division for the Department a little over six years. Prior to that, he was the audit coordinator/mineral evaluation manager for the Department for approximately seven years. He also worked for the Department of Audit and had experience in mineral tax audits and production tax audits.

13. Mr. Grenvik provided a handout which was admitted as Exhibit 505 to assist with his explanation of the overview of the mineral tax system in Wyoming. Mr. Grenvik prefaced his overview by reviewing some of the pertinent Wyoming Statutes and Department Rules.

14. Mr. Grenvik explained that Wyoming has a self reporting system for mineral taxation, much like the Federal Income Tax system. It requires an after-the-fact verification process to gain a level of confidence in the accuracy of what the taxpayer is reporting. To gain that level of confidence the Department of Audit may conduct formal audits or the Department may preform reviews.

15. In conducting reviews, the Department examines data from several sources, including but not limited to, severance tax returns, gross product returns and the Wyoming Oil and Gas Conservation Commission's Form 2.

16. Operators and TIK interest owners are required to report the value of their production for each mineral group annually on form 4201. The operator is also required to track all volumes on form 4201. The inlet volume is reported in box 5 of form 4201 by the operator and all TIK interest owners for each owner's sales. The operator must also report the inlet volumes for all of the TIK interest owners in box 4 of form 4201.

17. The operator must also file form 4211 which lists all of the TIK sales volumes. Form 4211 is a volume reconciliation form. Therefore, the total volume on form 4211 must match the total in box 4d of form 4201 filed by the operator.

18. Both operators and TIK interest owners are also required to file form 4231 for their own sales. The operator does not include the value of the TIK interest owners' production on this form. The purpose of form 4231 is to get an accounting of all the individual products' volumes and values sold after the processing of natural gas. This includes residue gas, condensate, natural gas liquids, sulfur, carbon dioxide, helium, nitrogen and any other valuable minerals. The value in the "GROSS VALUE OF PLANT PRODUCT" box on form 4231 must match the value in box 7 of form 4201.

19. When a natural gas stream enters a processing facility its volume is at a certain temperature and pressure. During processing many items are removed from the gas stream. The leftover residue gas is primarily methane and is of a lesser volume than when it entered the plant because all of the components are no longer in the residue gas. The processed components are measured in different units. Condensate is measured in barrels, liquids are measured in gallons, sulfur is measured in long tons, and the residue gas is measured in standard cubic feet. To complicate matters even more, components are at different temperatures and pressures.

20. If a Department review reveals discrepancies, the Department sends a letter to the TIK interest owner and the operator advising them of the discrepancies, giving them sixty (60) days to resolve the matter. Most matters are resolved at this stage by either the operator or the TIK interest owner filing an amended return which resolves the discrepancies.

21. If the discrepancy is not resolved within the sixty (60) days, the Department issues an assessment letter for additional value. The value adjustment in the assessment is determined by multiplying the unit sale price reported by the TIK interest owner against the difference between the sales volume the operator reported and what the TIK interest owner reported. If the TIK interest owner did not report any values, the state-wide average price is used. This assessment of additional value is an appealable administrative decision of the Department, which the TIK interest owner may appeal to the Board by filing a written notice of appeal within thirty (30) days.

22. Merit designated three (3) employees to respond to the Board's examination. Kaleen Reyna has been a senior accountant for Merit for seven and a half years. She supervises all the production and revenue from the Whitney Canyon and Painter assets. She is responsible for all of the Wyoming reporting, including severance reports. Angie Harrington is currently

Merit's corporate controller. She has been with Merit for a little over fifteen years. Joe Nicholas is an operations engineer for Merit. He has been with the company for two and a half years.

23. Mr. Nicholas began by giving an overview of how gas is processed. He explained how gas shrinks as it moves through the processing plant. He stated that the controversy arises because the operator reports "inlet" volumes while the TIK interest owner is reporting values based on actual sales after the gas is processed. He said the Department increased the value of production based upon the increased volumes reported by the operator. Mr. Nicholas informed the Board that even if the TIK interest owner adjusted the volume to match the operator's reported volume, the value would still be the same because they are reporting value based on actual sales.

24. Kaleen Reyna testified the reason there are so many discrepancies between the TIK interest owner's volumes and the operator's reported volumes is because the processing plant reports tailgate numbers to the TIK interest owners after the gas is processed. She explained that it is a complicated calculation to extrapolate the inlet volume of gas from the quantities of various products the TIK interest owners receive at the tailgate of the processing plant. She stated the fair market value of the various products reported on Form 4231 is from actual sales. Ms. Reyna argued it was unfair to use the sales price of processed gas to determine the taxable value of the inlet volume discrepancies between the TIK interest owner's reported volume and the operator's reported volume.

