BEFORE THE STATE BOARD OF EQUALIZATION

FOR THE STATE OF WYOMING

IN THE MATTER OF THE APPEAL OF	)	
CONOCOPHILLIPS/BURLINGTON	)	Docket No. **2018-62**
RESOURCES OIL & GAS CO.	)	
FROM A DECISION BY THE	)	
DEPARTMENT OF REVENUE (Audit)	)	

FINDINGS OF FACT, CONCLUSIONS OF LAW, DECISION, AND ORDER

APPEARANCES

Walter F. Eggers, III, P.C. and Kasey J. Schlueter, Holland & Hart LLP, appeared on behalf of ConocoPhillips/Burlington Resources Oil & Gas Co. (hereafter Conoco).

Karl D. Anderson and James Peters, Senior Assistant Attorneys General, Wyoming State Attorney General's Office, appeared on behalf of the Wyoming Department of Revenue. (hereafter Department).

SUMMARY

[¶ 1] Conoco appealed from the Department's audit assessment of its 2013-15 Madden Shallow gas production, in particular the Department's denial of a substantial mineral tax refund request. The Department offers two positions in response. First, it seeks a remand of its audit assessment, which it asserts was based on a faulty understanding of the valuation applied. The Department, upon remand would reassess, applying the "comparable value" method pursuant to Wyoming Statutes section 39-14-203(b)(vi)(B) (2021). In the alternative, the Department asserts that Conoco is not entitled to a refund of additional transportation expense deductions, and that the audit assessment should stand with minor adjustments.

[¶ 2] The Wyoming State Board of Equalization (State Board), Chairman E. Jayne Mockler, Vice-Chairman Martin L. Hardsocg, and Board Member David L. Delicath, held a contested case hearing and received post-hearing briefs. The State Board lacks authority to remand the audit assessment with directions to issue a revised audit assessment given the facts and circumstances presented. In response to the Department's "alternative" theory in defense of its assessment, the State Board **reverses** the audit assessment and **remands** for computation of additional transportation deductions described herein.

ISSUES

[¶ 3] Stated as arguments in its briefing to this Board, Conoco's stated issues are as follows:

1) May this Board consider the Department's "primary argument," which would have the Board reject the Department's audit assessment as illegal, and remand the audit assessment to the Department for a revised assessment under a different valuation methodology?

2) Is Conoco entitled to deduct all "demand fees" charged on the REX Pipeline as transportation expenses pursuant to *In the Matter of the Appeal of WPX Energy Inc.*, Docket No. 2016-31 (Wyo. State Bd. of Equalization, Dec. 1, 2017), and *In the Matter of the Appeal of WPX Energy Rocky Mountain, LLC*, Docket No. 2020-08 (Wyo. State Bd. of Equalization, Sept. 13, 2021)?

(Conoco's Opening Br. 6).

[¶ 4] The Department's arguments, also rephrased as questions, are as follows:

1) After Conoco filed its appeal, the Department discovered that its audit assessment improperly allowed Conoco to value its 2013-15 gas production under the netback method. The Department gave notice to Conoco that it would seek a remand of the assessment for the purpose of correctly revaluing the gas production. Should the Board, therefore, remand the audit assessment to the Department for reassessment under the appropriate valuation method, the comparable valuation method?

2) If no remand is issued and the Board adjudicates the Department's audit assessment as issued, did the Department's audit assessment correctly deny Conoco deduction of "unused" demand charges, a particular pipeline expense, paid to the REX Pipeline?

(Dep't's Confid. Opening Br., 14-15, 19-21).

JURISDICTION

[¶ 5] On November 5, 2018, Conoco appealed from a final Department audit assessment dated October 12, 2018. (Conoco's Case Notice/Notice of Appeal dated Nov. 5, 2018). Having appealed within 30 days of the Department's audit assessment, Conoco's appeal was timely. *See* Rules, Wyo. State Bd. of Equalization, ch. 2, § 5(e) (2021). The State Board shall review final decisions of the Department upon timely appeal by those adversely affected. *See* Wyo. Stat. Ann. § 39-11-102(c) (2021). The State Board has jurisdiction.

FINDINGS OF FACT

A. Procedural history

[¶ 6] Conoco appealed to this Board from a Department audit assessment, wherein the Department assessed additional severance taxes and denied Conoco's refund request. (Ex. 132; Conoco's Case Notice/Notice of Appeal dated Nov. 5, 2018). Conoco had sought a refund of mineral taxes owed for its 2013-15 natural gas production following this Board's decision, *In the Matter of the Appeal of WPX Energy Inc.,* 2017 WL 6276019, Docket No. 2016-31 (Wyo. State Bd. of Equalization, Dec. 1, 2017) (*WPX Energy I*). (Exs. 134, 502; Tr. at 176-88, 199-200, 253-55). In that case, we ruled that producers were entitled to deduct additional firm transportation fees called "reservation charges." *WPX Energy I*, ** 10-12, ¶¶ 40-47.

[¶ 7] This Board originally scheduled a contested case hearing to begin July 30, 2019. (Hr'g Order dated Jan. 16, 2019). However, various preliminary issues and proceedings arose necessitating several delays of the hearing. We finally heard this matter over a year later, between August 31, and September 2, 2021. (*See* Order on Parties' Prelim. Evidentiary Issue, dated December 6, 2019).

[¶ 8] One such preliminary matter was the Department's desire to substantially revise the statutory basis for its audit assessment. (Dep't's Second Amended Prelim. Statement, dated March 9, 2020). Disagreeing with its own audit assessment, the Department sought a remand so that it could apply a different valuation analysis and re-issue the audit assessment. *Id.* Conoco emphatically objected, and the Board granted the parties' joint motion to delay the hearing so that the parties could engage in additional discovery. (Joint Mot. to Vac. Hr'g and Set Status Conf., dated March 13, 2020).

[¶ 9] Just before the hearing, Conoco sought to exclude or limit the Department's evidence in support of its newly proposed theory for valuing Conoco's 2013-15 Madden Shallow natural gas production. (Conoco's Mot. in Limine, dated May 7, 2021; Renewed Mot. in Limine, dated August 11, 2021). The Board denied Conoco's Motion in Limine, but took under advisement Conoco's objections to evidence in support of the new theory, which the Department termed as its "primary theory." (Order Den. Mot. in Lim. and Taking Obj. under Advisement, dated August 25, 2021); *see infra* ¶¶ 43-48. The hearing proceeded on August 31, 2021.

