BEFORE THE STATE BOARD OF EQUALIZATION

FOR THE STATE OF WYOMING

IN THE MATTER OF THE APPEAL OF	)	
WPX ENERGY, INC. FROM A DECISION	)	Docket No. **2016-31**
OF THE DEPARTMENT OF REVENUE	)	
(Min. Gross Products, Production Year 2012)	)	

FINDINGS OF FACT, CONCLUSIONS OF LAW, DECISION AND ORDER

APPEARANCES

Walter F. Eggers, III, and Matthew J. Micheli, Holland & Hart LLP, appeared on behalf of WPX Energy, Inc. (WPX or Petitioner).

Karl D. Anderson, of Wyoming Attorney General's Office, appeared on behalf of the Wyoming Department of Revenue (Department or Respondent).

DIGEST

Natural gas producer/shipper WPX filed amended gross products returns reducing its taxable value for its 2012 coal bed methane production. The amended returns fully deducted pipeline fees paid by WPX, referred to as "demand charges" or "reservation fees," incurred under "firm" pipeline transportation arrangements. WPX had only partially deducted those fees when initially reporting taxable value and paying mineral taxes. Applying Wyoming Statutes section 39-14-203(b)(vi)(C) (2011), the Department rejected the amended returns, concluding WPX properly deducted only *that portion* of the pipeline demand charges tied to the pipeline capacity actually used. The State Board of Equalization (State Board)[1] conducted a contested case hearing December 6, 2016, after which the parties submitted written briefs. The State Board holds WPX was entitled to deduct the entire demand charge as a transportation expense under the statutory netback method and,

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[1] At the time of the hearing, the State Board was comprised of Chairman E. Jayne Mockler, Vice-Chairman Martin L. Hardsocg, and Board Member Robin Sessions Cooley. Mr. Hardsocg currently serves as the State Board Chairman, Ms. Mockler serves as the Vice-Chairman. Ms. Cooley was succeeded by Board Member Dave Gruver, who has since resigned and been succeeded by Board Member David L. Delicath. Mr. Delicath reviewed the record, including the transcript of proceedings, and participated in this decision.

accordingly, WPX is entitled to file amended returns reducing its taxable value. The State Board reverses and remands this matter to the Department.

ISSUES

WPX identifies the factual and legal issues as follows:

A. Are pipeline reservation fees and transportation service charges fundamental components of the charges WPX pays for the transportation of natural gas?

B. Was the Department of Revenue's decision prohibiting one portion of transportation charges (reservation and firm transportation charges), while allowing other components of the transportation costs, contrary to the facts of natural gas transportation?

C. Was the Department of Revenue's decision to prohibit one portion of WPX's transportation charges (pipeline reservation fees and firm transportation service fees), while allowing other components of the transportation costs, contrary to Wyoming law?

D. Would any assessment of interest and/or penalty by DOR relating to DOR's Final Decision be contrary to Wyo. Stat. §§ 39-14-208(c)(ii); 39-14-208(d)?

(WPX Issues of Fact & Law & Ex. Index 1-2).

From the Department's perspective, the question is more generally, "Whether the Department correctly rejected WPX's amended returns for its 2012 production based upon the inclusion of an unutilized demand charge for transportation deductions?" (Dep't Issue of Fact & Law & Ex. Index 1).

The Board restates the issue as whether WPX was entitled by statute to deduct the entire pipeline demand charge/reservation fee incurred for capacity on a pipeline when WPX used less than its entire reserved pipeline capacity?

The Board will not address WPX's hypothetical issue concerning interest and penalty, which WPX did not address in briefing. (See Issue D above).

JURISDICTION

WPX timely appealed from the Department's final decision, dated April 15, 2016, rejecting WPX's amended gross products returns. (WPX Case Notice for Review/Notice of Appeal filed May 11, 2016). *See* Rules, Wyo. State Bd. of Equalization, ch. 2 § 5(e) (2006). The State Board shall review final decisions of the Department upon timely application of those adversely affected. *See* Wyo. Stat. Ann. § 39-11-102(c) (2015). The State Board has jurisdiction.

FINDINGS OF FACT

The facts are not in dispute.

1. In 2012, WPX produced coal bed methane from various leases in the Powder River Basin. (Tr. 28-29). WPX's Manager of State Tax and Royalty Reporting, Steve Rodich, testified regarding WPX's mineral tax obligations and rights, including mineral tax refund claims submitted to the Department. (Tr. 26-28).

2. The present dispute arose when WPX submitted amended returns, claiming additional transportation deductions and thus lowering the taxable value of its 2012 coal bed methane production. (Tr. 28-30; Ex. 100). Having resolved a number of other tax reporting issues with the Department, disagreement remained concerning the proper deduction for costs to transport its coal bed methane production, in particular, the deductibility of specified pipeline charges. (Tr. 30-31).

