

IN THE CIRCUIT COURT OF TYLER COUNTY, WEST VIRGINIA

ANTERO RESOURCES CORPORATION,

Petitioner,

v.

Civil Action No. 16-AA- 1
The Honorable Cramer

THE HONORABLE MARK MATKOVICH,
West Virginia State Tax Commissioner,

THE HONORABLE JACKSON L. HAYES,
Assessor of Tyler County, and

THE COUNTY COMMISSION OF TYLER COUNTY,
Sitting as a Board of Assessment Appeals,

Respondents.

FILED

DEC - 2 2016

Candy L. Warner
Tyler Co. Circuit Clerk

COMPLAINT OF PETITIONER ANTERO RESOURCES CORPORATION

I. INTRODUCTION

Antero Resources Corporation ("Antero") is a producer of natural gas throughout the state of West Virginia, with wells located in Tyler County.

Those wells are appraised by the West Virginia Department of Revenue, State Tax Department, Property Tax Division (the "Tax Department" or "State") based on a mass appraisal system, state-wide. Certain variables are used by the State to value producing oil and natural gas wells, including, notably for this Brief, operating expenses. Specifically, the Tax Department periodically circulates a survey by which it solicits data from oil and natural gas producing taxpayers regarding operating expenses for their wells, and based on that, the Tax Department determines the operating expense variables used in its mass appraisal system. The amount of operating expenses applied to a well using the mass appraisal system is based on a percentage of the well's gross receipts not to exceed a maximum amount, and the percentage and maximum

vary by the type of well (typical or conventional, Marcellus, etc.). The operating expense calculations are included in a natural resources “valuation variables” document that the Tax Department releases annually.

In addition to the valuation variables document, the Tax Department releases an annual administrative notice that lists the percentages and caps for operating expense calculations. In prior years, the Tax Department invited taxpayers to submit actual operating expenses that exceed the percentages and maximum amounts listed in the valuation variables document. The 2016 administrative notice, unlike administrative notices from 2000 through 2015, however, does not include language that invites taxpayers to submit actual expenses, despite no changes to the West Virginia Code or the Tax Department’s Legislative Rule that governs the valuation of producing natural gas wells. For tax year 2016, Antero had submitted its actual operating expense information to the Tax Department prior to the Tax Department releasing the administrative notice in which it omitted the language inviting taxpayers to submit actual operating expense information.

In this matter, Antero evaluated its actual operating expenses for calendar year 2014, and determined that for Marcellus wells in the county, the amount of operating expenses that it was incurring for these wells exceeded the maximums set by the State. For property tax purposes, the operating expense data from calendar year 2014 is used to value the wells for tax year 2016.

When the Tax Department valued Antero’s gas well values for tax year 2016, it failed to adhere to its own regulations that direct how it is to consider actual operating expenses. Antero, like many mineral producers, generally reports its operating expenses to the Tax Department on a state-wide basis. Antero’s average operating expense per well was \$648,000, which includes

all operating expenses, gathering and compression expenses, processing expenses, and transportation expenses, necessary to get the gas to the point of sale. Antero reports its gross revenues based on the point of sale, and the allowed operating expenses should reflect the expenses incurred to get the gas to the point of sale. For tax year 2016, the Tax Department caps operating expenses at the lesser of 20% of revenue or \$150,000 for Marcellus wells. This cap unduly restricts the amount of operating expenses that should be allowed for each of well, and the imposition of a “cap” is not supported by the Tax Department’s legislative rule regarding the valuation of producing oil and natural gas properties. In sum, the Tax Department incorrectly and unfairly ignored the actual operating expenses and instead relied on the maximum calculations found in its valuation variables document and administrative notice. By failing to consider Antero’s actual operating expenses, the Tax Department overvalued Antero’s wells.

On October 25, 2016, Antero protested the Tax Department’s valuation (as adopted by the Tyler County Assessor) to the Tyler County Commission sitting as the Tyler County Board of Assessment Appeals (the “Board”). Antero presented clear and convincing evidence that the Tax Department failed to consider Antero’s actual operating expenses in determining the valuation for the wells assessed for Tyler County. Antero also presented a complete analysis of its actual operating expenses from the state and local tax firm Altus Group US, Inc. (“Altus”), supported by testimony from an Altus Senior Consultant, Elizabeth Burg, that correctly applies the approach to arrive at allowable operating expenses. The Board, however, made no adjustment to the Tax Department’s valuation.

