IN THE SUPREME COURT OF APPEALS
OF WEST VIRGINIA

NO. 24-26

MATTHEW R. IRBY, STATE TAX COMMISSIONER OF WEST VIRGINIA,

Respondent Below, Petitioner,

v.

EQUINOR USA ONSHORE PROPERTIES, INC.,

Petitioner Below, Respondent,

On Appeal from the Intermediate Court of Appeals of West Virginia,
Nos. 22-ICA-111, 22-ICA-225, 22-ICA-226

PETITIONER'S BRIEF

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ASSIGNMENTS OF ERROR

The Intermediate Court of Appeals' opinion in *StatOil USA Onshore, Inc. v. Irby*, 249 W. Va. 424, 895 S.E.2d 827 (2023) reversed several decisions of the Office of Tax Appeals ("OTA") and directed that Respondent, Equinor Onshore USA Properties, Inc., ("Equinor") receive over $4.5 million in severance tax refunds for the 2014, 2016, 2018, and 2019 tax years. This Court should reverse that part of the opinion in Appeal Nos. 22-ICA-111 and 22-ICA-226 based on the following:

I. The lower court should not have used the net value as the starting point for calculating Equinor's severance tax liability when the statute's formula begins at the gross value.

II. The lower court improperly disregarded the value of the services rendered by Equinor's third-party processor when those services were part of the consideration for the sale of the gas and the statute includes their value in the amount subject to tax.

III. Equinor can't deduct administrative and overhead costs because the legislative rule explicitly excludes those types of expenses from the available deduction.

IV. Equinor can't take the fifteen percent safe-harbor deduction because it already deducted the actual costs it paid to have its gas processed and transported to market, and the rule only lets producers take one deduction or the other.

INTRODUCTION

The Intermediate Court of Appeals calculated Equinor's severance tax liability incorrectly. It used too low of a value number to start the tax formula; it disregarded a considerable, contractually established part of the value of Equinor's gas; it let Equinor deduct costs that the legislative rule excludes; and it allowed the producer to take two deductions where the rule only gives it one or the other. None of this was right. And these errors would result in millions of dollars of refunds to Equinor that it's not entitled to. This Court should fix those errors and reverse.

The lower court's chief mistake was that it used the wrong number to start the calculation of the wellhead value of the gas Equinor severed in West Virginia. Severance tax applies to the value of the gas when it comes out of the ground at the well. But when producers sell it away from the well and after processing (as happens in most cases these days), the Severance Tax Code requires the Tax Commissioner to start with the total amount the gas sells for (*i.e.*, the "gross proceeds") and subtract the costs of transportation, transmission, and processing to get an estimated wellhead value that can be taxed. The total gross proceeds amount is the foundation of the tax formula: all deductions are subtracted from that starting number and the tax rate is applied to the remainder. So, it's no surprise that using the wrong number to begin the formula throws off the deductions, the taxable value amount, and the ultimate tax liability.

That's exactly what happened below. Rather than starting with Equinor's gross proceeds from the sale of the producer's gas, the Intermediate Court directed OTA and the Tax Commissioner to use a "net value" amount. But Equinor's starting gross proceeds is supposed to be "without any deduction for . . . expenses of any kind," W. VA. CODE § 11-13A-2(b)(5), and the net value the Intermediate Court mandated already had costs for transportation, transmission, processing, administration, marketing, and overhead taken out. Using the net value instead of the gross value was an error.

Additionally, the net amount the court used ignored a substantial part of the value Equinor received from selling its gas. The Intermediate Court thought the sale that counted was between Equinor and its third-party processor, MarkWest Liberty Midstream & Resources LLC ("MarkWest"). And the court believed the money Equinor got back from MarkWest was the only value that counted for severance tax. But Equinor also received millions of dollars' worth of processing services in that deal. The value of those services must be included in the starting gross proceeds number, too. That's especially true here because the contracts between Equinor and MarkWest listed MarkWest's services as part of the consideration of the sale of Equinor's gas. These services also significantly increased the value Equinor got back when MarkWest sold the processed gas to its customers. And Equinor paid for those services by letting MarkWest take the first cut of the total price the processed gas sold for at the market. All that means that Equinor received both money and services in the sale of its gas and that the Intermediate Court should've included both types of value in Equinor's gross proceeds. When it didn't, it also erred.

