

BEFORE THE STATE BOARD OF EQUALIZATION
FOR THE STATE OF WYOMING

IN THE MATTER OF THE APPEAL OF)
AMOCO PRODUCTION COMPANY)
FROM AN AUDIT ASSESSMENT) Docket No. **2000-69**
DECISION OF THE DEPARTMENT OF)
REVENUE (WHITNEY CANYON,)
PRODUCTION YEARS 1993-1995))

FINDINGS OF FACT
CONCLUSIONS OF LAW
DECISION AND ORDER

APPEARANCES

Appearances

Jesse R. Adams, III, Nicole Crighton and John L. Bordes, Jr. of Oreck, Bradley, Crighton, Adams, & Chase for Amoco Production Company
Petitioner (Amoco)

Michael Dinnerstein, Senior Assistant Attorney General, Wyoming Attorney General's Office for the Department of Revenue
Respondent (Department)

DIGEST

This appeal arises from the decision of the Department assessing Amoco for underpayment of severance taxes and increasing the gross product valuation for Amoco's 1993 through 1995 gas production processed through the Whitney Canyon Gas Processing Plant in Uinta County, Wyoming. The assessment was based on an audit of that production by the Wyoming Department of Audit (Audit). Pursuant to notice duly given to all parties in interest, this matter was heard by the Wyoming State Board of Equalization (Board), Edmund J. Schmidt, Chairman, Roberta A. Coates, Vice-Chairman and Sylvia Lee Hackl, Board Member, with Gayle R. Stewart, the Board's Hearing Officer, presiding, beginning on October 29, 2001, in Hearing Room 1699, Herschler Building, 122 West 25th Street, Cheyenne, Wyoming. On January 7, 2002, the parties

filed their written proposed findings of fact and conclusions of law with the Board. Pursuant to the Board's grant of Amoco's Motion to File Supplemental Brief, the parties filed supplemental briefs on April 8, 2002, addressing the effect, if any, of [Powder River Coal Co. v. State Board of Equalization, 2002 WY 5, 38 P.3d 423 \(Wyo. 2002\)](#) on this matter.

**ALL STATUTORY CITATIONS USED IN THIS DECISION AND ORDER
REFERENCE TITLE 39, PRIOR TO RECODIFICATION, WHICH WAS
EFFECTIVE MARCH 6, 1998.**

JURISDICTION

Upon application of any person adversely affected, the Board is mandated to review final decisions of the Department concerning state-assessed property and hold hearings after due notice pursuant to the Wyoming Administrative Procedure Act and prescribed rules and regulations. For state-assessed properties, pursuant to [Wyoming Statute § 39-2-201\(d\)\(i\)](#), the “person assessed” may file objections with the Board within 30 days of the postmark of the Department decision. *Rules, Chapter 2 § 5(a), Wyoming State Board of Equalization*. Petitioner timely filed its appeal.

DISCUSSION

In this case we are asked to revisit several of the issues addressed in *In the Matter of the Appeal of Amoco Production Co.*, Docket No. 96-216 (Sept. 24, 2001). Amoco reported the values for its 1993 through 1995 gas production from the Whitney Canyon Field processed through the Whitney Canyon Gas Processing Plant (Plant) located in Uinta County, Wyoming, using the proportionate profits method. [Wyo. Stat. § 39-2-208\(d\)\(iv\)](#). On September 23, 1998, the Department of Audit (Audit) engaged an audit of Amoco's gas production processed through the Plant for production years 1993 through 1995. Based on Audit's findings, the Department issued a final issue letter to Amoco on February 1, 2000, assessing Amoco for underpayment of severance taxes and increasing its gross product valuation in Uinta County. The increased values were the result of adding marketing fees (margins) to Amoco's gross revenue, changing the point of valuation, and denying the use of seven expense sub-accounts as direct costs of processing in calculating the direct cost ratio of the proportionate profits valuation method.

*2 Amoco filed its Notice of Appeal with the Board on February 25, 2000. On appeal Amoco contends:

1. Marketing fees, or margins, should be removed from the Department's assessment calculations;
2. The Department's point of valuation is inconsistent with the relevant statutes and regulations;
3. The Department erred in disallowing five of the sub-accounts as direct costs of processing in the proportionate profits formula; and
4. The expenses associated with the sulfur haul road and load out facility should be included in the denominator in calculating the direct cost ratio of the proportionate profits formula or, in the alternative, the expenses should be deducted from the sulfur sales revenue in determining the sulfur's fair cash market value.

Prior to the hearing, the parties agreed there was no evidence that would require the inclusion of margins to reflect fair market value in the particular circumstances of the audit at issue in this particular appeal [**Joint Stipulation of Fact, ¶ 9**], leaving as issues the point of valuation, sub-account treatment, and sulfur haul road and load out facility expenses.

The Department argues it properly determined the point of valuation. The Department further argues the disallowed sub-account expenses either were not related to processing as claimed by Amoco or were not typical of what Amoco booked to the account. The Department contends the expenses of the sulfur haul road and load out facility are deductible only from revenue realized by the sale of sulfur and only up to the actual amount of revenue realized from the sale of sulfur.

The Board finds the Department's disallowance of the gas gathering expenses as cost of processing in calculating the direct cost ratio, and disallowance of the use of the expenses in sub-accounts 9272-11 (automobile expenses), 9272-34 (personnel transfers) and 9635-71 (payroll taxes and employee plan expenses) in calculating the direct cost ratio was correct.

The Board finds the Department's disallowance of the use of the expenses in sub-account 9272-29 (radio communication expenses) in calculating the direct cost ratio was erroneous.

With respect to sub-account 9272-80 (other expenses), the Board finds the Department correctly disallowed the use of the typical recurring expenses reported in account 9272-80 in calculating the direct cost ratio. However, the Department incorrectly disallowed the use of the turnaround expenses incurred by Amoco in 1993 and 1995 in calculating the direct cost ratio.