B. Trial evidence

Conoco's 2013-15 Madden Shallow gas production
and transportation of its gas on the interstate REX Pipeline

[¶ 10] Conoco produces sour[1] natural gas from two production areas, referred to as Madden Shallow and Madden Deep Lost Cabin, in Fremont County, Wyoming. (Ex. 148, p. 1; Tr. at 48-51, 99, 135-36). Both production sources feed into the Lost Creek Gathering System. *Id.*

[¶ 11] The Lost Creek Gathering System is a network of pipelines that accept gas from wells in the field, moving the gas to processing facilities and larger interstate gas transportation systems downstream. Important to the Department's "primary theory" for reasons that will become clear, *infra* ¶¶ 43-49, Conoco partly owned the Lost Creek Gathering System during the production years 2013 through 2015. (Tr. at 50-51).

[¶ 12] The Madden production was processed at Conoco's Lost Cabin Processing Plant in Fremont County, then flowed south through the Lost Creek Pipeline until it reached three interstate pipelines, one of which is the Rockies Express Pipeline (REX Pipeline) that flowed from west to east. (Ex. 148, p. 1; Tr. at 52, 99, 134-36). The Madden Gas Production entered the REX Pipeline at or around the small mining community of Wamsutter, Wyoming. (Tr. at 63-65, 105-06, 128, 139; Ex. 148, pp. 1-3).

[¶ 13] The other two pipelines, offering gas transportation services along with the REX Pipeline, were the Wyoming Interstate Company (WIC) Pipeline and Colorado Interstate Gas (CIG) Pipeline. (Ex. 148, p. 1, Tr. at 54-55). Conoco could have sent its gas down the smaller CIG Pipeline, but doing so was not optimal due to gas quality requirements. (R. at 55-57, 106-07, 136-39). Associated with the CIG Pipeline, there is a published CIG index price comprised of the weighted average prices of gas sales on the CIG Pipeline. (R. at 57-59).

[¶ 14] The WIC Pipeline moves gas from the western side of the Rocky Mountains, from the Opal area, to Cheyenne. Similar to Conoco's minimal reliance on the CIG Pipeline to transport its gas, Conoco seldom relied on the WIC Pipeline. (Tr. at 60-61, 106-07).

[¶ 15] Allen Lee, Conoco's Western Commercial Gas and Power Group Manager, testified that the REX Pipeline came into service in 2009 to move "constrained" Rocky Mountain area gas to meet eastern demand, especially during winter months. Unlike other pipelines,

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[1] "Sour" natural gas has toxic components, such as hydrogen sulfide, which must be removed (processed out of the gas) before it can be burned or transported on most interstate pipelines. Natural gas production without such toxic components is considered "sweet" and requires less or no processing.

it moves east and west, and is referred to as a "header" system for the lower 48 states. (Tr. at 44, 61, 72, 130-31, 145).

[¶ 16] Mr. Lee testified that he was not aware of Conoco selling its gas at Wamsutter, where the gas entered the REX Pipeline for transportation east. *Id.*; (Tr. at 105-06, 192-93, 534-35); *supra* ¶ 12.

[¶ 17] The REX Pipeline, regulated by the Federal Energy Regulatory Commission (FERC), operates in accordance with a FERC approved tariff. (Ex. 517; Tr. at 76-79). The tariff includes a charge to shippers allowing them to reserve capacity on the pipeline, called a "demand charge" or "reservation rate." (Tr. 79-80, 269-71). The demand charge/reservation rate is charged for "firm" or uninterruptible access to the pipeline's transportation capacity, and a customer pays that charge whether it transports its gas on the pipeline, or doesn't. Interruptible transportation, by contrast, is a lower priority service, and the purchaser of this transportation service is not assured capacity for its gas on the pipeline. *Id.*; (Tr. at 79-80, 269-71, 423-24). Mr. Lee testified that Conoco opted for firm transportation to ensure that its gas production could continue, and to control access to downstream markets. (Tr. at 84-86, 88-89, 97-98, 114). Conoco transported the vast majority of its gas using firm transportation services. (Tr. at 84-85, 126-27).

[¶ 18] Conoco purchased transportation services on the REX Pipeline on a monthly cost-per-dekatherm basis, accounting for the variable number of days in each month. (Tr. at 83; Confid. Ex. 102). Conoco held capacity on the REX Pipeline of 400,000 MMBtus[2] per day during the audit period. (Tr. at 91, 100-01, 269-71; Confid. Ex. 102, COP 0014). Conoco's natural gas, whether purchased from third parties or produced from Madden, commingled with the production of other shippers that purchased REX Pipeline's services. (Tr. at 94-96, 194-95, 380-81). Conoco is unable to establish the origin of, or individually track, gas streams once placed into the REX Pipeline because its gas commingles with all gas in transit. *Id.* That fact is central to the dispute, although the parties disagree as to its significance.

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[2] The tariff's alternative use of "dekatherm" and "MMBTUs" is confusing to those not familiar with the terms and their relationship to each other. A dekatherm is ten "therms," each equal to 100,000 British Thermal Units (BTUs). A BTU is the amount of heat (energy) needed to raise one pound of water by one degree Fahrenheit. *See U.S. Energy Information Administration Glossary*, eia.gov/tools/faqs/faq. The tariff states that one dekatherm equals one MMBTU. (Ex. 517, DOR-009025). In short, the terms refer to the natural gas' heating energy.

The REX Pipeline, Conoco's Accounting System, and "marketing hooks"[3]

[¶ 19] Conoco's witnesses explained how it arrived at purchase prices and tracked transportation costs for its Madden Gas Production as it entered the REX Pipeline and flowed east. To assist the Board, Conoco offered an exhibit comprised of maps, illustrations, and financial information depicting Conoco's calculations of price and transportation, which it roundly referred to as its "weighted average price" and "weighted average transportation." (Ex. 148; Tr. at 147-73, 205-06).

[¶ 20] As illustrated on Ex. 148, the REX Pipeline's span from west to east is divided into geographic zones, each including large compressor stations identified as black squares and named after geographic locations. The three numbered zones are Zone 1, primarily Wyoming, Zone 2, western Nebraska and east to eastern Missouri, and Zone 3, eastern Missouri, through Indiana, and east into Ohio. (Ex. 148, p. 2; Tr. at 63-70). Along the zones from west to east, there are interconnecting pipelines, as well as "delivery points" and "receipt points," from which, or into which, additional gas can be received for transport or delivered for sale. *Id.*; (Ex. 148; Tr. at 68-71).

[¶ 21] Conoco designated "marketing hooks," five digit numbers assigned to various geographic zones[4] encompassing delivery/receipt points along the REX Pipeline. (Ex. 148, p. 3; Tr. 74-77, 144-45, 190-91). Most of the gas Conoco sold during the audit period, Mr. Lee explained, it sold in Zone 3. (Tr. at 110). Conoco had no ability to track specific gas downstream and could not designate that certain production sources, such as its Madden Shallow Production, be sold at particular delivery points. (Tr. at 95-97, 105, 113-14); *supra* ¶ 18; *infra* ¶ 45.