3. To ship its gas on interstate pipelines to distant markets, WPX acquired "firm transportation" services, for which it paid a "demand charge." (Tr. 32-34, 60-61). Opting for the more expensive firm transportation services assured WPX specified pipeline capacity regardless of market conditions and other factors. *Id.* WPX was obligated to pay the demand charge each month regardless of how much pipeline capacity it actually used.[2] (Tr. 60-61).

4. There were months in which WPX did not use all of its pipeline capacity under its firm transportation arrangements. (Tr. 61-62). Mr. Rodich testified that WPX may have

[2] The record contains confidential firm transportation agreements and related schedules which set the terms and expenses of WPX's firm transportation services. (Confid. Tr. 52-55; Confid. WPX Ex's. 108-20). The Department did not dispute their relevance, applicability, or meaning and generally accepted that WPX incurred demand charges to transport its gas. (Tr. 163-65). Thus, the parties spent little time discussing any contract or the terms thereof. *Id.* The parties focused instead on statutory language defining the netback method of valuation. (*Infra* ¶¶ 24-25, 28-30, 38, 41).

released some of its pipeline capacity to other shippers, but he had no specific knowledge of such. (Tr. 62-63; *see also* Tr. 117-18).

5. Ms. Kris Terry, an expert witness with substantial natural gas transportation negotiating and consulting experience, testified concerning the structure and purpose of WPX's firm transportation services. (Tr. 68-79, 105-08). Ms. Terry explained that firm transportation contracts employ a two-part rate, including a "demand charge" and a "commodity charge." (Ex. 107, WPX 048). The demand charge, also called a "reservation fee," is a set charge in return for which the gas pipeline assures access to allotted pipeline capacity and is paid monthly regardless of volumes transmitted. (Tr. 60-61, 82-83, 85, 95-96, 103-07, 134-35; Ex. 107 at WPX 047, 050). The commodity charge is based on the volume of gas actually transported. (Ex. 107 at WPX 048). Pipelines structured firm transportation agreements with a two-part rate to assure they would generate income regardless of market conditions and volume flows. (Tr. 82, 92-94).

6. Ms. Terry testified that "interruptible service," a less expensive alternative to firm transportation service, requires payment of the commodity charge only and "is a lower-priority service that permits the pipeline essentially to interrupt the flow of gas, in this case, for any other shipper who has a higher priority than you." (Tr. 96, 105; Ex. 107 at WPX 048). The shipper contracting for interruptible service has no guarantee it will be able to ship gas production on the pipeline. (Tr. 105). She explained:

> And on a warm day in August, interruptible transportation is pretty reliable usually because you're not likely to get interrupted. You nominate your gas at the beginning of the month and it's probably going to flow the whole month. Contrast that with a winter month, when you probably—they won't even accept your nomination under an interruptible agreement because they already have their capacity fully subscribed and expect to fully use it for firm shippers.

(Tr. 97). Describing firm transportation, Ms. Terry continued:

> In the industry, when we say firm transportation, we mean that transportation that permits the shipper – in this case that would be WPX – to deliver gas each and every day, up to its contract quantity, and that the pipeline is compelled to take that gas, to the exclusion of everyone else except other firm shippers, and deliver that gas to the point stated in the contract; so, barring a major force majeure event, that you can count on that transportation capacity. You don't have to worry about it.

(Tr. 95-96; *see also* Tr. 105-06).

7. Ms. Terry confirmed that customers holding firm transportation service rights can, however, sell or "release" their unused capacity to other shippers, in which case the shipper to whom the capacity is released steps into the shoes of the original shipper. (Tr. 109-16, 117-18).

8. Customers using 100% of their capacity ship at a "100% load factor" and are therefore receiving transportation services at their lowest per unit rate. (Tr. 98-99, 102-03; Ex. 107 at WPX 047).

9. Ms. Terry described the detrimental effect upon a producer unable to ship gas: "you don't want to bring wells on and shut them in and bring them on and shut them in ... It's a physical issue. It can damage the reservoir. In other instances it's just a disaster, from a business cash-flow standpoint, of having your gas sold for a few days and having it shut-in for extended periods." (Tr. 97).

10. Ms. Terry opined that the Department's permitted deduction (proportional and at a 100% load factor rate, *supra* ¶ 8) does not permit WPX to recover all transportation expenses actually incurred. (Tr. 99-100; *see also* Tr. 119-20, 129-30, 134-35). Responding to the argument that deducting the full demand charge when all capacity is not used amounts to a deduction "for transporting gas that was neither produced nor transported," she explained, "I disagree with that premise that there is such a thing. In fact, WPX did transport gas, it did pay transportation charges. Those demand charges are in fact the majority of the transportation costs." (Tr. 101-02; Ex. 105).