Finally, the Board finds the Department's treatment of the expenses related to the sulfur haul road and the sulfur load out facility was incorrect. Amoco should be allowed to deduct costs associated with the sulfur haul road and load out facility from the sales revenues received for the sulfur as part of the transportation expense.

FINDINGS OF FACT

1. For 1993 through 1995 Amoco was a producer of gas from the Whitney Canyon Field. **[Trans. Vol. III, p. 429.]**
2. Amoco was also the majority interest owner in the Whitney Canyon Gas Processing Plant and the operator of the Plant. **[Trans. Vol. III, p. 427; Amoco Exhibit 123.]**
3. In 1993 through 1995 Amoco produced gas from approximately 22 wells in the Whitney Canyon Field. **[Trans. Vol. III, p. 428; Trans. Vol. IV, p. 736; Board Exhibit No. 1; Department Exhibit 519.]** The gas contained a high concentration of hydrogen sulfide, H₂S, which was removed from the gas stream at the Plant so the gas stream was marketable. **[Trans. Vol. III, pp. 429-430, 448.]**
4. At the wellhead there were a choke or control valve, a heater, a meter, a corrosion inhibitor and valving allowing for testing of the gas stream at the wellhead. **[Trans. Vol. III, p. 436.]**
5. The testing of the gas stream at the wellhead was done on a regular basis so that the processed products, sulfur, natural gas liquids, condensate and gas, could be allocated back to each well. **[Trans. Vol. III, pp. 436-437.]**
6. The control valve served both production and sulfur processing functions. **[Trans. Vol. III, pp. 441-443.]**
7. The gas from each well was transported by a gathering system consisting of flow lines from each well site to one of two trunk lines, one 9 miles long, the other 2 miles long, which then connected to the inlet compressor. **[Trans. Vol. III, pp. 428-429; Board Exhibit No. 1; Department Exhibit 519.]**
8. From the inlet compressor the gas was transported approximately 1000 feet up a hill to the Plant where it was processed. **[Trans. Vol. III, pp. 434, 437; Board Exhibit No. 1.]**
9. At the Plant, the gas passed through a “sweetening system” where H₂S and CO₂ were removed from the gas stream. **[Trans. Vol. III, p. 448.]** The H₂S was then processed in

the sulfur recovery unit where it was converted first into sulfur dioxide and then into elemental sulfur. [Trans. Vol. III, pp. 449-451.]

10. The residue gas, condensate, and natural gas liquids were sold by Amoco at the tailgate of the Plant. [Trans. Vol. III, p.434; Board Exhibit No. 1.]

11. The sulfur was placed in a ten-day storage tank and then transported by specialized trucks 30 miles down a specially constructed roadway to a sulfur load-out facility where it was loaded on rail cars for transportation to market. [Trans. Vol. III, pp. 431-433; Board Exhibit No. 1.]

12. Processing of the sulfur ended when it was placed in the ten-day storage tank. [Trans. Vol. IV, p. 766; Amoco Exhibit 122, p. 804.]

13. The Sulfur Sales Agreement between Amoco and Amoco Oil Company provided that the parties may, by mutual agreement, specify either the tailgate of the Plant or the sulfur load out as the point of sale for the sulfur. [Amoco Exhibit 122, p. 804.]

14. For production years 1993 through 1995, Amoco reported the taxable value of its natural gas production from the Whitney Canyon Field processed through the Plant in Uinta County, Wyoming, using the proportionate profits method.

15. The proportionate profits method is one of the valuation methods allowed by statute where the production is not sold at or prior to the point of valuation. [Wyo. Stat. § 39-2-208\(d\)](#).

16. Using the proportionate profits method, taxable value is calculated, as follows:

TAXABLE VALUE=Total Sales Revenue-(exempt and nonexempt royalties and production taxes) X Direct Cost Ratio + nonexempt royalties and production taxes.

The Direct Cost Ratio is calculated by dividing the direct costs of producing by the direct costs of producing, processing and transporting the minerals. [Wyo. Stat. § 39-2-208\(d\)\(iv\)](#).

17. In reporting its taxable value for Whitney Canyon for production years 1993 through 1995, Amoco included every expense between the wells and the sulfur load-out facility as direct costs of processing in the denominator of the direct cost ratio. [Trans. Vol. IV, pp. 752-753; Vol. V, p. 901.]

18. By letter dated September 23, 1998, Audit informed Amoco that it was conducting an audit of Amoco's oil and gas for production years 1993 through 1995 from the Whitney Canyon plant and field located in Uinta County. [[Department Exhibit 500.]

19. Amoco's audit contact, Bill Warren, requested that Audit limit its sample of invoices to 125 to 150. [**Trans. Vol. I, p. 149; Vol. II, p. 208; Vol. IV, p. 772.**] Mr. Warren also agreed with Audit's use of the high dollar value invoices to get an idea of what Amoco reported in its accounts. [**Trans. Vol. II, p. 260; Vol. V, pp. 906-907.**]

20. The audit of Amoco's claimed expenses was conducted using a sampling method. [**Trans. Vol. IV, p. 780.**] The auditors selected sample months for review and then selected the large value expense invoices within the selected months to get a good idea of the type of expenses recorded by Amoco in a given expense account. [**Trans. Vol. I, p. 156; Vol. II, pp. 259-260; Vol. IV, pp. 778-785; Vol. V, pp. 905-906.**]

21. In reviewing the selected invoices, Audit applied a three-part test to determine whether the expenses in a given account should be included in the calculation of the direct cost ratio of the proportionate profits method. [[**Trans. Vol. I, pp. 150-152; Vol. IV, pp. 731-732.**] The first step was to determine whether or not the expense could be identified with the Plant. [[**Trans. Vol. I, p. 150; Vol. IV, p. 731.**] The second step was to determine whether or not the expense was the kind the statutes and Department rules allow to be included in the calculation of the direct cost ratio. [**Trans. Vol. I, p. 151; Vol. IV, pp. 731-732.**] The third step was to determine whether or not the expense was a direct cost. [**Trans. Vol. I, p. 151; Vol. IV, p. 732.**]

