

BEFORE THE STATE BOARD OF EQUALIZATION
FOR THE STATE OF WYOMING

IN THE MATTER OF THE APPEAL OF)
JONAH ENERGY LLC) Docket No. **2020-36**
FROM DECISIONS BY THE DEPARTMENT)
OF REVENUE (Severance Tax Prod. 2014-16))

IN THE MATTER OF THE APPEAL OF)
JONAH ENERGY LLC) Docket No. **2020-43**
FROM DECISIONS BY THE DEPARTMENT)
OF REVENUE (Severance Tax Prod. 2014-16))

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

APPEARANCES

Randall B. Reed, Long Reimer Winegar, LLP, and Judy Matlock, Davis Graham & Stubbs, LLP appeared on behalf of Taxpayer, Jonah Energy LLC.

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

DIGEST

[¶ 1] Jonah appeals from two Wyoming Department of Revenue final determinations. The appeals arise from an audit of Jonah's 2014 through 2016 production and sales of oil and gas from its fields in Sublette County. Jonah appealed after the Department rejected Jonah's attempt to deduct a Shortfall Capacity Deficiency Fee from its taxable value as a transportation expense under the netback method. Jonah has abandoned that claim in favor of a new theory that the Shortfall Capacity Deficiency Fee is actually a *component of* (rather than a *deduction from*) the sales price under the netback method. Finding that the fee is not a component of the sales price, we will affirm the Department's decision.

[¶ 2] At the start of the hearing, the Department asked us to remand so that it can correct some minor "calculation errors" and remove 30 days of interest. (Hr'g Tr. 20). Jonah did not oppose the request, and we will grant it.

ISSUES

[¶ 3] Jonah identified five issues before the hearing:

1. The proper deduction for federal royalties paid by Jonah;
2. The proper deduction for gathering fees and electricity costs;
3. The calculation of gain or loss on the gathering system;
4. The assessment of additional interest; and
5. The deductibility of transportation and processing (i.e. fractionation) expenses for reserved capacity on the transportation pipeline and processing at the fractionation plant.

(Pet'r's Confidential Post-Hr'g Opening Br. 7). The parties resolved all of those issues, except the deductibility of transportation and processing expenses, before the hearing. *Id.* At the hearing, and in its post-hearing briefs, Jonah added a new claim and it focused exclusively on that new claim at the hearing and in its post-hearing submissions:

The Shortfall Capacity Deficiency Fee Payment is part of the purchase price under the NGL (Natural Gas Liquids) Agreement.

(Pet'r's Confidential Post-Hr'g Opening Br. 13). We accept Jonah's declaration that, "[t]he sole issue in this appeal is the sales price under the statutory netback method." (*Id.* at 8). We conclude, therefrom, that the "deductibility of transportation and processing expenses" is no longer at issue, and we will not address it.

[¶ 4] The Department presented this statement of the issues:

- a. Is the Department's audit-based assessment correct, proper, and in accordance with law?
- b. Does the NGL Purchase Agreement between Jonah Energy, LLC (Jonah) and Enterprise Products Operating, LLC (Enterprise) encompass a deductible transportation expense for a contractual deficiency fee if Jonah fails to deliver a minimum volume to Enterprise?

(Dep't Issue of Fact and Law and Ex. Index, 1).

JURISDICTION

[¶ 5] The State Board shall "review final decisions of the department [of revenue] upon application of any interested person adversely affected." Wyo. Stat. Ann. § 39-11-102.1(c) (2021). An aggrieved taxpayer may file an appeal with this Board within 30 days after the

Department's final decision. Rules, Wyo. State Bd. of Equalization, ch. 2, § 5(e) (2021). The Department issued its final decisions on August 27, 2020 and October 20, 2020. (Ex. 501, 502). Jonah filed its appeals on September 16, 2020 and November 18, 2020, so both appeals are timely and we have jurisdiction.

FINDINGS OF FACT

[¶ 6] Jonah operates multiple natural gas wells in Sublette County. The gas from wells that were producing before June 1, 2012 is classified as “Base Production,” while the gas from wells that began producing thereafter is “New Production.” (Ex. 508 at DOR 163). This case is about New Production.

