BEFORE THE STATE BOARD OF EQUALIZATION

FOR THE STATE OF WYOMING

IN THE MATTER OF THE APPEAL OF **CHESAPEAKE OPERATING, INC.** FROM A DECISION BY THE DEPARTMENT OF REVENUE (Mineral Tax Division)	))))	Docket No. **2020-25**
IN THE MATTER OF THE APPEAL OF **CHESAPEAKE OPERATING LLC** FROM A DECISION BY THE DEPARTMENT OF REVENUE (Mineral Tax Division)	))))	Docket No. **2021-38**

FINDINGS OF FACT, CONCLUSIONS OF LAW, DECISION AND ORDER

APPEARANCES

Walter F. Eggers, III, and Kasey J. Schlueter, Holland & Hart LLP, representing Chesapeake Operating, Inc. and Chesapeake Operating LLC, (hereafter Chesapeake).

Karl D. Anderson and James Peters, Senior Assistant Attorneys General, representing the Wyoming Department of Revenue, (hereafter Department).

SUMMARY

[¶ 1] Chesapeake appeals from two Department assessments imposing additional mineral taxes. The Department assessed additional tax liability on Chesapeake's Converse County natural gas production for production years 2010-12 and 2014-16. Chesapeake contests the Department's assigned points of valuation for its natural gas production, and for Chesapeake's production of oil and liquids separated from the gas stream. The parties disagree about how *equipment*, to which points of valuation are statutorily assigned, is classified for purposes of applying Wyo. Stat. Ann. §§ 39-14-201(a)(xviii) & 39-14-203(b)(iii) & (iv) (2021), *infra* ¶¶ 29-30. Chesapeake claims entitlement to additional taxable value deductions as a result of its argued points of valuation. The Board conducted a contested case hearing and received post-hearing briefing. The Wyoming State Board of Equalization, Chairman E. Jayne Mockler, Vice-Chairman Martin L. Hardsocg, and Board

Member David L. Delicath, shall **affirm** the Department's audit assessments. As requested by the parties, we will remand the assessments to the Department for further action prompted by the outcome of Chesapeake's appeals.

ISSUES

[¶ 2] Chesapeake raises two issues before the Board, which it frames as affirmative arguments:

> 1. The Departments of Revenue and Audit failed to apply the correct point of valuation for Chesapeake's natural gas production.
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> 2. The Departments improperly applied two different points of valuation for Chesapeake's oil production.

(Chesapeake's Br., 8).

[¶ 3] The Department does not identify issues, but its Opening Brief arguments correspond well with Chesapeake' arguments regarding the point of valuation issues:

> A. The Department correctly placed the point of valuation for Chesapeake's gas production at the outlet of the initial TEG dehydrator.
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> B. The Department correctly placed the point of valuation at the initial storage tanks pursuant to Wyo. Stat. Ann. § 39-14-203(b)(iv) for oil.

(Dep't's Open. Br., 7, 8). Simply put, we are tasked with determining which party correctly identified the points of valuation for Chesapeake's natural gas production, and oils separated from the gas in the field.

JURISDICTION

[¶ 4] Chesapeake appealed from the Department's audit assessments, dated January 31, 2020, and January 25, 2021, within 30 days of the Department's issuance of those final decisions. (Chesapeake Exs. 310-11); Rules, Wyo. State Bd. of Equalization, ch. 2 § 5 (2021). We have jurisdiction to hear Chesapeake's appeals.

EVIDENCE PRESENTED AND FINDINGS OF FACT

[¶ 5] The facts are uncontested. Chesapeake produced "wet" natural gas[1] from numerous Converse County wells between 2010-2012 and 2014-2016. (Tr. at 44-56; Chesapeake Ex. 102). The Wyoming Department of Audit reviewed Chesapeake's reported tax liabilities to determine whether Chesapeake correctly calculated and paid mineral taxes[2] to the Department and Converse County. The Department of Audit determined that Chesapeake incorrectly valued its gas and oil production[3] because it applied the wrong "point of valuation," the statutorily designated point at which mineral production is valued for mineral tax purposes. (Tr. at 33-37, 132-51, 155-56; Jt. Exs. 300-07); Wyo. Stat. Ann. § 39-14-203(b)(iv) (2021), *infra* ¶ 29. The Department agreed and, relying upon the audit findings, assessed additional mineral production taxes and interest to Chesapeake. (Jt. Exs. 308-09; Tr. at 175-85); *infra* ¶ 18. Chesapeake appealed the two audit assessments, and this Board held a contested case hearing to resolve the appeals. (Jt. Exs. 310-11).