11. In its initial mineral tax returns filed with the Department, WPX deducted only a portion of its "demand" charges, along with the total commodity charges, to move its coal bed methane production on the Fort Union Gas Gathering or MIGC pipelines to Glenrock, Wyoming. (Tr. 34-35, 38-39, 59-60). In effect, WPX deducted a fraction of its demand charge equal to the proportion of its capacity used, rather than the full demand charge paid. *Id.* Through amended returns, WPX sought to deduct the balance of demand charges incurred. The deduction of additional transportation costs per WPX's amended returns would correspondingly lower its taxable value. (Tr. 35-39, 41-42, 44-47, 56, 60-61; Exs. 100, 102, 104, 500, 502).

12. Neither the valuation methodology nor point of valuation are disputed. The Department values coal bed methane in accordance with Wyoming Statutes sections 39-14-201 through 209, under which all oil and gas production is valued and taxed. As directed, WPX reported the taxable value of its 2012 coal bed methane under the "netback"

method. Wyo. Stat. Ann. § 39-14-203(b)(vi)(C) (2011), *infra* ¶ 22. The transportation expenses at issue are all post-point of valuation, so the Department does not dispute that the charges were generally deductible as transportation. Rather, the Department disputes whether the *entire* demand charge was deductible under the netback methodology for those periods during which WPX did not use all of the pipeline capacity it paid to reserve. (Tr. 39-40, 61, 141-48, 169-70).

13. The Department rejected WPX's amended returns, asserting WPX had initially reported its transportation deductions correctly by deducting only the portion of its demand charge relating to "actual delivered volumes." (Tr. 43-46, 155; Exs. 105, 500, 502). The Department reasoned that WPX was not entitled to a deduction for "unutilized demand charges." (Tr. 43-46; Exs. 105, 500; Dep't Resp. Br. 8-10). The Department equated a deduction for unused capacity to a deduction for unproduced volumes. (Tr. 45, 159; Ex. 105 at WPX 40). Correspondingly, the Department permits WPX to deduct the entire demand charge only when it uses 100% of its reserved capacity. (Tr. 171-72).

14. For authority supporting denial of the claimed deduction, the Department cites Wyoming Statutes section 39-14-203(b)(vi)(C) (2011), *infra* ¶ 22, and its internal departmental policy/decision; the Department's rules do not speak to the issue. (Tr. 145-46, 165-66, 176).

15. Deducting the full demand charge, the Department contends, could be problematic because the shipper might release its capacity to a different shipper who also deducts part or all of the same demand charge. No evidence indicated WPX claimed a deduction for capacity (associated fees) released to other shippers. (Tr. 168-69, 179, 183-86; Ex. 100 at WPX 003).

16. WPX's refund request equaled approximately $3.4 million in severance tax it paid to the State and ad valorem taxes it paid to the county. (Tr. 46-47).

CONCLUSIONS OF LAW

A. State Board's review function and burdens of proof

17. "Any person aggrieved by any final administrative decision of the department may appeal to the state board of equalization." Wyo. Stat. Ann. § 39-14-209(b)(i) (2015). The role of the State Board in such matters is to adjudicate the dispute between the parties.

> It is only by either approving the determination of the Department, or by disapproving the determination and remanding the matter to the Department,

> that the issues brought before the Board for review can be resolved successfully without invading the statutory prerogatives of the Department. The statutory mandate to the Board is not to maximize revenue or to punish nettlesome taxpayers, but to assure the equality of taxation and fairly adjudicate disputes brought before it.

Amoco Prod. Co. v. Wyo. State Bd. of Equalization, 12 P.3d 668, 674 (Wyo. 2000).

18. As the adjudicating body, the State Board "[d]ecide[s] all questions that may arise with reference to the construction of any statute affecting the assessment, levy and collection of taxes, in accordance with the rules, regulations, orders and instructions prescribed by the department[.]" Wyo. Stat. Ann. § 39-11-102.1(c)(iv) (2015).

19. "[T]he burden of proof with respect to tax valuation is on the party asserting an improper valuation." *Williams Prod. RMT Co. v. State Dep't of Revenue*, 2005 WY 28, ¶ 7, 107 P.3d 179, 183 (Wyo. 2005). More specifically, the State Board Rules provide:

> Except as specifically provided by law or in this section, the Petitioner shall have the burden of going forward and the ultimate burden of persuasion, which burden shall be met by a preponderance of the evidence. If Petitioner provides sufficient evidence to suggest the Department determination is incorrect, the burden shifts to the Department to defend its action.