[¶ 22] John Saltsman, Conoco's supervisor of fee audit, severance tax audit, and litigation support group, testified regarding Conoco's accounting system, including its calculation of gas pricing and transportation costs, which Conoco used to report the taxable value of its Madden Production. (Tr. at 141-44). Conoco's accounting system tracked the prices received for gas sales in each hook, and the costs to move gas to and from receipt/delivery points. (Ex. 148, p. 3; Tr. at 144-45); *infra* ¶¶ 23-26.

[¶ 23] Mr. Saltsman, through a demonstrative flow chart showing Conoco's geographical "hooks," explained how Conoco tied transportation costs to gas volumes sold downstream. (Ex. 148, pp. 4-6; Tr. at 148-61). He explained that the first hook, after which other hooks

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[3] Much of the Department's disagreement with Conoco's reported transportation deduction stems from the manner in which Conoco arrived at a price for its Madden Gas Production, termed its "weighted average price," and the manner by which it calculated transportation expenses. *Infra* ¶¶ 30-31, 39-43, 45-50.

[4] These marketing hook "zones" should not be confused with zones previously discussed, which the REX Pipeline created for other purposes. *Supra* ¶ 20.

followed downstream, is the "parent hook," while the downstream hooks are "dependent hooks." (Tr. at 148-51). The downstream hooks are "dependent" because Conoco derived its weighted average prices and weighted average transportation expenses by adding the prices and transportation costs in each dependent hook. *Id.* Mr. Saltsman stated: "So we're going to start on the right [of the flow chart, and downstream from where the gas entered the REX Pipeline], and we're going to work our way back, because we can't determine a price at Hook 1 until we know what happens at Hook 3. But we can't determine a price at Hook 3 until we know what happens at Hook 4 and 5." (Tr. at 151). In this way, Mr. Saltsman described an integrated weighted average pricing formula comprised of its gas sales along the REX Pipeline and tied together by all costs to transport *all gas* up and downstream of the points of sale, eventually tying back to the original "parent hook" from where the gas entered the Rex Pipeline.

[¶ 24] Conoco arrived at its transportation cost by dividing the volume sold at each hook by the transportation price to move the volume of gas to that hook. (Tr. at 152-56). This calculation was repeated at each hook from downstream points (east), to western upstream points, i.e. starting with hook five and moving back (upstream). *Id.* Each calculated price and transportation cost was added and divided to arrive at the total price of the original volume of gas, and the cost to move that gas (and each remaining quantity of gas moving beyond each downstream hook) to the eventual sales delivery points. (Tr. at 158-60, 173-75; Ex. 148, pp. 4-6).

[¶ 25] Mr. Saltsman then repeated his pricing explanation, this time referring to a spreadsheet with volumetric and cost information for one month of Conoco's sales of gas that flowed east on the REX Pipeline. (Ex. 148, pp. 4-9; Tr. at 161-69, 173-75, 193-94, 223-28).

[¶ 26] Mr. Saltsman confirmed that Conoco's calculated "weighted average price" of gas included sales of gas it purchased, including gas acquired downstream of a given hook without passing through an upstream hook. The Department seized upon that point to challenge Conoco's price and transportation calculations. (Tr. at 192-94, 206); *see supra* ¶ 18.

[¶ 27] Matt Sachse, the Department's Valuation Manager, offered extensive testimony concerning Conoco's gas pricing and deduction of transportation expenses. He relied on a multipage exhibit that included annotated maps of the REX Pipeline and spreadsheets to explain how Conoco developed pricing and transportation deductions. (Ex. 519; Tr. at 292-381, 440). Conoco placed up to 400,000 MMBtu of gas daily in the REX Pipeline at various locations for transportation to eastern destinations. (Ex. 519, Confid. Ex. 112; Confid. Tr. 312-16); *see supra* ¶ 18. Echoing Mr. Saltsman's testimony, Mr. Sachse detailed how Conoco used its REX Pipeline capacity to transport both Wyoming-produced

gas and gas purchased from other parties and originating from other states. (Tr. at 317-223; Ex. 519, pp. 28-30).

[¶ 28] The Department focused on Conoco's "weighted average pricing" and "transportation" cost accounting, disagreeing with how Conoco used these calculations to report taxable value. Conoco's Madden Production entered the REX Pipeline within hook 98138 at the "CIG pool, the Wamsutter location." (Tr. at 327-28; Ex. 519, p. 30); *see supra* ¶ 12. While commingling of gas is not unusual, the Department asserts that Conoco must be able to identify where Conoco sold *its Wyoming gas production* to value it correctly. (Tr. at 329-30; Dep't's Confid. Opening Br., 13-19). That is, Conoco was not permitted to indiscriminately lump its Madden Gas Production with purchased gas, without tracking the prices and costs to transport the audited Madden Gas, independent of the other gas, for tax purposes. *Id.*; *see infra* ¶¶ 44-49.

[¶ 29] Mr. Sachse walked the Board through maps and a Conoco hook report to illustrate how gas, including Conoco's Madden Production, flowed into the REX Pipeline at hook 98138, was commingled with other gas, and flowed east. (Ex. 519, pp. 25- 40; Tr. at 322-337, 380-81). Using Conoco's "Hook Reports," he accounted for other adjustments affecting the volumes of gas passing through the REX Pipeline, such as gas volumes that the REX Pipeline used to fuel its equipment. *Id.*; (Tr. at 337). He identified sales to various purchasers, the volumes and prices paid, and, again, noted that Conoco is not able to identify the exact origin of the particular gas sold, or where the Madden Gas Production was sold. (Ex. 519, pp. 40-50; Tr. at 338-46); *supra* ¶ 22.

[¶ 30] Between Mr. Sachse's and Mr. Saltsman's testimony, the parties generally agreed on how the audited production was received into the REX Pipeline for transportation at Hook 98138, was commingled with other Conoco gas and the gas of other shippers, and flowed east for delivery and sale. The witnesses agree that the Madden Gas is not specifically tracked such that it can be independently identified at a particular point of sale, nor are the transportation costs to move a particular source of gas independently identifiable. Rather, Conoco's "Hook" accounting system bundled all gas and formulated a "weighted average price" for the whole volume at each downstream hook, and a "weighted average cost" to transport all gas.

Conoco's reported taxable value for 2013-15 Madden production

[¶ 31] Applying the netback valuation method, *infra* ¶ 68, Conoco originally reported its calculated weighted average price when it valued its 2013-15 Madden Production. Conoco deducted only its "used" portion of REX Pipeline transportation expenses, which it calculated using the per unit rate set forth in the REX Pipeline Tariff. (Tr. at 174-77; Ex.