[¶ 6] The parties disagree only about the statutory status of equipment through which the natural gas and separated oil/condensate production moved during the years audited. (Tr. at 39-40); *infra* ¶¶ 27-28. This is because nearly all oil and gas production follows a typical extraction, gathering, processing, and transportation sequence of activities upstream of the point of sale. The legislature long ago settled upon the location of standard equipment in the field or in processing facilities to designate a mineral production's "point of valuation," thereby identifying deductible and non-deductible expenses to determine taxable value. 1990 Sess. Laws 117-20; *See infra* ¶¶ 27-28; *See also In re Appeal of Williams Prod. RMT Co.*, 2003 WL 22754175, Doc. No. 2002-103, ¶¶ 51-57, ** 11-13 (Wyo. State Bd. of Equalization, Nov. 14, 2003), *aff'd, Williams Prod. RMT Co. v. State Dep't of Revenue*, 2005 WY 28, 107 P.3d 179 (Wyo. 2005), *infra* ¶¶ 31-35; *Williams Prod. RMT Co. v. Wyo. Dep't of Revenue*, 2008 WY 155, 197 P.3d 1258 (Wyo. 2008).

[¶ 7] Chesapeake's case presentation began with review of its production field layout in January of 2010, demonstrated through a scaled-down map depicting a cluster of wells and

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[1] Gas is referred to as "wet" when it includes appreciable natural gas liquids (NGL's) that can be separated from the gas and separately sold. Dry methane gas production, by contrast, does not contain such NGL's and consists primarily of methane. *See U.S. Energy Information Administration* advisory at eia.gov/energyexplained/natural-gas/. NGL's include ethane, propane, butanes, and pentanes. *Id.*; *see also* characterization of gas as "rich," which also means that NGL's are present in gas. (Tr. at 173).

[2] Mineral producers and/or owners pay severance taxes on the value of mineral production to the state, and ad valorem taxes based on the same valuation, to the county from where the production occurred. Wyo. Stat. Ann. §§ 39-14-203(a); 39-13-103(b)(iii) (2021).

[3] Natural gas and oil producers are required to value their production, report production values, and remit mineral taxes to the Department each month. Wyo. Stat. Ann. § 39-14-207 (2021). The Department reviews severance tax and ad valorem returns, sometimes disputing a return's accuracy. Wyo. Stat. Ann. §§ 39-14-202(a); 39-14-208(a) (2021).

an "NGL Extraction Plant." (Chesapeake Ex. 102a; Tr. at 44-64). Chesapeake described how it expanded its production by drilling numerous additional wells between 2010 and 2016. The gathering system operator added facilities to assist with handling the additional gas from the wells, to separate oil and other heavy hydrocarbons from the gas, to dehydrate the gas, and to compress (transport) the gas to one of two NGL Extraction plants. *Id.*; (Chesapeake Ex. 102b-102l). The NGL Extraction plants are, in each party's estimation, "processing facilities." (Tr. at 87-88, 171-72, 247); *see infra* ¶ 16.

[¶ 8] Chesapeake extracted its gas at "well pads." In addition to the wellhead equipment, the well pads included a two-phase separator, storage tanks to store separated oil and other liquids, metering equipment, and gas-flaring equipment. (Jt. Exs. 316-17; Tr. at 64-67, 75). Chesapeake referred to a technical diagram and numerous pictures of the well pad equipment, including the separators[4] that induced liquids to drop from the gas. *Id.* The storage of the oil separated from the gas at the well pads is key to both the Department's and Chesapeake's oil production point of valuation arguments in this appeal. *See infra* ¶¶ 17, 47-48. The natural gas stream, free of most of its entrained oil and other heavy hydrocarbons, then passed through custody transfer meters to the operator of the gathering system, "Access Midstream." (Tr. at 66-69; Chesapeake Ex.. 317, p. 88). Chesapeake trucked the separated, stored oil to points of sale. *Id.*; (Tr. at 92-93).

[¶ 9] The equipment downstream of the well pads is the focus of Chesapeake's appeal with respect to its gas valuation. Critical semantical differences in how each party classifies the equipment (and classified the equipment during the audits), tie into the statutes governing the taxable valuation of natural gas and oil production. (Tr. at 52-55, 58-60, 61-66, 69, 73-75, 78, 82, 85-89, 99-100, 107-10, 170-72, 198-202, 207-22, 247-48; Jt. Exs. 313A, 315, 317); *see infra* ¶¶ 27-30. Seven installations, generically depicted in Exhibit 313A, were named: Pronghorn, Gumbo Hill, No Name, Antelope, Pale Horse, Rawhide, and Appaloosa. (Tr. at 62). But, for the purposes of our decision, we generally refer to the "field stations" because they are essentially the same.

