

IN THE CIRCUIT COURT OF BARBOUR COUNTY, WEST VIRGINIA

DENEX PETROLEUM CORPORATION,

A West Virginia Corporation,

Petitioner,

2017 AUG 17 PM 4:28

Vs.

CIRCUIT CLERK
BARBOUR COUNTY

CASE NO. 16-AA-1

Judge: Alan D. Moats

MARK MATKOVICH,

West Virginia State Tax Commissioner,

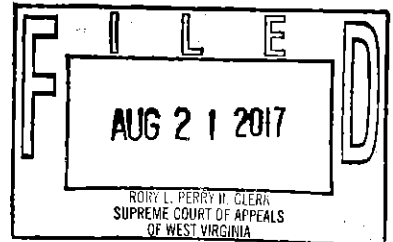
JOHN CUTRIGHT,

Assessor of Barbour County, and

THE COUNTY COMMISSION OF BARBOUR COUNTY,

Sitting as a Board of Equalization and Review,

Defendants.



MOTION TO REFER TO BUSINESS COURT DIVISION

Comes now the Court, sua sponte, and moves that the above styled case be referred to the Business Court Division for all further proceedings. Trial Court Rule 29.04 specifically provides that "complex tax appeals are eligible to be referred to the Business Court Division". A Motion to refer to the Business Court Division was recently granted in another case before the Circuit Court of Barbour County, that being Consol Energy, Inc. d/b/a CNX Gas Company LLC v. The Honorable Dale W. Steager et al., Case Number 16-AA-4. Also referred to the Business Court Division were similar cases from Harrison County, McDowell County, Lewis County, and Doddridge County.

The above styled case also involves a complex tax appeal much like the CNX cases, and the issues presented are very similar to the issues raised in the other matters which has already been referred to the Business Court Division. Therefore, it is in the interest of judicial economy to also refer this matter. Also, consideration of this matter by the Business Court Division could prevent an inconsistent result between the above styled cases and similar CNX Gas cases.

Attached to this Motion are the Complaint, Answer, Docket Sheet, and the Appeal Brief filed by Denex Petroleum.

This Court would respectfully moves, pursuant to Trial Court Rules 29.06, that the Chief Justice of the West Virginia Supreme Court of Appeals refer this matter to the Business Court Division.

The Clerk is directed to transmit a certified copy of this Motion to all parties or their counsel of record, to the Central Office of the Business Court Division, and to the Clerk of the Supreme Court of Appeals of West Virginia.

Date: 8/17/2017


JUDGE

A TRUE COPY

ATTEST: 
BARBOUR COUNTY CIRCUIT CLERK

BY: 
-DEPUTY CLERK

Document(s) served

Motion by Circuit Court *sua sponte* to refer case to Business Court Division

Attachments to Motion: Complaint, Answer, Docket Sheet, Appeal Brief filed by Petitioner
Denex Petroleum

Person(s) served / Method of Service: First Class US Mail

Rory L. Perry II, Clerk
West Virginia Supreme Court of Appeals
Capitol Complex
1900 Kanawha Boulevard East
Building One, Room E-317
Charleston, WV 25305

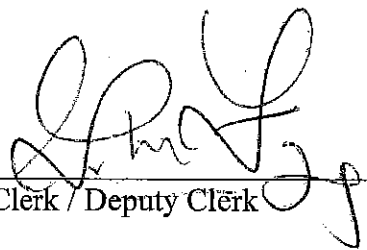
Carol A. Miller, Executive Director
Business Court Division
Berkeley County Judicial Center
380 W. South St., Suite 2100
Martinsburg, WV 25401

Counsel for Petitioner
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Weber & Weber
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Charleston, WV 25305

*Counsel for Respondent Barbour County
Assessor and Respondent
Barbour County Commission*
Stephen C. Sluss, Esq.
Attorney at Law
421 Midland Trail
Hurricane, WV 25526

August 18, 2017



Clerk / Deputy Clerk

GERALD M. FOGG
CLERK OF CIRCUIT COURT
BARBOUR COUNTY COURTHOUSE
26 NORTH MAIN ST. STE. 2
PHILIPPI, WEST VIRGINIA 26416

IN THE CIRCUIT COURT OF BARBOUR COUNTY, WEST VIRGINIA

DENEX PETROLEUM CORPORATION,
a West Virginia Corporation,

Petitioner,

v.

Civil Action No. 16-AA-1
The Honorable Alan D. Moats

THE HONORABLE MARK MATKOVICH,
West Virginia State Tax Commissioner,

THE HONORABLE JOHN CUTRIGHT,
Assessor of Barbour County, and

THE COUNTY COMMISSION OF BARBOUR COUNTY,
Sitting as the Barbour County Board of Review and Equalization,

Respondents.

COMPLAINT OF PETITIONER DENEX PETROLEUM CORPORATION

Comes now, Petitioner, Denex Petroleum Corporation, a West Virginia corporation, (hereinafter "Denex"), and for its complaint against Respondents The Honorable Mark Matkovich, West Virginia State Tax Commissioner, (hereinafter "Tax Commissioner"), The Honorable John Cutright, the Barbour County Assessor, (hereinafter "Assessor"), and The County Commission of Barbour County, West Virginia, (hereinafter "County Commission"), sitting as the Barbour county Board of Review and Equalization, Petitioner states, avers, and alleges as follows:

1. Denex Petroleum Corporation, a West Virginia corporation, (hereinafter "Denex"), is a small producer of natural gas in the state of West Virginia, and the operator of several producing conventional gas wells located in Barbour County.

2. Pursuant to *West Virginia Code* §11-3-1(a), as amended, all real property in Barbour County shall be assessed annually at sixty (60%) percent of its true and actual value.
3. Pursuant to *West Virginia Code* § 11-1C-10, as amended, the Tax Commissioner is charged with the duty of valuing all "natural resource" property, including but not limited to producing oil and natural gas properties, in the State of West Virginia.
4. Pursuant to *West Virginia Code* § 11-1C-10(d)(2) and (e), the Tax Commissioner is to value and provide the basis for assessment for all "natural resource" property, including but not limited to producing oil and natural gas properties, in the State of West Virginia through a mass "valuation plan".
5. That the mass "valuation plan" devised by the Tax Commissioner has been most recently codified as *110 CSR 1J*, (2006), "*Valuation of Producing and Reserve Oil and Natural Gas for Ad Valorem Property Tax Purposes*". (Exhibit No. 1 attached hereto).
6. That one of the variables to be used by the Tax Commissioner to value producing oil and gas wells is the operating expenses of the well, as defined in *110 CSR 1J* §3.16. The Tax Commissioner is to circulate a survey by which it solicits data from oil and natural gas producers regarding operating expenses for oil and natural gas wells, and, based upon that data, the Tax Commissioner determines operating expense variables to be used in its mass appraisal system. (See partial copy of the Tax Commissioner's "*Final Natural Resource Property Valuation Variables for 2016 Tax Year*" attached hereto as Exhibit No. 2).
7. Generally, operating expenses applied to a certain well by the Tax Commissioner's mass appraisal system is based upon 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. These operating expense calculations are included in a natural resources "valuation variables" document that the Tax Commissioner releases and distributes annually. (See Exhibit No. 2 attached hereto).

8. The 2016 allowed operating expense variable for producing, conventional natural gas wells is thirty (30%) percent of the well's gross revenue income, with a maximum operating expense of \$5,000.00. (See Exhibit No. 2 and Administrative Notice 2016-08, Exhibit No. 3, attached hereto).
9. The Tax Commissioner also mandates the use of an "income approach" to the valuation of oil and natural gas properties as set forth in the Tax Commissioner's *"Administrative Notice 2016-02, State Tax Commissioner's Statement Concerning Primary Reliance on the Income Approach to Value for Appraisals of Producing and Reserve Coal, Producing Oil and Gas, and Producing Other Mined Minerals Pursuant to §§ 110 CSR 11-4, 1J-4 and 1K-4"*. (See Exhibit No. 4 attached hereto).
10. *Administrative Notice 2016-02*, states, in part, that, "The income approach to value is based upon the assumption that a property is worth the future income, discounted to present worth, that it will generate for a prospective buyer". (See *Id.*).
11. Specifically, Denex is the operator of the producing, conventional natural gas and oil wells set out and listed on Exhibit Nos. 5 and 6, attached hereto and incorporated herein by reference. (It is noted that Exhibit Nos. 5 and 6 attached hereto are also Denex Hearing Exhibit Nos. 7 and 8).
12. Pursuant to statute and legislative rule, the Tax Commissioner is to prepare an annual natural resource property valuation variables for appraising oil and gas properties in

West Virginia. Further, the Tax Commissioner is to make a determination of those valuation variables pursuant to 110 CSR 1J, a legislative rule of the Tax Commissioner, promulgated pursuant to *West Virginia Code* § 11-1C-10(d). In order to determine the amount of Denex's operating expenses, and, in turn, the value of Denex's oil and gas wells, the Tax Commissioner is further governed by Administrative Notices 2016-02 and 2016-08.

