

IN THE CIRCUIT COURT OF LEWIS COUNTY, WEST VIRGINIA

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

Petitioner,

v.

**Civil Action No. 17-C-11
The Honorable Kurt W. Hall**

**THE HONORABLE DALE W. STEAGER¹,
West Virginia State Tax Commissioner,
THE HONORABLE JOHN L. BREEN,
Assessor of Lewis County, and
THE COUNTY COMMISSION OF LEWIS COUNTY,
Sitting as a Board of Assessment Appeals**

Respondents.

**ANSWER OF THE
WEST VIRGINIA STATE TAX DEPARTMENT**

COMES NOW Dale W. Steager, State Tax Commissioner of the State of West Virginia (hereinafter, sometimes referred to as "Tax Commissioner" or "Tax Department"), by counsel, in order to Answer the *Complaint of Petitioner* filed in this matter and states as follows. The *Complaint of Petitioner* (hereinafter, *Complaint*) was filed with the Circuit Court of Lewis

¹ On January 16, 2017, Governor Justice appointed Dale W. Steager, Esquire, to be the WV State Tax Commissioner. Tax Commissioner Steager is substituted as party in place of the previous Tax Commissioner, Mark W. Matkovich, pursuant to Rule 25(d) of the West Virginia Rules of Civil Procedure.

County on or about January 25, 2017. The *Complaint* was served on the Tax Department on or about January 26, 2017.

ANSWER TO COMPLAINT

The paragraphs in the *Complaint* are not individually numbered as required pursuant to the Rules of Civil Procedure; nevertheless, the Tax Department will respond to the *Complaint* as if the paragraphs were numbered as required.

1. The Tax Department admits the allegations set forth in Paragraph 1 of the *Complaint*.

2. Paragraph 2 of the *Complaint* summarizes the law and mechanical procedures regarding the valuation of property for *ad valorem* tax purposes. No response is required. To the extent that a response may be applicable, the Tax Department denies that it failed to correctly value CNX Gas's property for tax purposes and states that legal conclusions will be determined by the Court. Furthermore, the procedures applied by the Tax Department are set forth in the testimony of Cindi Hoover, Senior Appraiser, as recorded in the transcript of the October 2016 hearing.

3. The Tax Department states that sentence 1 of Paragraph 3 of the *Complaint* generally summarizes the law and mechanical procedures regarding the valuation of property for *ad valorem* tax purposes. No response is required. The Tax Department admits that it invited taxpayers to submit actual operating expenses per well for review and consideration by the Property Tax Division in prior years as alleged in the first part of sentence 2 of Paragraph 3. The Tax Department lacks sufficient information to form an opinion with regards to the truth or falsity of the remaining allegations in of sentence 2; consequently, those allegations are denied.

The Tax Department states that the applicable legislative rules do not authorize the Tax Department to utilize statewide allocated operating expenses for individual taxpayers as demanded by CNX Gas; furthermore, CNX Gas has failed to cite any statutory authority for the use of statewide CNX's allocated operating expenses for individual taxpayers as demanded by the Taxpayer. The Tax Department denies that CNX submitted actual operating expenses per well for review and consideration as alleged in sentence 3 of Paragraph 3; the Tax Department states that CNX submitted allocated expenses in prior years contrary to the allegations set forth in sentence 3 of Paragraph 3. The Tax Department admits that Administrative Notice 2016-08 does not invite taxpayers to submit actual operating expenses per well for review and consideration by the Property Tax Division as in prior years as alleged in the first part of sentence 4 of Paragraph 3. The Tax Department states that Administrative Notice 2016-08 complies with the applicable state law and legislative rules contrary to the remaining allegations set forth in sentence 4 of Paragraph 3. The Tax Department denies that CNX submitted actual operating expenses per well for review and consideration as alleged in sentence 5 of Paragraph 3. The Tax Department denies the remaining allegations set forth in Paragraph 3 of the *Complaint*. To the extent that a further response may be applicable, the Tax Department denies that it failed to correctly value the Petitioner's property for tax purposes and states that legal conclusions will be determined by the Court.