Rules, Wyo. State Bd. of Equalization, ch. 2 § 20 (2006). "Once the presumption is successfully overcome, the burden of going forward shifts to the DOR to defend its valuation." *Colo. Interstate Gas Co. v. Wyo. Dep't of Revenue*, 2001 WY 34, ¶ 10, 20 P.3d 528, 531 (Wyo. 2001) (citing *Basin Elec. Power Coop., Inc. v. Dep't of Revenue*, 970 P.2d 841, 851 (Wyo. 1998)). The taxpayer "bears the ultimate burden of persuasion to prove by a preponderance of the evidence that the valuation was not derived in accordance with the required constitutional and statutory requirements for valuing state-assessed property." *Id.*

20. A preponderance of the evidence is " 'proof which leads the trier of fact to find that the existence of the contested fact is more probable than its non-existence.' " *Kenyon v. State, ex rel., Wyo. Workers' Safety & Comp. Div.*, 2011 WY 14, ¶ 22, 247 P.3d 845, 851 (Wyo. 2011) (quoting *Judd v. State ex rel. Wyo. Workers' Safety & Comp. Div.*, 2010 WY 85, ¶ 31, 233 P.3d 956, 968 (Wyo. 2010)).

21. An administrative agency's statutory interpretation is entitled to weight when the Legislature has, over a long period of time, failed to change the statute. Such failure is an indication of legislative acquiescence to the agency's interpretation. *Seherr-Thoss v. Teton*

Cty. Bd. of Cty. Comm'rs, 2014 WY 82, ¶ 14 n. 2, 329 P.3d 936, 943-44 n.2 (Wyo. 2014) (citing *Public Serv. Comm'n v. Formal Complain of WWZ Co.*, 641 P.2d 183, 186 (Wyo. 1982)). Similarly, when interpreting an ambiguous statute, the State Board "will give some deference to an interpretation by the agency charged with execution of the statute unless its interpretation is clearly erroneous." *Campbell Cty. School Dist. v. Catchpole*, 6 P.3d 1275, 1285 (Wyo. 2000).

B. Applicable statutory and regulatory provisions

22. As reported by WPX, the Department accepted application of the netback method for valuation of the natural gas at issue. *Supra* ¶ 12. The netback method applies as follows:

> (vi) In the event the crude oil, lease condensate or natural gas production as provided paragraphs (iii) and (iv) of this subsection is not sold at or prior to the point of valuation by bona fide arms-length sale, or except as otherwise provided, if the production is used without sale, the department shall identify the method it intends to apply under this paragraph to determine the fair market value... The department shall determine the fair market value by application of one (1) of the following methods:
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> . . .
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> (C) Netback -- **The fair market value is the sales price minus expenses incurred by the producer for transporting produced minerals to the point of sale and third party processing fees.** The netback method shall not be utilized in determining the taxable value of natural gas which is processed by the producer of the natural gas;

Wyo. Stat. Ann. § 39-14-203(b)(vi)(C) (2011) (emphasis added). The present dispute concerns primarily the statutory language in bold.

23. Neither the Legislature nor the Department have defined the term "transportation" or any variation of the phrase "expenses incurred by the producer for transporting produced minerals," the operative netback methodology language. *See* Wyo. Stat. Ann. § 39-14-203(b)(vi)(C) (2011), *supra* ¶ 22.

C. Application of law to facts

24. The Department contends that while WPX could deduct the reservation/demand fee under Wyoming Statutes section 39-14-203(b)(vi)(C) (2011), *supra* ¶ 22, the Department

properly limited WPX's deduction to a pro rata fraction of the total fee, equal to the proportion of its pipeline capacity that WPX actually used. The deduction applies, explained the Department, at a rate which assumes a 100% load factor, i.e. WPX is sending its maximum allotment of gas and using 100% of the pipeline capacity it paid to reserve. (Tr. 160-61, 170-71; Exs. 105, 107 at WPX 047). Therefore, only when using 100% of its allotted pipeline capacity could WPX deduct the entire demand charge in a given period. *Id.* The Department further reasons the demand charge is "actually a reservation for the space in the pipe[]" and WPX may not deduct for pipeline capacity not actually used. (Tr. 167). The Department analogizes that deducting the entire demand charge when underutilizing pipeline capacity would effectively allow a deduction for gas not transported. *Supra* ¶ 13.

25. WPX counters it could deduct the entire demand charge, stressing that it actually incurred the entire demand charge to transport its gas production:

> The Department's attempt to reverse engineer some sort of 100% load factor unit price and apply that reverse engineered price to volume sold is not consistent with the statute or with what actually occurred. WPX had a contractual agreement to ship gas, it was required to pay the full amount due under the firm contracts to ship the gas it produced. WPX did in fact pay the full amount and did in fact ship the gas. The full amount is deductible.

(WPX Reply Br. 5).