502 at DOR-008950). However, Conoco also employed the "comparable value" method, deducting the fee it charged other producers to transport their gas on Conoco's Lost Creek Gathering System, upstream of the REX Pipeline. *Id.*; (Tr. at 201-02, 211-12). This blending of the "netback" and "comparable value" methods of valuation, the Department contends, was illegal. *Infra* ¶¶ 37-40, 55.

[¶ 32] Just before the Department of Audit issued its final audit findings, Conoco abruptly sought to significantly increase its transportation deduction. Conoco wanted to deduct as transportation the "unused"[5] REX Pipeline demand charge expenses, and not just the tariff-based per-unit deduction it originally reported when it valued its Madden Shallow Production. (Tr. at 176-77, 199). "So after we became aware of the WPX ruling[6], we decided to take a look and see what our overpayment of taxes were because we were not taking that deduction[,]" Mr. Saltsman explained. *Id.* Calculating its refund request, Conoco quantified the "unused" reservation fee it did not originally deduct, and applied it narrowly to its Wyoming Madden Production. (Tr. at 183-84, 508-12). In seeking this additional deduction, Conoco did not attribute the unused reservation charge to gas that it otherwise produced or purchased, and it deducted all unused reservation charges against its audited Madden production. (Tr. at 185-86, 199-200, 209-16).

Audit of Conoco's 2013-15 Madden production and Conoco's refund request

[¶ 33] Julie Davis, Principal Auditor for the Wyoming Department of Audit, testified regarding her audit of Conoco's 2013-15 Madden Production. (Tr. at 256-37). The Department of Audit sought to audit four mineral groups, consisting of Madden Shallow Production only. (Tr. at 240-41, 272, Ex. 500).

[¶ 34] In reconstructing Conoco's reported taxable value, she applied the netback valuation method, placing the point of value at the inlet to the Lost Creek pipeline. (Tr. at 248-49, 258, 422). She understood and accepted that Conoco's gas sales occurred downstream from receipt points on the REX Pipeline. *Id.* She confirmed that Conoco took as a partial transportation deduction, the transportation charges it imposed on others to move gas on its Lost Creek transportation system.[7] (Tr. at 249-50). Ms. Davis accepted the remaining

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[5] The parties employ the terms "used" or "unused," as applied to the REX Pipeline reservation charges, to help the Board understand the dispute. The "used" or "unused" status of the REX Pipeline reservation capacity refers to months when Conoco did not use its entire reserved capacity of 400,000 MMBtus to transport its gas. *See supra* ¶¶ 18, 27. The question Conoco raises in its appeal is whether it is entitled to deduct the entire reservation expense when less than the entire reserved capacity was used. *Supra* ¶ 3.

[6] *WPX Energy I, supra* ¶¶ 3, 6.

[7] Conoco's deduction of transportation expenses, calculated by using what others paid Conoco for transportation on its Lost Creek Pipeline, is a "comparable value" method concept, rather than a netback

REX Pipeline transportation deductions that Conoco calculated from its hook report. (Tr. at 251).

[¶ 35] In response to the Department of Audit's Preliminary Issue letter, which revealed minimal, insubstantial findings, Conoco abruptly sought a refund request of over $5.7 million, by email dated August 21, 2018. (Exs. 501-502; Tr. at 253-54). Conoco cited this Board's *WPX Energy I* decision as the basis for its refund request. *Id.*; (*See supra* ¶ 6; Conoco's Br., 17-21).

[¶ 36] Ms. Davis consulted the Department concerning Conoco's refund request. (Tr. at 254-56). Per the Department's guidance, the Department of Audit rejected Conoco's refund request, concluding that the *WPX Energy I* ruling did not apply to Conoco's refund request. (Tr. at 178-80, 182, 254-55, 285-87, 432-35, 502; Exs. 132-133). The Department thereafter issued a Final Determination Letter on October 12, 2018, assessing additional taxes and denying Conoco's recent refund claim. *Id.* The Department incorporated the Department of Audit's final findings as the basis of its audit assessment. *Id.*

The Department asserts that its audit assessment, because it accepted Conoco's invalid valuation methodology, is incorrect

[¶ 37] Mr. Sachse testified that, upon reviewing the audit initially, he mistakenly believed Conoco reported its gas valuation using the comparable value method. He believed Conoco used prices derived from sales at Wamsutter and subtracted upstream transportation/gathering costs incurred on the Lost Creek Pipeline to move the gas to Wamsutter.[8] (Tr. at 273-78, 389-90, 446-48).

[¶ 38] The Department of Audit, Mr. Sachse explained, relied entirely upon Conoco's system for reporting taxable value. (Tr. at 273-78, 287-90, 427-30). Mr. Sachse correspondingly relied upon the Department of Audit's final findings, which incorrectly accepted Conoco's pricing and transportation deduction calculations. Mr. Sachse, upon subsequent review of additional documents submitted during the appeal, concluded that the Department's audit assessment is incorrect and did not value the Madden Production

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method application. *See* Wyo. Stat. Ann. § 39-14-203(b)(vi)(B) (2015) (Applying the comparable value method, "fair market value is the arms-length sales price less processing and transportation fees charged to other parties for minerals of like quantity ...."). Ms. Davis did not address the incongruity of applying a comparable value transportation deduction as part of a netback valuation, a point the Department addressed at length in its "primary theory." *Infra* ¶¶ 44-48, 55.

[8] The parties disagree on whether gas sales occurred at Wamsutter; Mr. Lee testified that Conoco sold no gas at Wamsutter, or the hook within which Wamsutter exists, while Mr. Sachse testified that he believed there were Conoco gas sales at Wamsutter. *Supra* ¶ 16.

in accordance with Wyoming's mineral tax statutes. (Tr. at 281-84, 286-90, 440, 442-45); *see supra* n. 7.

[¶ 39] More specifically, Conoco's application of two valuation methods (netback and comparable value) to value its Madden Production was contrary to Wyoming statute and inconsistent with the Department's written guidance to mineral taxpayers about how to value their mineral production. (Tr. at 274-83, 377-78, 483-84; Ex. 512). Conoco's application of two valuation methods, Mr. Sachse continued, needed the Department's preapproval in accordance with the statutory "mutually agreed-upon" method option. *Id.*; *see* Wyo. Stat. Ann. § 39-14-203(b)(vii) (2015) (taxpayer and Department may agree upon alternate method if statutory methods do not work).

[¶ 40] Mr. Sachse, through a multipage, annotated map of the REX Pipeline, elaborated on the Department's position that Conoco incorrectly valued its 2013-15 Madden Production. (Ex. 519; Tr. at 292-381, 440). Noting that Conoco produced gas and purchased gas during the audit period, all of which was commingled in the REX Pipeline, Mr. Sachse disagreed with Conoco's valuation methodology because it could not identify where the gas was sold. (Tr. at 319-23, 329-30, 379-81, 504-06; Ex. 517, pp. 28-30).