13. That due to an unprecedented decrease in the market price of natural gas some of producing natural gas wells identified on page 1 of Exhibit Nos. 5 and 6 were operated at or below an economic limit, defined as a positive number after subtracting allowable expenses from gross receipts.
14. That by using its "mass valuation and appraisal system", as set forth above, and a vague income valuation approach, the Tax Commissioner has valued the Denex producing, conventional natural gas wells, as set forth on Exhibit Nos. 5 and 6, (being Denex Hearing Exhibit Nos. 7 and 8), in an amount greater than the well's true and accurate value, all in violation of *West Virginia Code* § 11-3-1(a), as amended.
15. To the best of Petitioner's information and belief, the State Tax Commissioner sent its valuation for the Denex wells to The Barbour County Assessor for assessment.
16. That Denex, as the taxpayer, was notified of the valuations and assessments for the 2016 tax year by the State Tax Department.
17. That on February 18, 2016, Denex, as the taxpayer, petitioned The County Commission of Barbour County, West Virginia, sitting as the Barbour County Board of Review and Equalization, to amend the Tax Commissioner's valuations to reflect

the true and actual value of the producing natural gas and oil wells set out on Exhibit Nos. 5 and 6.

18. That during the hearing, Denex produced the testimony of R. Dennis Xander, John Haskins, Dean Bucher, and Stephen Holmes. Denex further utilized and admitted, without objection, Petitioner's Exhibit Nos. 1 through 8. (Hrg. Tsp Pg. 44-45).
19. That all four (4) Denex witnesses testified, *inter alia*, that natural gas and oil wells that operate at a net loss, (where royalties, taxes, and operating expenses exceed gross revenue), have only a nominal value, using the income approach. (Hrg. Tsp Pgs. 20-31; 56-59; 67-73; 79-83).
20. That during the hearing, Denex witness John Haskins testified that the operating expenses charged by Denex for operation of the subject producing, conventional natural gas and oil wells was in line with industry standards for similar conventional well operating in Barbour County, West Virginia. (Hrg. Tsp. Pgs. 50-53).
21. That during the hearing the Tax Commissioner solicited the testimony of Cindy Hoover and admitted Respondents Exhibit Nos. 1 and 2, respectively.
22. As set forth on Petitioner's Exhibit Nos. 5 and 6 attached herein, (being Hearing Exhibit Nos. 7 and 8), through its witness testimony and exhibits, Denex clearly established, that on an actual per well basis, that the actual expenses of producing the wells was greater than the income generated for many of the subject wells, and, further, that the appraised values assigned for all of the subject wells exceed the true and actual value of said wells.
23. That during the February 18, 2016, hearing, the Tax Commissioner offered no credible evidence for its refusal to accept Denex's calculation of its actual operating

expenses for the producing natural gas and oil wells in question, except to question the presumption that Denex's stated operating expenses may be higher than others in the industry, to question Denex's expenses and costs applied to the individual wells for maintenance, and to question Denex's submission of forms. Petitioner notes that the Tax Commissioner does invite operators to submit actual expenses for a three year period for each producing well for consideration, however, the Tax Commissioner is under absolutely no statutory or regulatory duty to utilize same for valuation purposes. (See Exhibit No. 7 attached hereto).

24. Denex avers that all property in the State of West Virginia is required to "be assessed annually at its true and actual value" *West Virginia Code* § 11-3-1. The West Virginia State Tax Commissioner 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. *West Virginia Code* § 11-1C-10(d).
25. Pursuant to this statutory 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 outlines the mechanisms to be utilized in valuing taxable property.
26. 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. . . ." 110 CSR 1J §4.1. The methodology set forth in § 110-1J-4.1 is reflected in Tax Department Administrative Notice 2016-02, wherein it is provided that the Tax Commissioner is to primarily rely upon the income approach in valuing producing oil and gas property.

27. Denex further avers that, the Tax Commissioner should consider actual operating expenses to offset the presumed valuation of expenses for each well. Administrative Notice 2016-08. 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 Denex's witnesses, and the documents submitted to the Tax Commissioner and the Board of Review and Equalization, the operating expenses submitted by Denex are those contemplated in Section 3.14.
28. Denex's burden before the Board of Review and Equalization was to show by clear and convincing evidence that the Tax Commissioner's valuation (and, hence, the County's assessment) of its gas well operating expenses was erroneous. On appeal to this Court, the Court is to rely on the record developed before the Board of Review and Equalization and to determine whether the challenged property valuation is supported by substantial evidence.
29. That by letter dated February 20, 2016, and received by Denex on February 25, 2016, The County Commission of Barbour County, West Virginia, sitting as the Board of Review and Equalization, denied the relief sought. (See Exhibit No. 8 attached hereto).

30. The Tax Commissioner has failed to follow its statutory duty in that it is not utilizing an appraisal system that fairly and accurately values natural resource properties by ignoring actual operating expenses and instead relying upon out dated averages and estimates found in its valuation variables document and administrative notices. Clearly, when the sum of royalties, and actual operating expenses exceed gross revenue for any well, that well has no actual value, using the income approach to valuation.
31. The Tax Commissioner has abused its discretion by failing to consider Denex's actual and allowable operating expenses, in a manner contrary to the statutes, regulations and official releases from the Tax Commissioner governing valuation of natural resources property. Moreover, the Tax Commissioner has failed to support its valuation with substantial evidence. Denex, 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.
32. In this case, the Tax Commissioner failed to apply the demonstrated actual operating expenses supplied by Denex through its testimony and exhibits. Accordingly, Denex now petitions this Court to find that the Board of Review and Equalization incorrectly made no changes to the Tax Commissioner's valuation and that Denex's calculations of its allowed actual operating expenses clearly establish that the Tax Commissioner's mass valuation policy used to value producing natural gas wells is not correct.
33. Denex avers that although the State Tax Commissioner has discretion to select the appraisal/valuation method for determining natural resource property values for

assessment purposes, that the method selected must comply with the statutory mandate to determine the true and accurate value of the property, not a mere calculated estimate. Moreover, the method selected must be correctly applied to the type of asset. A true and actual valuation was not determined for the subject Denex wells.

34. Denex avers that the use of 30% of the gross revenues, capped at \$5,000 to determine operating expenses is inappropriate. As demonstrated in Exhibit No. 9 attached hereto, utilizing the data from Exhibit Nos. 5 and 6, (being Hearing Exhibit No. 7 and 8), the net price received by producers for natural gas delivered to Dominion Transmission, Inc., decreased from \$2.375 in 2014 to \$0.7523 in 2105, being a decrease of almost 70%. Assuming relatively stable gas production, gross revenues for the subject wells would similarly decline by 70%. Using the Tax Commissioner's method of determining operating expenses at 30% of gross revenue, those expenses would decrease by 70%, thus dramatically and erroneously understating said expenses, thereby overstating the value of the wells by the Tax Commissioner.
35. The Tax Commissioner's valuation formula does not appear to account for the variables of costs associated with future plugging liability and the Dominion Transmission, Inc., Firm Transportation nominations. (Hrg. Tsp. Pgs. 19-20; 27-29).
36. In this case, the Tax Commissioner has not applied the demonstrated, proven, actual operating expenses, as set forth in Denex's Exhibits and testimony at the hearing before the Board of Review and Equalization and the Tax Commissioner has, therefore, failed to properly assess the Denex natural resource properties pursuant to statutory and regulatory mandate.

WHEREFORE, Denex Petroleum Corporation, a West Virginia corporation, respectfully requests that the Court:

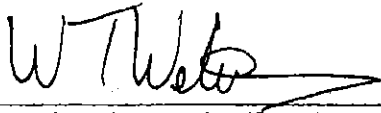
(i) Find that the Barbour County Board of Review and Equalization incorrectly upheld the valuation of Denex's Barbour County producing natural gas wells by the West Virginia Department of Revenue, State Tax Department, Property Tax Division for the 2016 tax year;

(ii) Fix the value of Denex's Barbour County producing natural gas and oil wells for the 2016 tax year at their true and actual value, based on the actual revenue realized and the actual direct operating expenses incurred by Denex in Barbour County for the 2016 calendar year;

(iii) Enter and Order finding that those Denex producing, conventional natural gas wells, subject of this action, which are operating at a net loss have only a nominal value and require the State Tax Department and Barbour County Assessor to correctly value and assess the same based upon the "*Minimum Working Interest Appraisal*" of \$500.00 per well as set forth in the Tax Commissioner's "*Final Natural Resource Property Valuation Variables for 2016 Tax Year*", attached hereto as Exhibit No. 2; and

(iv) Order such other relief as the Court deems appropriate.