26. We find WPX carried its initial burden of going forward—WPX's statutory analysis does not, on its face, offend the operative statutory language, "minus expenses incurred by the producer for transporting produced minerals to the point of sale[.]" Wyo. Stat. Ann. § 39-14-203(b)(vi)(C) (2011), *supra* ¶ 22. WPX presented factual and expert evidence that WPX incurred the entire reservation charge to transport its gas. *Supra* ¶¶ 3-10. The Department countered with no evidence to suggest otherwise and did not dispute the intent of the firm transportation agreements. *Supra* ¶ 3, n. 2; *infra* ¶ 39. *See e.g. BP America Prod. Co. v. Dep't of Revenue, State of Wyo.*, 2005 WY 60, ¶¶ 24-26, 112 P.3d 596, 608-09 (Wyo. 2005) (Contrary to taxpayers' contractual interpretations, Department demonstrated that processing agreement among producer-processors established mutually imposed arms-length processing fees, upon which a comparable value for tax purposes could be derived); *EOG Res., Inc., v. Dep't of Revenue,* 2004 WY 35, ¶¶ 19-21, 86 P.3d 1280, 1285-86 (Wyo. 2004) (Contrary to taxpayer's claim that contracts merely reflected financing arrangement, Department demonstrated concurrent purpose of contractual volumetric production payments reflected value paid for Wyoming gas production).

27. As a starting point in resolving this dispute, the statutory "netback" valuation method expresses the Legislature's intent with respect to the deduction of transportation expenses. *See* Wyo. Stat. Ann. § 39-14-203(b)(vi)(C) (2011), *supra* ¶ 22. When resolving statutory interpretation disputes, the Wyoming Supreme Court directs that:

> In interpreting statutes, our primary consideration is to determine the legislature's intent. All statutes must be construed *in pari materia* and, in ascertaining the meaning of a given law, all statutes relating to the same subject or having the same general purpose must be considered and construed in harmony. Statutory construction is a question of law, so our standard of review is de novo. We endeavor to interpret statutes in accordance with the legislature's intent. We begin by making an inquiry respecting the ordinary and obvious meaning of the words employed according to their arrangement and connection. We construe the statute as a whole, giving effect to every word, clause, and sentence, and we construe all parts of the statute *in pari materia.* When a statute is sufficiently clear and unambiguous, we give effect to the plain and ordinary meaning of the words and do not resort to the rules of statutory construction. Moreover, we must not give a statute a meaning that will nullify its operation if it is susceptible of another interpretation.
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> Moreover, we will not enlarge, stretch, expand, or extend a statute to matters that do not fall within its express provisions.
>
> Only if we determine the language of a statute is ambiguous will we proceed to the next step, which involves applying general principles of statutory construction to the language of the statute in order to construe any ambiguous language to accurately reflect the intent of the legislature. If this Court determines that the language of the statute is not ambiguous, there is no room for further construction. We will apply the language of the statute using its ordinary and obvious meaning.
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> Whether a statute is ambiguous is a question of law. A statute is unambiguous if reasonable persons are able to agree as to its meaning with consistency and predictability, while a statute is ambiguous if it is vague or uncertain and subject to varying interpretations.

Travelocity.com LP v. Wyo. Dep't of Revenue, 2014 WY 43, ¶ 20, 329 P.3d 131, 139 (Wyo. 2014) (quoting *Redco Const. v. Profile Props., LLC,* 2012 WY 24, ¶ 26, 271 P.3d 408, 415-16).

28. Neither party suggests the operative statutory language is ambiguous, nor do we find it to be. We must, therefore, ascribe to the words their ordinary and obvious meaning

and apply them consistent with their given arrangement. *Supra* ¶ 27. Further, determining legislative intent requires a consideration of the plain and ordinary meaning of undefined terms. *Wyo. Dep't of Revenue v. Hanover Compression, LP,* 2008 WY 138, ¶¶ 12, 14, 196 P.3d 781, 785 (Wyo. 2008).

29. Importantly, neither the netback valuation statute, *supra* ¶ 22, nor the oil and gas tax statutes in general, offer guidance as to how demand charges/reservation fees or any like fee which is not a unit-calculated charge, shall be treated for deductibility purposes. The Department, familiar with both types of pipeline fees (Tr. 159-60), determined it would treat the demand charge like the commodities charge, a unit-based fee. (Tr. 160-61).

30. The Department keys in on several terms to support its interpretation. Referring to the italicized terms, "minus *expenses incurred* by the producer for *transporting produced* minerals to the point of sale," the Department argues "[t]he plain language of the netback statue requires any deductible transportation cost to be *logically associated* with the produced minerals being valued and taxed." (Dep't Resp. Br. 9) (emphasis added). Only that portion of the demand charge tied to capacity used, the Department adds, is "*directly attributed* to the movement of gas which is sold." (Dep't Resp. Br. 10) (emphasis added). The Department reasons that "[t]o hold otherwise permits a taxpayer to receive transportation deductions for non-transported gas – a logical absurdity[.]" *Id.*

31. While not statutorily defined, "expenses," "transporting," and "production" are readily understood when viewed in context. The word "expense" commonly means "something expended to secure a benefit or bring about a result . . . financial burden or outlay: cost . . . an item of business outlay chargeable against revenue for a specific period[.]" Merriam-Webster's Collegiate Dictionary, p. 440 (11th ed. 2014). As applied, the term "expenses" refers generally to any WPX expenditure or consideration exchanged for a gas transportation service, or, WPX's own expense to operate transportation facilities moving gas beyond the point of valuation.