[¶ 41] Mr. Sachse walked the Board through maps and a Conoco hook report to illustrate how gas, including Conoco's Madden Production, flowed into the REX Pipeline at hook 98138, was commingled with other gas, and flowed east. (Ex. 519, pp. 25- 40; Tr. at 322-337, 380-81). He identified sales to various purchasers, the volumes and prices paid, and repeated that Conoco was not able to identify the origin of the gas sold or the precise costs of transporting particular gas. (Ex. 519, pp. 40-46; Tr. at 338-40, 379-81). These objections to Conoco's reported taxable values, and resistance to the Department's own audit assessment, prompted the Department to seek remand of its audit assessment so that it could revalue Conoco's gas production.

Department's "Primary" and "alternative" valuation theories

[¶ 42] The Department, having asserted that Conoco ran afoul of the tax statutes when it reported the taxable value of its 2013-15 Madden Shallow production, offered a new "primary theory" of how Conoco should have valued its gas. (Tr. at 376-391; Dep't's Confid. Opening Br. 14-19). Correspondingly, the Department asserts that this Board should reject the Department's audit assessment, adopt its "primary theory," and resolve Conoco's appeal consistent with the "primary theory," which would altogether deny REX Pipeline transportation deductions. *Id.*; (Tr. at 472-75, 493; Dep't's Confid. Opening Br. at 14-19; Dep't's Resp. Br. at 2-8).

[¶ 43] The Department formulated its "primary theory" after reviewing additional information, which it argues was not available to it until after issuance of the audit assessment. This new information included the FERC Tariffs and Transportation Service Agreements entered by Conoco. (Tr. at 376-77). The Department's primary theory uses information the Department *believed* Conoco *was using* to value its gas. (Tr. at 389-90, 393, 427-28).

[¶ 44] In further support of its "primary theory" of how the Department would revalue Conoco's Madden Production, Mr. Sachse lined out reasons Conoco miss-valued its production in the first place. First, Conoco did not begin with a bona fide arm's length sale of its gas production, instead calculating a "weighted average price" of its numerous gas sources passing through, or delivered at, downstream hooks. (Tr. at 377-79; *see also* 411-12, 462-65). The Department argues Conoco's price is not a weighted average price, and it disagrees with the price's use in its taxable valuation:

> [T]heir weighted average price is not a weighted average sales price. It's a calculated price based on various downstream hooks. Part of, say, 98205 includes production that went to Louisiana. And Wyoming volumes may have never actually gone to Louisiana. In Louisiana a portion of the natural gas was added in at that location quite a bit, and all of those numbers get rolled into Wyoming's volumes and Wyoming's valuation. And that's just not anywhere near a market – a market price.

(Tr. at 386-87). Mr. Sachse further objected to the "hypothetical nature" of Conoco's valuation:

> [E]verthing after it enters the pipeline is a hypothetical. ConocoPhillips is hypothetically identifying that some of it went to 205 and some of it went to 206 and some of it went to 9028. All those are hypothetical locations that we do not know whether they went down to the location, and we are not allowed to use hypotheticals.

(Tr. at 389).

[¶ 45] Second, the Department complains that Conoco could not track its Madden Production to its points of sale. (Tr. at 379-81, 411-12, 462-65). Conoco puts gas, both purchased or produced, into the REX Pipeline and calculates pricing and transportation expenses downstream without regard to the source of gas. *Id.*

[¶ 46] The Department would revalue Conoco's 2013-15 Madden Production in accordance with its Chapter Six Rules, which, in the absence of a bona fide arm's length sale, permits it to rely upon the "terms equivalent to cash that a willing and well-informed

buyer would pay for a mineral and a willing and well-informed seller would accept." (Tr. at 382-85, quoting Rule, Wyo. Dep't of Revenue Ch. 6 § 4(c) (2014); *see also* Tr. at 466-72).

[¶ 47] To identify the Madden Production's equivalent arm's length price at hook 98138, the Department would calculate the gas's price using the CIG market index published rate. (Tr. at. 385-87, 472-75, 491-94); *supra* ¶ 13. Mr. Sachse testified that the published CIG Rocky Mountain Index offered an average price for similar gas, sold in reasonable proximity to where Conoco's production was placed into the REX Pipeline. *Id.*

[¶ 48] Mr. Sachse continued to explain the Department's primary valuation method: "You would use that price for the volumes that were produced, and then you would take a deduction for the Lost Creek pipeline that would then get it back to the point of valuation. And then you would take any sort of royalty deduction of that number." (Tr. at 388). Mr. Sachse added that in accordance with the Department's "primary" approach, Conoco would not deduct REX transportation costs because the sales value, and deduction of transportation costs to the point of sale, established through comparable transportation charges, would occur upstream of the gas' placement into the REX Pipeline. *Id.*; (Tr. at 391-93, 411-12). In other words, the valuation would be complete by the time Conoco's gas entered the REX Pipeline. *Id.*

[¶ 49] Mr. Sachse also explained the Department's "alternative theory" on how to calculate Conoco's transportation deduction. (Tr. at 391). Assuming Conoco's application of the netback and comparable value methods stands as audited, Conoco would be permitted to deduct a portion of the REX Pipeline transportation expenses. He said that any deduction would be limited to the actual volumes transported and would exclude portions of the Reservation charge that Conoco did not use to transport the audited volumes. Conoco would not receive a refund reflecting additional transportation deductions. (Tr. at 393-95, 402-07, 417-18).

[¶ 50] A minor adjustment to the audit assessment, Mr. Sachse explained, would be needed in applying its "alternative" theory. He directed the Board's attention to transportation paid for Conoco gas received by the REX Pipeline in Zone 3, and delivered within Zone 3. (Confid. Tr. at 352, 357-58; Tr. at 420-21; Dep't's Confid. Opening Br. 26). The Department claimed that this transportation should be removed from the weighted average price calculation and transportation cost deduction because it was not Madden Shallow production and could not have pertained to the transportation of Madden Shallow production. *Id.* Conoco responded that removing the price and transportation costs of this gas would be improper because its weighted average price calculation considered and included prices and transportation costs across the REX Pipeline hooks, regardless of where the gas came from. (Tr. at 516-17, 542-43; Conoco's Reply Br., 12).

CONCLUSIONS OF LAW

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

[¶ 51] "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) (2021). 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) (2021).

[¶ 52] "[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 show the Department determination is incorrect, the burden shifts to the Department to defend its action.

Rules, Wyo. State Bd. of Equalization, ch. 2 § 20 (2021). "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.*

[¶ 53] 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)).