22. In reviewing sub-account 9272-80, titled "other expenses," Audit also looked at whether or not the expenses contained in the account were "typical" of what had been seen in the account during past audits. Expenses not considered to be "typical" were not considered in determining whether or not to disallow the use of the account in calculating the direct cost ratio. [**Trans. Vol. I, pp. 171-172; Vol. IV, p. 806.**]

23. In applying the above audit methodology, Audit determined that certain plant expenses claimed by Amoco were not properly included in the direct cost ratio as direct costs of processing. [**Audit Report, Preliminary Findings Issue Letter, Amoco Exhibit 107, pp. 74-75; Department Exhibit 501, pp. 11-12, incorporated in Audit Final Issue Letter, Amoco Exhibit 101, and Department Final Determination, Amoco Exhibit 100.**]

24. Audit disallowed the claimed direct costs of processing taken by Amoco for accounts 9272-1 (charges from other company locations), 9272-10 (truck and service equipment expenses), 9272-11 (automobile expenses), 9272-29 (radio communication expenses), 9272-34 (personnel transfers), 9272-80 (other expenses), and 9635-71 (payroll taxes and employee plan expenses). [**Trans. Vol. I, p. 144.**]

25. On appeal, Amoco contends that accounts 9272-11 (automobile expenses), 9272-29 (radio communication expenses), 9272-34 (personnel transfers), 9272-80 (other expenses), and 9635-71 (payroll taxes and employee plan expenses) were direct costs of

processing improperly excluded by the Department from the calculation of the direct cost ratio. [**Amoco Production Company's Closing Argument, p. 11; Trans. Vol. I, pp. 56-57.**]

26. In addition to the above accounts, Audit disallowed the use of expenses associated with the gathering system and the sulfur haul road and load-out facility as direct costs of processing in the direct cost ratio.

27. Audit determined that the inlet to the initial compressor was the point of valuation and, therefore, reclassified the costs associated with the gas gathering system as production costs. [**Trans. Vol. IV, pp. 742, 755-756.**]

28. Audit disallowed the use of the costs associated with the sulfur haul road as a component of the direct cost ratio because the sulfur was in marketable condition at the tailgate of the Plant. [**Joint Stipulation of Facts, ¶ 8; Trans. Vol. IV, pp. 756-757, 766.**]

29. Audit issued its preliminary issue letter on December 9, 1999. [**Joint Stipulation of Facts, ¶ 3; Amoco Exhibit 107; Department Exhibit 501.**]

30. Audit issued a final issue letter dated February 1, 2000. [**Joint Stipulation of Facts, ¶ 4; Amoco Exhibit 101; Department Exhibit 502.**]

31. The Department issued its final determination letter on February 1, 2000. [**Joint Stipulation of Facts, ¶ 5; Amoco Exhibit 100.**]

32. The additional taxable values alleged by Audit did not change from the preliminary issue letter to the final issue letter. [**Joint Stipulation of Facts, ¶ 6; Amoco Exhibits 101, 107; Department Exhibits 501, 502.**]

33. The Department's final determination made no material changes with respect to the audit findings for the gross products additional taxable value and the additional severance taxes due. The additional severance tax due was \$614,683.32, together with interest of \$524,802.00 through March 2, 2000, for a total of \$1,139,485.32. The total increase in ad valorem taxable value was \$10,526,625. [**Amoco Exhibit 100.**]

34. Amoco filed its notice of appeal with the Board on February 25, 2000. Turning to the specific issues raised by Amoco in this appeal we find as follows:

Margins

35. Audit disallowed the marketing fees, the “margin,” claimed by Amoco as a deduction. [**Amoco Exhibit 107.**]

36. The parties stipulated “[t]here is no evidence that would require the inclusion of margins to reflect fair market value in the particular circumstances of the audit at issue in this particular appeal.” [**Joint Stipulation of Facts, ¶ 9.**]

Point of Valuation

37. Audit determined the point of valuation to be the inlet to the initial compressor, and disallowed the expenses related to the gathering system prior to that point. The decision was based on the determination that the expenses from the well to the inlet to the compressor were production related expenses according to Wyoming law and, therefore, not deductible. [**Trans. Vol. IV, pp. 742, 755-756.**] Expenses from the inlet of the compressor to the plant were allowed. [**Trans. Vol. IV, p. 744.**]

38. Neil Bidwell, Amoco's turnaround supervisor and engineering authority for the Plant since 1999, testified that the gathering system began after the wellhead where there is a choke or control valve controlled by the Plant, a heater, a meter, a methanol corrosion inhibitor and valving to allow for testing. [**Trans. Vol. III, pp. 436-437; Board Exhibit 1.**]

39. Individual flow lines go from the wells into main trunk lines and then to the inlet of the compressor. [**Trans. Vol. III, 429; Board Exhibit No. 1; Department Exhibit 519.**] No evidence was presented that dehydration occurs in the field. [**Amoco Production Company's Closing Argument, ¶ 49.**]

40. Prior to the hearing the parties stipulated to the introduction of their respective exhibits. [**Trans. Vol. I, p. 5.**] The Department's exhibits included a portion of the transcript of the Board's hearing in Docket No. 96-216, where Bill Warren testified concerning the meters at the well. He testified the meters at the wellhead were not sales meters. “In theory, for state tax purposes, it's a custody transfer meter. In theory only, for the simple reason that the products that's going through that meter are unprocessed.” (*In the Matter of the Appeal of Amoco Production Co.*, Board Docket No. 96-216, Trans. Vol. II, p. 368). [**Department Exhibit 512.**]

41. Mr. Bidwell stated that if there were a problem after the meter at the well, the loss would come out of the processing fee. [**Trans. Vol. III, pp. 437-438.**] However, the Agreement for the Construction, Ownership and Operation of the Whitney Canyon Gas Processing Plant does not contain any provision supporting that assertion. [**Amoco Exhibit 123.**]

42. The Agreement of the Construction, Ownership and Operation of the Whitney Canyon Gas Processing Plant is also silent as to the transfer of custody of the gas stream.