Denex Petroleum Corporation,
A West Virginia Corporation
Petitioner, By counsel



W. T. Weber, III, Esquire (State Bar Id 6108)

Weber & Weber

239 Main Avenue

P. O. Box 270

Weston, West Virginia 26452

304-269-2228

Counsel for Petitioner

**CIVIL CASE INFORMATION STATEMENT
CIVIL CASES**

In the Circuit Court of Barbour County, West Virginia

I. CASE STYLE

**DENEX PETROLEUM CORPORATION,
a West Virginia Corporation,**

Petitioner,

v.

**Case No. 16-AA-1
Judge Alan D. Moats**

**THE HONORABLE MARK MATKOVICH,
West Virginia State Tax Commissioner,
THE HONORABLE JOHN CUTRIGHT,
Assessor of Barbour County, and
THE COUNTY COMMISSION OF BARBOUR COUNTY,
Sitting as the Barbour County Board of Review and Equalization,**

Respondents.

CIRCUIT CLERK
BARBOUR COUNTY

2016 MAY -2 PM 4: 08

PLAINTIFF: Denex Petroleum Corporation

CASE NUMBER: 16-AA-1

DEFENDANTS: Mark Matkovich, West Virginia State Tax Commissioner,
John Cutright, Assessor of Barbour County, and
The County Commission of Barbour County

II. TYPE OF CASE:

- ☐ General Civil
- ☐ Asbestos ☐ Adoption ☐ Appeal from Magistrate Court
- ☐ Professional Malpractice ☐ Contract ☒ Miscellaneous Civil Petition
- ☐ Administrative Agency Appeal ☐ Magistrate Sentence
- ☐ Personal Injury ☐ Real Property
- ☐ Product Liability ☐ Mental Health ☐ Other
- ☐ Other Tort

III. JURY DEMAND: ☐ Yes ☒ No

CASE WILL BE READY FOR TRIAL BY:

IV. DO YOU OR ANY OF YOUR CLIENTS OR WITNESSES IN THIS CASE REQUIRE SPECIAL ACCOMMODATIONS DUE TO A DISABILITY OR AGE?

☐ Yes ☒ No

IF YES, PLEASE SPECIFY:

- ☐ Wheelchair accessible hearing room and other facilities
☐ Interpreter or other auxiliary aid for the hearing impaired
☐ Reader or other auxiliary aid for the visually impaired
☐ Spokesperson or other auxiliary aid for the speech impaired
☐ Other: _____

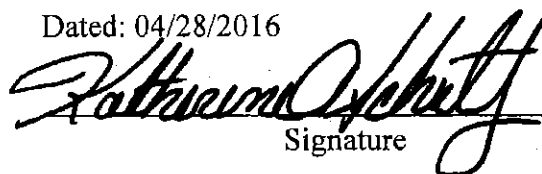
Attorney Name: Katherine A. Schultz,
Senior Deputy Att'y Gen. (WVSB #3302)

Representing: Mark Matkovich, West Virginia State Tax
Commissioner and John Cutright, Assessor of
Barbour County

Firm: WV Attorney General's Office
Address: Bldg. 1, Room W-435
1900 Kanawha Blvd., E.
Charleston, WV 25305
Telephone: (304) 558-2522

☐ Plaintiff ☒ Defendant
☐ Cross-Complainant ☐ Cross-Defendant

Dated: 04/28/2016


Signature

☐ Pro Se

IN THE CIRCUIT COURT OF BARBOUR COUNTY, WEST VIRGINIA

2016 MAY -2 PM 4:09

**DENEX PETROLEUM CORPORATION,
a West Virginia Corporation,**

Petitioner,

CIRCUIT CLERK
BARBOUR COUNTY

v.

**Civil Action No. 16-AA-1
Judge Alan D. Moats**

**THE HONORABLE MARK MATKOVICH,
West Virginia State Tax Commissioner,
THE HONORABLE JOHN CUTRIGHT,
Assessor of Barbour County, and
THE COUNTY COMMISSION OF BARBOUR COUNTY,
Sitting as the Barbour County Board of Review and Equalization,**

Respondents.

**RESPONDENTS MARK MATKOVICH, WEST VIRGINIA STATE
TAX COMMISSIONER AND JOHN CUTRIGHT, ASSESSOR
OF BARBOUR COUNTY'S MOTION TO DISMISS AND RESPONSE
TO COMPLAINT OF PETITIONER DENEX PETROLEUM CORPORATION**

Come now Respondents Mark W. Matkovich, West Virginia State Tax Commissioner (hereinafter, "Tax Commissioner") and John Cutright, Assessor of Barbour County (hereinafter, "Assessor"), by counsel, Katherine A. Schultz, Senior Deputy Attorney General, to request that the above-referenced matter be dismissed with prejudice because it was untimely filed. Without waiving their argument that the matter be dismissed, the Tax Commissioner and the Assessor respond to the Complaint of Petitioner Denex Petroleum Corporation (hereinafter, "Petitioner").

MOTION TO DISMISS

The Tax Commissioner and the Assessor move for dismissal of this action with prejudice because it was untimely filed.

West Virginia Code section 11-3-25(a)¹ sets the time for appealing decisions from both the County Commission sitting as a Board of Equalization and Review and the Board of Assessment. The time for filing an appeal depends on whether the decision is rendered by the Board of Equalization and Review or by the Board of Assessment. The decision being appealed *sub judice* is from a decision of the Board of Equalization and Review. West Virginia Code section 11-3-25(a) as it relates to such an appeal states that the Petitioner has “up to thirty days after the adjournment of the board sitting as a Board of Equalization and Review . . . [to] apply for relief to the circuit court.”

Upon information and belief, the Board of Equalization and Review adjourned on February 18, 2016. Therefore, this Complaint is untimely filed. Assuming *arguendo* that the February 20th date on the Board of Equalization and Review’s letter is determined to be the date of adjournment, then the Complaint is still untimely.

Based on the foregoing, these Defendants respectfully request that the matter be dismissed with prejudice and stricken from the Court’s docket.

RESPONSE TO COMPLAINT

Without waiving their argument asserted in the Motion to Dismiss, the Tax Commissioner and the Assessor respond as follows to the Complaint of Petitioner Denex Petroleum Corporation.

1. The Tax Commissioner and Assessor admit that Petitioner is a West Virginia corporation and the operator of several producing conventional gas wells located in Barbour County, but deny

¹In *Shenandoah Sales & Service, Inc. v. Assessor of Jefferson County*, 228 W. Va. 762, 724 S.E.2d 733 (2012), the West Virginia Supreme Court of Appeals found the portion of W. Va. Code § 11-3-25(b), which allowed non-lawyers to represent parties in an appeal to the circuit court, unconstitutional. This in no way affects the applicability of W. Va. Code § 11-3-25(a) upon which the Tax Commissioner and the Assessor rely.

that Petitioner is a small producer of natural gas in the State of West Virginia.

2. Paragraph 2 of the *Complaint* recites the West Virginia State Code. No response is required. However, Petitioner erroneously ignores that the West Virginia Legislature prescribed the manner in which oil and gas is to be assessed so that all property is equally and uniformly assessed.
3. Paragraph 3 of the *Complaint* recites the West Virginia State Code. No response is required. Notwithstanding the foregoing, the allegation is admitted.
4. Paragraph 4 of the *Complaint* recites the West Virginia State Code. No response is required. Notwithstanding the foregoing, the allegations are admitted.
5. The Tax Commissioner and Assessor admit that the mass "valuation plan" devised by the Tax Commissioner was most recently codified as W. Va. Code R. § 110-1J, but state that the rule became effective June 1, 2005, not 2006.
6. The allegations in the first sentence of Paragraph 6 are admitted. The average industry operating expenses are determined pursuant to the Legislative Rule, W. Va. Code R. § 110-1J-4.3. The way in which the Tax Commissioner determines the average operating expenses is left to the Tax Commissioner's discretion. He is not required to send a survey. However, the average industry standards were determined based on the survey results.
7. The Tax Commissioner and Assessor admit the allegations set forth in Paragraph 7 of the *Complaint* with the caveat that the allegations fail to acknowledge that for the year in question, the operators of oil and gas wells had the option of producing their actual expenses for the last three years to the Tax Department for consideration. The Petitioner's witness admitted that he chose not to submit the actual production expenses to the Tax Department.

Furthermore, the variable referenced in Paragraph 7 are filed with the Secretary of State along with the public comments received.