Making matters worse, the lower court gave Equinor deductions it wasn't entitled to as well. It effectively let Equinor deduct actual administration, marketing, and overhead expenses—even though these are expressly disallowed by the legislative rule—because the net value already incorporated deductions for these costs. And it gave Equinor a fifteen percent safe harbor deduction designed as an alternative to the actual cost deduction even though the rule lets producers take one deduction or the other—but not both.

All told, the Intermediate Court was wrong to reverse OTA on the merits. It was wrong to direct the Tax Commissioner to use a net value to start Equinor's severance tax calculation. And it was wrong to give the producer multiple deductions the rule doesn't allow. This Court should reverse and remand with instructions to set the tax calculation aright.

STATEMENT OF THE CASE

I. West Virginia's Severance Tax Formula Starts With The Gross Proceeds and Works Back to the Taxable Wellhead Value of the Gas.

West Virginia imposes an annual tax on producers engaged "in the business of severing" natural resources "for sale, profit or commercial use," W. VA. CODE § 11-13A-3a(a) (2006). Severing means "the physical removal of the natural resources from the earth or waters of this state." W. VA. CODE § 11-13A-2(c)(11). Natural resources subject to the tax include "natural gas, oil and natural gas liquids." W. VA. CODE § 11-13A-2(c)(8) (2004), *amended* (2021). The tax is generally calculated on the "market value of the natural resource" at the point "where [it is] severed" from the ground and is "commercially marketable or usable." W. VA. CODE § 11-13A-2(c)(6). For natural gas and natural gas liquids ("NGLs"), that point is "at the wellhead," W. VA. CODE § 11-13A-2(c)(6)(G)—an industry term meaning: "where [gas] first emerges from the ground" in raw unprocessed form—*i.e.*, "the head of the well." *Leggett v. EQT Prod. Co*., 239 W. Va. 264, 271, 800 S.E.2d 850, 857 (2017) (regarding use of term in royalty contracts), *superseded by statute on other grounds as recognized in SWN Prod. Co. v. Kellum*, 247 W. Va. 78, 85, 875 S.E.2d 216, 223 (2022).

Historically, that's where most, if not all, "oil and gas sales occurred." *Leggett*, 239 W. Va. at 271, 800 S.E.2d at 857. Gas was removed from the ground and sold directly to interstate pipeline operators who "undertook the expense of [transporting and] preparing" it for sale at the commercial market. *Id.* For those wellhead sales, calculating taxable value was straightforward: "The entire output of natural gas from" the well was "purchase[d] at the well head" for a definite price. W. VA. CODE R. § 110-13A-2a.10.1 (1992). So, the producer would report that exact amount on its "severance tax return . . . as gross income," *id.*, and pay taxes on that gross value.

But these days, most gas isn't sold at the well. *Leggett*, 239 W. Va. at 271, 800 S.E.2d at 857. Instead, it is sold downline and often after the raw gas has been processed into its several marketable components. *Id.* The sales price for these downline sales is often higher than at the well to account for the enhanced value of the more refined products and to compensate producers for the added costs of transporting and processing the gas. *Id.*

Likewise, the taxable value calculation is not as simple as in wellhead sales. Producers are still taxed on the gas's wellhead value: they must "file an annual return," W. VA. CODE § 11-13A-

8, that shows "the gross proceeds derived from the sales" of their gas, *id.* § 11-13A-3a(b). Their reported "gross proceeds" must include "the value, whether in money or other property, actually proceeding from the sale" of their gas "or from the rendering of services" and must be reported prior to "any deduction[s]" for costs "or expenses of any kind." W. VA. CODE § 11-13A-2(b)(5). But since they aren't selling the gas at the well, their gross proceeds are just the start of the formula.