32. The verb, "transport," or its gerund "transporting," simply means "to transfer or convey from one place to another[.]" Merriam-Webster's Collegiate Dictionary, p. 1330 (11th ed. 2014). Applied within the natural gas production industry, "transportation" occurs as part of the "efficient and effective movement of natural gas from producing regions to consumption regions require[ing] an extensive and elaborate transportation system[]" and generally refers to three pipeline systems: gathering, interstate system, and distribution system. NaturalGas.org, *The Transportation of Natural Gas*, http://naturalgas.org/natural-gas/transport/.

33. The words "transport," "transporting, or "transportation," as used in the natural gas tax statutes, inclusively refer to the physical movement of natural gas, along with the operation of equipment to move gas, i.e., the operation of compressors. Correspondingly, "Compressor" means "a device associated with processing or transporting natural gas which mechanically increases the pressure of natural gas[.]" Wyo. Stat. Ann. § 39-14-201(a)(v) (2011). "Gathering" is the transportation of gas prior to the point of valuation or a central point of accumulation. Wyo. Stat. Ann. § 39-14-201(a)(ix) (2011). The Legislature's choice of "transportation" demonstrates an intent the term be non-specific and inclusive, i.e. facilitating the movement of gas from point A to point B.

34. The meaning of "produced" is also readily understood. For example, "Severance tax" refers to "an excise tax imposed on the present and continuing privilege of *removing, extracting, severing or producing* any mineral in this state[.]" Wyo. Stat. Ann. § 39-14-201(a)(xxiii) (2011) (emphasis added). The point of valuation for natural gas production occurs "after extracting from the well, gathering, separating, injecting and any other activity which occurs before the outlet of the initial dehydrator[.]" Wyo. Stat. Ann. § 39-14-203(b)(iv) (2011). "Unreported production" is a "production volume for which no tax reported was filed for the reporting period by the taxpayer or his agent[.]" Wyo. Stat. Ann. § 39-14-201(a)(xxviii) (2011). Within the definition of "Natural gas," the Legislature included the following: "For purposes of taxation, the term natural gas includes products separated for sale or distribution during processing of the natural gas stream including, but not limited to plant condensate, natural gas liquids and sulfur[.]" Wyo. Stat. Ann. § 39-14-201(a)(xv) (2011).

35. Thus the words "produced" or "production" generally refer to gas and valuable components removed from the ground which reach the end of the production process, or "point of valuation." That would include all production at issue under the present facts.

36. Read *in pari materia*, the Legislature used "expenses," "transporting," and "produced" in a generic, inclusive manner relative to the taxation of natural gas. The Legislature did not specify, imply, or even suggest how non-unit based pipeline fees might be apportioned for deductibility purposes, if at all.[3]

[3] Agencies often regulate or clarify general statutory language, applied to industry-specific complexities, through rulemaking; the Wyoming Supreme Court may find agency action in the absence of rulemaking to be arbitrary and capricious. *See Rissler & McMurry v. Envtl. Quality Council,* 856 P.2d 450, 453 (Wyo. 1993) (Phrase "very rare or uncommon" lands deemed amorphous, requiring further regulatory definition before application); *See e.g.,* Rules, Wyo. Dep't of Revenue, ch. 6, § 7(c) (2014) (Production reporting requirements addressing "entitlements" and "take-in-kind"); *See also Battlefield, Inc. v. Neely*, 656 P.2d 1154, 1159-60 (Wyo. 1983) (distinguishing between "interpretative" rules and "substantive" rules).

37. We disagree with the Department's interpretation of Wyoming Statutes section 39-14-203(b)(vi)(C) (2011). Classifying pipeline fees for deductibility purposes, the Department infers a statutory refinement and exception not cognizable or implicit in the language itself. We are unable to reconcile the Department's splitting of pipeline fees for deduction purposes with the operative words employed in their plain and ordinary form. *Supra* ¶ 27. "[W]e will not enlarge, stretch, expand, or extend a statute to matters that do not fall within its express provisions." *Hanover Compression, LP*, 2008 WY 138, ¶ 8, 196 P.3d at 784 (citations omitted) (quoting *BP Am. Prod. Co.*, 2005 WY 60, ¶ 15, 112 P.3d at 604). Further, because the Legislature has limited transportation deductions under specified circumstances, its failure to limit the deductibility of main pipeline fees is conspicuous by comparison. *See* Wyo. Stat. Ann. § 39-14-203(b)(xi) (2011) (limiting transportation deductions from point of valuation to inlet of main transmission line to 50%).