However, it does require warranties from the producer that the producer owns the unprocessed gas when delivered to the plant for processing and the products after processing. [**Amoco Exhibit 123, p. 935.**]

The Sub-Accounts

43. The Department did not allow expenses booked to Amoco's Sub-Accounts 9272-1, 9272-10, 9272-11, 9272-29, 9272-34, 9635-71 or 9272-80 to be used as direct costs of processing in the direct cost ratio calculation.

44. Amoco did not contest the disallowance of sub-account 9272-1 and withdrew its objection to the allowance of sub-account 9272-10 at the start of the hearing. [**Trans. Vol. I, pp. 56, 57.**]

45. All expenses for the operations of the Plant were given an identifier by Amoco. Expenses related to the Plant were identified by "9272." [**Trans. Vol. I, p. 42; Trans. Vol. IV, p. 771.**] In addition, each property had a FLAC identifier associated with it: 163624-000 identified the processing plant, 163624-059 identified the gas collection system, 163624-067 identified the sulfur haul road and 163624-076 identified the sulfur load out facility. [[**Trans. Vol. I, pp. 42, 126; Trans. Vol. V, pp. 886-887; Amoco Exhibit 119.**]

Sub-Account 9272-11 (automobile expenses)

46. Account 9272-11 was used to report mileage costs for vehicles. [**Trans. Vol. I, p. 40.**]

47. One Amoco witness, Neil Bidwell, Amoco's turnaround manager and engineering authority, testified the vehicles were assigned to and used only at the Plant to transport personnel and tools and equipment within the Plant. They were not used in either the gathering system or the sulfur haul road. [**Trans. Vol. III, pp. 416, 432, 529-530, 604.**]

48. However, another Amoco witness, Roberta Dean, a senior business analyst for Amoco, testified she didn't know what the vehicles were used for, or whether vehicles were used in the gathering system or on the sulfur haul road. [[**Trans. Vol. I, pp. 36, 63, 73.**] Nor could she say how many vehicles were assigned to the Plant. [**Trans. Vol. I, p. 64.**]

49. The auditor testified that he had not seen vehicles being used in the plant during his tours, although he had seen vehicles in the parking lot. [[**Trans. Vol. IV, p. 791.**]

50. From the records provided by Amoco to Audit, it could not be determined what type of vehicles were charged to the account, who used a vehicle or the purpose for which the

person was using the vehicle. [**Department Exhibit 505, p. 29; Trans. Vol. I, pp. 72-73.**] It can be determined that a charge of \$23.91 per mile was claimed for one vehicle. [**Trans. Vol. V, p. 919-920; Department Exhibit 505, p. 29.**]

Sub Account 9272-29 (radio communication expenses)

51. Charges to Sub-Account 9272-29 were for radio communication expenses. [[**Trans. Vol. I, p. 43.**]

52. Radios are the primary communications devices used in the Plant. They are used for operational communications and safety. [**Trans. Vol. III, p. 527.**]

53. Production employees and sulfur transportation employees have separate communications systems. [**Trans. Vol. III, p. 528.**]

54. Telephones were observed at the plant and were allowed as a cost of processing in the proportionate profits formula. [**Trans. Vol. IV, p. 797.**] However, no radios were observed during a tour of the plant by Audit, and the Plant was so noisy Audit did not believe radios could be used for communications within the Plant. [**Trans. Vol. IV, pp. 794-795.**]

Sub-Account 9272-34 (personnel transfers)

55. Account 9272-34 contained moving expenses for employees transferred to work in the Plant. [**Trans. Vol. I, p. 44.**] The expenses charged to the account included hotels, rental cars, moving vans and airlines. [**Trans Vol. IV, p. 801.**]

56. Actual labor expenses were not included in the account. [**Trans. Vol. I, pp. 88-89; Trans. Vol. IV, pp. 799-800.**]

57. No evidence was provided by Amoco identifying any transferred employee or the employee's function at the Plant. [**Trans. Vol. IV, pp. 798-799, 803-804.**]

Sub-Account 9635-71 (payroll taxes and employee plan expenses)

58. No explanation was provided for the use of a different identifier, 9635, for the claimed payroll taxes and employee plan expenses. Plant expenses were identified by 9272. [**Trans. Vol. I, pp. 46, 110.**]

59. An Amoco representative, Paul Syring, indicated that by using an organizational chart, tax master file and stack of microfiche he was able to tie the charges in the account to employees at the Plant with two exceptions. [[**Trans. Vol. II, pp. 350-353, 383-384.**]

60. However, these documents were not provided by Amoco to Audit; nor were they offered at the hearing. [**Trans. Vol. II, pp. 381, 384.**]

61. The information provided by Amoco to Audit did not identify the employees or indicate that the employees actually worked at the Plant. [**Trans. Vol. IV, p. 805; Trans. Vol. V, p. 910.**] Rather, the information reflects that the charges to the account were an estimate of expenses based on a different percentage each year rather than the actual expenses incurred by Amoco. [**Department Exhibit 510.**]

Sub-Account 9272-80 (other expenses)

62. Account 9272-80 was an account used by Amoco to record “everything that doesn't have a real good home in any of the other accounts.” [**Trans. Vol. II, pp. 349-350.**] It is “... just kind of a hodgepodge and catchall of some other expenses.” [**Trans. Vol. IV, pp. 805-806.**]

63. Account 9272-80 included expenses that Audit had seen during earlier audits. The expenses included charges for right-of-way agreements for pipelines and access roads, safety expenses, leases for a storage facility, well and salt water injection well, nitrogen safety training, testing in Naperville, Illinois, a transformer and Department of Environmental Quality permit payments. [**Trans. Vol. IV, pp. 806-808, 810; Department Exhibit 509, pp. 38-48, 96-97; Amoco Exhibit 120, pp. 365-377; Amoco Exhibit 121, pp. 576-577.**]