Antero timely petitioned the Court for appeal of the Board’s decision. As explained below, the Tax Department has abused its discretion by failing to consider Antero’s actual and

allowable operating expenses in a manner contrary to the statutes, regulations and official releases from the Tax Department governing valuation of personal property. Moreover, the Tax Department has failed to support its valuation with substantial evidence. Antero, on the other hand, presented clear and convincing evidence for its allowable operating expenses to be used in valuing its wells for tax year 2016.

II. FACTUAL BACKGROUND

A. Antero's Property.

Antero owns several Marcellus wells in Tyler County. (Certified Transcript of October 25, 2016 Hearing before the Tyler County Board of Assessment Appeals, See Exhibit A (hereinafter "Hr'g Tr.")). Antero pays significant taxes to Tyler County for its oil and gas wells.

B. Antero's 2014 Operating Expenses.

Antero completed the Tax Department's survey related to operating expenses. Phil Yoo of Antero testified, however, that the survey asked for expenses related to lifting the gas out of the ground only, not transportation or processing costs, which are necessary to get the gas to the market. (Hr'g Tr., p. 70:14-71:19). The Tax Department's survey information for horizontal Marcellus wells pertained almost solely to typical lease operating expenses and was based on prior surveys used for conventional wells. No line items were included for gathering and compression, processing or transportation. If such expense categories had been included on the survey, Antero would have calculated and listed those substantial expenses, and the Tax Department's calculations would have been substantially different, given that Antero is the largest producer for Marcellus wells in West Virginia and represents approximately 40% of the Marcellus well production statewide. (Hr'g Tr., p. 34:5- 34:13; *see also* Hr'g Exhibit 16). As

required by the State Tax Department, Antero reports its gross revenues based on the point of sale, and the allowed operating expenses should reflect the expenses incurred to get the gas to the point of sale. Requiring gross receipts to be reported based on the point of sale, while not recognizing the substantial expenses incurred to get the gas to the point of sale, results in overvaluation of the produced natural gas.

Antero submitted proof of its actual operating expenses from 2014 to the Tax Department for consideration for tax year 2016. (*See* Hr'g Tr., 84:3-84:6). Antero's average operating costs for Marcellus wells is approximately 23% of gross revenue, or \$648,000. (Hr'g Tr. at p. 27:3-27:16). Ultimately, the Tax Department did not adjust the operating expenses it used to value Antero's wells in Tyler County for tax year 2016.

C. The Tax Department's Calculation of Antero's Operating Expenses.

The Tax Department prepares annual natural resource property valuation variables for appraising oil and gas. Further, the Tax Department makes determination of those valuation variables pursuant to Series 1J of Title 110, a legislative rule of the Tax Department, promulgated pursuant to W. Va. Code §§ 11-1C-5(b), 11-1C-5a, and 11-1C-10(d). In order to determine the amount of Antero's operating expenses, and, in turn, the value of Antero's oil and gas wells, the Tax Department further is governed by Administrative Notices.

In the past, the Tax Department included a statement in its Administrative Notices indicating that it was willing to consider actual operating expenses if a taxpayer thought that the value of their wells was overstated. (Hr'g Tr. At 45:20-46:3). In 2016, the Tax Department decided that it would no longer consider actual operating expenses.

The State caps the allowed operating expenses at the lesser of 20% of revenue, or \$150,000, for Marcellus Wells. Antero's operating expenses are on average \$648,000. Due to the State's failure to take into account Antero's actual operating expenses, the value of Antero's wells is significantly overstated. The State valued Antero's wells in Tyler County at over \$58 million, whereas Antero's expert appraised them at just under \$23 million. (Hr'g Tr., at p. 58:16-58:23).

Antero timely noticed the Tyler County Commission with its Notice of Protest on February 10, 2016. The Tyler County Commission, sitting as the Tyler County Board of Assessment Appeals, held a hearing on October 25, 2016.

At the hearing, the Tax Department offered no credible evidence as the basis for its refusal to accept Antero's calculation of its operating expenses, except to argue that it would be impractical and expensive for the Tax Department to look at the actual expenses for individual wells (Hr'g Tr., at p. 10:12-10:20), and that the State's current procedures are in accordance with the legislative rules and the law. (*Id.* at p. 10:21-10:24).

