

**IN THE CIRCUIT COURT OF LEWIS COUNTY, WEST VIRGINIA  
BUSINESS COURT DIVISION**

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

**Petitioner,**

**v.**

**Civil Action No. 17-C-11  
The Honorable Christopher C. Wilkes**

**THE HONORABLE DALE STEAGER,  
West Virginia State Tax Commissioner,**

**THE HONORABLE JOHN L. BREEN,  
Assessor of Lewis County, and**

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

**Respondents.**

**ORDER REVERSING THE DECISION OF THE LEWIS COUNTY BOARD OF  
ASSESSMENT APPEALS UPHOLDING THE VALUATION OF CONSOL ENERGY  
INC. DBA CNX GAS COMPANY LLC'S GAS WELLS FOR THE 2016 TAX YEAR**

This matter came before the Court pursuant to Petitioner Consol Energy Inc. dba CNX Gas Company LLC's (hereinafter "CNX") appeal of its producing natural gas wells in Lewis County for tax year 2016, as appraised by the West Virginia State Tax Commissioner and assessed by the Assessor. The parties have fully briefed the issues before the Court. The Court dispenses with oral argument because the facts and legal contentions are adequately presented in the materials before the Court, and argument would not aid the decisional process. So, upon full consideration of the issues, the record, and the pertinent legal authorities, the Court rules as follows.

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### Procedural Background

1. On February 17, 2016, CNX submitted to the Assessor and County Commission of Lewis County, sitting as a Board of Assessment Appeals (the “BAA”), an Application for Review of Property Assessment with regard to its gas wells.

2. CNX appeared on October 24, 2016, by counsel, before the BAA (the “Hearing”) in order to protest the Tax Department’s valuation of its producing wells, as adopted by the county Assessor.

3. The BAA made no adjustment to the State Tax Department’s valuation of CNX’s gas wells for the 2016 tax year.

4. The Lewis County BAA Order was dated December 27, 2016, and received on January 3, 2017.

5. CNX timely petitioned the Circuit Court for relief from the BAA’s erroneous determination within thirty (30) days of the date of service of the Order denying relief. (*See* W. Va. Code § 11-3-25).

### Findings of Fact

6. CNX operated 863 producing conventional wells in Lewis County for purposes of tax year 2016.

7. The Tax Department determines fair market value for producing natural gas wells through a net income approach to valuation.

8. Producers for natural gas wells file gross receipts information with the Tax Department, and the Tax Department reduces the receipts by a production decline rate. WV CSR § 110-1J-4.2, 4.6.

9. After application of the production decline rate, the Tax Department calculates a net working interest income series by reducing the gross receipts by the annual average industry operating expense and then applying a capitalization rate to determine market value for the working interest of the natural gas well. WV CSR § 110-1J-4.6.1

10. For tax year 2016, the Tax Department calculates operating expenses by multiplying the reported gross receipts for a well by 30%, and “caps” the amount of allowable operating expense per well at \$5,000 for conventional wells.

11. CNX’s actual operating expenses for calendar year 2014, the year used by the Tax Department for calculating operating expenses for tax year 2016, was 37% of gross receipts, or \$5,898 per well.

12. CNX provided its actual operating expense information to the Tax Department via e-mails, including spreadsheets breaking down operating expenses, charts demonstrating increases in operating expense percentages from 2012-14, SEC Form 10K information for CNX, and results of impairment testing.

13. The actual operating expense percentage as a function of gross receipts fluctuates as gas prices fluctuate. Operating expenses correlate with volume, not price of gas.

14. The State’s imposition of a “cap” of operating expenses of \$5,000 per well results in certain wells receiving the full 30% operating expense allowance, while other wells receive far less than 30%.

15. Upon receipt of its tentative valuations from the Tax Department, CNX objected to the values via a December 2015 e-mail, and noted the allowed operating expenses resulted in an overvaluation of its wells.

16. At the Hearing, detailed charts and documentation of actual operating expenses, with numbers specific to Lewis County, were submitted to the Board.

17. The Tax Department's final valuation variables for tax year 2016 allow operating expenses based on 30% of gross revenue with a cap of \$5,000 per well.

18. The Tax Department increased the average annual industry operating expense percentage for typical producing wells from 30% to 45% for tax year 2017 because of the precipitous drop in gas prices from calendar year 2014 to calendar year 2015. However, the cap of \$5,000 is still in place.

19. Applying CNX's operating expense percentage of 37% for tax year 2016, with no "cap" on the amount of operating expense per well, results in a value for its conventional wells in Lewis County of \$18.1 million, far below the Tax Department's value of \$26.7 million. Hr'g Ex. 1.

#### Conclusions of Law

This matter is before the Court for consideration of CNX's appeal of the tax assessment valuation of its producing natural gas wells in Lewis County. "[J]udicial review of a decision of a board of equalization and review regarding a challenged tax assessment valuation is limited to roughly the same scope permitted under the West Virginia Administrative Procedures Act, W. Va. Code ch. 29A." *In re Tax Assessment Against American Bituminous Power Partners, L.P.*, 208 W. Va. 250, 255, 539 S.E.2d 757, 762 (2000). "In such circumstances, a circuit court is primarily discharging an appellate function little different from that undertaken by [the West Virginia Supreme Court of Appeals. . . .]"; the Circuit Court's review of the Board's decision, under W. Va. Code § 11-3-25, is therefore *de novo*.