From there, producers get to subtract either actual costs of transportation, transmission, and processing as deductions, W. VA. CODE R. § 110-13A-4.8.1 (1992), or fifteen percent of their gross proceeds to account for the same costs, *id.* § 110-13A-4.8.4.[1] Either deduction is designed to work-backwards to mathematically determine the value of gas before the producer incurs transportation and processing costs—*i.e.*, at the point when the gas is severed. W. VA. CODE § 11-13A-2(c)(6) (2004) *amended* (2021). They are then taxed at "five percent of" the wellhead value. W. VA. CODE § 11-13A-3a(b).

II. Equinor's Production, Processing, And Sale Of Natural Gas.

Equinor is a natural gas producer that drills wells in West Virginia. Its wells generate a mixture of water, sediment, and various liquid and gaseous natural resources. A.R.610, 952. Once out of the ground, the mixture goes through various pieces of Equinor's production equipment—separators, line heaters, dehydrators, and compressors—that separate the water, sediment, and oil from the raw gas and transform it into "pipeline specifications." A.R.952. After this, the raw gas is metered, measured, and transferred to a processing plant owned and operated by MarkWest, A.R.952, who "provide[s] gas processing services to" Equinor. A.R.1151.

[1] Alternatively, producers can use Federal Energy Regulatory Commission ("FERC") data, W. VA. CODE R. § 110-13A-4.8.2, or "same pool" "average purchase price" numbers, *id.* § 110-13A-4.8.3, to establish their wellhead value. But these other methods are rarely, if ever, used.

At this point, the raw gas could include both "raw make," (*i.e.*, the unprocessed "conglomerate of all the NGLs"), A.R.953, 1139, and residue gas, A.R.611, but the exact volume of each product is unknown until after processing. *CNX Gas Co. v. Irby*, No. 23-ICA-36, 2024 WL 1261813, *4 (Mar. 25, 2024) (mem. decision) (acknowledging "risk of uncertainty in determining the ratio of methane, ethane, butane, and propane present in any unprocessed mixture" of gas). Still, under a purchase agreement, MarkWest takes title to Equinor's raw make once the gas is delivered at the receipt point, A.R.1126, 1143—typically the inlet value of the processing plant. A.R.966. But Equinor retains title to any of its residue gas as it moves through MarkWest's system. A.R.611. From there, MarkWest breaks down and processes the raw gas into residue gas or methane, A.R.954, and raw make. A.R.953, 1139. The residue gas, if any, is delivered back to Equinor who sells it to customers. A.R.976, 1161. Then, the raw make is transferred to a fractionation plant, A.R.611, where MarkWest separates it into various marketable NGL components: ethane, butane, and propane. A.R.953.

After fractionation, MarkWest brings these processed NGLs to a delivery point where Equinor can elect to "take all or a portion of" them "in kind." A.R.1132. If it declines this option, "MarkWest shall purchase all" of the processed NGLs "from" Equinor, and correspondingly, Equinor "shall sell all" of the NGLs to MarkWest. A.R.1132. The contract provides that this sale occurs "at the Delivery Point," A.R.1132, which is after MarkWest has processed the NGLs, A.R.967, and Equinor has declined its take-in-kind rights. A.R.1132. MarkWest then markets and sells the NGLs to customers. A.R.962, 1133.

After that, MarkWest and Equinor settle up with each other. MarkWest takes the monthly "weighted average" price per gallon it receives from its customers for each type of NGL (ethane, butane, and propane), A.R.1132; multiples that per gallon price by the volume of each NGL it processed for Equinor, A.R.1132; and sums the separate NGL values for a total which it describes as a monthly "product value" or "gross value." A.R.611. This product value would "otherwise [be] due," A.R.1175, and "payable," A.R.1142, to Equinor as the price of its gas, except that MarkWest services aren't free. As "consideration" for "the receipt and exchange" of the NGLs, Equinor must pay MarkWest several fees related to its services. A.R.1128. For example, for each gallon of "fractionated products" (*i.e.*, NGLs) MarkWest purchases at the delivery point, Equinor agrees to pay "a fractionation fee" calculated at "$[redacted]," A.R.1128, and a "marketing fee" of "$[redacted]." A.R.1129. Equinor also pays MarkWest various receipt point, loading, and administrative fees. A.R.1128-30, 1132. And it agrees to pay similar fees for the processing of its methane gas. A.R.1174.