[¶ 7] Jonah and Enterprise Products Operating LLC (Enterprise) signed an “NGL Purchase Agreement” providing that Jonah would sell and deliver its New Production to Enterprise. (Ex. 508 at DOR 166). The New Production is first transported to the Pioneer Gas Processing Plant, where it is separated into natural gas liquids (NGL's or “Raw Make”) and residue gas. (Hr'g Tr. 34, 42). The point of sale for the Raw Make is “the upstream side of the flange connection” between the Pioneer Plant and the Mid-America Pipeline (MAPL) – in other words, right outside the Pioneer Gas Processing Plant. (Ex. 508 at DOR 159, 164). The Raw Make (having become the property of Enterprise) is then transported on MAPL to Enterprise's facility in Mont Belvieu, Texas for fractionation into commercial products such as ethane and propane. (Hr'g Tr. 34-35). Enterprise (*not* Jonah) contracts with MAPL to transport the Raw Make to Texas. (Ex. 508 at DOR 206-27).

[¶ 8] The Purchase Agreement obligates Enterprise to buy a Committed Volume of Raw Make from Jonah. (Ex. 508 at DOR 167). That Committed Volume consists of two components: a “Primary Capacity” of 16,000 barrels per day; and a “Secondary Capacity” of 4,000 barrels per day. (*Id.* at DOR 170). The Purchase Agreement specifies that: 1) Base Production will be allocated to Primary Capacity; 2) available New Production will be allocated to Primary Capacity, and 3) if additional New Production is available, it will be allocated to Secondary Capacity. (*Id.* at DOR 169). In other words, the Base Production is all allocated to Primary Capacity. New Production will also be allocated to Primary Capacity until the full 16,000 barrels are received. Any New Production beyond the 16,000 barrels for Primary Capacity, up to 4,000 barrels, will then be allocated to Secondary Capacity.

[¶ 9] During the relevant 2014-2016 period, Jonah valued its production for tax purposes using the Netback method, as allowed by statute. (Hr'g Tr. 242). Under that method, “[t]he 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). Sales price “means the transaction price determined in

connection with a bona fide arm’s length sale.” Wyo. Stat. Ann. § 39-14-201(a)(i) (2015). Neither party disputes that the Purchase Agreement is a bona fide, arm’s length sale, and we find that the “sales price,” as that term is defined in statute, is the Monthly Component Purchase Price, defined in the Purchase Agreement as the Index Price minus the Transportation Fee and the Fractionation Fee. (Ex. 508 at DOR 177). The Index Price is the weighted sum of the prices for the individual components into which the Raw Make is fractionated in Texas. (Ex. 508 at DOR 177).

[¶ 10] The Purchase Agreement prescribes this formula for the Transportation Fee:

- A. **Transportation Fee.** The “**Transportation Fee**” for each Gallon of New Production delivered by Jonah Energy and accepted by Enterprise at the Raw Make Delivery Point shall be equal to the amount identified in the table below (rounded to the nearest one hundredth of a cent) for the applicable Month:

Capacity	Transportation Fee	Transportation Shortfall Fee
Primary Capacity and Excess Volume	a. \$0.1292 per Gallon; and b. The above fee shall escalate pursuant to Paragraph B below.	None
Secondary Capacity	The then current Volume Fee provided for in the MAPL TSA for a Mont Belvieu destination. On the date that is 10 Years after July 1, 2014, the Secondary Capacity Transportation Fees shall be reduced to the Primary Capacity Transportation Fees with no Shortfall Volume Fee provided for in the MAPL TSA for a Mont Belvieu destination.	The then current Shortfall Volume Fee provided for in the MAPL TSA for a Mont Belvieu destination.

(Ex. 508, at DOR 178).