[¶ 10] Chesapeake's Revenue Advisor and Audit Administrator, Steve Armstrong, described the equipment in one of the field stations, which Chesapeake argues was and is a "processing facility" as the mineral tax statutes use the word. (Tr. at 41, 70-80; Jt. Exs. 313A, 315); *supra* ¶ 9. Describing a tour he attended, as well as diagrams and photos in

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[4] Wyoming's tax code defines "separating" as "the isolation of the well stream into discrete gas, liquid hydrocarbons, liquid water and solid components." Wyo. Stat. Ann. § 39-14-201(a)(xxii) (2021). Separators are often simple vessels, larger than the pipeline into which the gas flows, allowing the gas to expand and cool, causing heavier components of the gas to drop and collect in the vessel. *See e.g., In re Appeal of Williams Prod. RMT Co.,* 2003 WL 22754175, Doc. No. 2002-103, ¶¶ 51-57, ** 11-13 (Wyo. State Bd. of Equalization, Nov. 14, 2003) (Referring to "headers" designed to allow water to drop from gas stream). They may also be more complex and mechanical in operation. *Id.*

exhibits 313A and 315, Mr. Armstrong characterized each field station's equipment as "enormous," stating that each station covered an area of about 12 acres. *Id.*; (Tr. at 93-94, 105-06, 112-13, 123-24). The first building (of three) included a separator and numerous compressors (as many as ten). *Id.* The compressors increased the gas stream's pressure to between 800 and 900 psi. *Id.* The separators, as with the first separators at the well pads, caused heavier condensate, oil, water and other materials to drop out of the gas. *Id.*; (Tr. at 91-92, 98-99).

[¶ 11] The gas then flowed to the next equipment, a TEG[5] dehydrator, to remove water vapor from the gas stream. (Tr. at 41, 70-80, 99; Jt. Exs. 313A, 315). A separate building housed TEG regeneration equipment which essentially boiled the captured water vapor out of the TEG solution, allowing the regenerated TEG to circulate back to the dehydrator for continued dehydration of the gas. *Id.*

[¶ 12] Referring back to the separator, Mr. Armstrong explained that liquids, consisting of "drip condensate," water, and heavy hydrocarbons, dropped from the gas stream, were collected, and delivered to a "slug catcher." (Jt. Exs. 313A, 315; Tr. at 72-80). The operator stored the heavy hydrocarbons in large storage tanks at the field station facility. *Id.* As with the oil collected after initial separation of liquids at the well pads, these were likewise trucked to points of sale. (Tr. at 78, 92).

[¶ 13] The stations' operator monitored the stations remotely through monitoring systems. By contrast, the two downstream NGL Extraction Plants were staffed around the clock. (Tr. at 82-84, 97-98); *see infra* ¶ 19.

[¶ 14] Mr. Armstrong, neither an engineer nor attorney, explained why Chesapeake asserted the seven field stations were "processing facilities" as the term applied in Wyoming's tax statutes: "Well, basically, you're removing heavier hydrocarbons, which is a marketable product, off each one of these processing facilities on the Jackalope system."[6] (Tr. at 85; *see also* Tr. at 93-94). He added that the processes in the seven facilities enhanced the marketability of the mineral products, specifically by removing heavier hydrocarbons from the gas stream for sale, and by compressing the gas. (Tr. at 85-

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[5] TEG stands for triethylene glycol, which employs absorption to remove water from the gas it contacts. *See In re Williams*, at ¶¶ 61, 67, ** 13-14. The location of the "initial dehydrator" when gathering or processing gas, often a TEG dehydrator, is key to establishing the point of valuation. *See* Wyo. Stat. Ann. § 39-14-203(b)(iv) (2021), *infra* ¶ 29.

[6] The name "Jackalope" applies to the entire midstream gathering system. (Tr. at 110-12, 121-23). Without fully explaining the ownership sequence, Mr. Armstrong testified that Chesapeake sold its interest in the gathering system facilities in December of 2012. *Id.* Ownership of the facilities was merely informational and played no role in the parties' dispute.

87, 93-94); for significance of Mr. Armstrong's mention of "enhancement," *see* Wyo. Stat. Ann. § 39-14-201(a)(xviii) (2021), *infra* ¶ 30.

[¶ 15] When questioned by the Department as to why the facilities were "processing facilities," Mr. Armstrong again emphasized that the equipment was very large and handled high volumes of gas production, separating heavy hydrocarbons from the gas stream for sale. (Tr. at 94-95, 117-18). He added:

> Well, in this case, these are processing facilities from my position is [sic] these are sizable separators. These is [sic] a large amount of gas. In the instance here of Rawhide, they indicated that there's 50 million can be moving through this facility. Not only is there separation going on in this facility, there's compression. The separated hydrocarbons [sic] is a marketable product that we're selling. In addition to, we have dehydration here that's occurring in this facility.

(Tr. at 109). He repeated, "It's because we're changing the chemical makeup. We have a marketable product. We're enhancing the value of both streams. We're compressing and we're meeting pipeline specs." (Tr. at 118-19); *see* Wyo. Stat. Ann. § 39-14-201(a)(xviii) 2021), *infra* ¶ 30.