4. The Tax Department denies that CNX Gas provided actual operating expenses for each of the 864 gas wells under protest in Lewis County as alleged in Paragraph 4 of the *Complaint*. Nancy Sitton, witness for CNX Gas, admitted that CNX Gas "...does not track their expenses at the individual well level." Transcript of October 24, 2017 Hearing at P. 20, lines 11-12. Upon information and belief, the Tax Department states that CNX Gas has allocated its

statewide expenses to its West Virginia gas wells. CNX Gas has provided no statutory or other authority for the use of CNX Gas' substitute figures instead of the average annual industry operating expenses as required by the applicable legislative rules for valuing operating oil and gas wells. See W. Va. St. R. § 110-1J-4.3. The Tax Department admits that the valuation for the 2016 tax year is based on the operating results for the 2014 calendar year as alleged in Paragraph 4 of the *Complaint*. The Tax Department lacks sufficient information to determine the truth or falsity of the remaining allegations set forth in Paragraph 4 of the *Complaint* regarding the basis on which CNX Gas calculated operating expenses; consequently, those allegations are denied.

5. The Tax Department admits that Administrative Notice 2016-08 established the direct ordinary operating expenses for the various types of oil and gas wells as alleged in Paragraph 5 of the *Complaint*. The Tax Department further states that direct ordinary operating expenses are set forth with particularity in Administrative Notice 2016-08. The Tax Department denies that CNX Gas provided actual operating expenses for the gas wells under protest as alleged in Paragraph 5 of the *Complaint*. The Tax Department denies the remaining allegations set forth in Paragraph 5.

6. The Tax Department admits that CNX Gas appeared at a Board of Assessment Appeals hearing in October 2016, presented a report from Altus group, and that the BAA made no changes to the Tax Department's valuation as alleged in Paragraph 6 of the *Complaint*. However, the Tax Department denies that CNX presented clear and convincing evidence to support its protest, also that CNX provided actual operating expenses for each well under protest, and the remaining allegations set forth in Paragraph 6 of the *Complaint*.

7. The Tax Department lacks sufficient information to determine whether the appeal before the Circuit Court of Lewis County was filed timely; consequently, that allegation is

denied. The Tax Department denies the remaining allegations set forth in Paragraph 7 of the *Complaint*.

8. The Tax Department admits the allegations set forth in Paragraph 8 of the *Complaint*.

9. The Tax Department denies that CNX Gas submitted actual operating expenses per well for review and consideration as alleged in sentence 1 of Paragraph 9 of the *Complaint*. The Tax Department lacks sufficient information to form an opinion with regards to the truth or falsity of the allegations in of sentence 2 of Paragraph 9; consequently, those allegations are denied. In valuing the CNX Gas wells for the 2016 TY, the Tax Department applied the average annual industry operating expenses as required by the applicable legislative rules for valuing operating oil and gas wells. See W. Va. St. R. § 110-1J-4.3. The Tax Department admits that it did not change the average annual industry operating expenses as calculated under the legislative rule in order to accommodate CNX Gas' request as alleged in sentence 3 of Paragraph 9 of the *Complaint*. The Tax Department further denies that the valuation of CNX Gas' property for ad valorem tax purposes is erroneous in any manner.

10. Paragraph 10 of the *Complaint* summarizes some of the mechanical procedures regarding the valuation of property for *ad valorem* tax purposes. No response is required. To the extent that a response may be applicable, the Tax Department denies that it failed to correctly value the Petitioner's property for tax purposes and states that legal conclusions will be determined by the Court.

