

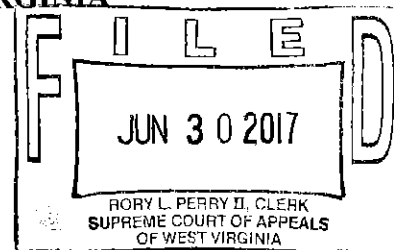
IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

**CONSOL ENERGY INC.
DBA CNX GAS COMPANY LLC,**

Petitioner,

vs.

**Barbour County Circuit Court
Civil Action No. 16-AA-4
The Honorable Judge Moats**



**THE HONORABLE DALE W. STEAGER,
West Virginia State Tax Commissioner,
THE HONORABLE JOHN M. CUTRIGHT,
Assessor of Barbour County, and
THE COUNTY COMMISSION OF BARBOUR COUNTY,
Sitting as the Board of Assessment Appeals,
Respondents.**

TO: THE HONORABLE CHIEF JUSTICE

MOTION TO REFER CASE TO THE BUSINESS COURT DIVISION

Pursuant to Rule 29.06 of the West Virginia Trial Court Rules, the Petitioner, CONSOL Energy Inc. dba CNX Gas Company LLC ("CNX"), by counsel, John Meadows, Craig Griffith, and the law firm of Steptoe & Johnson, PLLC, respectfully requests that the above-styled case be referred to the Business Court Division for all further proceedings. Trial Court Rule 29.04 expressly provides that "complex tax appeals are eligible to be referred to the Business Court Division." W. Va. Trial Ct. R. 29.04. This matter constitutes a complex tax appeal, and involves issues for which specialized treatment will be helpful. For these reasons, the Court should grant CNX's Motion to Refer Case to Business Court Division.

Additionally, the following related actions should be the subject of consolidation and transfer to the Business Court Division, and are currently pending:

- *CNX Gas Company, LLC, v. The Honorable Dale Steager, et al.*, Civil Action No. 17-C-142, Harrison County Circuit Court (Judge McCarthy).
- *CNX Gas Company, LLC, v. The Honorable Dale Steager, et al.*, Civil Action No. 16-C-135, McDowell County Circuit Court (Judge Murensky).
- *CNX Gas Company, LLC, v. The Honorable Dale Steager, et al.*, Civil Action No. 17-C-11, Lewis County Circuit Court (Judge Hall).
- *CNX Gas Company, LLC, v. The Honorable Dale Steager, et al.*, Civil Action No. 17-AA-2, Doddridge County Circuit Court (Judge Sweeney).

The above-styled cases present identical claims and issues of law as those in this case. In tax year 2016, CNX filed appeals of the West Virginia Department of Revenue, State Tax Department, Property Tax Division's assessment of its wells in Lewis, Doddridge, McDowell, Harrison, and Barbour Counties. In the interest of judicial economy, these cases should be consolidated and heard by the Business Court Division. If these cases are not consolidated, five (5) different circuit court judges will have to hear and decide the same issues, possibly reaching inconsistent results. Thus, not only is this precisely the type of case suited to the Business Court Division, but, here, granting the Motion to Refer will also accomplish the important goal of judicial economy and consistency.

I. INTRODUCTION AND BACKGROUND

CNX is a producer of natural gas throughout the state of West Virginia, with conventional and Marcellus wells located in Barbour 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 state-wide mass appraisal system. CNX filed this action, as well as actions in Lewis, McDowell, Doddridge, and Harrison Counties, because the Tax Department failed to properly calculate the fair market value of its wells.

Certain variables are used by the State to value producing oil and natural gas wells, including, 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 maximum amounts 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. In several prior tax years, CNX submitted their actual operating expenses to the Tax Department for consideration. The 2016 administrative notice, unlike administrative notices from 2000 through 2015, however, did 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, the Tax Department calculates operating expenses at the lesser of 20% of gross receipts or \$150,000 for Marcellus wells, and 30% of gross receipts or \$5,000 for conventional wells (the "maximum amount" of \$150,000 of operating expenses per Marcellus well and \$5,000 of operating expenses per conventional well will be referred to as the "maximum amounts" or "caps"). These caps unduly restrict the amount of operating expenses

that should be allowed for each 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. The legislative rule instead requires the Tax Department to use “average annual industry operating expenses per well” in valuing producing wells, and does not authorize the Tax Department to “cap” operating expenses at a certain amount.