[¶ 16] Asked why seven facilities were needed upstream from the NGL Extraction Plants, Tall Grass and Bucking Horse, which all parties agree are processing facilities, he explained that the additional wells and increased production volumes necessitated the processing facilities upstream. (Tr. at 86-88, 96, 103, 116-18 Jt. Ex. 318). He opined that the downstream NGL Extraction plants, much larger and more complex than the seven field stations, would have been overwhelmed without the initial processing. *Id.* He added that the production would have shut down. *Id.*

[¶ 17] Chesapeake, Mr. Armstrong explained, contends that because the seven field stations were processing facilities, the gas production's point of valuation was the custody transfer meters at or near the well pads, rather than at the outlet of the initial dehydration equipment as the Department contends. (Tr. at 65-66, 88-89); *infra* ¶¶ 29-30. The point of valuation for all oil separated from the gas stream, Mr. Armstrong continued, was the oil storage tanks at the well pads, including for the oil separated downstream at one of the seven stations. *Id.*; (Tr. at 66, 69, 90-91); *infra* ¶ 29. The Department countered that Chesapeake's point of valuation for natural gas production was further downstream at the outlet of the field dehydrators because they were not located in "processing facilities" as Chesapeake asserted. (Tr. at 178-80, 182, 198-202); *infra* ¶¶ 29-30. Chesapeake's point of valuation for oil, by statute, depended on its storage location: for oil stored at the well pad, the point of valuation was the outlet of the initial storage facility at the well pad, and for

oil first stored at one of the seven field stations, those storage tanks set the point of valuation for that particular oil. (Tr. at 156-57, 194-96, 240-41, 289-94); *infra* ¶ 29.

[¶ 18] Two employees of the Department of Audit and Department of Revenue countered Mr. Armstrong's position that the seven field stations were processing facilities. Both testified that the seven facilities, isolating oil and water from the gas immediately downstream of the well pads, dehydrating the gas, and compressing the gas, were typical field compression stations common throughout the state. (Tr. at 157-58, 175, 258-59). Matt Sachse, the Department's Valuation Manager responsible for advising auditors when valuation questions arise, consulted with the auditors and reviewed all audit findings and correspondence that precipitated the Department's assessments. (Tr. at 168, 176-80; Jt. Exs. 302, 304, 306, 308). He emphasized that the seven installations were commonly found gathering/production facilities under Wyoming tax law since the valuation statute's 1990 enactment, and that Chesapeake's theory would, if correct, drastically alter the valuation of natural gas:

> When you produce a rich gas, you have a separator. That's just the way it works. These compression facilities, most of them have some sort of TEG dehydrator, but just about all of them have some sort of separator in order to get the gas into a gaseous state and remove all the liquids that need to be removed.
>
> And each of those functions is of themselves production functions, and so if we were to say they are no longer production functions, but are processing functions, essentially this whole point of valuation issue would – all of the statute would become moot. All of the guidelines that the legislature has determined would become irrelevant. Because, basically, everywhere there was a separator, everywhere there was a wide spot in the line, as has been stated, you would magically create a processing facility and that's not the way the statutes are written.

(Tr. at 200-201; *see also* Tr. at 175, 202, 257-59).

[¶ 19] He concluded that the two "NGL Extraction Plants" were the only facilities that processed Chesapeake's gas, and that they were like other sweet gas processing facilities in Wyoming. (Tr. at 171-72, 175-76, 200-01, 236-38; Jt. Ex. 319). Describing a processing facility generally, Mr. Sachse elaborated:

> Generally speaking, a processing facility uses compression and uses refrigeration and cryogenics to separate out the natural gas liquids from the natural gas stream in order to get it into a pipeline quality. The residue gas that's produced can go into an interstate pipeline as is. It doesn't need any

> further processing. And the natural gas liquids can be shipped down a natural gas pipeline, Enterprise Pipeline for example, with no further changes to it. It can be sold at that location.
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> Generally when you look at a processing facility, you see the cryogenic chambers. You see an administrative building. You have people who work there around the clock keeping track of what's going on. You see loadout facilities. At that location you see various meters, pipes, pipe, hundreds and hundreds of pipes going every which direction. This is what you would see normally with a processing facility.

(Tr. at 233-34; *see also* Tr. at 236-37 & Jt. Ex. 319).

[¶ 20] Mr. Sachse explained the difference between non-deductible gas production activities in the field, and deductible post-production activities such as processing, and the Department's historic application of the valuation statutes. (Tr. at 201-224, 244-46); *see infra* Wyo. Stat. Ann. § 39-14-203(b) (2021). He detailed how the Department viewed Chesapeake's natural gas production development in Converse County for valuation purposes, including the cost of the Jackalope gathering system's addition of seven compression stations. *Id.*

[¶ 21] Mr. Sachse discussed several informative natural gas tax valuation case rulings, which he testified guided the Department's valuation decisions and disagreement with Chesapeake's submitted valuations. (Tr. at 224-33); *see infra* ¶¶ 31-35.

[¶ 22] Other agencies had likewise identified the seven compressor stations and two processing facilities as such, Mr. Sachse added, contrary to Chesapeake's argument that the seven compressor stations were processing facilities. (Tr. at 234-36; DOR Exs. 500-501). He testified that according to the Department of Environmental Quality and Wyoming Oil and Gas Conservation Commission, there were 43 processing facilities, including Tallgrass and Bucking Horse, and 642 compressor stations, including the seven that Chesapeake argued were actually processing facilities. (Tr. at 235-36, 261-63, 295-301; DOR Exs. 500-501).

CONCLUSIONS OF LAW

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

[¶ 23] "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). 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).