But Equinor doesn't typically write a check to cover those fees. Instead, the contract lets MarkWest "deduct[]" the fees "from the amounts payable to" Equinor (*i.e.*, the "gross" product value). A.R.1142. MarkWest accounts for these multi-faceted payments in statements it provides Equinor each month. These identify the quantity of various NGLs processed from Equinor's raw gas, the price per gallon for each product, and the total value for each product. The statements also detail the various marketing, pipeline, and fractionation fees Equinor is charged each month. A.R.812. They list a "gross value," the total "fees and adjustments" deducted, and the resulting "net value." A.R.812. For example, the statement from January 2015 lists the gross value at $[redacted]. A.R.812. And it lists $[redacted] in fees that were deducted from that gross to get the resulting net value of $[redacted]. A.R.812. As long as the gross value amount exceeds the fees, MarkWest pays Equinor the "net amount," but if the fees exceed the gross, Equinor "shall pay MarkWest" the difference. A.R.1174.

III. Equinor Files Several Years Returns Based On Gross Proceeds, Amends Them To Report Net Proceeds, And Requests Refunds Which Are Denied.

When Equinor filed its returns for 2014, 2015, 2016, 2018, and 2019, it used the gross value amount listed on MarkWest's statements as the starting point of its tax calculations. This resulted in a total severance tax payment of over $42 million for these five years. A.R.918 (2014: $[redacted]); A.R.1615 (2015: $[redacted]); A.R.910 (2016: $[redacted]); A.R.1978 (2018: $[redacted]); A.R.1981 (2019: $[redacted]).

Later on, a tax service firm, Ryan LLC, reviewed Equinor's severance tax returns, A.R.940, and in 2018, filed amended returns for Equinor requesting over $19 million in refunds for these five tax years. A.R.1079, *see also* A.R.918 (2014: $[redacted]); A.R.1615 (2015: $[redacted]); A.R.910 (2016: $[redacted]); A.R.1978 (2018: $[redacted]); A.R.1981 (2019: $[redacted]). The Tax Division reviewed each amended return, and while finding some parts appropriate, the Division determined that Ryan had subtracted all the fees Equinor paid to MarkWest (including administrative, marketing, and overhead fees) from the gross values reported on Equinor's original returns. A.R.1080.

The Division also found that Ryan claimed the fifteen percent safe-harbor cost deduction on top of these actual cost deductions, A.R.1080, even though the rule only lets producers take one or the other. *See* W. VA. CODE R. § 110-13A-4.8. So, the Tax Commissioner granted nearly $13 million in refunds, A.R.887 ($2014: $[redacted]); A.R.1931 (2015: $[redacted]); A.R.856 (2016: $[redacted]); A.R.2063 (2018: $[redacted]); A.R. 2026 (2019: $[redacted]), which included actual costs Equinor paid to MarkWest for transportation, transmission, and processing. A.R.887. But he denied the remaining $5,353,524.49 refund Equinor claimed for these five years because this part improperly deducted administrative and overhead costs as well as the safe-harbor deduction, A.R.887.

IV. Equinor Appeals To OTA, Which Upholds The Tax Commissioner's Refund Denial.

Equinor timely appealed four of the five refund denials to the Office of Tax Appeals,[2] all the cases were consolidated, A.R.1972, and a hearing was held on the 2014 and 2016 refunds as test cases for the other tax years.

At that hearing, Thomas Gaytan, a Ryan consultant, testified that he believed the "net price" MarkWest paid Equinor is the producer's gross proceeds, A.R.953, and should be used to start Equinor's severance tax calculation. He testified that the only money Equinor receives for its gas is the "net value" amount listed on the monthly statements from MarkWest and that the "product value" on those statements is "what MarkWest" made when it sold the processed NGLs "to a third party." A.R.956. But he admitted that the only "compensation" MarkWest receives "is the fees that are" deducted from the monthly product value. A.R.973. He also conceded that Equinor would "owe" MarkWest "those fees" even if its NGLs sold for nothing. A.R.974. He further admitted that MarkWest's services "obtain[ed] a greater value for the NGLs" and allowed the "NGLs" to be sold "to market at a higher price." A.R.978.