64. Amoco provided evidence at the hearing concerning the surface lease for ““tracts of land in Sec. 17-17N-119W and section 17-17N-119WN for storage facilities.” [**Department Exhibit 509, pp. 40, 43; Amoco Exhibit 120, pp. 367, 373.**] While Section 17 was identified as the location of the Plant, Amoco did not explain why the lease was for “tracts,” did not provide the lease, and was not able to explain what the storage facility was used for. [**Trans. Vol. III, pp. 539-540; Amoco Exhibit 126, p. 1010 for diagram showing three post-processing storage facilities associated with the Plant: condensate storage, natural gas liquid storage, and sulfur storage.**]

65. During the audit, Amoco did not provide documentation establishing that the right-of-way agreements or leases were related to processing or the Plant. [**Trans. Vol. IV, pp. 814-816.**] No evidence was provided at the hearing tying the pipeline or road right-of-ways directly to the Plant or to processing. [**Trans. Vol III, pp. 540.**]

66. Mr. Bidwell could only speculate on what the testing expenses from Naperville were for. [**Trans. Vol. III, p. 521.**]

67. Mr. Bidwell could only guess where the 3,750 KVA transformer was located because there were no records of it. [**Trans. Vol III, p. 526.**] However, the invoice indicates the transformer was for the “WC Gas Collection” system. [[**Amoco Exhibit 121, p. 645.**]

68. The nitrogen was used during processing and turnaround at the Plant. [[**Trans. Vol III, pp. 523-524.**]

69. The safety training was provided on rescue techniques that might be necessary during turnaround or shutdown. [**Trans. Vol III, p. 557.**]

70. Audit and the Department disallowed the use of sub-account 9272-80 in the calculation of the direct cost ratio based on a review of the representative expenses in sub-account 9272-80. [**Trans. Vol. IV, pp. 810-811.**]

71. In addition to the representative expenses seen during earlier audits, the sub-account 9272-80 contained expenses related to turnarounds at the Plant incurred during 1993 and 1995. [**Trans. Vol. I p. 423.**] The turnaround expenses were covered under a specific appropriation for each year. [**Trans. Vol III, pp. 463-464; Amoco Exhibit 120, pp. 387, 394.**] The appropriation number for the 1993 turnaround was 66030. [**Trans. Vol III, pp. 471-472.**] The appropriation number for the 1995 turnaround was 66051. [**Trans. Vol. III, p. 507.**] Amoco stated that only work at the Plant was covered under the appropriations for 1993 and 1995. [**Trans. Vol III, p. 473.**]

72. During the turnarounds the Plant is shut down and scheduled maintenance is performed to avoid unscheduled failures at the Plant. [**Trans. Vol. III, pp. 456, 458.**]

73. The Plant was shut down for 34 to 35 days during the 1993 turnaround and for 20 to 21 days during the 1995 turnaround. [**Trans. Vol. III, p. 587.**]

74. The expenses incurred under the specific appropriations for the maintenance performed during turnaround at the plant were required to facilitate the processing of gas at the Plant. [**Trans. Vol. III, p. 548.**]

75. However, Amoco also included charges to other appropriations in sub-account 9272-80. [**Amoco Exhibit 121, pp. 578, 579.**] In addition the invoices reflect Amoco charged work on the valve system in the field [**Amoco Exhibit 121, p. 580**], work on the low pressure collection system [**Amoco Exhibit 120, p. 440**] and work at a well site [**Amoco Exhibit 120, p. 463**] to the appropriations for turnarounds, contrary to the testimony that only expenses related to the Plant were charged to the turnaround appropriations.

76. Because the turnaround expenses were not normally seen in sub-account 9272-80, Audit did not consider the expenses to be representative of usual account expenses and

did not consider them in determining whether or not to allow the use of the account in the calculation of the direct cost ratio. **[[Trans. Vol. IV, p. 806.]**

77. If the turnaround costs were captured in their own account and were directly related to the plant facilities, and directly related to processing and not to transportation or production, the costs would have been allowed as a direct cost of production, processing and transporting gas in the denominator of the direct cost ratio. **[Trans. Vol. IV, p. 677; Trans. Vol. V, pp. 949-950.]**

78. Any discussion above or Conclusion of Law below which includes a finding of fact may also be considered a Finding of Fact and, therefore, is incorporated herein by this reference.

CONCLUSIONS OF LAW

79. Amoco's notice of appeal was timely filed and the Board has jurisdiction to determine this matter.

80. Amoco has the burden of going forward and the ultimate burden of persuasion. *Rules, Chapter 2, § 19, Wyoming State Board of Equalization.*

81. The Department's valuation established for state assessed property is presumed valid, accurate, and correct, a presumption which survives until overturned by credible evidence. In the absence of evidence to the contrary, it is presumed that the officials charged with establishing value, be it a county assessor or the Department, exercise honest judgment in accordance with the applicable statutes, rules, regulations, and other directives, which presumption survives until overturned by credible evidence. [*Chicago Burlington & Quincy Railroad Co. v. Bruch*, 400 P.2d 494, 498-499 \(Wyo. 1965\)](#).

82. A party challenging an assessment has the initial burden to present credible evidence to overcome the presumption. A mere difference of opinion as to value is not sufficient. [*Amoco Production Co. v. State Board of Equalization*, 899 P.2d 855, 858 \(Wyo. 1995\)](#); [*Teton Valley Ranch v. State Board of Equalization*, 735 P.2d 107 \(Wyo. 1987\)](#); [*Hillard v. Big Horn Coal Company*, 549 P. 293 \(Wyo. 1976\)](#); [*Weaver v. State Board of Equalization*, 511 P.2d 97 \(Wyo. 1973\)](#); [*CF&I Steel Corporation v. State Board of Equalization*, 492 P.2d 529 \(Wyo. 1972\)](#); [*Chicago Burlington & Quincy Railroad v. Bruch*, 400 P.2d 494 \(Wyo. 1965\)](#); [*J. Ray McDermott & Co. v. Hudson*, 370 P.2d 363 \(Wyo. 1962\)](#); [*Certain-Teed Products Corporation v. Comily*, 87 P.2d 21 \(Wyo. 1939\)](#).