38. Nor does the evidence align with the Department's characterizations of how the demand charge works. In permitting only a fractional deduction of the demand charge, the Department re-characterizes the demand charge's purpose, structure, and effect to justify denial of the full charge as a transportation expense:

a. WPX does not "use" the reservation fee to the extent less than full capacity is used (Dep't Resp. Br. 6);

b. "charges for transporting gas . . . neither produced nor transported is not a legitimate deduction[.] (Exs. 105, 500);

c. WPX does not use pipeline space to extent less than full capacity is used and, therefore, is not entitled to deduct entire charge. (Dep't Resp. Br. 7);

d. part of reservation fee, equal to unused capacity, is not "directly related" to actual transported volumes of gas. (Dep't Resp. Br. 8);

e. fees are "not connected" to transported gas to extent capacity is underused. (Dep't Resp. Br. 8);

f. fees representing underutilized pipeline capacity are not "directly attributed to the movement of gas which is sold." (Dep't Resp. Br. 10);

g. fees proportionate to underutilized capacity are not "directly associated with gas that is sold and taxed." (Dep't Resp. Br. 11);

h. commodity charges are "clearly and inexorably associated with the movement of specific volumes of gas" while "demand charges are not so necessarily linked" and merely reserve future space on a pipeline; (Dep't Resp. Br. 12-13);

i. reservation fees "only become associated with actual physical transportation of produced gas if the reservation is utilized to move particular gas." (Dep't Resp. Br. 13);

j. reservation fee purchases a "right" which is used and deductible only to extent actually exercised to transport produced gas." (Dep't Resp. Br. 13);

k. "only those expenses necessary to transport produced minerals to point of sale can be deducted." (Dep't Resp. Br. 13);

l. portion of fee equal to unused capacity are "yet to be connected to the movement of any gas – they are unused." (Dep't Resp. Br. 13);

(*See also* Tr. 159, 161-66). Without evidence demonstrating the demand charge/reservation fee was tied to individual volumes or units, the Department's arguments are unpersuasive.

39. The evidence demonstrated otherwise. Craig Grenvik testified "I have nothing to refute what the experts have said (about the operation of firm transportation contracts)." (Tr. 160). He further stated the Department did not contest any terms of the firm transportation agreements. (Tr. 163-65). WPX incurred the additional demand charge to not only transport its production, but more particularly to secure pipeline access priority relative to other producers or shippers of gas, regardless of market conditions. *Supra* ¶¶ 3-10.

40. Further, the evidence demonstrated WPX paid the entire demand charge for *each and every unit* (mcf/mmbtu) of gas, ensuring that no matter the market conditions or competing interests, each unit of its gas production would ship and reach the desired market. *Supra* ¶¶ 5-6. We find that during months when WPX did not use all of its pipeline capacity, it effectively paid higher transportation costs on a per unit basis, but those costs were deductible as transportation under the netback method. In partially denying the deductibility of the demand charges incurred, the Department incorrectly redefined the demand charge as a quasi-commodity charge, which it is not. *See supra* ¶¶ 12-14.

41. The Department understandably counters that full deduction of the demand charge may disproportionately reduce or even negate taxable value under various market or business conditions. (Tr. 161-64, 166-67). The Department asserts that a transportation

deduction that could eviscerate taxable value, generates an "absurd" result, which by statutory caveat the Board should avoid. (Dep't Resp. Br. 10, 12, 14). And, WPX acknowledges the possibility. (Tr. 64).

42. Yet, as the Department well knows, this possibility is, and always has been, inherent under the netback method. Producers, under a wide range of circumstances, may overpay for processing or transportation services, the deductions for which might disproportionately reduce taxable value in a low market price environment. (Tr. 173-74, 178-79).

43. Regardless, the Legislature has long understood this problem. Indeed, enactment of the "proportionate profits" valuation method, applicable to producer-processed natural gas, was a response to extremely low or zero taxable valuations. *See* Wyo. Stat. Ann. § 39-14-203(b)(vi)(D), (E) (2011) (Proportionate profits and Modified netback methods for valuing natural gas production either assure a positive valuation or set a floor beneath which a mineral valuation may not dip, regardless of the expenses incurred). The Legislature's recognition of the netback's shortcomings is traceable at least as far back as litigation in 1986, during which a Wyoming gas producer reported a zero taxable valuation.[4] Yet, the netback remains among the valuation methods available for the taxation of certain natural gas production, including WPX's production. The Department's internal policy response to address this particular type of pipeline charge for deduction purposes, while a compelling alternative, finds no current support under the law.