CNX evaluated its actual operating expenses for calendar year 2014,¹ and determined that for conventional wells and the Marcellus wells in the county, the amount of operating expenses that it was incurring for each of these wells exceeded the maximums set by the state.

CNX, like many mineral producers, generally reports its operating expenses to the Tax Department on a state-wide basis. For 2014, CNX’s average operating costs for a Marcellus well is 26% of revenue, or \$537,000. (Hr’g Tr., at p. 28:4-28:16). CNX’s average operating costs for a conventional well is 37% of revenue, or \$5,898. (*Id.*). Thus, the “caps” unduly restrict the amount of operating expenses allowed for these wells. By failing to consider CNX’s actual operating expenses, the Tax Department has overvalued the wells.

On October 17, 2016, CNX protested the Tax Department’s valuation (as adopted by the Barbour County Assessor) to the Barbour County Commission sitting as the Barbour County Board of Assessment Appeals (the “Board”). CNX presented clear and convincing evidence that the Tax Department failed to consider CNX’s actual operating expenses in determining the valuation for the wells assessed for Barbour County. (Certified Transcript of October 17, 2016 Hearing before the Barbour County Board of Assessment Appeals, See Exhibit A to CNX’s Petition [hereinafter “Hr’g Tr.”]). CNX also presented an analysis of its actual operating expenses from the state and local tax firm Altus Group US, Inc. (“Altus”), supported by

¹ For property tax purposes, the operating expense data from calendar year 2014 is used to value the wells for tax year 2016.

testimony from Kirsten Evans of Altus. (Hr'g Tr., at pp. 13-78.) The Board, however, made no adjustment to the Tax Department's valuation.

Ms. Evans of Altus explained that a correct application of the allowable operating expenses demonstrated that the Tax Department erred by failing to allow the operating expenses documented by CNX. (*See* Hr'g Tr., 28:10-29:6). CNX submitted detailed charts and documentation of actual operating expenses, with numbers specific to Barbour County, to the Board. (*See* Petitioner's Exhibits). Ms. Evans further testified regarding an impairment test done by CNX in connection with required Securities and Exchange Commission filings, which provided evidence that the State had significantly overvalued CNX's wells. (*See* Hr'g Tr. at pp. 32:9-33:15; Hr'g Tr., Ex. 5). Ms. Evans also explained that the percentage of operating expenses is increasing as gas prices are going down. She explained that expenses have not changed, but because revenues have decreased, the State's cap places an artificially low ceiling on the operating expenses that CNX is allowed to take. (Hr'g Tr., at pp. 22:15-22:21, 23:14-29:6, 42:12-43:5). She testified that, as a result, the values derived from the State's methodology are in excess of the true value of the wells.

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 CNX's wells in Barbour County. (*See* Hr'g Tr., 83:15-85:4; *see also* Hr'g Tr., Ex. 7). Mr. Harden explained that the Tax Department's valuation did not properly account for the actual operating costs of the wells at issue, and used a different discount (capitalization) rate and a different production decline percentage. (Hr'g Tr., 83:15-98:14.) Mr. Harden valued CNX's Barbour County wells at just over \$40 million, while the State valued them at over \$71 million. (*Id.* at 98:4-98:14; *see also* Hr'g Tr., Ex. 7).

Despite the clear and convincing evidence produced by CNX, by October 24, 2016 Order, the Board determined to make no adjustment to the State Tax Department's valuation of CNX's gas wells for the 2016 tax year. (See Ex. B to CNX's Petition). CNX timely petitioned the Barbour County Circuit Court for relief from the Board's erroneous determination.