8. The allegations contained in Paragraph 8 of the *Complaint* are accurate to the extent that they reflect the information contained in Exhibit 2 and Administrative Notice contained in Exhibit 3; however, the allegation fails to acknowledge that the Petitioner had the ability to submit its itemized production expenses for the relevant time period.
9. The Tax Commissioner and Assessor deny the allegation in Paragraph 9 of the *Complaint* that the Tax Commissioner mandates the use of an "income approach." The Legislative Rule mandates the use of the "income approach" for the valuation of oil and natural gas properties. The remainder of the allegations contained in Paragraph 9 of the *Complaint* are admitted.
10. The Tax Commissioner and Assessor admit the allegations set forth in Paragraph 10 of the *Complaint*.
11. The Tax Commissioner and Assessor admit the allegations set forth in Paragraph 11 of the *Complaint*.
12. The Tax Commissioner and Assessor admit the allegations set forth in Paragraph 12 of the *Complaint* with the caveat that the Petitioner had the option of producing their actual expenses for the last three years to the Tax Department for consideration. The Petitioner's witness admitted that he chose not to submit the actual production expenses to the Tax Department. Furthermore, the variable referenced in Paragraph 12 are filed with the Secretary of State along with the public comments received.
13. The Tax Commissioner and Assessor deny the allegations set forth in Paragraph 13 of the *Complaint*.

14. The Tax Commissioner and Assessor deny the allegations set forth in Paragraph 14 of the *Complaint*.
15. The Tax Commissioner and Assessor admit the allegations set forth in Paragraph 15 of the *Complaint*.
16. The Tax Commissioner and Assessor admit the allegations set forth in Paragraph 16 of the *Complaint*.
17. The Tax Commissioner and Assessor admit that Petitioner has described its Petition before the County Commission of Barbour County sitting as the Barbour County Board of Equalization and Review.
18. The Tax Commissioner and Assessor admit the allegations set forth in Paragraph 18 of the *Complaint*.
19. The allegations contained in Paragraph 19 reflect a portion of these witnesses' testimony. However, the testimony expands the allowable expenses in the Legislative Rule and ignores other factors including, but not limited to, the future value of the wells.
20. The allegations in Paragraph 20 are admitted with the clarification that Mr. Haskins' testimony as a whole must be considered. Specifically, Mr. Haskins admitted that costs vary from well to well. Additionally he acknowledged that taxpayers have the ability to provide itemized expenses for the last three years. Furthermore, he admitted that he did not file any public comments to the Department's proposed operation expenses for the year.
21. The Tax Commissioner and Assessor admit the allegations set forth in Paragraph 21 of the *Complaint*.
22. The Tax Commissioner and Assessor deny the allegations set forth in Paragraph 22 of the

Complaint.

23. The allegation that no credible evidence was submitted by the Tax Commissioner is denied. Furthermore, the Petitioner had the burden of proof and it failed to provide itemized expenses.
24. The Tax Commissioner and Assessor admit the allegations set forth in Paragraph 24 of the *Complaint* with the qualification that the Legislature has determined that fair market value must be determined consistent with the Legislative Rule, W. Va. Code R. §110-1J-1, *et seq.* Furthermore, the Petitioner admits that its oil and gas wells were valued consistent with the Legislative mandate contained in the aforesaid Rule.
25. The Tax Commissioner and Assessor admit the allegations set forth in Paragraph 25 of the *Complaint* with the qualification that the Legislature has determined that fair market value must be determined consistent with the Legislative Rule, W. Va. Code R. §110-1J-1, *et seq.*
26. The allegations contained in the first sentence of Paragraph 26 of the *Complaint* are admitted. The allegations contained in the second sentence of Paragraph 26 are denied because although the Administrative Notice states that it "will address these rules' primary reliance on the income approach to value when appraising active and reserve coal, producing oil and gas," when read in its entirety the Notice concludes:

From the above discussion it becomes readily apparent that development of a cost or a market approach valuation for producing and reserve coal and *producing oil and gas and other minerals properties is inappropriate*. The Tax Department therefore developed and relied upon an income approach appraisal; as the income approach is the *only one* (1) of the three (3) generally accepted approaches to value that can properly be developed to yield reasonable estimates of current market value when used in a mass appraisal environment.

Administrative Notice 2016-02 (emphasis added).

27. The Tax Commissioner and Assessor admit that the portion of the Legislative Rule referenced is correctly quoted. However, the remaining allegations in Paragraph 27 are denied.
28. The Tax Commissioner and Assessor admit the allegations set forth in Paragraph 28 of the *Complaint*.
29. The Tax Commissioner and Assessor admit that the County Commission denied the relief sought in a letter dated February 20, 2016. The Tax Commissioner and Assessor lack sufficient information or knowledge to admit the remaining allegations contained in Paragraph 29.
30. The Tax Commissioner and Assessor deny the allegations set forth in Paragraph 30 of the *Complaint*.
31. The Tax Commissioner and Assessor deny the allegations set forth in Paragraph 31 of the *Complaint*.
32. The Tax Commissioner and Assessor deny the allegations set forth in Paragraph 32 of the *Complaint*.
33. The Tax Commissioner and Assessor deny the allegations set forth in Paragraph 33 of the *Complaint*. The Tax Commissioner is required to follow the applicable Legislative Rule.
34. The Tax Commissioner and Assessor deny the allegations set forth in Paragraph 34 of the *Complaint*.
35. The Tax Commissioner and Assessor admit the allegations set forth in Paragraph 35 of the *Complaint*; however, the plugging liability and the Dominion Transmission Inc. Firm

Transportation nominations are not operation costs, which are considered under the proper application of the Legislative Rule, to uniformly value natural gas.

36. The Tax Commissioner properly applied the Legislative Rule to arrive at the valuation of the Petitioner's property. The Tax Commissioner and Assessor deny the allegations set forth in Paragraph 36 of the *Complaint*.
37. The Tax Commissioner and Assessor deny all allegations set forth in the *Complaint* that have not been specifically admitted.
38. The Tax Commissioner and Assessor deny that Petitioner is entitled to any of the relief requested.

WHEREFORE, the Tax Commissioner and Assessor pray that the Honorable Court **DISMISS** this matter with prejudice because it was untimely filed. In the alternative, the Tax Commissioner and Assessor request that the Petitioner's Complaint be **DENIED** with prejudice.

Respectfully submitted,

**MARK W. MATKOVICH,
WEST VIRGINIA STATE
TAX COMMISSIONER,**

**JOHN CUTRIGHT, ASSESSOR
OF BARBOUR COUNTY,**

By counsel

**PATRICK MORRISEY
ATTORNEY GENERAL**

A handwritten signature in black ink, appearing to read "Katherine A. Schultz", written over the printed name.

**KATHERINE A. SCHULTZ (WVSB #3302)
SENIOR DEPUTY ATTORNEY GENERAL**

1900 Kanawha Boulevard, East
Building 1, Room W-435
Charleston, West Virginia 25305
(304) 558-2522

IN THE CIRCUIT COURT OF BARBOUR COUNTY, WEST VIRGINIA

DENEX PETROLEUM CORPORATION,
a West Virginia Corporation,

Petitioner,

v.

Civil Action No. 16-AA-1
Judge Alan D. Moats

THE HONORABLE MARK MATKOVICH,
West Virginia State Tax Commissioner,
THE HONORABLE JOHN CUTRIGHT,
Assessor of Barbour County, and
THE COUNTY COMMISSION OF BARBOUR COUNTY,
Sitting as the Barbour County Board of Review and Equalization,

Respondents.

CERTIFICATE OF SERVICE

I, Katherine A. Schultz, hereby certify that on the 28th day of April, 2016, true copies of the
“Respondents Mark Matkovich, West Virginia State Tax Commissioner and John Cutright,
Assessor of Barbour County’s Motion to Dismiss and Response to Complaint of Petitioner
Denex Petroleum Corporation” and the “Civil Case Information Statement” were served upon
the following by depositing the same in the United States mail, via first-class postage prepaid,
addressed as follows:

W.T. Weber III, Esquire
WEBER & WEBER
PO Box 270
Weston, West Virginia 26452

Stephen C. Sluss, Esquire
PO Box 635
Teays, West Virginia 25569


Katherine A. Schultz



RECEIVED
2016 MAY -2 PM 4:08

State of West Virginia
Office of the Attorney General
Tax & Revenue, Court of Claims and Transportation Division
Patrick Morrissey
Attorney General

CIRCUIT CLERK
BARBOUR COUNTY
(304) 558-2522
Fax (304) 558-2525

April 28, 2016

The Honorable Gerald M. Fogg
Clerk of Circuit Court of Barbour County
26 N. Main Street, Suite 2
Philippi, West Virginia 26416

Via Facsimile (304) 457-2790
and U.S. Mail

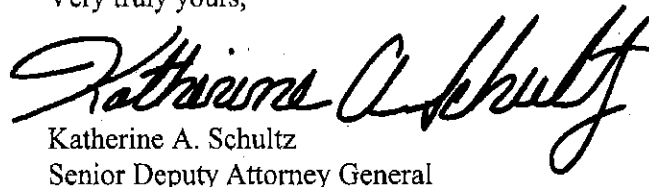
Re: *Denex Petroleum Corporation v. Matkovich, State Tax Commissioner, et al.*
Civil Action No. 16-AA-1

Dear Mr. Fogg:

Enclosed please find the "Respondents Mark Matkovich, West Virginia State Tax Commissioner and John Cutright, Assessor of Barbour County's Motion to Dismiss and Response to Complaint of Petitioner Denex Petroleum Corporation" and the "Civil Case Information Statement" for filing in the above-referenced matter. A copy of the same has been provided to the parties as evidenced in the attached certificate of service.