B. Analysis

[¶ 54] Because the Department challenges its own audit assessment and asks this Board to remand so that the Department may issue a new audit assessment, we first resolve whether

the Department may do so under the facts presented. Resolving that question in the negative, *infra* ¶¶ 55-62, we address Conoco's appeal and the Department's "alternative" theory in defense of its audit assessment. *Supra* ¶¶ 49-50.

May the Board remand the Department's audit assessment to the Department to issue a wholly different assessment premised on a different valuation methodology?

[¶ 55] The Department discovered new facts in discovery during the appeal which compel it to disagree with, and abandon, its audit assessment. The Department argues that the audit assessment of Conoco's mineral production, which accepted Conoco's internal accounting mechanisms and valuation analysis, runs afoul of Wyoming tax law and, therefore, must be rejected and replaced. *Supra* ¶¶ 27, 37-39; (Dep't's. Confid. Opening Br. 12). The Department's "primary" theory, *supra* 42-48, presumes its authority to, through the course of a taxpayer's appeal, seek remand of an audit assessment to issue essentially a different audit assessment premised on a different valuation methodology. The Department further presumes this Board's authority to issue such a remand.

[¶ 56] Conoco objects to the Department's reassessment demand on several independent grounds, including that the Department lacks authority to issue a new assessment under the circumstances presented. (Conoco's Br. 7-15). The Department responds that this Board's fundamental authority to "[d]ecide all questions that may arise with reference to the construction of any statute affecting the assessment, levy and collection of taxes ..." supersedes, and confers sufficient authority for a remand and order that the Department correct its improper assessment under the circumstances. (Dep't's Resp. Br. 3-6, quoting Wyo. Stat. Ann. § 39-11-102.1(c)(iv) (2021)). Correcting the current, illegal valuation of Conoco's production, it insists, is a legal imperative outweighing all procedural or other objections. (Dep't's Resp. Br. 5-6).

[¶ 57] The Legislature has specifically decided otherwise, and our exercise of authority must operate within the statutory tax assessment, audit, refund, and investigatory system frameworks. Wyoming's mineral tax code imposes limits on both the mineral taxpayer's ability to amend its severance and ad valorem tax liability, i.e. seeking refunds or credits for overpaid taxes, and the Department's authority to assess additional tax liability:

A) Mineral taxpayers[9] must submit an ad valorem tax return to the Department annually before February 25 of the year following the calendar production year. Wyo. Stat. Ann. § 39-14-207(a)(i) (2021);

B) Taxpayers must also submit a monthly severance tax return for the production two months prior, no later than the 25th of each month. (Wyo. Stat. Ann. § 39-14-207(a)(v) (2021);

C) Upon a taxpayer's failure to submit returns, the Department shall value the production using the "best information available." Wyo. Stat. Ann. § 39-14-208(a)(i) (2021);

D) Among other remedies, taxpayers may file an amended tax return and seek a refund within three years from the date the production should have been reported in accordance with Wyoming Statutes section 39-14-207(a)(i), which is February 25 of the year following the production year. Wyo. Stat. Ann. § 39-14-209(c)(i), (ii) (2021);

E) Taxpayers are entitled to refunds if sums to be refunded are discovered during audit, regardless of whether the taxpayer submitted an amended return. (Wyo. Stat. Ann. § 39-14-209(c)(iii) (2021);

F) The Department of Audit, an agency independent of and separate from the Department of Revenue, may initiate an audit no later than three years and six months following the taxpayer's reporting date for ad valorem taxes (February 25th of the year following the production year). Wyo. Stat. Ann. § 39-14-208(a)(vii) (2021);

G) Unless there is an agreement to the contrary, final audit findings must issue to the taxpayer no later than the "end of the month two (2) years after the audit [was] commenced[.]" If, however, the audit reveals gross negligence by the taxpayer in reporting, the Department may examine records without regard to the time limitations set forth in that statute. Wyo. Stat. Ann. § 39-14-208(b)(v)-(vii) (2021);

H) The Department of Revenue may, in reliance on an audit or department review, assess additional taxes and interest within one year of the audit's completion. Wyo. Stat. Ann. § 39-14-208(b)(v)(E) (2021).

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[9] The code sets different requirements for producers that incur less than $30,000 in severance tax liability annually. *See* Wyo. Stat. Ann. § 39-14-207(a)(vi) (2021).

Thus, in the absence of a mutual agreement to waive deadlines, the Department may assess additional tax liability until approximately six and one-half years after February 25th of the year following the production year.[10]

[¶ 58] Notwithstanding that Conoco may have valued its 2013-2015 production in a manner technically inconsistent with statute, as the Department claims, the legislature unambiguously limits the timeframe within which to assess additional tax liability through an audit. One exception[11] to that limit exists: no time limit applies if there is "evidence of gross negligence by the taxpayer in reporting and valuing production[.]" Wyo. Stat. Ann. § Wyo. Stat. Ann. § 39-14-208(a)(v)-(vii) (2021). The Department has not alleged gross negligence.

[¶ 59] The Board, when it adjudicates disputes between the Department and taxpayers, is not free to disregard the tax system's prescribed deadlines. "An administrative agency is limited in authority to powers legislatively delegated[]" and "must find within the statute warrant for the exercise of any authority which they claim." *Amoco Prod. Co. v. Wyo. St. Bd. of Equalization*, 12 P.3d 668, 673 (Wyo. 2000) (quoting *Union Pac. Res. Co. v. State*, 839 P.2d 356, 370 (Wyo. 1992)); *see also Solvay Chemicals, Inc. v. Dep't of Revenue*, 2018 WY 124, 430 P.3d 295 (Wyo. 2018) (Boomgaarden, J., dissenting) (disagreeing with majority's restrictive interpretation of Board's review of issues not raised by the parties). However, administrative agencies have "certain implied powers necessary to fulfillment of their statutory purposes" but are limited to those necessarily implied from the express authority granted. *BP America Prod. Co. v. Dep't of Revenue*, 2006 WY 27, ¶ 28, 130 P.3d 438, 466-67 (Wyo. 2006) (citing *Billings v. Wyo. Bd. of Outfitters and Guides*, 2001 WY 81, ¶ 24, 30 P.3d 557, 569 (Wyo. 2001)).

[¶ 60] Like that of the Department, the Board's authority is limited to that which is expressed, or necessarily implied, in statute or its own rules, as the state's courts have interpreted them. Pursuant to Wyoming Statutes section 39-11-102.1(c) (2021), the Board is Wyoming's "tax court" and adjudicates disputes between taxpayers and the Department. The statute expressly authorizes the Board to interpret and apply Wyoming's laws,

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[10] Notably, the Legislature significantly shortened the timeframes for submitting amended returns and completing audit and audit assessment processes in 2002. Before 2003 taxpayers could submit amended returns up to five years from the initial reporting deadline, and the Department of Audit could initiate an audit within five years of a taxpayer's reporting deadline. The Legislature reduced both deadlines to three years, and three years and six months, respectively. 2002 Sess. Laws 90-94.