Mr. Gaytan also conceded that in August 2018 Equinor had to write a check to MarkWest to cover those fees. A.R.993, 738. In that month, MarkWest's fees were over twice the "product value" it obtained from selling Equinor's NGLs. A.R.738. But Equinor still owed MarkWest for its services. A.R.1175. So, it wrote MarkWest a check for $977,442.26, A.R.738, 993.

[2] Equinor was eleven months late filing its appeal of the 2015 refund denial and OTA initially dismissed because the 60-day appeal window under West Virginia Code Section 11-10-14(d)(1) is jurisdictional. A.R.1610. That dismissal was reversed by the Circuit Court of Kanawha County on equitable estoppel grounds. A.R.1610. But on the Tax Commissioner's cross-assignment of error, the Intermediate Court reversed the circuit court and remanded the 2015 case, No. 22-ICA-225, to OTA with directions to dismiss because Equinor's late filing deprived OTA of jurisdiction and the delay wasn't excused by equitable estoppel. *StatOil*, 249 W. Va. at --, 895 S.E.2d at 834. This part of the lower appellate court's decision is the subject of Equinor's separate appeal in *StatOil USA Onshore Props. v. Irby*, No. 23-760.

Still, Mr. Gaytan believed the fees Equinor paid to MarkWest shouldn't be counted as actual costs because they were "incurred" in MarkWest's system, A.R.958, and were not expenses Equinor incurred to get its gas from the well "to the point of sale in Equinor's system." A.R.958. He said that Equinor owns the well and the processing equipment in the field, including separators, heaters, dehydrators, and compressors, but MarkWest owns the processing and fractionation plants. A.R.952. He also pointed out that, under the contracts, title to the NGLs passed to MarkWest at the "receipt point" (*i.e.*, the beginning of MarkWest's plants), so he believed the "sale" between Equinor and MarkWest occurred there, A.R.971, *see also* A.R.961 (Gayton: stating that the sale between Equinor and MarkWest took place "[a]t the receipt point of the inlet of the plant"), even though the contract says that Equinor "shall sell all" of the NGLs to MarkWest "at the Delivery Point," A.R.1132, which is after MarkWest processes the NGLs into separate marketable commodities. A.R.967.

Mr. Gaytan also acknowledged that the contracts allow Equinor to take "in-kind" NGLs after processing. A.R.961. But he said that option wasn't exercised in 2014 and 2016, A.R.961, or in any of the tax years at issue, A.R.984. Regardless, he believed the sale "occurred" at "the receipt point" when MarkWest first took title to the NGLs in the raw make, A.R.971, that only the money MarkWest pays Equinor should be accounted for in the tax calculation, and that Equinor should get to take the fifteen percent safe harbor deduction for its costs. A.R.963.

Stacy Acree, Director of the Tax Commissioner's Tax Account Administration Division, also testified at the hearing. She explained that when Equinor reported its "gross proceeds" on its amended return, it had already deducted tens of millions of dollars in costs paid to MarkWest for processing its gas. A.R.1059. For example, in 2016 alone, Equinor reported $[redacted] in "product value" from MarkWest. A.R.912. But when it filed its amended returns for this year, it subtracted $[redacted] in MarkWest's fees from that value and used the remaining $[redacted] as its "gross proceeds." A.R.912. She testified that Equinor's ratio of gross value to costs was "about 19% higher than [the] industry average" of 30 to 40 percent. A.R.1063. On top of that, Equinor also claimed a safe harbor deduction, which dropped its taxable value by several million dollars more. A.R.912. She testified that ultimately the Tax Commissioner allowed Equinor to deduct most of these fees, A.R.1062 ($[redacted] in 2016) because they related to transportation, transmission, and processing. A.R.1059. But the Tax Commissioner denied Equinor's claimed deductions for marketing or demand fees because those counted as administrative and overhead and the legislative rule didn't allow for that type of cost deduction. A.R.1059. She also said Equinor wasn't given the safe harbor because it could only take the actual cost deduction or the safe harbor (but not both). A.R.1060. Its actual costs were also higher; so, the Tax Commissioner gave Equinor the more favorable deduction. A.R.1060.