83. The Department is required to annually value crude oil, lease condensate and natural gas "... at the fair cash market value of the product, after the mining or production process is completed." [*Wyo. Stat. § 39-2-208\(a\)*](#).

84. The proportionate profits method provides:
- (iv) Proportionate profits - The fair cash market value is:
 - (A) The total amount received from the sale of the minerals minus exempt royalties nonexempt royalties and production taxes times the quotient of the direct cost of producing the minerals divided by the direct cost of producing, processing and transporting the minerals; plus
 - *11 (B) Nonexempt royalties and production taxes.
- [Wyo. Stat. § 39-2-208\(d\)\(iv\)](#).

Margins

85. The parties have agreed that “[t]here is no evidence that would require the inclusion of margins to reflect fair market value in the particular circumstances of the audit at issue in this particular appeal.” **[Joint Stipulation of Facts, ¶ 9.]**

86. Therefore, we conclude that this matter must be remanded to the Department for recalculation of the severance tax and ad valorem value in conformance with the parties' stipulation.

Point of Valuation

87. Amoco contends the point of valuation is the meter located at each well and that it is entitled to include all costs of the individual flow lines and trunk lines as a direct cost of processing in the denominator of the direct cost ratio of the proportionate profits method. The Department contends that the inlet to the initial transportation related compressor is the point of valuation.

88. Natural gas is valued after the production process is completed. [Wyo. Stat. § 39-2-208\(a\)](#).

89. The production process is completed:

For natural gas, 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.

[Wyo. Stat. § 39-2-208\(b\)\(ii\)](#).

90. [Wyoming Statute Section 39-2-208\(m\)](#) provides definitions for various terms used in the section.

(I) “Compressor” means a device associated with processing or transporting gas which mechanically increases the pressure of natural gas;

- (ii) “Dehydrator” means a device which removes water vapor that is commonly associated with raw natural gas;
- (iii) “Gathering” means the transportation of crude oil or natural gas from multiple wells by separate and individual pipelines to a central point of accumulation, dehydration, compression, separation, heating and treating or storage;
- (iv) “Heating and treating” means the removal of solid, liquid and gaseous components from the well stream by chemical, mechanical and thermal processes;
- (v) “Lease automatic custody transfer unit (LACT)” means a device which automatically and mechanically measures and at which point custody of crude oil transfers from the producer to the purchaser;
- (vi) “Processing” means any activity occurring beyond the inlet to a 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, beneficiation, 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;
- *12 (vii) “Separating” means the isolation of the well stream into discrete gas, liquid hydrocarbons, liquid water and solid components;
- (viii) “Sweetening” means any activity that removes acid gases, such as hydrogen sulfide and carbon dioxide, from the well stream. Sweetening includes, but is not limited to absorption, stabilization, thermal and catalytic conversions, chemical reaction and regeneration;
- (ix) “Well” means a hole drilled in the earth for the purpose of finding or producing crude oil and natural gas.

91. The production process is completed “after gathering” and where there is no dehydration, as in this case, “at the inlet of the initial transportation related compressor, custody transfer meter or processing facility, whichever first occurs.” [Wyo. Stat. § 39-2-208\(b\)\(ii\)](#).

92. Processing occurs beyond the inlet to a gas processing facility. [Wyo. Stat. § 39-2-208\(m\)\(vi\)](#).

93. The evidence presented clearly established that the inlet to the initial transportation related compressor is the statutorily defined point where the production process is complete. Gathering occurred from the well head to the inlet to the initial compressor. No processing as defined by [Wyoming Statute Section 39-2-208\(m\)\(iv\)](#) had occurred up to that point.

94. We reject Petitioner's contention that the meters located at or near the wellhead and prior to the inlet to the gathering system are custody transfer meters as that term is used in [Wyoming Statute Section 39-2-208\(b\)\(ii\)](#). The only evidence presented that the meters at the wells were custody transfer meters came from *In the Matter of the Appeal of Amoco Production Co.*, Docket No. 96-216 where an Amoco representative testified the meters at the wells were custody transfer meters "... [i]n theory only, for purposes of taxation." **[[Department Exhibit 512; Trans. Vol. IV, p. 833.]**

95. We conclude that the meters located at each well head are not custody transfer meters as that term is used in [Wyoming Statute Section 39-2-208\(b\)\(ii\)](#).

96. This interpretation is consistent with the definition of "lease automatic custody transfer meter" used by the legislature for crude oil valuation requiring a transfer from producer to purchaser. [Wyo. Stat. § 39-2-208\(m\)\(v\)](#). In this case transfer from producer to purchaser occurs at the tailgate of the processing plant, not at the beginning of the gathering system.

97. The point of valuation selected by Audit and used by the Department in valuing Amoco's 1993 through 1995 production, the inlet to the initial transportation related compressor, is correct. [Wyo. Stat. § 39-2-208\(b\)\(ii\)](#). Amoco failed to meet its burden of proof with respect to this issue.

The Sub-Accounts

98. Amoco had a clear duty to properly report its costs to the Department and to maintain and provide proper documentation of such costs upon audit. This included the obligation of being able to establish that claimed processing expenses actually related to the processing function. [Wyoming Statute Section 39-6-304\(o\)](#) provides that:

Audits provided by this article shall commence within five (5) years of the reporting period and **taxpayers shall keep accurate books and records of all production subject to taxes imposed by this article and determinations of taxable value as prescribed by [W.S. 39-2-202](#) for a period of five (5) years and make them available to department examiners for audit purposes.** If the examination discloses evidence of gross negligence by the taxpayer in reporting and paying the tax, the department may examine all pertinent records for any reporting period without regard to the limitations set forth in paragraphs (o) and (p) of this section. **[Emphasis supplied].**

99. Only direct costs of producing, processing, and transporting the minerals may be used in the denominator of the direct cost ratio of the proportionate profits method. [Wyo. Stat. § 39-2-208\(d\)\(iv\)\(A\)](#). [Powder River Coal Co. v. Wyo. State Board of Equalization, 2002 WY 5, 38 P.3d 423 \(Wyo. 2002\)](#).