[11] A different remedy afforded outside of the audit assessment process is the Board's "investigative" authority set forth in Wyoming Statutes section 39-11-102.1(c)(x) (2021). That authority allows the Board to examine allegations "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." *Id.* Petitions for investigation must be filed within five years of the date taxes were, or should have been, paid. There is no limitation on the Board's investigatory authority, however, if fraud is alleged. *Id.*

regulations, and judicial rulings when adjudicating disputes. *Id.* But, the statutes do not imply an authority to extend the scope of the audit assessment authority beyond the six and one-half years set in statute. In the absence of allegations that Conoco was grossly negligent when it reported its mineral tax liability for 2013-15, the Department's authority to enforce a different mineral tax liability through audit ended six and one-half years after the deadline by which Conoco reported its tax liability.

[¶ 61] Importantly, we do not hold that the Department is unable to seek revisions to audit assessments when defending them on appeal. It has done so on many occasions, and such is often necessary to reconcile very complex evidence and valuation methodologies, especially when communication between taxpayers and the state's agencies are lacking. But, under the circumstances presented in this appeal, the Department may not abandon its audit assessment and seek remand to issue a substantially different audit assessment premised on a different valuation methodology altogether.

[¶ 62] In sum, this Board may not entertain the Department's "primary" theory and its request for remand of the audit assessment for a new, revised assessment using the comparable value method.

Is Conoco entitled to deduct "unused" reservation charges paid to the REX Pipeline for transportation of its 2013-15 Madden Production?

[¶ 63] Reviewing the audit assessment as issued and originally appealed, Conoco asserts that it is entitled to deduct additional transportation expenses, specifically that portion of the REX Pipeline reservation expense it did not deduct when it originally reported its mineral tax values. It cites our 2017 ruling in *WPX Energy I*, *supra* ¶ 6, for the proposition that all reservation charges paid are fully deductible transportation expenses. *Supra* ¶¶ 31-32, 35; (Conoco Opening Br., 17-21, 23-25).

[¶ 64] The Department, still maintaining that its audit assessment arises from an illegal combination of valuation methods, responds that Conoco is, in any event, entitled to only the unit-based, "pro rata share of the invoiced REX firm transportation expenses associated with produced and transported audited volumes." (Dep't's Confid. Opening Br., 19); *Supra* ¶¶ 49-50.

[¶ 65] We find ourselves in uncharted territory with respect to Conoco's refund claim, in large part because we begin with a complex, unorthodox variation of the netback and comparable value methods: Conoco's "weighted average pric[ing]" and "weighted

average" transportation costs.[12] *Supra* ¶¶ 22-30. Conoco's entire valuation calculus meshes together pricing and transportation expenses for multiple sources of gas which were indistinguishable once commingled in the REX Pipeline. The produced and purchased gas passed from the Rocky Mountains region to Ohio, and portions were diverted, branched off, and/or were sold at delivery points downstream. *Id.* So, while the traditional netback or comparable value methods would simply require that the taxpayer subtract from arm's length revenues downstream, the cost to transport that quantity of gas from the point of valuation to the points of sale, Conoco relied on its corporate "hook" accounting system as a surrogate for the "netback" component (transportation on REX Pipeline) of its valuation calculus. *Id.*

[¶ 66] Taken a step further, Conoco asserts that it may deduct the balance of its unclaimed reservation charge expenses against *only the gas under audit*, even though that gas was just one of various sources of gas Conoco commingled and shipped east on the REX Pipeline. *Supra* ¶¶ 32, 35.

[¶ 67] We recall our recent decision addressing whether producers may deduct the entirety of pipeline reservation expenses when less than the reserved pipeline capacity was used. *In re Appeal of WPX Energy Rocky Mountain, LLC*, 2021 WL 4238112, Doc. No. 2020-08 (Wyo. State Bd. of Equalization, Sept. 13, 2021) (omitting paragraphs addressing confidential aspects of appeal) (*hereafter WPX II*). In that ruling, we revisited our ruling in *WPX Energy I*, *supra* ¶ 6, and qualified our determination that producers may deduct the entirety of pipeline reservation charges when less than full pipeline capacity is used. We explained in *WPX II* that reservation fees, when they embody and are paid for more than a *producer's* gas transportation services, are not fully deductible. *WPX II*, ** 10-12, ¶¶ 47-48, 54-55. In that case, the obligation to pay reservation charges stemmed from an original obligation to construct the pipeline and pay all operating and like expenses; thus, the reservation charge included far more than just the cost to transport gas, and those costs therefore were not fully deductible under Wyoming's mineral tax statutes. *Id.*

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[12] Because the parties have, in a sense, mutually accepted Conoco's "weighted average pricing," this Board must do so as well for the purposes of this appeal. The Wyoming Supreme Court has determined that this Board may not raise fundamental questions not raised by the parties, and that we must constrain our review to the issue(s) presented on appeal, **even when the dispute concerns an incorrect interpretation of statute**. *Solvay Chemicals, Inc. v. Dep't of Revenue*, 2018 WY 124, ¶¶ 18-28, 430 P.3d 295, 300-304 (Wyo. 2018 (Boomgaarden, J., Davis, C.J., dissenting). In other words, we must decide which party to a litigation is correct as to **their asserted claims and defenses**, even if we conclude that both parties have incorrectly interpreted a statute or failed to consider a statutory guideline. *Id.* Accordingly, we may review only the pipeline transportation deduction issue as Conoco has presented it. We may not question whether Conoco's valuation method is consistent with statute under the facts of this case because the **Department's authority and time within which to raise that possibility has ended, in the absence of Conoco's alleged gross negligence**.

[¶ 68] As in *WPX II*, we carefully consider the precise statutory language permitting *producers* a deduction for transportation from the point of value to the point of sale under the netback method: "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." Wyo. Stat. Ann. § 39-14-203(b)(vi)(C) (2015). Referring to this language, and responding to WPX Energy's liberal interpretation thereof, we stated, "[t]he answer to WPX's claim lies in the parties' pipeline transportation agreements and requires that we carefully examine the bargained-for consideration paid for the transportation service. Given the plain meaning of 'transporting,' the correct deduction is the precise cost to 'transport' the audited production to the point of sale." *WPX II*, * 10, ¶ 41. We reasoned: "We disagree that the legislature intended 'transporting,' as applied in the statutory netback method, to include a marketing affiliate's cost to fund a pipeline. We are guided by the legislature's core directive: taxpayers may deduct the direct costs incurred to transport gas from one point to the next. Nothing less, nothing more." *Id.* *11, ¶ 47 (internal citation omitted).