In its petition, CNX alleges that the Tax Department (1) has not applied the demonstrated, proven, actual operating expenses, as set forth in CNX's Exhibits and expert testimony at the hearing before the Board on October 17, 2016; (2) failed to apply its own rules in calculating the fair market value of CNX's wells, (3) improperly placed a "cap" on operating expenses, resulting in an inflated value of CNX's wells, (4) treats similarly situated tax payers differently in violation of United States Constitution and the West Virginia Constitution, as the "caps" only adversely affect tax payers that have wells with gross receipts over a certain threshold.

CNX asks the Court to (1) find that the Board incorrectly upheld the valuation of CNX's Barbour County gas wells by the West Virginia Department of Revenue, State Tax Department, Property Tax Division for the 2016 tax year, and (2) fix the value of CNX's Barbour County gas wells for the 2016 tax year at its true and actual value of \$40.3 million, as calculated by Hein & Associates and based on the actual direct operating expenses incurred by CNX.

Because the issues in this matter are complex and require specialized knowledge with respect to the taxation of oil and gas wells, specialized treatment will improve the expectation of a fair and reasonable resolution of this matter. Accordingly, CNX requests that this matter be transferred to the Business Court Division.

II. APPLICABLE LEGAL STANDARD

West Virginia Trial Court Rule 29.06 provides that "[a]ny party . . . may seek a referral of Business Litigation to the [Business Court] Division by filing a Motion to Refer to the

Business Court Division with the Clerk of the Supreme Court of Appeals of West Virginia.” Tr.

Ct. R. 29.06(a). “Business Litigation” is defined as follows:

(a) “Business Litigation”-- one or more pending actions in circuit court in which:

(1) the principal claim or claims involve matters of significance to the transactions, operations, or governance between business entities; and

(2) the dispute presents commercial and/or technology issues in which specialized treatment is likely to improve the expectation of a fair and reasonable resolution of the controversy because of the need for specialized knowledge or expertise in the subject matter or familiarity with some specific law or legal principles that may be applicable; and

(3) the principal claim or claims do not involve: consumer litigation, such as products liability, personal injury, wrongful death, consumer class actions, actions arising under the West Virginia Consumer Credit Act and consumer insurance coverage disputes; non-commercial insurance disputes relating to bad faith, or disputes in which an individual may be covered under a commercial policy, but is involved in the dispute in an individual capacity; employee suits; consumer environmental actions; consumer malpractice actions; consumer and residential real estate, such as landlord-tenant disputes; domestic relations; criminal cases; eminent domain or condemnation; and administrative disputes with government organizations and regulatory agencies, provided, however, that *complex tax appeals are eligible to be referred to the Business Court Division.*

W. Va. Trial Ct. R., 29.04 (emphasis added).

III. ANALYSIS

This is a complex tax appeal that should be referred to the Business Court Division. The tax assessment issues in this case are technical, and are precisely the type of issues that should be referred to the Business Court Division. *See* Trial Ct. R., 29.04(a)(3) (providing that “complex tax appeals are eligible to be referred to the Business Court Division.”). Further, this case “involve[s] matters of significance to the transactions, operations, or governance between business entities,” and “presents commercial and/or technology issues in which specialized

treatment is likely to improve the expectation of a fair and reasonable resolution of the controversy.” *See* Trial Ct. R., 29.04(a)(1)-(2).

Here, CNX is challenging the Tax Department’s valuation of its wells in Barbour County. Before the Board, CNX submitted proof of its actual operating expenses, which it contends should be used in determining the value of its wells. CNX’s expert, Ms. Evans of Altus, testified regarding an impairment test done by CNX in connection with required Securities and Exchange Commission filings, which provided evidence that the State had significantly overvalued CNX’s wells. (*See* Hr’g Tr. at pp. 32:9-33:15; Hr’g Tr., Ex. 5). Ms. Evans also explained how decreases in gas prices have affected the valuation of the wells. (Hr’g Tr., at pp. 22:15-22:21, 23:14-29:6, 42:12-43:5). Hein & Associates also explained that the Tax Department’s valuation did not properly account for actual operating costs of the wells at issue, and used a different discount (capitalization) rate and a different production decline percentage than the Tax Department. (*See* Hr’g Tr., 83:15-98:14; *see also* Hr’g Tr., Ex. 7). Despite the clear and convincing evidence produced by CNX, the Board made no adjustment to the Tax Department’s valuation.