25. Angie Harrington stated if an operator's volume is different than the TIK interest owner's volume it should only be used as an indicator. The TIK interest owner's tax liability to the Department is based on value not volume. She explained the TIK taxpayer information is the best available information for the value of the product and what tax should be paid.

26. Ms. Harrington contended the TIK interest owner's information was more relevant than the operator's volumes because the TIK interest owner is the only one who knows what the value is for the processed volumes. She reiterated Ms. Reyna's position that it was unfair for the Department to apply the sales price of processed gas to the discrepancy of an inlet volume for wet or unprocessed gas.

27. Both Ms. Harrington and Ms. Reyna acknowledged the operator's inlet volume information was available to TIK interest owners.

## PRINCIPALS OF LAW

28. Wyoming Statutes Annotated § 39-14-202(a) provides:

(i) The department shall annually value and assess crude oil, lease condensate or natural gas production at its fair market value for taxation;

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(iii) Annually, on or before June 1, or as soon thereafter as the fair market value is determined, the department shall certify the valuation determined by the department to the county assessor of the county from which the crude oil, lease condensate or natural gas was produced to be entered upon the assessment rolls of the county;

29. Wyoming Statutes Annotated § 39-14-203(b) provides in part as follows:

(i) Crude oil, lease condensate and natural gas shall be valued for taxation as provided in this subsection;

(ii) The fair market value for crude oil, lease condensate and natural gas shall be determined after the production process is completed. Notwithstanding paragraph (x) of this subsection, expenses incurred by the producer prior to the point of valuation are not deductible in determining the fair market value of the mineral;

\* \* \*

(iv) The production process for natural gas is completed after extracting from the well, gathering, separating, injecting and any other activity which occurs before the outlet of the initial dehydrator. When no dehydration is performed, other than within a processing facility, the production process is complete at the inlet to the initial transportation related compressor, custody transfer meter or processing facility, whichever occurs first;

30. Wyoming Statutes Annotated § 39-14-207(a) provides:

(v) Except as provided in paragraph (vi) of this subsection, each taxpayer liable for severance taxes under W.S. 39-14-203(a) shall report monthly to the department. The monthly tax reports are due on or before the twenty-fifth day of the second month following the month of production. Reports shall be filed on forms prescribed by the department. The department may allow extensions for filing returns by regulation;

(vi) If a taxpayer's liability for severance taxes is less than thirty thousand dollars (\$30,000.00) for the preceding calendar year, monthly reporting requirements are waived and the taxpayer shall report annually. The annual report is due on February 25 of the year following the year in which production occurred.

31. Chapter 6 § 7(a)(i)(G) of the Wyoming Department of Revenue Rules provides in part that:

(2.) Extensions of time to file these reports, for up to 60 days, may be granted for cause. Extension requests must be in writing and be received by the Mineral Tax Division prior to the statutory due date.

(3.) In addition to the gross products reports filed with the Department of Revenue, each taxpayer whose current reported annual volume produced is in excess of 500,000 mcfs of gas or 50,000 barrels of oil per county shall provide an estimate of taxable value to the appropriate county assessor by May 1 of the current reporting year to enable the various tax districts to begin their budget process in a timely and accurate manner.

32. “‘Department Review’ means, but is not limited to corrections of clerical errors or reconciliations of tax reports with reports acquired by other state or federal agencies.” *Wyo. Stat. Ann. § 39-14-201(a)(viii)*.

33. “‘Operator’ means any person responsible for the day-to-day operations of a mine or oil and gas property by reason of contract, lease or operating agreement or ownership of an unleased producing mine or well operated by the owner thereof.” *Rules, Wyoming Department of Revenue, Chapter 6 § 4(j)*.

34. “‘Take in kind’ means the event when an election is made by an interest owner under a lease or joint operating agreement, with notice to the affected parties, to separately market or dispose of crude oil, natural gas or natural gas products. An interest owner must affirmatively exercise an option under a lease or operating agreement to separately market his share of the production to qualify as take in kind. If an option to separately market is not exercised by the interest owner, the operator shall report the interest owner's portion of the production. *Rules, Wyoming Department of Revenue, Chapter 6 §4b(s)*.”



35. The Department's Rules provide that:

(b.) In order to minimize erroneous reporting, the following exchange of information shall occur.

(i.) Exchange of Oil and Natural Gas Data. On or before the second Monday in February, the take in-kind interest owner shall provide the operator an annual summary of monthly volumes taken in-kind by property name and by property identification number as assigned by the Mineral Tax Division. The take in-kind interest owner may negotiate an extension of time for cause with the operator not to exceed thirty days.

(ii.) the operator shall notify the take in-kind interest owner of any discrepancies in volume, property name or property identification number within thirty days of receipt of the take in-kind interest owner's data.