[¶ 69] We must, therefore, carefully examine Conoco's agreement to pay reservation charges to the REX Pipeline between 2013 and 2015 and discern precisely the service it purchased, and whether it paid reservation fees for more than transportation of its gas. To the extent the reservation fees included services beyond the narrow transportation of gas, that portion the fee is not deductible for mineral tax purposes under the netback method. *Supra* ¶¶ 67-68. The complexities of Conoco's transportation fee calculation make it especially difficult to answer this question. *See supra* ¶¶ 19-30.

[¶ 70] Conoco reserved 400,000 MMBtus per day on the REX Pipeline. (Confid. Ex. 102, COP 0014; Ex. 517, 009025) *supra* ¶¶ 18, 27. Conoco utilized its reserved capacity by designating its gas volumes to be received at several named receipt points, and it paid a different reservation rate depending upon the receipt point and/zones. (Confid. Exs. 102-129); *supra* ¶¶ 19-30. It continually adjusted the quantities delivered at different points through a prescribed form "FTS Transportation Service Agreement" with the REX Pipeline, which it periodically amended as it adjusted the gas volumes designated for receipt at each location. *Id.*

[¶ 71] Conoco argues that it may deduct all unused reservation expenses against the Madden Shallow Production revenue. We disagree. First, Conoco has not explained how it would do so mechanically as part of its "weighted average pricing" calculation. It merely argues that it is entitled to deduct the unused reservation charges pursuant to our first *WPX Energy* rulings. *Supra* ¶¶ 3; (Conoco Opening Br., 17-21, 23-25). Conoco has offered no evidence that the Department's refund denial on this claim was contrary to law on that basis.

[¶ 72] Second, we struggle to understand how this outcome would be consistent with its gas pricing calculation and deduction of transportation expenses. All of Conoco's produced and purchased gas commingles within the REX Pipeline at different receipt points and passes downstream through a series of geographical regions or "hooks." Some of that gas is diverted and flows through other "hooks." *Supra* ¶¶ 19-30. Conoco's witnesses explained at great length that its "weighted average pricing" and "weighted average" transportation relied upon the prices of the commingled gas at various delivery points for sale, and from those delivery points, the upstream costs of transportation within the upstream "hooks." *Id.* Conoco argued that removing the expenses of any gas transportation within any hook would be incorrect, and that its calculation (hook report) worked backward from all "dependent" hooks, to the "parent" hook, to correctly derive the pricing and deduction of transportation across the entire system. *Id.* Conoco's argument, therefore, appears inconsistent with the "weighted average pricing" and "weighted average" transportation system it employs, as that system does not distinguish between different sources of gas once placed in the REX Pipeline. In other words, it makes no sense within *Conoco's pricing and transportation deduction calculations* that the unused reservation charges would be allocated disproportionately or exclusively to the Madden Shallow Production.

[¶ 73] The question then becomes, how should the unused reservation expense be allocated to the audited Madden production, if at all? As we explained in *WPX II*, taxpayers are entitled to deduct the precise cost to transport gas from the point of valuation to the point of sale, and deduction of pipeline reservation charges may not encompass more than the bare cost to transport. *Supra* ¶¶ 67-68.

[¶ 74] Consistent with Conoco's allocation and calculation of transportation costs to its commingled gas volumes in the REX Pipeline between 2013 and 2015, the unused reservation charges must be allocated proportionately to all Conoco gas, purchased or produced and transported on the REX Pipeline, and any additional deduction of unused pipeline reservation charges may not be weighted more heavily as a deduction to the value of audited gas production. We appreciate that the deduction at issue in this appeal applies only to the audited gas for tax purposes, but the calculation of this deduction must treat all Conoco gas the same because, as Conoco acknowledges, it is indistinguishable once in the pipeline. Moreover, Conoco did not pay the reservation charge to transport only its produced gas, but to transport all of its gas, regardless of origin, to eastern markets. *Supra* ¶¶ 17-30.

[¶ 75] In sum, when Conoco utilized its full reserved capacity, the deduction of transportation in valuing the audited gas production would equal the base load rate at 100%. When Conoco used less than its allotted 400,000 MMBtus reserved capacity, each

reservation charge (by zone) is allocable to all Conoco gas proportionately, and deduction of the reservation charge for Conoco's 2013-15 Madden Production must be consistent therewith.

[¶ 76] For the same reason that the Department may not revalue the Madden production under its "Primary" theory, it may not remove Zone 3 transportation expenses from Conoco's weighted average pricing accounting system methodology. Here again, because the Department accepted Conoco's weighted average pricing and transportation cost calculations as a valuation methodology, it agreed with Conoco as to basic features of that system as a method to value the Madden Production. Conoco offered persuasive evidence that its weighted average pricing and transportation calculation depended upon comprehensive inclusion of all pricing and costs across all zones. *Supra* ¶ 50. The Department reasonably responded by asking how the transportation of gas unrelated to the Madden Production within Zone 3 should affect the value of the Madden Production, but offered no evidence that including those costs was *incorrect within Conoco's accounting system*. *Id.*

CONCLUSION

[¶ 77] Because the Department did not allege Conoco was grossly negligent in reporting its 2013-15 Madden Production taxable values, it lacks authority to issue a revised audit assessment, as it requests, more than six and one-half years after Conoco reported its taxable values. The Board likewise lacks authority to remand the audit assessment to the Department for a new audit assessment in accordance with the Department's "primary" theory.

[¶ 78] Conoco is entitled to deduct additional reservation charge expenses, but must proportionately allocate "unused" reservation charges to all of its transported gas, regardless of origin. Conoco is not permitted to allocate all "unused" reservation charge expenses to its Wyoming Madden production.

ORDER

[¶ 79] **IT IS, THEREFORE, ORDERED** that the Department of Revenue's audit assessment of Conoco's 2013-2015 Madden Production is **Reversed** and **Remanded** to the Department for the allowance of additional transportation deductions consistent with this Decision

[¶ 80] **Pursuant to Wyoming Statutes section 16-3-114 (2021) 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 after the date of this decision.**

DATED this 19 day of April 2022.

STATE BOARD OF EQUALIZATION

E. Jayne Mockler, Chairman

Martin L. Hardsocg, Vice-Chairman

David L. Delicath, Board Member

ATTEST:

Jennifer Fujinami, Executive Assistant

CERTIFICATE OF SERVICE

I certify that on the 19 day of April 2022, I served the foregoing **FINDINGS OF FACT, CONCLUSIONS OF LAW, DECISIONS, AND ORDER** 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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