[¶ 24] 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).

[¶ 25] "[T]he burden of proof with respect to tax valuation is on the party asserting an improper valuation." *Williams*, ¶ 7, 107 P.3d at 183. 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 (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.*

[¶ 26] 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); *see also infra* ¶ 35.

B. Application of law to facts, and analysis of parties' respective statutory interpretations

[¶ 27] The parties do not dispute that Chesapeake correctly selected the netback valuation method to value its natural gas production throughout the audit periods. (Tr. at 146, 181). That method required that:

> (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) (2021) (emphasis added).

[¶ 28] The parties dispute application of a critical component of the netback methodology, location of the proper point of valuation, also referred to as "completion of the production process." *Infra* ¶¶ 29-30. The point of valuation is pivotal because producers may deduct expenses incurred *downstream* of that point, such as transportation and processing costs. *Id.*, *see Williams Prod. RMT Co. v. State Dep't of Revenue*, 2005 WY 28, ¶ 10, 107 P.3d 179, 183-84 (Wyo. 2005) ("it is to the producer's benefit to have the point of valuation determined 'upstream' as far as possible."). Conversely, costs incurred upstream of the point of valuation are "production" costs, and are not deductible. *Id.*

[¶ 29] Wyoming Statutes subsections 39-14-203(b)(ii), (iii), (iv) (2021), defining the point of valuation for oil and gas, have not materially changed over the last twenty years:

> (b) Basis of Tax. The following shall apply:
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> ...
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> (ii) The fair market value for crude oil, lease condensate and natural gas shall be determined after the production process is completed. . . . , expenses incurred by the producer prior to the point of valuation are not deductible in determining the fair market value of the mineral;
>
> (iii) The production process for crude oil or lease condensate is completed after extracting from the well, gathering, hearting, and treating, separating, injecting for enhanced recovery, and any other activity which occurs before the outlet of the initial storage facility or lease automatic custody transfer (LACT) unit;
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> (iv) The production process for natural gas is completed after extracting from the well, gathering, separating, injecting and any other activity which occurs before the outlet of the initial dehydrator. When no dehydration is performed, other than within a processing facility, the production process is completed at the inlet to the initial transportation related compressor, custody transfer meter or processing facility, whichever occurs first;

[¶ 30] Unquestionably, the legislature's failure to define "processing facility,"[7] integral to determining point of valuation, invites tax appeals like the one now before the Board. This is because an analytical circular reasoning arises when applying these statutes, as the bolded words in the definition of "processing" reveal below:

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[7] Amidst consistent disagreement between the Department and mineral industry generally, the legislature has repeatedly attempted to define "processing facility" and related terms for natural gas and oil taxation purposes, but has not yet succeeded. In 2002, the legislature sought to define various complex processing expenses in HB 0095, but it failed introduction in the House. *See* Wyoleg.gov/Legislation/2002/HB0095. Again in 2005, the Joint Revenue Interim Committee issued H.B. 0049, which would have defined "processing facility" and other valuation terms. It, however, died in the Committee of the Whole after it failed to consider the bill. *See* Wyoleg.gov/2005/Digest/HB0049.htm. The legislature tried again to clarify how certain processing costs would be included in the valuation methodologies for natural gas in 2006, but House Revenue Committee Bill 0043 died on its third reading. *See* Wyoleg.gov/2006/Digest/HB0043.htm. In 2010, HB0078 would have defined "processing facility," and it passed out of its house of origin. Yet, it died in the Senate's Revenue Committee on a 2-3 vote. *See* Wyoleg.gov/2010/Digest/HB0078.htm.

(xviii) "Processing" means any activity occurring **beyond the inlet to a natural gas processing facility** that changes the well stream's physical or chemical characteristics, enhances the marketability of the stream, or enhances the value of the separate components of the stream. Processing includes, but is not limited to fractionation, absorption, adsorption, flashing, refrigeration, cryogenics, sweetening, dehydration within a processing facility, benefication, stabilizing, compression (other than production compression such as reinjection, wellhead pressure regulation or the changing of pressures and temperatures in a reservoir) and separation **which occurs within a processing facility**;

Wyo. Stat. Ann. § 39-14-201(a)(xviii) (2021) (emphasis added).

[¶ 31] Because no precise definition of "processing facility" exists in statute or rule, taxpayers have argued that activities in the field are "processing" by asserting that they occur within a "processing facility." *See e.g. Williams* (which attached this Board's decision, *In re Appeal of Williams Prod. RMT Co.,* 2003 WL 22754175, Doc. No. 2002-103 (Wyo. State Bd. of Equalization, Nov. 14, 2003), as appendix A, incorporating it into its ruling). When successfully argued, the point of valuation moves further upstream, and additional costs become deductible. *Id.*; *see e.g. ExxonMobil Corp. v. Dep't of Revenue*, 2009 WY 139, 219 P.3d 128 (Wyo. 2009) (ExxonMobil's very large, complex Black Canyon Dehydrator found to be a processing facility, thereby rendering costs of operating that dehydrator deductible for taxable value purposes.).