*Rules, Wyoming Department of Revenue Chapter 6 § 6(b.).*

36. Wyoming Statute Annotated § 39-14-208(b)(v)(F) provides "Upon receipt of department review findings, the taxpayer shall have sixty (60) days in which to submit a response."

37. Wyoming Statutes Annotated § 39-14-209(c) provides:

(i) If a taxpayer has reason to believe that ad valorem taxes imposed by this article have been overpaid, a request for refund shall be filed with the department by submitting an amended return within three (3) years from the date the production should have been reported pursuant to W.S. 39-14-207(a)(i).

(ii) If a taxpayer has reason to believe that severance taxes imposed by this article have been overpaid, a request for refund shall be filed with the department by submitting an amended return within three (3) years from the date the production should have been reported pursuant to W.S. 39-14-207(a)(i).

38. Wyoming Statute Annotated § 39-11-102.1(c) provides the Board shall review final decisions of the Department on application of any interested person adversely affected.

39. A taxpayer's appeal must be filed with the Board within thirty days of the Department's final decision. *Rules, Wyoming State Board of Equalization, Chapter 2 § 5(a); Wyo. Stat. Ann. § 39-14-209(b(i)).*

## ANALYSIS

40. The Department is mandated by Wyoming Statutes Annotated § 39-14-202(a) to annually value natural gas production at its fair market value for taxation. Wyoming Statutes Annotated § 39-14-203(b) requires the fair market value for natural gas to be determined after the production process is completed. When no dehydration is performed, other than within a processing facility, **the production process is complete at the inlet to the processing facility.** Since the Department is required to determine the fair market value of natural gas at the inlet to the processing facility, it stands to reason the inlet to the processing facility is the logical place to resolve any volume discrepancies between the operator and TIK interest owners.

41. Even though the process is not perfect, there are sufficient safeguards in place to resolve any discrepancies in volumes reported by the operator and TIK interest owners.

42. TIK interest owners are required to provide the operator with an annual summary of monthly volumes taken in kind. In turn, the operator must notify the TIK interest owner of any discrepancies in volume within thirty days of receipt of the take in-kind interest owner's data. *Rules, Wyoming Department of Revenue Chapter 6 § 6* This process allows the parties to informally resolve any discrepancy between themselves.

43. If a discrepancy is discovered during a Department review, the Department discloses its findings and the taxpayer has sixty (60) days to submit a response. Wyo. Stat. Ann. § 39-14-208(b)(v)(F). Again, this provides the operator and TIK interest owner an opportunity to informally resolve any discrepancy. If the parties are not able to resolve the discrepancy within this sixty (60) day window, the Department issues an assessment letter and the taxpayer has thirty (30) days to appeal the additional assessment to the Board.

44. Even if the taxpayer failed to resolve the discrepancy with the operator or timely appeal the Department's additional assessment, the taxpayer still has three (3) years from the date the production should have been reported to file an amended return with the Department. *Wyo. Stat. Ann. § 39-14-209(c)*. If the Department rejects the amended return, the taxpayer may appeal to the Board.

## REGULATORY FINDINGS

A. There are sufficient safeguards in place to allow TIK interest owners to resolve volume discrepancies with the Department, whether it be by informal resolution with the operator, amended tax returns or appeal of the Department's assessment of additional value to the Board.

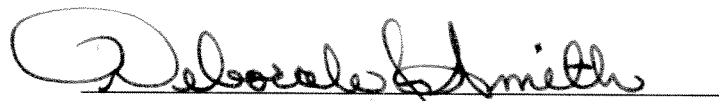
B. After carefully examining the parties' assertions and contentions, the Board concludes the Department's method of resolving volume discrepancies between the operator and TIK interest owners does not result in any improper, illegal or unequal assessments for TIK interest owners.


**Pursuant to *Wyo. Stat. Ann. § 16-3-114* and *Rule 12, Wyoming Rules of Appellate Procedure*, any person aggrieved or adversely affected in fact by this decision may seek judicial review in the appropriate district court by filing a petition for review within 30 days of the date of this decision.**

DATED this 27<sup>th</sup> day of September, 2011.


### STATE BOARD OF EQUALIZATION

  
Steven D. Olmstead, Chairman

  
Deborah J. Smith, Vice-Chairman

  
Paul Thomas Glause, Board Member

ATTEST:

  
Wendy J. Soto, Executive Secretary

## CERTIFICATE OF SERVICE

I hereby certify that on the 27<sup>th</sup> day September, 2011, I served the foregoing **EXAMINATION REPORT** by placing a true and correct copy thereof in the United States Mail, postage prepaid, and properly addressed to the following:

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