D. Antero's Expert Analysis and Testimony.

Antero's expert, Altus, a leading independent state and local tax firm, by Senior Consultant Elizabeth Burg, testified before the Board on October 26, 2016, and showed that a correct application of the allowable operating expenses demonstrated that the Tax Department had erred by failing to allow the operating expenses documented by Antero. (*See* Hr'g Tr., pp. 11-12). Detailed charts and documentation of actual operating expenses, with numbers specific to Tyler County, were also submitted to the Board. (*see* Certified Record, Petitioner's Exhibits, 4, 6, 8, 9, and 10).

Altus explained that by artificially capping operating expenses at \$150,000, which is not required by the legislative rule, the State is grossly overvaluing the fair market value of Antero's wells. (Hr'g Tr., at p. 27:17-27:24). The State also does not take into account Antero's point-of-sale, and the operating expenses incurred to get the gas downstream to market. (Hr'g Tr. at p. 29:7-29:19). Altus testified that Antero volumetrically represented 40% of horizontal production in West Virginia in 2014, and that its average operating expense was \$648,000 per well. (Hr'g Tr., p. 34:5- 34:13).

An expert appraiser from Hein & Associates, Clarence Jim Harden, M.B.A., A.S.A., also testified at the hearing. He testified that he appraised Antero's wells in Tyler County. (See Hr'g Tr., 55:21-58:23). Mr. Harden explained that the Tax Department's valuation did not properly account for the decline rate or actual operating costs of the wells at issue, and used a different discount rate than his methodology. Mr. Harden valued Antero's Tyler County wells at just under \$23 million, while the State valued them at over \$58 million. (*Id.* at 58:16-58:23).

Finally, Altus testified that, while Hein's valuation is the fair market value of the wells, an alternative approach would be to calculate operating costs as 20% of gross production, without any cap. Altus stressed that this method would still overstate the fair market value of the wells, but that 20%, without a cap, is a reasonable resolution. (Hr'g Tr., pp. 66:13-67:15). This approach would value Antero's wells at approximately \$40 million. *Id.*

E. Antero's Protest to the Tyler County Board of Assessment Appeals.

On February 10, 2016, Antero submitted to the Tyler County Assessor and the Tyler County Commission sitting as the Board of Assessment Appeals an Application for Review of Property Assessment with regard to its gas wells, and Antero appeared on October 25, 2016, by

counsel, before the Board. (*See* W. Va. Code § 11-3-24). Antero hired third-party court reporter to produce a certified transcript of the hearing at which it presented the evidence discussed above. Exhibits introduced at the hearing and provided to the Board will be transmitted to the Court within thirty (30) days, as provided by West Virginia Code § 11-3-25. The original transcript of the proceeding was attached to Antero's Petition as Exhibit A. (*See* W. Va. Code § 58-3-4.)

By October 31, 2016 Order, the Board determined to make no adjustment to the State Tax Department's valuation of Antero's gas wells for the 2016 tax year. (*See* Ex. B to Antero's Petition). Antero received notice of the Order on November 4, 2016, and Antero timely petitions this Court for relief from the Board's erroneous determination on December 2, 2016. (*See* W. Va. Code § 11-3-25).

III. ANALYSIS

A. Applicable Legal Standards.

All property in the State of West Virginia is required to "be assessed annually at its true and actual value" W. Va. Code § 11-3-1. The West Virginia State Tax Commissioner¹ is charged with determining "the fair market value of all natural resource property in the State" and then providing the values to county assessors to use in assessing the property. W. Va. Code § 11-1C-10(d).

¹ Elsewhere in Brief, the Tax Commissioner is variously referred to as the Tax Department or simply the State. All terms refer to the same entity.

Pursuant to this responsibility to value producing mineral property and reserves, the Tax Commissioner promulgated Title 110, Series 1J of the West Virginia Code of State Rules, which explains the mechanisms to be utilized in valuing taxable property.

To determine the fair market value of producing oil and natural gas property, the Tax Department applies “a yield capitalization model to the net receipts (gross receipts less royalties paid less operating expenses) for the working interest. . . .” W. Va. Code R. § 110-1J-4.1. The methodology set forth in § 110-1J-4.1 is reflected in Tax Department Administrative Notice 2016-02, in which the Tax Commissioner states that the Tax Department primarily relies upon the income approach in valuing producing oil and gas property.