44. In support of its decision rejecting WPX's amended returns, the Department cites the Board's recent ruling in *In re ConocoPhillips Co.*, 2016 WL 7428101, Docket No. 2015-30 (Wyo. State Bd. of Equalization, Dec. 13, 2016). (Dep't Resp. Br. 10-11). The Department cites that ruling for the proposition that "post-point of valuation expenses must

[4] In 1986, ExxonMobil reported a zero valuation under the netback method for its LaBarge production processed in its Shute Creek facility. Exxon incurred high processing costs and claimed substantial "return on investment" deductions, which zeroed out its taxable value under the 1986 market prices. The Legislature enacted law on April 1, 1988, establishing a 40% cap on deductions for valuing natural gas through the "netback" valuation method. 1988 Sess. Laws Ch. 93. Exxon sued the State and Sublette County in the First Judicial District, challenging the law as special legislation. *Exxon Corp. v. State of Wyoming, et al.*, Civ. Action No. 116-495. The State settled and consented to a decree that the methodology was unconstitutional, thereafter entering a Tax Settlement Agreement under which Exxon's gas production would be valued. *See In re Matter of Sublette Cty. Bd. of Cty. Comm'rs*, 2004 WL 1174651, Docket. Nos. 2000-142, 2000-02, ¶¶ 28-87 (Wyo. St. Bd. of Equalization, May 20, 2004) (describing history of tax disputes between county, Exxon Mobil, and Department, including producer's reporting of zero taxable value and eventual execution of "tax settlement agreement" between parties regarding valuation of Exxon's LaBarge production for tax purposes).

be associated with actual production which is transported, sold and taxed." (Dep't Resp. Br. 11).

45. We agree with WPX, however, that *ConocoPhillips* is distinguishable both factually and as to the disputed point of statutory law. ConocoPhillips sought to deduct transportation expenses against the entire volume of gas it produced from the ground, notwithstanding that it conveyed some of its production to third-parties that used the gas as fuel. Consequently, that gas was never sold. The State Board held that deductions for transportation and processing could be taken only against volumes actually sold and taxed under the netback method, not against volumes conveyed as part of the cost for transportation and processing, volumes which were not taxed. *ConocoPhillips*, at ¶¶ 25, 29. In the present case, WPX's demand charge expenses are not analogous to Conoco's conveyance of gas as fuel for compression or processing. WPX incurred the demand charge for all quantities shipped, and there is a direct evidentiary tie between the demand charges and production volumes taxed upon sale, even when WPX does not fill all allotted pipeline capacity.

46. Finally, the Department objects that WPX could release and convey its firm transportation rights to other parties who also might deduct the reservation fee as a transportation cost, resulting in simultaneous deduction of those costs by different parties. *Supra* ¶ 15. While the transferability of firm transportation rights raises the possibility of simultaneous deductions of transportation costs when only one producer actually incurred the expense, there is no evidence of that occurring. *Supra* ¶ 15. WPX explained that it would not deduct its demand charge to the extent pipeline capacity was released to, and used by, other producers. (Tr. 184-87).

CONCLUSION

47. WPX demonstrated the Department erred in rejecting its amended returns. The Department incorrectly interpreted Wyoming Statutes section 39-14-203(b)(vi)(C) (2011), *supra* 22, as authority to deny WPX's deduction of firm transportation service demand charges for its 2012 natural gas production. Accordingly, WPX is entitled to amend its returns to deduct its transportation related expenses.

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ORDER

IT IS HEREBY ORDERED the Department of Revenue's refund denial related to WPX's 2012 natural gas production, in which the Department determined that incurred demand charges were not fully deductible as a transportation expense, is **reversed**, and this matter is **remanded** to the Department for further action consistent with the Findings of Fact, Conclusions of Law, Decision and Order.

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 1st day of December, 2017.

STATE BOARD OF EQUALIZATION

Martin L. Hardsoog, Chairman

E. Jayne Mockler, Vice-Chairman

David L. Delicath, Board Member

ATTEST:

Nadia Broome, Executive Assistant

CERTIFICATE OF SERVICE

I hereby certify that on the 4th day of December, 2017, I served the foregoing **FINDINGS OF FACT, CONCLUSIONS OF LAW, DECISION AND ORDER** by placing a true and correct copy thereof in the United States Mail, postage prepaid, and properly addressed to the following:

Walter F. Eggers, III, P.C.
Matthew J. Micheli
Holland & Hart LLP
2515 Warren Avenue, Suite 450
P.O. Box 1347
Cheyenne, WY 82001

Karl D. Anderson
Senior Assistant Attorney General
Kendrick Building
2320 Capitol Ave.
Cheyenne, WY 82002

Nadia Broome
Executive Assistant
State Board of Equalization
P.O. Box 448
Cheyenne, WY 82003
Phone: (307) 777-6989
Fax: (307) 777-6363

cc: State Board of Equalization
Craig Grenvik, Mineral Tax Division, Department of Revenue
Department of Audit
ABA State and Local Tax Reporter