The taxpayer's burden before the Board is to show by clear and convincing evidence that its valuation, and assessment, of its property is erroneous. Syl. pts. 5-6, *Stone Brooke Limited Partnership v. Sisnni*, 224 W. Va. 691, 688 S.E.2d 300 (2009). However, "there must be a proper assessment before there can be a presumption that the assessment is correct, and where it appears that there was no proper assessment there can be no presumption in favor of the correctness of the assessment." *In Re Pocahontas Land Co.*, 172 W. Va. 53, 61, 303 S.E.2d 691, 699 (1983). Furthermore, "[p]ursuant to *In Re Pocahontas Land Co.*, [citation omitted] once a taxpayer makes a showing that tax appraisals are erroneous, the Assessor is then bound by law to rebut the taxpayer's evidence." *Mountain Am., LLC v. Huffman*, 224 W. Va. 669, 786 n.23, 687 S.E.2d 768, 785 n.23 (2009).

In considering this appeal, the Court relies on the record developed before the Board and determines whether the challenged property valuation is supported by substantial evidence. An assessment made by a board of review and equalization will not be reversed when supported by substantial evidence unless plainly wrong. See W. Va. Code § 58-3-4; syl. pts. 1-2, *Stone Brooke*, 224 W. Va. 691, 688 S.E.2d 300.

Here, the Court finds that the assessment of CNX's producing gas wells in Lewis County for Tax Year 2016 was improperly applied and is not supported by substantial evidence. For the reasons explained below, the evidence demonstrates that the Tax Department failed to assess CNX's producing gas wells at their true and actual value, and the Board's decision must therefore be reversed.

First, CNX contends that the Tax Commissioner's use of an operating expense of 30% of gross receipts with a "cap" of \$5,000 in assessing the value of producing oil and natural gas wells

violates the West Virginia Code, Constitution, and the legislative rule used to value producing oil and natural gas for property tax purposes. The Court agrees.

For purposes of valuing producing operating oil and gas properties throughout the state, the Tax Commissioner is required to “every five (5) years, determine the average annual industry operating expenses per well. The average annual industry operating expenses shall be deducted from working interest gross receipts to develop an income stream for application of a yield capitalization procedure.” WV CSR § 110-1J-4.3. The Rule contemplates a single average, which the Tax Department has calculated as 30% of gross receipts for conventional wells. However, the Tax Department imposes two “averages,” a percent of gross receipts and a “cap” or “maximum amount” of \$5,000 per conventional well for tax year 2016. This cap unduly restricts the amount of operating expenses that should be allowed for each well, and the imposition of a “cap” is not supported by the Rule.

CNX contends that the Tax Commissioner violated the West Virginia Constitution by failing to “equally and uniformly” value all producing conventional oil and gas wells throughout the State of West Virginia. The Court finds that the Tax Department’s approach to calculating and applying operating expenses to producing natural gas wells through use of a “maximum amount” or “cap” violates the requirements under Article X, section 1 of the West Virginia Constitution that taxation be “equal and uniform throughout the state” and that both real and personal property “be taxed in proportion to its value to be ascertained as directed by law.”

The Supreme Court has held that “[t]he equal and uniform clause of Section 1 of Article X of the West Virginia Constitution requires a taxpayer whose property is assessed at true and actual value to show more than the fact that other property is valued at less than true and actual value. To obtain relief, he must prove that the undervaluation was intentional and systematic.” Syl. Pt. 1,

*Kline v. McCloud*, 174 W. Va. 369, 326 S.E.2d 715 (1984); *see also* Syl. Pt. 1, *In re Tax Assessments Against Pocahontas Land Corp.*, 158 W. Va. 229, 210 S.E.2d 641 (1974) (Where it is clear that the assessment has systematically discriminated against property owners and violated the equal and uniform provision, such assessments are illegal and cannot stand.)

The Supreme Court has further held,

Where there is intentional discrimination against a taxpayer by knowingly applying a different formula to the computation of his taxes from that generally used for all other taxpayers in similar circumstances, such discrimination cannot be excused as a sporadic deviation and the aggrieved taxpayer is entitled to have its taxes computed in same manner and on same basis as the favored taxpayers.

Syl. Pt. 2, *Town of Burnsville v. Cline*, 188 W. Va. 510, 425 S.E.2d 186 (1992) (Quoting Syl. Pt. 3, *Matter of U.S. Steel Corp.*, 165 W. Va. 373, 268 S.E.2d 128 (1980)). “The constitutional requirement of equal and uniform taxation means that as to classes of property, businesses, or incomes there shall be uniformity of taxation and tax upon all businesses of same class which is uniform as to that class of business is not unconstitutional.” *Capitol Cablevision Corp. v. Hardesty*, 168 W. Va. 631, 285 S.E.2d 412 (1981). The Court noted that “[c]ourts have implemented this rule of equal treatment by invalidating taxes falling unequally on business competitors who make the same product or offer the same service.” *Id.* at 642.