[¶ 11] The Purchase Agreement prescribes this formula for the Fractionation Fee:

The “**Fractionation Fee**” for each Gallon of New Production delivered by Jonah Energy and accepted by Enterprise at the Raw Make Delivery Point shall be determined each Month pursuant to the following formula (rounded to the nearest one hundredth of a cent):

$$\text{\$0.0080 / Gallon} \times (\text{Fuel Index} / \text{\$3.50}) + \text{Fixed Fee}$$

WHERE FOR PURPOSES OF THIS SECTION:

“**Fuel Index**” shall equal the Monthly price of natural gas for the applicable Month in dollars per million BTU’s as reported in the first (1st) issue each Month of Inside F.E.R.C.’s Gas Market Report, Market Center Spot Gas Prices, East Texas-Houston Ship Channel Index, plus \$0.10 per million BTU’s. The Fuel Index shall never be less than \$3.50.

“**Fixed Fee**” shall be equal to the amount identified in the table below during the applicable Year:

Capacity	Fixed Fee
Primary Capacity And Excess Volume	The greater of: (a) \$0.0510 per Gallon; or (b) An amount determined under the following formula: Fixed Fee * MTU
Secondary Capacity	The greater of: (a) \$0.0565 per Gallon; or (b) An amount determined under the following formula: Fixed Fee * MTU

(Ex. 508, at DOR 179).

[¶12] Later in the Purchase Agreement, a section titled “Shortfalls and Deficiency Payments” provides that:

B. Secondary Capacity Shortfalls.

i. In any Month from the Month commencing as of the Effective Date until the Month ending July 1, 2024, if the total volume of New Production delivered or caused to be delivered by Jonah Energy and accepted by Enterprise at the Raw Make Delivery Point under Secondary Capacity is less than the then current Secondary Capacity for such Month, Enterprise will calculate the shortfall volume pursuant to the following formula (the “**Secondary Capacity Shortfall Volume**”):

$$\text{Shortfall Volume} = \text{MBV} - (\text{AV} = \text{AEV})$$

WHERE, FOR PURPOSES OF THIS SECTION:

“MBV” means the then current Secondary Capacity for the applicable Month;

“AV” means the aggregate volume of New Production actually delivered or caused to be delivered by Jonah Energy and accepted by Enterprise pursuant to this Agreement under the Secondary Capacity during the applicable Month; and

“AEV” means the aggregate volume of New Production satisfying the requirements in Section 7.1 that is nominated and physically capable of being delivered as Secondary Capacity but is unable to deliver at the Raw Make Delivery Point in the applicable Month due to an Allocation Event (the “**Shortfall Capacity Allocation Event Volume**”).

ii. Deficiency Fee Payment.

a. For each Month in which the Secondary Capacity Shortfall Volume is a positive number, Enterprise will invoice Jonah Energy and Jonah Energy will pay Enterprise an amount (the “**Shortfall Capacity Deficiency Fee Payment**”) equal to the product obtained by multiplying (i) the sum of (a) the then in effect Fixed Fee portion of the Fractionation Fee associated with Secondary Capacity plus (b) the then in effect Transportation Shortfall Fee associated with Secondary Capacity by (ii) the Secondary Capacity Shortfall Volume.

(Ex. 508, at DOR 180) (Bold in original). The Shortfall Capacity Deficiency Fee (SCDF) is at the heart of this appeal. Jonah says it’s a fee for ensuring capacity on the pipeline, and therefore is an element of the sales price. The Department says it’s a penalty for failing to deliver the agreed-upon amount of production and, therefore, is not a component of the sales price and does not play a role in the netback valuation method.

CONCLUSIONS OF LAW

A. State Board’s review function, burdens of proof, and applicable law

[¶ 13] This Board shall “review final decisions of the department upon the application of any person adversely affected[.]” Wyo. Stat. Ann. § 39-11-102.1(c) (2021). At the request of an adversely affected party, we “[d]ecide 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 instruction prescribed by the department.” Wyo. Stat. Ann. § 39-11-102.1(c)(iv) (2019). We review the parties’ statutory interpretations de novo. *Town of Pine Bluffs v. Eisele*, 2017 WY 117, ¶ 9, 403 P.3d 126, 128 (Wyo. 2017) (*quoting Bates v. Chicago Lumber Co. of Omaha*, 2016 WY 58, ¶ 27, 375 P.3d 732, 739 (Wyo. 2016)).