[¶ 32] In the absence of legal definitions, this Board's tax decisions and the Wyoming Supreme Court's review have played prominently in clarifying this area of mineral tax law. This Board's ruling in *In re Williams* was such a case and best captures the prevailing analysis of when a "processing facility" exists. (Dep't's Br., 11-17; Chesapeake's Br., 9-10, 12-14, 17-19). Williams' appeal before this Board addressed, at the time, a recently developing natural gas industry trend, the production of "coal bed methane" from shallow coal bed seams in Wyoming's Powder River Basin (primarily Campbell and Converse counties). Relatively inexpensive to produce, coal bed methane (CBM) differed from more traditional methods of natural gas production in that CBM trickled out from well bores drilled into shallow coal bed seams as producers pumped ground water from the coal formations. The water's removal released CBM gas trapped in the seams, which carried with it much water. However, the CBM gas contained no heavy hydrocarbons or dangerous contaminants to speak of, so it was less expensive to handle. *Id.* at ¶¶ 1-4, * 2.

[¶ 33] Because the CBM gas was saturated with water and flowed at very low pressures, well operators employed a different configuration and type of equipment than that

employed to gather and handle conventional gas production. Conventional gas well operators extracted gas from deeper reservoirs under high pressure, and conventional gas contained all sorts of challenging and/or toxic components. *In re Williams* at ¶¶ 1-4, 50-67, ** 11-14. As it exited the well bore, CBM producers piped the water-saturated gas to "central delivery points" (CDP's) where midstream gathers repeatedly separated water vapor from the gas in separators (also called "water knock-outs"), dehydrated the gas in TEG dehydrators, and compressed the gas, often multiple times, as the gas accumulated with other sources of CBM production moving downstream toward market pipelines. *Id.* at ¶¶ 1-4, 13, 50-67, **2, 11-14; (Tr. at 276). Because the trickle of gas from each well was saturated, water readily dropped out in all field equipment and the pipelines, requiring that operators "pig" the pipelines to remove water and other waste materials.[8] *Id.*

[¶ 34] During an audit of Williams' gas production, Williams claimed that separators and compressors were dehydrators, and alternatively that dehydrators and separators in the field were "processing facilities." *In re Williams* at ¶¶ 30, 38-39, 94, ** 6-9, 19. If either of these arguments was correct, the point of valuation for CBM production would have moved upstream nearer to the wellhead at the custody transfer meters where Williams transferred the gas to the operator of the gathering system. *In re Williams,* at ¶ 94, * 19; *See supra* ¶ 29.

[¶ 35] Affirming the Department's position, this Board disagreed with Williams. We found that grouped separators, dehydrators, and compressors in the field were not "processing facilities." *In re Williams,* at ¶¶ 123-31, ** 25-27. Among other reasons, the Board determined that the Department's interpretation of "processing facility" was entitled to deference, as it did not conflict with implicit legislative intent. The rule of statutory interpretation, fully stated, is: "If a statute is ambiguous, we give some deference to an interpretation by the agency charged with execution of the statute unless its interpretation is clearly erroneous." *Campbell Cty Shool Dist. v. Catchpole*, 6 P.3d 1275, 1285 (Wyo. 2000) citing *Parker Land & Cattle Co. v. Game & Fish Comm'n*, 845 P.2d 1040, 1042-43 (Wyo. 1993). The Board noted that the legislature's implicit intent tied to processing facilities known to the legislature in 1990 at the governing statute's inception, and those facilities did not resemble the CDP's that Williams argued were processing facilities. *Id.* The Board also reviewed several characteristics and activities of traditional "processing facilities," distinguishing those from the central delivery point stations that Williams proposed were processing facilities. *Id.*

[¶ 36] With the Wyoming Supreme Court's affirmance of *Williams* in mind, we examine Chesapeake's evidence and arguments that the seven field stations were "processing

[8] This entailed passing a cylindrical object, or "pig," down the pipeline to flush water, waste, and other materials into a receptacle for disposal. *Williams*, at ¶ 65, * 14.

facilities" as used in the valuation statute. Mr. Armstrong relied heavily on the definition of "processing," arguing that the stations were initial "processing facilities" because they included very large equipment that removed heavy hydrocarbons and enhanced the marketability of the gas stream. *Supra* ¶¶ 14-17; *see* Wyo. Stat. Ann. § 39-14-201(a)(xviii) (2021), *supra* ¶ 30.

[¶ 37] We find that, indeed, the separators at both the well pads and in the downstream field stations caused heavier components of the gas stream to fall out of the gas, including oils, water, and other materials entrained within those liquids. *Supra* ¶¶ 8-12. Yet, Chesapeake's focus on the enormity of equipment does not signify that those facilities were "processing facilities," as opposed to large field gathering equipment that performed a production function. And, when asked why he considered the equipment to be so large and substantial, he offered no basis of comparison or technical explanation, just his subjective observation. (Tr. at 105-09).