This tax appeal presents “issues in which specialized treatment is likely to improve the expectation of a fair and reasonable resolution of the controversy.” *See* Trial Ct. R., 29.04(a)(2). In order to fairly and reasonably resolve these issues, the decision-maker should have familiarity with the tax code, the mechanisms used to value taxable property, the mass appraisal system used to assess oil and gas wells (including the methodology set forth in § 110-1J-4.1 as reflected in Tax Department’s 2016 Administrative Notice), as well as familiarity with allowable operating expenses under Section 3.16 of Series 1J, Title 110. As demonstrated in the hearing transcript and exhibits (attached to CNX’s complaint), CNX has placed clear and convincing

evidence on the record as to why its conventional wells have been overvalued. CNX asserts that specialized knowledge on the above-mentioned issues would improve the likelihood that the submitted documentation and testimony is fairly considered, and that a reasonable resolution of this controversy will result.

Furthermore, several tax matters have been referred to the Business Court Division. *See e.g., Lee Trace LLC v. Berkeley County Council as Board of Review and Equalization, et al.*, Case Nos. 11-AA-2 and 14-AA-1, 2015 WL 7628718 (W. Va. Nov. 20, 2015) (deciding Lee Trace LLC's appeal of the Business Court Division's decision related to its challenge of its property tax assessments, including that it did not receive proper notice of its right to appeal its assessment, that the assessor did not consider the requisite depreciation factors, and that the assessor failed to consider income information); *Matkovich v. University Healthcare Foundation, Inc.*, 238 W.Va. 345, 795 S.E.2d 67 (2016) (deciding whether a parcel of real property is exempt from *ad valorem* property tax); *John Skidmore Trucking, Inc. v. Mark W. Matkovich*, Case No. 14-C-27, Braxton County Circuit Court, Business Court Division (involving an assessment for sales and use tax related to services provided by an Enrolled Agent). Most recently, the Court referred Antero Resources Corporation's 2016 and 2017 tax appeals related to the valuation of its oil and gas wells to the Business Court Division. *See* June 22, 2017 Administrative Order, attached as Exhibit A. Like Antero Resources Corporation's appeals, CNX's appeals concern the interplay between allowed operating expenses and overvaluation of the wells.² The issues presented in this case similarly qualify for referral and transfer to the Business Court Division under W.Va. Trial Court Rule 29.06.

² CNX notes that slight differences exist in these cases, particularly because all of Antero Resources Corporation's wells are Marcellus wells, while most of CNX's wells are conventional wells.

Finally, because this case is in the early stages of litigation, referral to the Business Court would not prejudice the Respondents or waste judicial resources. Instead, it is in the interest of the parties and judicial economy for the above-referenced related cases to be consolidated and referred to the Business Court Division. Absent transfer and consolidation, five (5) different circuit judges will have to hear and decide the same issue, possibly reaching inconsistent results. Thus, not only is this case exactly the type that should be referred to the Business Court Division, but consolidation in the Business Court Division will also promote judicial economy and consistency. For all of these reasons, this case should be referred to the Business Court Division.

In further support of this Motion, please find attached hereto an accurate copy of the operative complaint, answer, and docket sheet.

IV. CONCLUSION

WHEREFORE, the undersigned hereby moves, pursuant to W.Va. Trial Court Rule 29.06, the Chief Justice of the West Virginia Supreme Court of Appeals to refer this case to the Business Court Division.

Respectfully submitted, this 30th day of June, 2017.

CNX GAS COMPANY LLC,

By Counsel



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CERTIFICATE OF SERVICE

I, John Meadows, do hereby certify that on this 30th day of June, 2017, I have served the foregoing "*Motion to Refer Case to Business Court Division*," with attachments by first class mail to all counsel of record at the addresses provided below:

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