[¶ 14] We have described the Petitioner’s burden in this way:

Except as specifically provided by law or in this section, the Petitioner shall have the burden of going forward¹ 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).

[¶ 15] There are no material issues of fact in this case: it’s all about interpreting statutes, rules, and contracts. Therefore, our standard of review is de novo. *Town of Pine Bluffs v. Eisele*, 2017 WY 117, ¶ 9, 403 P.3d 126, 1128 (Wyo. 2017) (*quoting Bates v. Chicago Lumber Co. of Omaha*, 2016 WY 58, ¶ 27, 375 P.3d 732, 739 (Wyo. 2016)). We also apply de novo review to the Department’s findings of ultimate fact:

When an agency’s determinations contain elements of law and fact, we do not treat them with the deference we reserve for findings of basic fact. When reviewing an “ultimate fact,” we separate the factual and legal aspects of the finding to determine whether the correct rule of law has been properly applied to the facts. We do not defer to the agency’s ultimate factual finding if there is an error in either stating or applying the law.

Britt v. Fremont Cty. Assessor, 2006 WY 10, ¶ 17, 126 P.3d 117, 122-23 Wyo. (2006) (*quoting Basin Elec. Power Coop., Inc*, 970 P.2d at 850-51).

B. Is the Shortfall Capacity Deficiency Fee a component of the sales price?

[¶ 16] In its sole remaining issue, Jonah contends that the SCDF is a component of the sales price, from which the fair market value is calculated using the Netback Method. As stated above, the sales price is the Index Price minus the Transportation Fee and the Fractionation Fee. (*Supra* ¶ 9; Ex. 508, at DOR 177). All three of those terms are defined

¹ The burden of going forward, also called the burden of production, is “[a] party’s duty to introduce enough evidence on an issue to have the issue decided by the fact-finder, rather than decided against the party in a peremptory ruling such as a summary judgment or a directed verdict.” *Burden of Production*, *Black’s Law Dictionary*, 236 (10th ed. 2014).

in the Purchase Agreement, and none of those definitions include the SCDF. (*Supra* ¶¶ 9-12). But, says Jonah, the SCDF is a fee for ensuring capacity on the pipeline. (Pet'r's Confidential Post-Hr'g Opening Br. 22). For support, Jonah looks to one of this Board's decisions, a federal circuit court decision, testimony from the hearing, and the Purchase Agreement. We will examine each, in turn.

[¶ 17] Jonah directs us to our decision in *In re WPX Energy, Inc.*, 2017 WL 6276019, *2, Docket No. 2016-31 (Wyo. State Bd. of Equalization, Dec. 1, 2017). (Pet'r's Confidential Post-Hr'g Opening Br. 31). That case featured a transportation services agreement in which a producer (WPX, acting through an affiliate) contracted for and paid a reservation fee or demand charge² to reserve pipeline capacity. WPX didn't use all of the capacity it reserved, and the Department rejected WPS's attempt to deduct the entire reservation fee as a transportation expense. We determined that the entire reservation fee was a deductible transportation expense under the netback method.

[¶ 18] Because Jonah has abandoned its theory that the SCDF is a deductible transportation expense under the netback method, we don't see how *WPX Energy* has any bearing on this appeal. Jonah has agreed that the point of sale occurs before the Raw Make enters the pipeline that takes it to Texas, so the SCDF can't be a cost of transporting the Raw Make to the point of sale. (Pet'r's Confidential Post-Hr'g Opening Br. 7-8).

[¶ 19] Jonah also seeks support from *Indep. Petroleum Ass'n of Am. v. DeWitt*, 279 F.3d 1036 (D.C. Cir. 2002). (Pet'r's Confidential Post-Hr'g Opening Br. 31-32). The *IPAA* court determined that the Department of the Interior's refusal to allow deductions for unused demand charges was arbitrary and capricious. *Id.* at 1042-43. We first note that a federal court's decision interpreting a federal rule is not binding on this Board as we apply Wyoming statutes and rules. Furthermore, *IPAA*, at best, supports Jonah's abandoned claim that the SCDF is a deductible transportation expense. It has nothing to teach us about whether the SCDF is a component of the sales price in this appeal.