[¶ 38] While we note that processing and production facilities may be very large and substantial, those characteristics occur for different reasons, including the degree of complexity, the accumulation of different equipment, or the type or volumes of gas involved. This is especially true for facilities that handle sour gas, requiring redundant environmental protection and emergency response systems. *See e.g., In re Appeal of ExxonMobil*, 2008 WL 1692796, Doc. Nos. 2006-69, 2006-116, ¶¶ 17-62, 81-89, ** 6-14, 17-18 (Wyo. State Bd. of Equalization, April 3, 2008), *rev'd, Exxon Mobil Corp.*, 2009 WY 139, 219 P.3d 128 (Wyo. 2009) (Hill, J., dissenting) (Because the LaBarge gas reservoir was uniquely toxic and produced at exceptionally high volumes, the Black Canyon dehydrator was likewise uniquely large, complex, and necessarily located many miles from the downstream processing facility so that the gas could be more safely transported to the Shute Creek Processing facility.). Without further explanation of why the equipment's size mattered from a technical "processing" standpoint, we give little weight to Chesapeake's evidence of the equipment's relative size.

[¶ 39] From a more technical perspective in support of Chesapeake's position, Mr. Armstrong repeatedly cited the separation of significant heavy hydrocarbons from the gas. *Supra* ¶¶ 10-12, 14-15. Here again, without more, this is of little significance. Separators, by design and according to statutory definition, separate gas from liquids. *Supra* ¶ 8, fn. 4. The legislature expressly recognized that separation may occur in the field during production, or within processing facilities along with other less common processes, such as cryogenics. *Supra* ¶ 30. Mr. Armstrong's explanation leaves unanswered the critical question: why the seven field stations upstream of the two processing facilities were "initial processing," rather than gathering? "Gathering" is the "transportation of crude oil, lease condensate or natural gas from multipole wells by separate and individual pipelines to a

central point of accumulation, dehydration, compression, separation, heating and treating or storage." Wyo. Stat. Ann. § 39-14-201(a)(ix) (2021). Were we to agree with Chesapeake's argument on this reasoning alone, we could find that the separators at the well pads performed processing as well. Yet, Chesapeake does not press that claim. (Tr. at 92-93).

[¶ 40] Another factor Mr. Armstrong offered in support of Chesapeake's position, the seven field stations prevented the two downstream facilities from becoming overwhelmed as Chesapeake increased gas production volumes sent to the NGL Extraction Plants. *Supra* ¶ 16. Mr. Armstrong did not support this contention with engineering expertise or verifiable production estimates. *Id.* Yet, the Department did not contest or otherwise respond to this point, possibly because it found such to be irrelevant. It may be that many production functions must be well performed for downstream processing facilities to operate efficiently. That a field station might benefit the operation of downstream equipment, or prevent the bogging down of downstream processing facilities, is a heretofore untested reason for finding that separators and related equipment are "processing facilities" within the meaning of Wyoming's natural gas valuation statutes.

[¶ 41] Chesapeake offered yet an additional factor in support of its position that the seven field stations were "initial" processing facilities upstream of the two NGL Extraction Plants. It asserted that "horizontally" drilled wells first became prevalent in the area during the audit period and necessitated the installation of initial processing facilities in the field. (Chesapeake Br., 11-12). Chesapeake more particularly argues that "[t]his rich, wet gas production from horizontal wells in this area differs from gas produced from conventional wells and requires a different processing facility to handle the gas." *Id.* It continues, "the wet gas is produced in significantly higher initial volumes, at greater pressure, and at higher temperatures." *Id.* Unfortunately, Chesapeake offered no technical evidence explaining why horizontal drilling, or the nature of the gas production in particular, should influence the analysis of whether separators, compressors, and dehydrators in the field perform processing.

[¶ 42] Regardless, this argument finds little traction in light of the *Williams* decision, wherein Williams argued that the Department should have valued CBM under different statutory guidance because CBM gas was so different than conventional gas. The Wyoming Supreme Court rejected that argument, confirming the Board's understanding of "processing facility" in light of the legislature's 1990 understanding of processing facilities. *Id.* at ¶ 23. It remains true today that all natural gas production, regardless of chemical make-up, extraction method, or circumstances under which the gas is produced, is valued under the same statute, Wyoming Statutes section 39-14-203(b) (2021). *See e.g. Solvay Chem., Inc. v. Wyo. Dep't of Revenue*, 2022 WY 122, 517 P.3d 1123 (Wyo. 2022)

(Trona mining company's capture and use of escaping "waste gas" was taxable production of natural gas.). Moreover, the conventional gas production paradigm governs, so variations in how natural gas is produced, gathered, treated, handled, or processed must be made to fit within the conventional gas production framework for valuation purposes.

[¶ 43] The reason for this is plain: the legislature has not addressed the point of valuation definitional omissions since the often-cited *Williams* rulings issued in 2005 and 2008. "We have adhered to the principle that administrative interpretations are entitled to deference particularly when, following those interpretations, the legislature has failed to make changes in the statute." *State Bd. of Equalization v. Tenneco Oil Co.*, 694 P.2d 97, 99 (Wyo. 1985). Until the legislature acts, the *Williams* and *ExxonMobil* analyses are the litmus test for what constitutes field production activities versus a "processing facility" within the meaning of Wyoming's natural gas taxation statutes.