Should you have any questions please do not hesitate to contact me.

Very truly yours,


Katherine A. Schultz
Senior Deputy Attorney General

KAS/dde

Enclosures: As stated

cc: The Honorable Alan D. Moats, Judge

W.T. Weber III, Esquire

Stephen C. Sluss, Esquire

John Cutright, Assessor of Barbour County

Mark S. Morton, General Counsel

West Virginia State Tax Department

State Capitol, Building 1, Room W-435, 1900 Kanawha Boulevard East, Charleston, WV 25305

**CIVIL CASE INFORMATION STATEMENT
CIVIL CASES**

SCANNED

In the Circuit Court of Barbour County, West Virginia

I. CASE STYLE

**DENEX PETROLEUM CORPORATION,
a West Virginia Corporation,**

Petitioner,

v.

**Case No. 16-AA-1
Judge Alan D. Moats**

FILED
CIRCUIT CLERK
BARBOUR COUNTY

2016 APR 28 PM 3:38

**THE HONORABLE MARK MATKOVICH,
West Virginia State Tax Commissioner,
THE HONORABLE JOHN CUTRIGHT,
Assessor of Barbour County, and
THE COUNTY COMMISSION OF BARBOUR COUNTY,
Sitting as the Barbour County Board of Review and Equalization,**

Respondents.

PLAINTIFF: Denex Petroleum Corporation**CASE NUMBER:** 16-AA-1**DEFENDANTS:** Mark Matkovich, West Virginia State Tax Commissioner,
John Cutright, Assessor of Barbour County, and
The County Commission of Barbour County**II. TYPE OF CASE:**

- ☐ General Civil
- ☐ Asbestos ☐ Adoption ☐ Appeal from Magistrate Court
- ☐ Professional Malpractice ☐ Contract ☒ Miscellaneous Civil Petition
- ☐ Administrative Agency Appeal ☐ Magistrate Sentence
- ☐ Personal Injury ☐ Real Property
- ☐ Product Liability ☐ Mental Health ☐ Other
- ☐ Other Tort

III. JURY DEMAND: ☐ Yes ☒ No**CASE WILL BE READY FOR TRIAL BY:****IV. DO YOU OR ANY OF YOUR CLIENTS OR WITNESSES IN THIS CASE REQUIRE SPECIAL ACCOMMODATIONS DUE TO A DISABILITY OR AGE?**☐ Yes ☒ No**IF YES, PLEASE SPECIFY:**

- ☐ Wheelchair accessible hearing room and other facilities
- ☐ Interpreter or other auxiliary aid for the hearing impaired
- ☐ Reader or other auxiliary aid for the visually impaired
- ☐ Spokesperson or other auxiliary aid for the speech impaired
- ☐ Other: _____

Attorney Name: Katherine A. Schultz,
Senior Deputy Att'y Gen. (WVSB #3302)**Representing:** Mark Matkovich, West Virginia State Tax
Commissioner and John Cutright, Assessor of
Barbour County**Firm:** WV Attorney General's Office**Address:** Bldg. 1, Room W-435

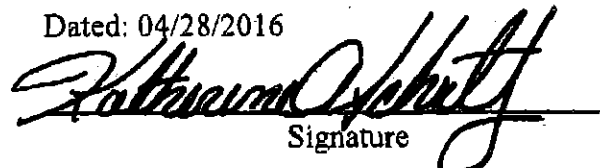
1900 Kanawha Blvd., E.

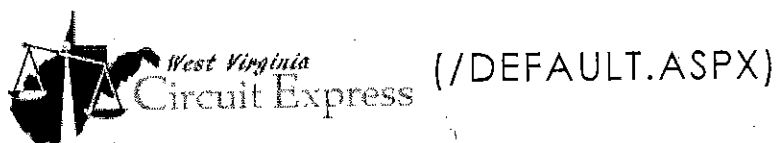
Charleston, WV 25305

Telephone: (304) 558-2522

☐ Plaintiff ☒ Defendant☐ Cross-Complainant ☐ Cross-Defendant

Dated: 04/28/2016


Signature☐ Pro Se



Civil

Case Information

Nineteenth Judicial Circuit of Barbour County

16-AA-1

Judge: ALAN MOATS

DENEX PETROLEUM CORPORATION VS. MARK MATKOVICH, STATE TAX COMMISSIONER

Plaintiff(s)Plaintiff Attorney(s)

DENEX PETROLEUM CORPORATION

W. T. WEBER III

Defendant(s)Defendant Attorney(s)MATKOVICH, MARK AS TAX COMM'R
COUNTY COMMISSION OF BARBOUR
BARBOUR COUNTY COMMISSION
CUTRIGHT, JOHN AS ASSESSOR

N/A

Date Filed: 03/23/2016

Case Type: ADMINISTRATIVE APPEAL

Appealed: 0

Final Order Date: N/A

Statistical Close Date: N/A

<u>Line</u>	<u>Date</u>	<u>Action / Result</u>
0001	03/23/2015	COMPLAINT OF PETITIONER DENEX PETROLEUM CORPORATION
0002	03/23/2015	PETITIONER'S EXHIBIT NO. 1
0003	03/23/2015	PETITIONER'S EXHIBIT NO. 2
0004	03/23/2016	CCIS & ATT'Y FILING LETTER
0005	03/23/2016	PETITIONER'S EXHIBIT NO. 3
0006	03/23/2016	PETITIONER'S EXHIBIT NO. 4
0007	03/23/2016	PETITIONER'S EXHIBIT NO. 5
0008	03/23/2016	PETITIONER'S EXHIBIT NO. 6
0009	03/23/2016	PETITIONER'S EXHIBIT NO. 7
0010	03/23/2016	PETITIONER'S EXHIBIT NO. 8
0011	03/23/2016	PETITIONER'S EXHIBIT NO. 9 (COLOR IMAGE REDUCED LEGAL/LETTER)
0012	03/23/2016	MACEL L AUUIL, COUNTY CLERK, CERTIFICATE THAT TRANSCRIPT OF
0013		HEARING FOR DENEX PETROLEUM BEFORE THE BARBOUR COUNTY COMMISSION

0014		ON 2/18/16 IS THE TRUE AND ORIGINAL COPY - DATED 3/22/16
0015	03/23/2016	TRANSCRIPT OF ABOVE HEARING, 111 PAGES WITH REPORTER'S
0016		CERTIFICATE
0017	03/23/2016	EXHIBITS 1-9 ADMITTED INTO RECORD OF HEARING ON 2/18/16 FILED
0018		WITH TRANSCRIPT (LINES 1-18 GMF)
0019	03/28/2016	SUMMONS, COMPLAINT, EXHIBITS AND OTHER DOCUMENTS DELIVERED TO
0020		SHERIFF FOR SERVICE ON ASSESSOR, COUNTY COMMISSION; SERVED ON
0021		STATE TAX COMM'R BY CERTIFIED MAIL RRR (GMF)
0022	03/28/2016	CLERK'S LETTER TO PET'R ATT'Y RE FILING DOCUMENTS (GMF)
0023	03/29/2016	RETURN OF SERVICE OF PROCESS ON JOHN CUTRIGHT, ASSESSOR
0024	03/29/2016	RETURN OF SERVICE OF PROCESS ON BARBOUR COUNTY COMMISSION
0025	04/23/2016	CM RETURN RECEIPT DELIVERED TO TAX COMM MATKOVICH ON 3/29/16 (G)
0026	04/28/2016	RESPONDENT'S MARK MATKOVICH, WV, STATE TAX COMMISSIONER & JOHN
0027		CUTRIGHT, ASSESSOR OF BARBOUR COUNTY'S MOTION TO DISMISS &
0028		RESPONSE TO COMPLAINT OF PETITIONER DENEX PETROLEUM CORP, (P)
0029	04/28/2016	RESPONDENTS THE COUNTY COMMISSION OF BARBOUR COUNTY, SITTING AS
0030		THE BARBOUR CO. BOARD OF REVIEW & EQUALIZATION, MOTION TO DISMISS
0031		& RESPONSE TO COMPLAINT OF PETITIONER DENEX PETROLEUM CORP. (P)
0032	05/02/2016	ORIGINAL CCIS & RESPONSE BY RESPONDENT MARK MATKOVICH, WV ST.
0033		TAX COMMISSIONER & JOHN CUTRIGHT RECEIVED TODAY, FAX COPY RECEIVED
0034		4/28/16 (P)
0035	05/06/2016	NOTICE OF SCHEDULING HEARING FOR 7/8/16 9AM, (P)
0036	05/06/2016	PETITIONER'S RESPONSE TO RESPONDENTS' MOTION TO DISMISS (P)
0037	07/06/2016	AGREED ORDER ESTABLISHING A BRIEFING SCHEDULE & CANCELING THE
0038		JULY 8TH. SCHEDULING HEARING, (P)
0039	07/11/2016	AGREED ORDER WITHDRAWING THE RESPONDENTS MOTIONS TO DISMISS WNC
0040	08/11/2016	APPEAL BRIEF OF PETITIONER DENEX PETROLEUM CORP INTRO WNC
0041	10/04/2016	RESPONDENTS MARK MATKOVICH WV ST. TAX COMMISSIONER & JOHN
0042		CUTRIGHT ASSESSOR OF BARBOUR COUNTY-RESPONSE TO THE PETITIONER'S
0043		BRIEF, FILED (P)
0044	10/05/2016	RESPONDENTS B.C. COMMISSION SITTING AS BOARD OF EQUALIZATION &
0045		APPEAL'S RESPONSE TO THE PETITIONER'S BRIEF FOR FILING (P)
0046	10/12/2016	REPLY BRIEF OF PETITIONER DENEX PETROLEUM CORP, FILED (P)
0047	12/21/2016	ORDER SETTING HEARING FOR 3/3/17
0048	12/21/2016	LETTER FROM DENEX ATTORNEY REQUESTING STATUS/SCHEDULING HEARING
0049	02/13/2017	NOTICE OF SCHEDULING CONFLICT W/COVER LETTER FROM COUNSEL FOR
0050		DEFENDANTS STATE TAX COMM'R AND BARBOUR ASSESSOR
0051	02/16/2017	ORDER CONTINUING HEARING FROM MARCH 3, 2017 TO APRIL 7, 2017
0052	02/27/2017	LETTER FROM WV STATE TAX DEPT. KATHERINE A. SCHULTZ