[¶ 20] Christopher J. Barr, an attorney with considerable experience in oil and gas law, testified on behalf of Jonah. (Hr'g Tr. 127-235). Jonah cites Mr. Barr's testimony for the proposition that the SCDF is a fee. (Pet'r's Confidential Post-Hr'g Opening Br. 32-33). Mr. Barr testified that he believed the SCDF is a "fee for transportation," not a penalty. (Hr'g Tr. 179-80). We disagree with Mr. Barr: the plain language of the Purchase Agreement shows that the SCDF is neither a deductible transportation fee nor a component of the sales price.

[¶ 21] The Purchase Agreement provides that:

² As one of Jonah's witnesses testified, the terms "reservation fee" and "demand charge" are interchangeable. (Hr'g Tr. 139).

For each Month in which the Secondary Capacity Shortfall Volume is a positive number, Enterprise will invoice Jonah Energy and Jonah Energy will pay Enterprise an amount (the “**Shortfall Capacity Deficiency Fee Payment**”) equal to the product obtained by multiplying (i) the sum of (a) the then in effect Fixed Fee portion of the Fractionation Fee associated with Secondary Capacity plus (b) the then in effect Transportation Shortfall Fee associated with Secondary Capacity by (ii) the Secondary Capacity Shortfall Volume.

(*Supra* ¶ 12). Thus, the SCDF is not invoiced and paid every month, but only for months “in which the Secondary Capacity Shortfall Volume is a positive number.” In fact, the Secondary Capacity Shortfall Volume (SCSV) is calculated only for months in which “the total volume of New Production delivered or caused to be delivered by Jonah Energy and accepted by Enterprise at the Raw Make Delivery Point under Secondary Capacity is less than the then current Secondary Capacity for such Month[.]” *Id.* In other words, the SCSV is not even calculated unless Jonah delivers less than the Secondary Capacity.

[¶ 22] Had the parties to the Purchase Agreement intended for the SCDF to operate as a component of, or an adjustment to, the sales price, they presumably would have said so in an obvious manner. For example, they could have made it part of the Monthly Component Purchase Price equation in Article 4.1. They didn’t.

[¶ 23] Further, the Purchase Agreement provides that Enterprise will invoice Jonah for the SCDF, and Jonah will pay Enterprise. We believe the separate invoice and payment further distance the SCDF from the sales price. Again, had Jonah and Enterprise intended the SCDF to be a component of the Monthly Component Purchase Price, they could have included it in the formula for computing that price in the Purchase Agreement.

DECISION

[¶ 24] The SCDF doesn’t change the sales price that Enterprise pays Jonah for Raw Make, so it isn’t a component to be considered in determining the fair market value of Jonah’s production under the Netback Method. Rather, it’s a separate fee that Enterprise charges Jonah.

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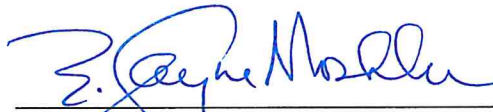
ORDER

[¶ 25] The Wyoming Department of Revenue’s decision is **affirmed**. We, nonetheless, remand to the Department, as requested, so it can correct some minor “calculation errors” and remove 30 days of interest.

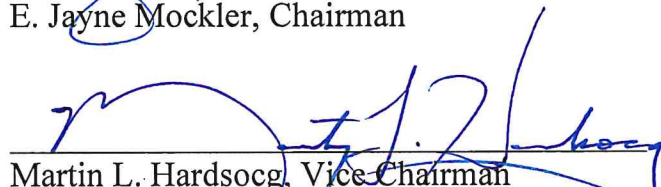
[¶ 26] Pursuant to Wyoming Statutes section 16-3-114 (2021) and Rule 12, Wyoming Rules of Appellate Procedure, any person aggrieved or adversely affected in fact by this decision may seek judicial review in the appropriate district court by filing a petition for review within 30 days after the date of this decision

DATED this 14 day of September 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 14 day of September 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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