11. The Tax Department admits that in prior years the Tax Department stated in the administrative notices that it would consider, and possibly use, the actual operating expenses from individual producers in the valuation of the property as alleged in the first sentence of

Paragraph 11 of the *Complaint*. The Tax Department denies that it is authorized by statute or legislative rule to use actual operating expenses for each well for individual taxpayers or any other substitute figure requested by taxpayers in valuing the property instead of the "average annual industry operating expenses" required pursuant to W.Va. St. R. § 110-1J-4.3 as alleged in Paragraph 11 of the *Complaint*; the Tax Department demands strict proof thereof. The Tax Department further denies that CNX submitted actual operating expenses per well for the 864 conventional gas wells under protest in Lewis County as alleged in Paragraph 11 of the *Complaint*. Upon information and belief, the Tax Department argues that CNX Gas provided allocated expenses and not actual operating expenses for the 864 conventional gas wells under protest in Lewis County. The Tax Department lacks sufficient information to determine the truth or falsity of the remaining allegations in Paragraph 11 of the *Complaint*; consequently, those allegations are denied.

12. The Tax Department states that the deduction for the "average annual industry operating expenses" required pursuant to W.Va. St. R. § 110-1J-4.3 is set forth in the administrative notices as alleged in sentence 1 of Paragraph 12 of the *Complaint*. The Tax Department states that the administrative notices speak for themselves. Furthermore, the Tax Department objects to any attempts to characterize the administrative notices as alleged in sentence 1 of Paragraph 12 of the *Complaint*. The Tax Department denies the allegations set forth in sentence 2 of Paragraph 12. The Tax Department admits that it valued CNX Gas' wells at \$26.7 million and that the Taxpayer proffered a value of \$18.1 million as alleged in sentence 3 of Paragraph 12. However, the Tax Department denies that CNX Gas has correctly valued its gas wells under the legislative rules as alleged in sentence 3 of Paragraph 12. The Tax Department admits that CNX Gas hired Hein & Associates to value the gas wells as alleged in

sentences 4 & 5 of Paragraph 12. However, the Tax Department denies that the values proffered by Hein & Associates represent the true and actual value of CNX Gas' wells as alleged in sentences 4 & 5 of Paragraph 12.

13. The Tax Department admits the allegations set forth in Paragraph 13 of the *Complaint*.

14. The Tax Department denies that it failed to support the refusal to accept CNX's proffered allocated expenses with credible evidence as alleged in the first part of Paragraph 14. Furthermore, the Tax Department admits that it questioned CNX's "apportionment of expenses" since CNX Gas did not provide the actual expenses of each of the 864 gas wells under protest as alleged in Paragraph 14. The Tax Department admits that it argued its procedures are in accordance with the legislative rules as alleged in Paragraph 14. The Tax Department admits that it would be impractical and expensive to perform a fee appraisal on each of the 864 gas wells challenged by CNX Gas in Lewis County and statewide as alleged in Paragraph 14 of the *Complaint*.

15. The Tax Department admits that Nancy Sitton of Altus Group testified at the Board of Assessment Appeals hearing on October 24, 2016, as alleged in sentence 1 of Paragraph 15. The Tax Department denies the remaining allegations set forth in sentence 1 of Paragraph 15. The Tax Department admits that numerous documents were admitted into the record as alleged in sentence 2 of Paragraph 15. However, the Tax Department denies the remaining allegations set forth in sentence 2 of Paragraph 15. The Tax Department admits that two pages from the SEC Form 10-K for CNX Gas' parent company were admitted into the record as alleged in sentence 3 of Paragraph 15. However, the Tax Department denies the remaining allegations set forth in sentence 3 of Paragraph 15.

16. The Tax Department admits that Ms. Sitton, of Altus, also testified regarding an impairment test as alleged in sentence 1 of Paragraph 16. The Tax Department denies that it has erroneously valued the CNX Gas wells and the remaining allegations set forth in sentence 1 of Paragraph 16. In addition, the Tax Department admits that Ms. Sitton testified regarding the valuation of CNX Gas' property in Lewis County and that Ms. Sitton argued that CNX's property should be valued at \$18.1 million as alleged in Paragraph 16 of the *Complaint*. The Tax Department denies that Ms. Sitton's testimony demonstrated that the CNX wells were overvalued under West Virginia law as alleged Paragraph 16 of the *Complaint*. The Tax Department further denies that it has valued CNX Gas' property incorrectly in any manner under West Virginia law as alleged in Paragraph 16 of the *Complaint*. The Tax Department denies the remaining allegations in Paragraph 16 of the *Complaint*.