The Tax Department should consider actual operating expenses to offset the presumed valuation of expenses for each well. According to the Tax Department’s legislative rule, the Tax Commissioner considers “operating expenses” to be “the “ordinary expenses which are directly related to the maintenance of production of natural gas and/or oil. These expenses do not include extraordinary expenses, depreciation, ad valorem taxes, capital expenditures, or expenditures relating to vehicles or other tangible personal property not permanently used in the production of natural gas or oil.” Section 3.16 of Series 1J, Title 110 State Tax Department Legislative Rule for Valuation of Producing and Reserve Oil & Natural Gas for Ad Valorem Property Tax Purposes. Based on the testimony of Antero’s experts, Altus and Mr. Harden, and the documents submitted to the Tax Department and the Board, the operating expenses submitted by Antero are those contemplated in Section 3.14.

Antero’s burden before the Board was to show by clear and convincing evidence that the Tax Department’s valuation (and, hence, the County’s assessment) of its gas well operating

expenses was erroneous. Syl. pts. 5-6, *Stone Brooke*, 224 W. Va. 691, 688 S.E.2d 300. On appeal to this Court, the Court relies on the record developed before the Board and determines whether the challenged property valuation is supported by substantial evidence.² See W. Va. Code § 58-3-4; syl. pts. 1-2, *Stone Brooke*, 224 W. Va. 691, 688 S.E.2d 300.

In this case, the Tax Department failed to apply the demonstrated actual operating expenses supplied by Antero in both informal and formal testimony. Accordingly, Antero now petitions this Court to find (1) that the Board incorrectly made no changes to the Tax Department's valuation and (2) that Antero's calculation of its allowed actual operating expenses to be used to value its producing natural gas wells is correct.

B. The Tax Department Failed to Consider the Actual Operating Expenses of Antero's Gas Wells and, Thus, Failed to Correctly Value that Property; Antero, on the Other Hand, Introduced Clear Evidence of the Allowable Operating Expenses.

While the State Tax Department has discretion to select the appraisal method that it determines should provide the most accurate valuation of personal property, once it chooses a method, it must correctly apply the method.

For Antero's Marcellus wells in Tyler County, the Tax Department has not followed its own rules regarding average industry operating expenses, as set forth in Antero's Exhibits and expert testimony at the hearing before the Board on October 25, 2016, and the Tax Department has, therefore, failed to properly calculate the fair market value of Antero's Marcellus wells. It is

² Furthermore, "[p]ursuant to *In Re Pocahontas Land Co.*, 172 W. Va. 53, 61, 303 S.E.2d 691, 699 (1983), once a taxpayer makes a showing that tax appraisals are erroneous, the Assessor is then bound by law to rebut the taxpayer's evidence." *Mountain Am., LLC v. Huffman*, 224 W. Va. 669, 786 n.23, 687 S.E.2d 768, 785 n.23 (2009). While the Court in *In Re Pocahontas Land Co.* suggested that a county assessor could meet that burden by introducing the State Tax Department's valuation, in this case, Antero showed that the State Tax Department's valuation itself is incorrect, so it was incumbent on the State Tax Department to rebut Antero's evidence.

also improper for the Tax Department to place a cap on operating expenses, another factor resulting in an inflated value for Antero's Marcellus wells. As demonstrated at the hearing, the survey used by the Tax Department to calculate average industry operating expenses for Marcellus wells was poorly drafted and misleading and resulted in the Tax Department calculating an operating expenses "cap" well below the amount of operating expenses actually required to operate a Marcellus well. Antero avers that not only is a "cap" not supported by law, but that the Tax Department also calculated a wildly inaccurate "cap."

Finally, the Tax Department's valuation of Antero's wells did not properly account for the decline rate or discount rate. As a result, Antero's wells were overvalued.

IV. CONCLUSION

WHEREFORE, Antero Resources Corporation respectfully requests that the Court:

- (i) Find that the Tyler County Board of Assessment Appeals incorrectly upheld the valuation of Antero's Tyler County gas wells by the West Virginia Department of Revenue, State Tax Department, Property Tax Division for the 2016 tax year;
- (ii) Fix the value of Antero's Tyler County gas wells for the 2016 tax year at its true and actual value of \$40,971,679, based on 20% of the actual direct operating expenses incurred by Antero; and
- (iii) Order such other relief as the Court deems appropriate.

ANTERO RESOURCES CORPORATION,

By Counsel

A handwritten signature in dark ink, appearing to read "John J. Meadows by WSO", is written over a horizontal line.

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