IN THE CIRCUIT COURT OF BARBOUR COUNTY, WEST VIRGINIA

DENEX PETROLEUM CORPORATION,
a West Virginia Corporation,

2016 AUG 11 PM 3:39

Petitioner,

CIRCUIT CLERK
BARBOUR COUNTY

v.

Civil Action No. 16-AA-1
The Honorable Alan D. Moats

THE HONORABLE MARK MATKOVICH,
West Virginia State Tax Commissioner,

THE HONORABLE JOHN CUTRIGHT,
Assessor of Barbour County, and

THE COUNTY COMMISSION OF BARBOUR COUNTY,
Sitting as the Barbour County Board of Review and Equalization,

Respondents.

RECEIVED
2016 AUG 11 PM 12:09
CIRCUIT CLERK
BARBOUR COUNTY

APPEAL BRIEF OF PETITIONER DENEX PETROLEUM CORPORATION

INTRODUCTION

Denex Petroleum Corporation, a West Virginia corporation, (hereinafter "Denex"), is a small producer of natural gas in the state of West Virginia, and the operator of several producing conventional gas wells located in Barbour County.

These wells are appraised for ad valorem tax purposes by the West Virginia Department of Revenue, State Tax Department, Property Tax Division, (being referenced herein as the "Tax Department" or the "State") based upon a mass appraisal system, state-wide. Certain variables are used by the Tax Department to value producing oil and gas wells, including but not limited to operating expenses.

The Tax Department periodically circulates a survey by which it solicits data from oil and gas producers (taxpayers) regarding operating expenses for their wells, and based upon the

information received, the Tax Department determines the operating variables used in the 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, coalbed methane, 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. As a part of that notice for Tax Year 2016, the Tax Department invited taxpayers to submit actual operating expenses for consideration by the Tax Department in appraising the subject oil and gas properties.

In this case, Petitioner, Denex, avers that the Tax Commissioner has failed to follow its statutory duty to implement and utilize an appraisal system that fairly and accurately determines the "true and actual value" of the subject natural resource properties. The Tax Department ignored actual operating expenses and instead relied upon outdated averages and estimates found in its valuation variables document and administrative notices, resulting in calculated expenses that were significantly less than the actual operating expenses incurred. By understating operating expenses, the appraised value of the property is overstated, resulting in excess and unfair taxes.

In this matter, Denex evaluated its actual operating expenses for the relevant period and determined that for its conventional wells, which are the subject of this appeal, in Barbour County, the amount of operating expenses actually incurred for each of these wells significantly exceeded the expenses determined by the Tax Department's mass appraisal system.

When the Tax Department valued Denex'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. The Tax Department incorrectly and unfairly ignored the actual operating expenses and instead relied on the calculations found in its valuation variables document and administrative notice.

Denex avers that the methodology employed by the State Tax Department's mass appraisal system to estimate operating expenses does not result in a fair and reasonable determination of such expenses. Rather, as implemented, the system is inconsistent and discriminatory, resulting in systematic deviations in values among various groups of wells.

On February 18, 2016, Denex 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 Review and Equalization (the "Board"). Denex presented clear and convincing evidence that the Tax Department's methodology did not result in the determination of reasonable, accurate operating expenses. The Tax Department's methodology understates operating expenses, which, in turn, overstates the value of the subject wells in Barbour County. Understating expenses does not result in the determination of "true and actual" value. At the February 18, 2016, hearing, Denex also presented a complete analysis of its actual operating expenses for the oil and gas wells at issue in this action. The Board, however, made no adjustment to the Tax Department's valuation.

Denex timely petitioned the Court for appeal of the Board's decision. As explained below, the Board abused its discretion by failing to consider Denex'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. Denex, 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.

ARGUMENT

Article X, Section 1 of the Constitution of the State of West Virginia mandates, in part, that”

“Subject to the exceptions in this section contained, taxation shall be equal and uniform throughout the State, and all property, both real and personal, shall be taxed in proportion to its value to be ascertained as directed by law. No one species of property from which a tax may be collected shall be taxed higher than any other species of property of equal value;. . .”. (Id.)

In regard to *Article X, Section 1*, one court has held that:

“To meet the mandate of *Article X, Section 1* of the West Virginia Constitution, there must be like treatment in the valuation of all species of property, both within a species of property and among all species of property. In conformance [sic] with this constitutional standard, it is the duty of the Tax Commissioner in all valuation efforts to value all property at a true and actual value”. *Janet Pauley et al., v. Larrie Bailey, et al.*, Circuit Court of Kanawha County, West Virginia, Case No. 75-1269 (1982).

Statutorily, all property in the State of West Virginia is required to “be assessed annually at its true and actual value” *West Virginia Code* § 11-3-1. The West Virginia State Tax Commissioner is charged with implementing a valuation system which will determine “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. *West Virginia Code* § 11-1C-10(d).

The West Virginia Supreme Court holds that:

“Assessments of property for taxation purposes are based on the property’s ‘true and actual value’, which has been defined as its market value”. *In re Tax Assessment of Foster Foundation’s Woodlands Retirement Community*, 672 SE2d 150, W.Va. 2008).

Pursuant to this statutory 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 outlines the mechanisms to be utilized in valuing oil and gas 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. . . .” (See 110 CSR 1J §4.1). The methodology set forth in § 110-1J-4.1 is reflected in Tax Department *Administrative Notice* 2016-02, wherein it is provided that the Tax Commissioner is to primarily rely upon the income approach in valuing producing oil and gas property.

The West Virginia Supreme Court holds that:

“The ‘income approach’ to appraising property for tax purposes is defined as the appraisal process of discounting an estimate of future income into an expression of present worth; in other words, the income approach to value is based on the principal that something is worth what it will earn”. *In re Tax Assessment Against American Bituminous Power Partners, LP*, 539 SE2d 757, W.Va. 2000).

The Tax Commissioner has mandated the use of an “income approach” to the valuation of oil and natural gas properties as set forth in the Tax Commissioner’s “*Administrative Notice* 2016-02, *State Tax Commissioner’s Statement Concerning Primary Reliance on the Income Approach to Value for Appraisals of Producing and Reserve Coal, Producing Oil and Gas, and Producing Other Mined Minerals Pursuant to §§ 110 CSR 11-4, 1J-4 and 1K-4*”. (See Petitioner’s Exhibit No. 4 attached to the Complaint in this Action).

Administrative Notice 2016-02, states, in part, that, “The income approach to value is based upon the assumption that a property is worth the future income, discounted to present worth, that it will generate for a prospective buyer”. (See *Id*).

One component of valuing oil and gas assets using the income approach is the consideration of expenses. Pursuant to CSR §110-1J-3.16, the Tax Department considers “operating expenses” to be “those 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.”

The Tax Department further issues an annual administrative notice addressing operating expenses for oil and gas assets. The administrative notice applicable to this case is “*Administrative Notice 2016-08, Property Tax State Tax Commissioner's Statement from the Determination of Oil and Gas Operating Expenses for Property Tax Purposes for Tax Year 2016, Pursuant to §110-1J-4.3*”. The stated purpose of this administrative notice is to “set forth procedures used in developing expenses and their application against receipts for the working interest of oil and gas producing properties”. However, *Administrative Notice 2016-08* states, in part, that, “Direct ordinary expenses will be estimated to be 30% of the gross receipts derived from gas production, not to exceed \$5,000...”. (Id.). Not mentioned is royalty.

