

IN THE CIRCUIT COURT OF BARBOUR COUNTY, WEST VIRGINIA

RECEIVED

2016 MAR 23 AM 10:25

DENEX PETROLEUM CORPORATION,
a West Virginia Corporation,

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.

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:

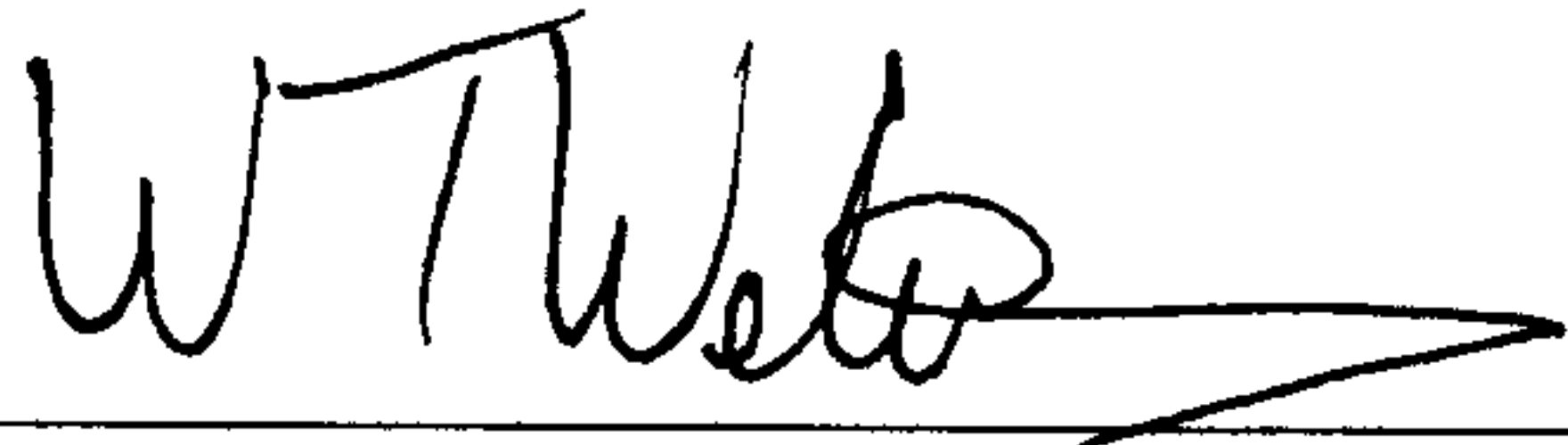
(i) Find that the Barbour County Board of Review and Equalization incorrectly upheld the valuation of Denex's Barbour County producing natural gas wells by the West Virginia Department of Revenue, State Tax Department, Property Tax Division for the 2016 tax year;

(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