100. Processing is defined as:

(vi) "Processing" means any activity occurring beyond the inlet to a 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, beneficiation, 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. § 39-2-208\(m\)](#).

101. To be included in the calculation of the direct cost ratio as a direct cost of processing the expense must occur beyond the inlet of the gas processing facility and change the well streams's physical or chemical characteristics, enhance its marketability or enhance the value of its separate components. [Wyo. Stat. § 39-2-208\(m\)\(iv\)](#). In addition the cost must be of the same general kind or class as those enumerated in [Wyoming Statute Section 39-2-208\(m\)\(vi\)](#). *Powder River Coal Company v. Wyo. State Board of Equalization*, 202 WY 5 ¶¶ 19, 20; [38 P.3d 423 \(Wyo. 2002\)](#).

Audit Methodology

102. Petitioner alleges the audit method of sampling account invoices is flawed and does not meet generally accepted auditing standards.

103. However, sampling is specifically authorized by Audit's rules. *Rules, Chapter XXI § 14, Wyoming Department of Audit*.

104. Without clear statutory guidance or rules, this Board is not willing to set aside an audit based on mere allegations and must conclude Amoco has failed to meet its burden of proof on this issue. Amoco failed to demonstrate any prejudice as a result of the procedure utilized by Audit.

105. Amoco's own audit representative requested that Audit limit its invoice sample and agreed with the selection of the high dollar invoices. **[Findings of Fact ¶ 19.]**

106. Amoco also failed to provide any testimony or point to any statute or rule establishing that the audit methodology was flawed or that strict adherence to a standard was required and not met. *In the Matter of the Appeal of Amoco Production Co.*, State Board of Equalization, Docket No. 96-216 (Sept. 24, 2001).

Sub-Account 9272-11 (automobile expenses)

107. Amoco provided testimony concerning the use of the vehicles charged to sub-account 9272-11. However that testimony was equivocal, with one witness saying the vehicles were only used at the Plant and another saying that they could have been used elsewhere. No testimony was elicited identifying the vehicles or describing how the costs were calculated. **[Findings of Fact ¶¶ 46-50.]**

108. There was no demonstration the expenses charged to this sub-account were for processing as opposed to production, or that the expenses were correctly allocated to the Plant. Petitioner failed to meet its burden of demonstrating the Department erred in denying the use of sub-account 9272-11 as a direct cost of processing for purposes of calculating the direct cost ratio.

Sub Account 9272-29 (radio communication expenses)

109. While the testimony of Amoco and Audit was contradictory, we conclude that the radios charged to this account were used at the Plant for operations and safety. **[Findings of Fact ¶¶ 51-54.]**

110. Amoco met its burden of persuasion with respect to this sub-account. The Department erred in denying the use of sub-account 9272-29 as a direct cost of processing for purposes of calculating the direct cost ratio.

Sub-Account 9272-34 (personnel transfers)

111. Petitioner failed to identify any person transferred or tie the person to the processing function at the Plant. **[Findings of Fact ¶ 57.]** Amoco did not prove by a preponderance of the evidence that the personnel transfer expenses were directly related to processing at the Plant.

112. The Department did not err in denying the use of sub-account 9272-34 as a direct cost of processing for purposes of calculating the direct cost ratio.

Sub-Account 9635-71 (payroll taxes and employee plan expenses)

113. The Wyoming Supreme Court held that only actual costs can be used in a formula to determine the value of mine products pursuant to [Wyoming Statute. State ex rel. State Bd. of Equalization v. Monolith Portland Midwest Co., 574 P.2d 757 \(Wyo.1978\)](#); [Amoco Production Company v. Wyoming State Board of Equalization, 12 P.3d 668 \(Wyo. 2000\)](#).

114. Because the evidence provided by Amoco to Audit to substantiate its expenses for payroll taxes and employee plan expenses was based on a percentage of payroll rather than on the actual costs incurred by Amoco, we conclude Amoco has failed to meet its burden of persuasion. Amoco's attempt to substantiate the claimed percentage deduction by use of an organizational chart, tax master file and stack of microfiche is unpersuasive. **[Findings of Fact ¶¶ 58-61.]**

115. The Department did not err in denying the use of this account as a direct cost of processing for purposes of calculation the direct cost ratio.

Sub-Account 9272-80 (other expenses)

116. Sub-account 9272-80 presents a different issue than the other sub-accounts because of its use by Amoco to report typical expenses incurred every year and to report turnaround expenses incurred once every two to three years. Amoco argues the entirety of account 9272-80 should be allowed as a direct expense in calculating the direct cost ratio. The Department argues none of the account should be used in calculating the direct cost ratio because, disregarding turnaround expenses, the remaining expenses are not directly related to the processing of the gas stream. Neither argument squarely addresses the difficulty created by Amoco's accounting and tax reporting practices.

117. With respect to the typical sub-account 9272-80 expenses, right-of-way agreements for pipelines and access roads, safety expenses, testing, transformer, DEQ payment, leases for a storage facility, well and salt water injection well and nitrogen, we conclude Amoco did not demonstrate by a preponderance that all or even a majority of the claimed expenses were directly related to processing at the Plant. Amoco failed to keep complete and accurate records with respect to the claimed deductions. **[Findings of Fact ¶¶ 64-67.]** Expenses for the DEQ permit and right-of-ways for a pipeline and road were not a direct cost of processing. [*Powder River Coal Company v. Wyo. State Board of Equalization*, 2002 WY 5, ¶ 22, 38 P.3d 423 \(Wyo. 2002\).](#)

118. There was no clear demonstration by Amoco that the majority of the typical expenses in sub-account 9272-80 were directly related to processing as opposed to production, or that the expenses were correctly allocated to the Plant. Amoco failed to meet its burden of demonstrating the error with respect to the typical expenses.