17. The Tax Department admits that Clarence James Harden of Hein & Associates testified on behalf of CNX Gas at the hearing as alleged in sentence 1 of Paragraph 17. The Tax Department further admits that Mr. Harden appraised the CNX gas wells; however, the Tax Department denies that Mr. Harden's appraisal of the CNX Gas wells represents the true and actual value of the gas wells under West Virginia law as alleged in sentence 2 of Paragraph 17. The Tax Department denies that it has failed to correctly value the CNX gas wells as alleged in sentence 3 of Paragraph 17. The Tax Department admits the allegations in sentence 4 of Paragraph 17. The Tax Department further denies that the valuation of CNX Gas' property for ad valorem tax purposes is erroneous in any manner as alleged in Paragraph 17.

18. The Tax Department admits that CNX Gas protested the valuation of its gas wells as determined by the Lewis County Assessor, appeared at the Board of Assessment Appeals hearing in October 2016, and produced a transcript of the proceedings as alleged in Paragraph 18

of the *Complaint*. The Tax Department lacks sufficient information to determine the truth or falsity of the remaining allegations set forth in Paragraph 18 of the *Complaint*; consequently, those allegations are denied.

19. The Tax Department admits that the Board of Assessment Appeals affirmed the Tax Department's valuation of the gas wells by an Order entered November 7, 2016 and that CNX appealed the decision to the Circuit Court of Lewis County as alleged in Paragraph 19 of the *Complaint*. The Tax Department lacks sufficient information to form an opinion with regards to the truth or falsity of the remaining allegations in Paragraph 19; consequently, those allegations are denied.

20. Paragraph 20 of the *Complaint* summarizes the law and legislative rule regarding the valuation of property for *ad valorem* tax purposes. No response is required. To the extent that a response may be applicable, the Tax Department denies that it failed to correctly value the Petitioner's property for tax purposes and states that legal conclusions will be determined by the Court.

21. Paragraph 21 of the *Complaint* summarizes the law and mechanical procedures regarding the valuation of property for *ad valorem* tax purposes. No response is required. To the extent that a response may be applicable, the Tax Department denies that it failed to correctly value the Petitioner's property for tax purposes and states that legal conclusions will be determined by the Court.

22. Paragraph 22 of the *Complaint* summarizes the law and mechanical procedures regarding the valuation of property for *ad valorem* tax purposes. No response is required. To the extent that a response may be applicable, the Tax Department denies that it failed to correctly

value the Petitioner's property for tax purposes and states that legal conclusions will be determined by the Court.

23. The Tax Department denies the allegations set forth in the first sentence of Paragraph 23 of the *Complaint*; the Tax Department states that CNX Gas has failed to cite any statutory authority requiring the use of an individual taxpayer's actual operating expenses in calculating the value of gas wells and demands strict proof thereof. Furthermore, the Tax Department denies that CNX presented actual operating expenses for each well under protest and denies that the information provided by CNX is the type of information contemplated by the legislative rule as alleged in the last sentence of Paragraph 23. The remaining allegations set forth in Paragraph 23 of the *Complaint* summarize the law and mechanical procedures regarding the valuation of property for *ad valorem* tax purposes. No response is required. To the extent that a response may be applicable, the Tax Department denies that it failed to correctly value the Petitioner's property for tax purposes and states that legal conclusions will be determined by the Court.

24. Paragraph 24 of the *Complaint* summarizes the law regarding the burden of proof for taxpayers challenging the valuation of property and the record to be reviewed in circuit court for the valuation of property for *ad valorem* tax purposes. No response is required. To the extent that a response may be applicable, the Tax Department denies that it failed to correctly value the Petitioner's property for tax purposes and states that legal conclusions will be determined by the Court.

25. The Tax Department denies the allegations set forth in the first sentence of Paragraph 25 of the *Complaint*. The remainder of Paragraph 25 recites CNX's prayer for relief.