Pursuant to *West Virginia Code* §11-3-1(a), as amended, all real property in Barbour County shall be assessed annually at sixty (60%) percent of its *true and actual value*. (Emphasis added). The legislature has defined *true and accurate value* as:

“...the price for which such property would sell if voluntarily offered for sale by the owner thereof, upon such terms as such property, the value of which is sought to be ascertained, is usually sold...”. (*West Virginia Code* § 11-3-1(a)).

Pursuant to *West Virginia Code* § 11-1C-10, as amended, the Tax Commissioner is charged with the duty of valuing all “natural resource” property, including but not limited to producing oil and natural gas properties, in the State of West Virginia.

Pursuant to *West Virginia Code* § 11-1C-10(d)(2) and (e), the Tax Commissioner is to value and provide the basis for assessment for all “natural resource” property, including but not limited to producing oil and natural gas properties, in the State of West Virginia through a mass “valuation plan”.

The mass “valuation plan” devised by the Tax Commissioner has been most recently codified as *110 CSR 1J*, (2006), “*Valuation of Producing and Reserve Oil and Natural Gas for Ad Valorem Property Tax Purposes*”. (See Petitioner’s Exhibit No. 1 attached to the Complaint in this Action).

One of the variables to be used by the Tax Commissioner to value producing oil and gas wells is the operating expenses of the well, as defined in *110 CSR 1J* §3.16. The Tax Commissioner is to circulate a survey by which it solicits data from oil and natural gas producers regarding operating expenses for oil and natural gas wells, and, based upon that data, the Tax Commissioner determines operating expense variables to be used in its mass appraisal system. (See partial copy of the Tax Commissioner’s “*Final Natural Resource Property Valuation Variables for 2016 Tax Year*” attached as Petitioner’s Exhibit No. 2 attached to the Complaint in this Action).

Generally, the regulations require that operating expenses applied to a certain well by the Tax Commissioner’s mass appraisal system be based upon an estimated percentage of the well’s gross receipts not to exceed a maximum amount, and the percentage and maximum vary by the type of well. (See Administrative Notice 2016-08, attached as Exhibit No. 3 to Petitioner’s

Complaint in this action). These operating expense calculations are to be included in a natural resources "valuation variables" document that the Tax Commissioner releases and distributes annually. (See Petitioner's Exhibit No. 2 attached to the Complaint in this Action).

Pursuant to the Tax Commissioner's own regulations, the 2016 allowed operating expense variable for producing, conventional natural gas wells is estimated to be thirty (30%) percent of the well's "gross receipts", with a maximum operating expense of \$5,000.00.

In fact, this is not the case. The State Tax Commissioner does not appear to be following its own regulation and is actually allowing only thirty (30%) percent of the "working interest" revenue, or net revenue after deduction of royalties, not thirty (30%) percent of the well's "gross receipts". (See *Administrative Notice* 2016-08 and *Natural Resource Valuation Variables* for 2016 Tax Year attached as Petitioner's Exhibit Nos. 3 and 2, to the Complaint in this Action).

In effect, the Tax Commissioner's own Valuation Table for 2016 is inaccurate, does not adhere to the applicable Administrative Order 2016-08 or the regulations, and is wrong as applied.

In fact, the Tax Commissioner's mass valuation method does not treat like species of property the same for valuation purposes. It allows expenses for conventional oil and gas wells to be calculated at differing values depending upon transportation providers and transportation rates, all in violation of *Article X, Section 1* of the Constitution of the State of West Virginia.

Specifically, Denex is the operator of the producing, conventional natural gas and oil wells set out and listed on Petitioner's Exhibit Nos. 5 and 6, attached to the Complaint in this action and incorporated herein by reference. (It is noted that Petitioner's Exhibit Nos. 5 and 6 attached to the complaint are also Denex Hearing Exhibit Nos. 7 and 8).

Pursuant to statute and legislative rule, the Tax Commissioner is to prepare annual natural resource property valuation variables for appraising oil and gas properties in West Virginia. Further, the Tax Commissioner is to make a determination of those valuation variables pursuant to 110 CSR 1J, a legislative rule of the Tax Commissioner, promulgated pursuant to *West Virginia Code* § 11-1C-10(d). In order to determine the amount of Denex's operating expenses, and, in turn, the value of Denex's oil and gas wells, the Tax Commissioner is further governed by the mandate of Administrative Notices 2016-02 and 2016-08.

Due to an unprecedented decrease in the market price of natural gas, some of Denex's producing natural gas wells, as identified on page 1 of Petitioner's Exhibit Nos. 5 and 6, were operated at or below an economic limit, defined as a positive number after subtracting allowable expenses from gross receipts.

By using its "mass valuation and appraisal system", which is inaccurately applied as it does not follow the Tax Department's own regulations as set forth above, as well as a vague income valuation approach, the Tax Commissioner has valued the Denex producing, conventional natural gas wells, as set forth on Petitioner's Exhibit Nos. 5 and 6, (being Denex Hearing Exhibit Nos. 7 and 8), in an amount greater than the wells' true and accurate value, all in violation of *West Virginia Code* § 11-3-1(a), as amended.

To the best of Petitioner's information and belief, the State Tax Commissioner sent its valuation for the Denex wells to The Barbour County Assessor for assessment.

Denex, as the taxpayer, was notified of the valuations and assessments for the 2016 tax year by the State Tax Department.

On February 18, 2016, Denex, as the taxpayer, petitioned The County Commission of Barbour County, West Virginia, sitting as the Barbour County Board of Review and

Equalization, to amend the Tax Commissioner's valuations to reflect the true and actual value of the producing natural gas and oil wells set out on Petitioner's Exhibit Nos. 5 and 6.

During the hearing, Denex produced the testimony of R. Dennis Xander, John Haskins, Dean Bucher, and Stephen Holmes. Denex further utilized and admitted, without objection, Petitioner's Exhibit Nos. 1 through 8. (Hrg. Tsp Pg. 44-45).

All four (4) Denex witnesses testified, *inter alia*, that natural gas and oil wells that operate at a net loss, (where royalties, taxes, and operating expenses exceed gross revenue), have only a nominal value, using the income approach. (Hrg. Tsp Pgs. 20-31; 56-59; 67-73; 79-83). These witnesses further testified that oil and gas properties are routinely bought and sold by experienced oil and gas operators in West Virginia using the income approach to valuation. As previously stated, *West Virginia Code* § 11-3-1(a), as amended, requires that property shall be assessed annually at sixty (60%) of its "true and accurate value", defined as:

"...the price for which such property would sell if voluntarily offered for sale by the owner thereof, upon such terms as such property, the value of which is sought to be ascertained, is usually sold...". (*West Virginia Code* § 11-3-1(a)).

During the hearing, Denex witness John Haskins testified that the operating expenses charged by Denex for operation of the subject producing, conventional natural gas and oil wells were in line with industry standards for similar conventional well operating in Barbour County, West Virginia. (Hrg. Tsp. Pgs. 50-53).

As set forth on Petitioner's Exhibit Nos. 5 and 6 attached herein, (being Hearing Exhibit Nos. 7 and 8), through its witness testimony and exhibits, Denex clearly established, that on an actual per well basis, that the actual expenses of producing the wells was greater than the income generated for many of the subject wells, and, further, that the appraised values assigned for all of the subject wells exceed the true and actual value of said wells.

During the February 18, 2016, hearing, the Tax Commissioner offered no credible evidence for its refusal to accept Denex's calculation of its actual operating expenses for the producing natural gas and oil wells in question, except to question the presumption that Denex's stated operating expenses may be higher than others in the industry, to question Denex's expenses and costs applied to the individual wells for maintenance, and to question Denex's submission of forms. Petitioner notes that the Tax Commissioner did invite operators to submit actual expenses for a three year period for each producing well for consideration, however, the Tax Commissioner is under absolutely no statutory or regulatory duty to utilize same for valuation purposes. (See Petitioner's Exhibit No. 7 attached to the complaint in this action).

Based on the testimony of Denex's witnesses, and the documents submitted to the Tax Commissioner and the Board of Review and Equalization, the operating expenses submitted by Denex are those contemplated in Section 3.16.

Denex's burden before the Board of Review and Equalization was to show by clear and convincing evidence that the Tax Commissioner's valuation (and, hence, the County's assessment) of its gas well operating expenses was erroneous. On appeal to this Court, the Court is to rely on the record developed before the Board of Review and Equalization and to determine whether the challenged property valuation is supported by substantial evidence.