119. However, with respect to the 1993 and 1995 turnaround expenses reported in sub-account 9272-80, we conclude that Amoco has demonstrated by a preponderance of the evidence that the majority of the turnaround expenses were directly related to the processing function at the Plant and should have been allowed by the Department as a direct cost of processing in the denominator of the direct cost ratio.

120. This conclusion is supported by the testimony of both Audit and the Department that if the turnaround costs were captured in their own account and were directly related to the

plant facilities, directly related to processing and not to transportation or production, the costs would have been allowed as a direct cost of production, processing and transporting gas in the denominator of the direct cost ratio. [**Trans. Vol. IV, p. 677; Trans. Vol. V, pp. 949-950.**]

121. Therefore, we are left with the issue whether the entire account should be allowed as argued by Amoco or disallowed as argued by the Department. Under the facts presented to us in this case, neither position is tenable.

122. Amoco's accounting shortcomings aside, its failure of proof with respect to a majority of the typical expenses contained in sub-account 80 does not support the disallowance of the significant 1993 and 1995 turnaround expenses directly related to the Plant.

123. The costs directly attributable to turnaround at the Plant, supported by invoices, included in sub-account 80, and identified by Appropriation No. 66030 for 1993 or Appropriation No. 66051 for 1995, were direct costs of processing and should be included in the denominator of the direct cost ratio for 1993 and 1995 for those years.

Sulfur Haul Road and Load out Facility

124. The Department's rules allow only transportation costs associated with processing to be included in the direct cost ratio of the proportionate profits formula. *Rules, Chapter 6, Section 4b (x), Wyoming Department of Revenue.*

125. The processing of the hydrogen sulfide into elemental sulfur is complete when the sulfur leaves the Plant and is placed in the ten day storage tank. The storage and transportation of the sulfur down the sulfur haul road to the load out facility occurs after the tailgate of the processing plant. [**Findings of Fact ¶¶ 11-13.**]

126. Audit and the Department disallowed the costs related to the sulfur haul road and load out facility under the theory that such activity was not processing. We agree the costs associated with the sulfur haul road and the load out facility are not expenses of processing.

127. The costs associated with the sulfur haul road and load out facility were not processing costs because such activity did not change the chemical or physical composition of the sulfur. No value was added to the sulfur by the haul road and load out facility. An activity constitutes processing only if it changes the oil or gas stream's physical or chemical characteristics, enhances the marketability of the stream, or enhances the value of the separate components of the stream. [Wyo. Stat. § 39-2-208\(m\)\(vi\).](#)

128. However, we conclude the expenses associated with the sulfur haul road and load out facility were necessary expense related to the transport of the sulfur to market.

129. Under Wyoming law the fair market value of oil and gas production is determined at the point when the production process has been completed. [Wyo. Stat. § 39-2-208\(a\)](#). Where there is no processing or the processing is done by a third party, Wyoming Statutes allow the producer to deduct from the sales price the expenses of transporting the gas to market. [Wyo. Stat. § 39-2-208\(b\)\(ii\) and \(iii\)](#).

130. Where the natural gas stream requires extensive processing in order to be marketable, the amount received from the sale of oil and gas reflects the value of the product after both production and processing. The purpose of the direct cost ratio in the proportionate profits formula is to grant the producer a deduction for the value added by processing through adjustment of the amount received from sales by the ratio that the production costs bear to the costs of processing and production. Because transportation costs incurred after processing bear no relevance to the value added by processing they do not belong in the direct cost ratio. The sulfur haul road and load out facility are not part of the processing function and as such should not be included in the direct cost ratio. *In the Matter of the Appeal of Amoco Production Co.*, State Board of Equalization Docket No. 96-216 (Sept. 24, 2001).

131. Even though the sulfur haul road expenses and load out facility are not processing costs, they do occur after the production process has been completed. Therefore, the producer should be allowed to deduct costs associated with the sulfur haul road and load out facility from the sales revenues received for the sulfur as part of the transportation expense. This conclusion is consistent with the position of the Department and the alternate position of Amoco. [**Wyoming Department of Revenue's Proposed Finds of Fact and Conclusions of Law, ¶ 364, p. 110; Amoco Production Company's Closing Argument, p. 22.**]

ORDER

IT IS THEREFORE HEREBY ORDERED:

A. The Department's inclusion of marketing fees (margins) in its calculation of severance taxes and ad valorem value is **reversed**;

B. The Department's disallowance of the gas gathering expenses as cost of processing in calculating the direct cost ratio is **affirmed**;

C. The Department's disallowance of the use of the expenses in sub-accounts 9272-11 (automobile expenses), 9272-34 (personnel transfers) and 9635-71 (payroll taxes and employee plan expenses) in calculating the direct cost ratio is **affirmed**;

D. The Department's disallowance of the use of the expenses in sub-account 9272-29 (radio communication expenses) in calculating the direct cost ratio is **reversed**;

E. With respect to sub-account 9272-80 (other expenses), the Department correctly disallowed the use of the typical reoccurring expenses reported in account 9272-80 in calculating the direct cost ratio, and its decision with respect to these expenses is **affirmed**. However, the Department incorrectly disallowed the use of the turnaround expenses incurred by Amoco in 1993 and 1995 in calculating the direct cost ratio, and its decision to disallow the expenses directly attributable to turnaround at the Plant, included in sub-account 80, identified by Appropriation No. 66030 for 1993 or Appropriation No. 66051 for 1995, and supported by invoices identifying the expenses by appropriation number, is **reversed**;

F. The treatment of the expenses related to the sulfur haul road and the sulfur load out facility is **reversed**; and

G. This matter is **remanded** to the Department to recalculate taxes due, interest and penalties (if any) in accordance with this decision.

PURSUANT TO [Wyoming Statute Section 16-3-114](#) and Rule 12, Wyoming Rules of Appellate Procedure, any person aggrieved or adversely affected in fact by this decision may seek judicial review in the appropriate district court by filing a petition of review within thirty (30) days of the date of this decision.

DATED this 19th day of November, 2002.

Edmund J. Schmidt
Chairman

Roberta A. Coates
Vice-Chairman

Sylvia Lee Hackl
Member