No response is necessary. To the extent that a response may be applicable, the Tax Department denies that any relief is warranted in this case.

26. The Tax Department denies that it has discretion to select the appraisal methodology for operating oil and natural gas wells as alleged in Paragraph 26 of the *Complaint*. According to the applicable legislative rules, the value of oil and natural gas producing properties "...shall be determined through the process of applying a yield capitalization model to the net receipts...." See W. Va. St. R. § 110-1J-4.1. The Tax Department is required to use the income approach to value for operating oil and gas wells under the legislative rule. The Tax Department further denies that it failed to correctly apply the yield capitalization model to Petitioner's property for tax purposes and states that legal conclusions will be determined by the Court.

27. The Tax Department denies that it has erroneously valued the CNX Gas wells in Lewis County as alleged in sentence 1 of Paragraph 27 of the *Complaint*. Furthermore, the Tax Department denies that CNX Gas provided the actual operating expenses for the 864 conventional gas wells in Lewis County as alleged in sentence 1 of Paragraph 27. In addition, the Tax Department denies that it is authorized by statute or legislative rule to use actual operating expenses for each well for individual taxpayers or any other substitute figure requested by taxpayers in valuing the property instead of the "average annual industry operating expenses" required pursuant to W.Va. St. R. § 110-1J-4.3 as alleged in sentence 1 of Paragraph 27. The Tax Department denies the remaining allegations set forth in Paragraph 27. The Tax Department further denies that the valuation of CNX Gas' property for ad valorem tax purposes is erroneous in any manner as alleged in Paragraph 27.

28. The Tax Department denies every allegation in the *Complaint* which has not been specifically admitted.

AFFIRMATIVE DEFENSE NUMBER 1

29. CNX Gas has failed to cite any statutory authority requiring the Tax Department to use the actual operating expenses for an individual taxpayer or any other substitute figure requested by taxpayers in valuing the operating oil and gas wells under protest for *ad valorem* tax purposes in a mass appraisal environment. The Tax Department demands strict proof thereof.

AFFIRMATIVE DEFENSE NUMBER 2

30. CNX Gas has failed to provide the actual operating expenses per well for the 864 gas wells under protest in Lewis County. CNX has simply allocated the arithmetic average of its statewide expenses to gas wells.

AFFIRMATIVE DEFENSE NUMBER 3

31. The applicable legislative rule states:

4.3. Average industry operating expenses. -- The Tax Commissioner shall every five (5) years, determine the average annual industry operating expenses per well. The average annual industry operating expenses shall be deducted from working interest gross receipts to develop an income stream for application of a yield capitalization procedure.

W. Va. St. R. § 110-1J-4.3 (emphasis added). The Tax Department has correctly valued the operating gas well as required under the applicable legislative rules.

WHEREFORE, State Tax Commissioner prays the Honorable Court **DISMISS** the *Complaint* with prejudice, **AFFIRM** the valuation of the CNX Gas properties as determined by The Honorable John L. Breen, Assessor of Lewis County, **AFFIRM** the valuation of the CNX

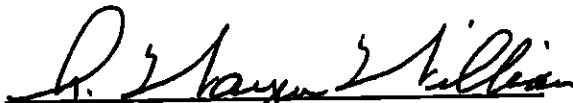
Gas properties as determined by the Lewis County Commission sitting as a Board of Equalization and Review, and for such additional relief as the Court deems just and proper.

Respectfully submitted,

DALE W. STEAGER
STATE TAX COMMISSIONER
OF WEST VIRGINIA,

By counsel

PATRICK MORRISEY
ATTORNEY GENERAL

A handwritten signature in cursive script, appearing to read "L. Wayne Williams", written over a horizontal line.

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CERTIFICATE OF SERVICE

I, L. Wayne Williams, Assistant Attorney General, do hereby certify that the foregoing *Answer of the West Virginia State Tax Department* was served upon the following by depositing a copy of the same in the United States Mail, via first-class postage prepaid, this 13th day of February, 2017, addressed as follows:

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