[¶ 44] Answering Chesapeake claims, the Department correctly observed that the seven field facilities were typical of compressor stations throughout Wyoming, which the Department has not classified as processing facilities. *Supra* ¶¶ 18-19. The Department accurately contrasts compressor stations with the forty or so recognized processing facilities in the state, including the two "NGL Extraction Plants" that both parties agreed were and are processing facilities. *Supra* ¶¶ 20-22. We again observe that processing facilities, as in 1990 when the statutes were first enacted, are more complex than compression stations and often perform various involved processes set forth in the definition of "processing," even when they are relatively simple. *Supra* ¶ 35; *see* Wyo. Stat. Ann. § 93-14-201(a)(xviii) (2021), *supra* ¶ 30.

[¶ 45] Chesapeake did not overcome the presumption that the Department correctly established the point of valuation for Chesapeake's natural gas production for all years at issue. Chesapeake's evidence, even if the benefit of every doubt is conceded, does not explain how the compressor stations perform anything other than gathering, separating, dehydration, and compression in the field, upstream of bona fide processing facilities.

[¶ 46] Chesapeake's suggestion that the seven field compression stations are "initial processing" facilities that enabled downstream processing facilities to fully operate is unconvincing for several reasons. First, Chesapeake offered no technical evidence in support of this contention, relying entirely upon Mr. Armstrong's generalized understanding. *Supra* ¶¶ 14-17, 40-41. Second, even if true, the Board is unclear how field compression stations become processing facilities under these circumstances. The field stations still do not resemble the traditional "processing facilities" from the legislature's understanding in 1990, as this Board and the Wyoming Supreme Court discussed in *In re Williams* and the Wyoming Supreme Court's decision affirming that Board ruling. *Supra*

¶¶ 32-35. The Department correctly placed the point of valuation for Chesapeake's gas production at the initial dehydrator's outlet, in the field, per Wyoming statute. *Supra* ¶ 17.

[¶ 47] The Department's point of valuation analysis applied to Chesapeake's oil and liquids separated from its gas at the well pad and in the field stations is also correct. *Supra* ¶ 17. The Department strictly applied the statutory point of valuation language such that wherever oil was first stored, the point of valuation for that particular stored oil was the "outlet of the initial storage facility[.]" *Supra* ¶ 29. Chesapeake responds that, "statutorily there can be only one point of valuation for oil – the storage facility near the wellhead." (Chesapeake's Br., 24). It argues that the Department's interpretation "has no basis in the governing statute." *Id.*

[¶ 48] In fact, the statute does not offer direction sufficient to conclude that either interpretation is absolutely correct or incorrect. So, we begin with Wyoming's valuation authority, the Department, and determine whether its historic interpretation conflicts with the operative statute. The Department has chosen to value oil production applying what it calls a "molecule" approach, such that the point of valuation depends on the circumstances and activities specific to each molecule of oil. *Supra* ¶ 17. As the Department's point of valuation analysis for oil is not erroneous on its face and does not conflict with statutes or regulations, it again is entitled to deference. Even were this not so, we struggle with the notion that the point of value for all Chesapeake oil is at the well pad storage tank for oil that is not stored in those tanks. The Department's interpretation more logically aligns with the statute, while Chesapeake's interpretation requires an assumption that all oil must be valued at the first storage tank. Again, Chesapeake did not carry its initial or ultimate burdens of proof with respect to the Department's valuation of oil and liquids separated from its gas. *Supra* ¶ 25.

CONCLUSION

[¶ 49] Chesapeake incorrectly designated the seven compression stations as processing facilities within the definition of "processing," in Wyoming Statutes section 39-14-201(a)(xviii) (2021). The equipment in question performed field production, not processing. Therefore, the Department correctly revalued Chesapeake's production of gas, locating the point of valuation at the outlet of the initial dehydrators, rather than at the custody transfer meters. Likewise, the Department correctly located the point of valuation for oil production at the outlet of each storage facility where separated heavy hydrocarbons were separated and first stored.

ORDER

[¶ 50] **IT IS, THEREFORE, ORDERED** that the Department of Revenue's audit assessments of Chesapeake's 2010-12 and 2014-2016 oil and gas production are **Affirmed**;

[¶ 51] **IT IS FURTHER ORDERED** that the assessments are remanded to the Department of Revenue to make, if they deem necessary, any adjustments per the parties' mutual request during the contested case hearing in this matter.

[¶ 52] **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 22nd day of November 2022.

STATE BOARD OF EQUALIZATION

E. Jayne Mockler, Chairman

Martin L. Hardsocg, Vice-Chairman

David L. Delicath, Board Member

ATTEST:

E. Jayne Mockler, Chairman

CERTIFICATE OF SERVICE

I hereby certify that on the 22nd day of November 2022, 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:

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