By letter dated February 20, 2016, and received by Denex on February 25, 2016, The County Commission of Barbour County, West Virginia, sitting as the Board of Review and Equalization, denied the relief sought. (See Petitioner's Exhibit No. 8 attached to the Complaint in this action).

The West Virginia Supreme Court holds, that:

“[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 SE2d 768, 785 n.23 (2009). *In Re Pocahontas Land Co.*, 172 W.Va. 53, 61, 303 SE2d 691, 699 (W.Va. 1983).

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, Denex presented actual evidence that the Tax Department’s valuation itself is flawed and incorrect, so it became incumbent on the Tax Department to rebut Denex’s evidence, which it did not.

The Tax Commissioner has failed to follow its statutory duty to determine “true and actual value” by not utilizing an appraisal system that fairly and accurately values natural resource properties by ignoring actual operating expenses and instead relying upon outdated averages and estimates found in its valuation variables document and administrative notices. Denex avers that the Tax Department has used the same factors (30% of gross revenue for gas wells and 35% of gross revenues for oil wells) to determine allowable operating expenses for more than 20 years. Considering the dramatic decrease in the “*Producer Net Price on Dominion After Gathering & Gateway Firm*” from 2008 to 2015 (\$8.4810/mcf to \$0.7253/mcf-See Denex Exhibit No. 6), this is simply not appropriate. The impact of a dramatic decrease in natural gas prices on operating expenses as determined by the Tax Department is demonstrated on Denex Exhibit 5. Clearly, operating expenses allowable under 110CSR 1J §3.16 are not proportional to gross revenues. Many of these costs, such as routine well maintenance, tend to be “fixed” and do not vary with changes to revenue. (See Tsp. Pgs. 55-56). It costs an operator as much to visit and maintain a well generating \$10,000 in annual revenue as it does a well generating twice that amount. Moreover, when the sum of royalties, and actual operating expenses exceed gross revenue for any well, that well has no actual value, using the income approach to valuation.

Denex further avers that the Tax Commissioner's valuation plan is skewed in that it fails to follow stated rules and regulations. The Administrative Notice requires ordinary operating expenses to be estimated at thirty (30%) percent of GROSS RECEIPTS, while the Tax Commissioner's own valuation variables are set at thirty (30%) percent of the NET RECEIPTS. This results in an inherent inaccuracy nullifying the results of the Tax Commissioner's valuations. (See Exhibit Nos. 3 and 2 to Petitioner's Complaint in this action).

Denex further avers that by using a fixed percentage of revenues to determine operating expenses the Tax Department's mass appraisal system failed to fairly and equitably calculate operating expenses, and, therefore, the "true and actual value" of the subject wells. Denex witnesses Xander and Haskins both testified about the costs associated with "firm transportation" expenses associated with the "Gateway" project on the Dominion Transmission system. Denex Exhibit 6 from the hearing shows historic monthly prices for gas delivered to both Dominion Transmission and Columbia Gas Transmission over the last nine years. This Exhibit was admitted to the record without objection. For Tax Year 2016, the Assessor was charged with assessing property based on its value as of July 1, 2015. In July, 2015, the index price for gas delivered to Columbia Gas Transmission was \$2.68, while the index price for gas delivered to Dominion Transmission, net of "Gateway" charges and gathering fees, was just \$0.5792. Both Columbia and Dominion operate transmission lines in Barbour and surrounding counties. However, assuming similar volumes, the State Tax Department's flawed method of determining operating expenses based on a percentage of revenue would allow far greater expenses for wells connected to Columbia than for wells connected to Dominion. This is simply unfair, unjust and discriminatory against wells connected to the Dominion system.

Denex Exhibit 5 from the hearing demonstrates the difference between the operating expenses allowed under the Tax Department's mass appraisal system for a well selling gas at \$5 per mcf compared to the same well selling gas for just \$1 per mcf. In the case of gas at \$5 per mcf, the Tax Department's methodology would allow operating expenses of \$3,285 per year. At \$1 per mcf the allowable expenses would be just \$657. Even assuming, *arguendo*, that the actual expenses listed on Exhibit 5 are inaccurate, it is still abundantly clear that a variation in price results in a dramatic discrepancy in allowed operating expenses. Clearly, wells in Barbour County (and throughout West Virginia) which deliver gas to Dominion are allocated less operating expense than wells delivering gas to Columbia Gas. These operating expenses are not in any way linked to actual expenses, which would be used to determine "true and actual value" using the income approach by an able and willing buyer and seller operating at arm's length. Accordingly, it is clear that the mass appraisal system has not determined "true and actual value".

The Tax Commissioner has abused its discretion by failing to consider Denex's actual and allowable operating expenses in a manner consistent with the statutes, regulations and official releases from the Tax Commissioner governing valuation of natural resources property. Moreover, the Tax Commissioner has failed to support its "mass valuation" of the Denex wells with substantial evidence.

Denex, 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.

In this case, the Tax Commissioner failed to apply the demonstrated actual operating expenses supplied by Denex through its testimony and exhibits pursuant to its own rules and regulations. Accordingly, Denex now appeals to this Court seeking an order to find that the

Board of Review and Equalization incorrectly made no changes to the Tax Commissioner's valuation and that Denex's calculations of its allowed actual operating expenses clearly establish that the Tax Commissioner's mass valuation policy used to value producing natural gas wells is not correct.

Denex avers that although the State Tax Commissioner has discretion to select the appraisal/valuation method for determining natural resource property values for assessment purposes, that selected method must comply with the statutory mandate to determine the true and accurate value of the property, not a mere calculated estimate. Moreover, the method selected must be correctly applied to the type of asset. A true and actual valuation was not determined for the subject Denex wells.

Denex avers that the use of 30% of the gross revenues, capped at \$5,000 to determine operating expenses is inappropriate. As demonstrated in Petitioner's Exhibit No. 9 attached to the Complaint in this action, utilizing the data from Petitioner's Exhibit Nos. 5 and 6, (being Petitioner's Hearing Exhibit No. 7 and 8), the net price received by producers for natural gas delivered to Dominion Transmission, Inc., decreased from \$2.375 in 2014 to \$0.7523 in 2105, being a decrease of almost 70%. Assuming relatively stable gas production, gross revenues for the subject wells would similarly decline by 70%. Using the Tax Commissioner's method of determining operating expenses at 30% of gross revenue, those expenses would decrease by 70%, thus dramatically and erroneously understating said expenses, thereby overstating the value of the wells, as of July 1, 2015, by the Tax Commissioner.

Moreover, the Tax Commissioner's valuation formula does not appear to account for the cost associated with the Dominion Transmission, Inc., Firm Transportation obligations. (Hrg. Tsp. Pgs. 19-20; 27-29).

In this case, the Tax Commissioner has not applied the demonstrated, proven, actual operating expenses, as set forth in Denex's Exhibits and testimony at the hearing before the Board of Review and Equalization and the Tax Commissioner has, therefore, failed to properly assess the Denex natural resource properties pursuant to statutory and regulatory mandate. Moreover, the Barbour County Board of Review and Equalization, having been presented with undisputed factual evidence of the failure of the State Tax Department to utilize reasonable and appropriate operating expenses in the determination of the "true and actual value" of the subject natural gas wells, failed to make any adjustments to the assessed value of such wells to ensure proper taxation as required by *West Virginia Code* § 11-3-1(a).

Denex asserts that the true and actual value of the subject wells to be the values set forth in Petitioner's Exhibit No. 6 attached to the Complaint, as well as being the Denex Hearing Exhibit No. 8.

WHEREFORE, Denex Petroleum Corporation, a West Virginia corporation, respectfully requests that the Court:

(i) Find that the Barbour County Board of Review and Equalization incorrectly upheld the valuation of Denex's Barbour County producing natural 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 Denex's Barbour County producing natural gas and oil wells for the 2016 tax year at their true and actual value, based on the actual revenue realized and the actual direct operating expenses incurred by Denex in Barbour County for the 2016 calendar year, as set forth in Petitioner's Exhibit No. 6 attached to the Complaint, as well as being the Denex Hearing Exhibit No. 8;

(iii) Enter an Order finding that those Denex producing, conventional natural gas wells, subject of this action, which are operating at a net loss have only a nominal value and require the State Tax Department and Barbour County Assessor to correctly value and assess the same based upon the "*Minimum Working Interest Appraisal*" of \$500.00 per well as set forth in the Tax Commissioner's "*Final Natural Resource Property Valuation Variables for 2016 Tax Year*", attached hereto as Exhibit No. 2; and

(iv) Order such other relief as the Court deems appropriate.

Denex Petroleum Corporation,
A West Virginia Corporation
Petitioner, By counsel



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CERTIFICATE OF SERVICE

I, W. T. Weber, III, Weber & Weber, and do hereby certify that I served a true copy of the *Appeal Brief of Petitioner Denex Petroleum Corporation* upon the following individuals at the following address by mailing the same to them in a sealed envelope, United States mail, postage prepaid, this the 11th day of August, 2016:

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