It is uncontroverted that the Tax Department applies a different formula for calculating operating expenses depending on the amount of gross receipts for a particular well. For certain producers, a 30% “average annual industry operating expense” percentage is used for tax year 2016, whereby 30% of gross receipts for a particular well is used to calculate the operating expenses for the well. For other producers, the “maximum amount” or “cap” used by the Tax Department results in a much lower operating expense percentage being used. The Tax Department’s methodology of applying a 30% operating expense allowance for certain

conventional well producers, while applying a much lower percentage for other conventional well producers, is intentional and systematic. This methodology is reflected in the Tax Department's final valuation variables for tax year 2016 and in Tax Department Administrative Notices 2016-08. The evidence presented demonstrates that the Tax Department's methodology results in overvaluation of certain conventional well producers (those with gross receipts per well of over \$16,666 for tax year 2016) that produce the same product as other producers (those with gross receipts per well of \$16,666 or less for tax year 2016). Of the 863 conventional wells appealed by CNX in Lewis County, only 241 of them receive the benefit of the 30% operating expense allowance. The rest of CNX's wells were subject to the "cap." Accordingly, the Court concludes that the methodology violates the "equal and uniform" requirement of Article X, Section 1 of the West Virginia Constitution, as it essentially singles out CNX and other conventional well producers with wells that generate higher gross receipts on an annual basis by limiting operating expenses to \$5,000 per well for tax year 2016.

CNX also contends that the Tax Commissioner violated the Equal Protection Clause of the United States Constitution by treating similarly situated taxpayers differently, and that the Tax Department's application of the Rule results in gross disparities in the assessed value of generally comparable property, which violates the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution.

The United States Constitution guarantees citizens equal protection of the laws. U.S. Const. amend. XIV § 1. As noted by the West Virginia Supreme Court of Appeals in *Town of Burnsville*, *supra*:

It is well recognized in both State and federal law that tax rates, although different for different classes, must be equal and uniform within the individual class. In *Allegheny Pittsburgh Coal Co. v.*



*County Commission of Webster County*, 488 U.S. 336, 109 S.Ct. 633, 102 L.Ed.2d 688 (1989), the United States Supreme Court ruled that the Equal Protection Clause of the United States Constitution is applicable in some taxation cases: “The Equal Protection Clause ‘applies only to taxation which in fact bears unequally on persons or property of the same class.’ ” *Id.* at 343, 109 S.Ct. at 637, 102 L.Ed.2d at 697 (citations omitted). “The equal protection clause ... protects the individual from state action which selects him out for discriminatory treatment by subjecting him to taxes not imposed on others of the same class.” *Id.* at 343, 109 S.Ct. at 637, 102 L.Ed.2d at 698 (citations omitted). The Court concluded that the Equal Protection Clause allows the state to divide different types of property into different classes, which are each assigned an appropriate tax burden. The differing tax rates are proper as long as the division and resulting tax burdens are not arbitrary or capricious.

*Town of Burnsville v. Cline*, 188 W. Va. at 512, 425 S.E.2d at 188 (Footnote omitted).

The Tax Department’s methodology of applying the “net receipts” model under the Rule violates the Equal Protection Clause under the Fourteenth Amendment of the United States Constitution, since it creates two disparately taxed groups within the same class of taxpayers, i.e., conventional well producers. The Tax Department calculates operating expenses for certain conventional well producers based on 30% of gross receipts. For others, an operating expense percentage much less than 30% is used due the imposition of a cap. The Tax Department has offered no plausible explanation for the application of its “net receipts” model whereby producers are treated disparately. The Court therefore finds that application of different operating expense percentages to these producers, through the use of the Tax Department’s \$5,000 “cap,” violates the equal protection clause of the United States Constitution.

WHEREFORE, it is ORDERED and ADJUDGED that the decision of the Lewis County Board of Assessment Appeals upholding the valuation of CNX’s gas wells for the 2016 tax year is hereby REVERSED, OVERRULED, and SET ASIDE. Because the case before the court has an inadequate record, this court cannot set the fair market value. Accordingly, the appeal is hereby

REMANDED back to the County Commission to set the fair value of CNX's Lewis County gas wells for the 2016 tax year based on application of the Tax Department's 30% average annual industry operating expense percentage by CNX's gross receipts without the imposition of a cap. The Petitioner's and Respondents' exceptions are noted for the record. The Court directs the Circuit Clerk to enter the foregoing and forward an attested copy to all counsel of record and the Business Court Division Central Office, Berkeley County Judicial Center, Suite 2100, 380 West South Street, Martinsburg, WV 25401. This being a FINAL ORDER, the Clerk is directed to remove the above captioned case from the active docket and place it amongst those causes ended.

ENTERED:

*January 17, 2018*

  
CHRISTOPHER C. WILKES, JUDGE  
BUSINESS COURT DIVISION