She further testified that Equinor provided the Tax Division invoices showing gathering, compression, transportation, transmission, process, and lease operating costs unrelated to MarkWest's services, A.R.1040-41, *see e.g.*, 732-36, and that these were also allowed. A.R.1041, 1077. But she admitted that Equinor may have additional lease operating costs invoices that they did not submit to the Tax Commissioner. A.R.1077-78.

OTA upheld the Tax Commissioner's 2014 and 2016 refund denials in August 2022. A.R.627, 641. Despite Equinor's "repeated insistence" to the contrary, OTA found that the "facts and evidence" showed that the fees paid to MarkWest were Equinor's costs. A.R.633-34. They may be for "activities that are occurring in [MarkWest's] plant," but it found that MarkWest was "providing a service to" Equinor, A.R.636, and that the "fees [were] for [those] services." A.R.639. OTA also noted that on at least one occasion, Equinor had written a check to cover these fees.

A.R.633. OTA was convinced that the fees had to be Equinor's costs "if it is writing a million-dollar check" to cover them, A.R.634: "once [Equinor] pays these costs they clearly become [Equinor's] expenses." A.R.639. OTA doubted Equinor's explanation of the "product value" as the price MarkWest received from its customers and its characterization of the fees as MarkWest's cost because that would leave no space for profit. A.R.635-36. Instead, it held that the wellhead value of Equinor's gas was the "product value" minus the producer's actual transportation, transmission, and processing costs including those MarkWest charged it. A.R.640.

So, OTA upheld the $1,305,064.34 refund denial for 2014 and the $702,411.24 refund denial for 2016. A.R.641. Two months later, OTA relied on its August 2022 decision to also uphold the $708,438.95 refund denial in 2015, A.R.1611, and the combined $2,637,609.96 denial in 2018 and 2019, A.R.1973.

V. The Intermediate Court Reverses OTA On The Merits.

Equinor appealed, and the Intermediate Court of Appeals reversed the merits of OTA's decisions in Appeal Nos. 22-ICA-111 and 22-ICA-226. The court found that "Equinor significantly overstated the gross value in its initial severance tax filings," *Statoil*, 249 W. Va. -- n.10, 895 S.E.2d at 833 n.10, and that the "net value" listed on MarkWest's statements should be the starting number for Equinor's tax liability instead of the "product value." *Id.* --, 895 S.E.2d at 833. The court thought that number was "the gross amount" of money "Equinor receives" from the sale of its gas. *Id.* The court thought it was important that "MarkWest obtains title to the NGLs contained in [Equinor's] raw gas" once it "reaches the Plant Inlet." *Id.* --, 895 S.E.2d at 829. That meant, in its view, that the sale of the gas occurred when MarkWest received it. *Id.* It also believed that the money MarkWest paid Equinor was the only "consideration that Equinor actually receives from MarkWest," *id.* --, 895 S.E.2d at 833, and so "constitutes the entire gross proceeds derived by Equinor from the sale of [its] NGLs" as the statute defined "gross proceeds," *id.* --, 895 S.E.2d at 832 (citing W. VA. CODE § 11-13A-2(b)(5)).

The court also disagreed with OTA's treatment of the fees MarkWest charged Equinor. It viewed those as "reflect[ing] costs incurred by MarkWest" and not "of natural resources moving through Equinor's system." *Id.* --, 895 S.E.2d at 834. It found that the legislative rule allowed a deduction for the costs to transport or transmit "gas through the system of the producer from the well-mouth point of severance and production to the point of sale," *id.* (quoting W. VA. CODE R. § 110-13A-4.8.1), and believed that the fees MarkWest charged Equinor didn't qualify. Its theory that title to the NGLs transferred at the plant inlet was key to this ruling, too. *Id.* In the court's mind, that meant the fees related to transportation, transmission, processing, and fractionation in MarkWest's facilities occurred "*after* the point of sale" instead of before it. *Id.*

The court then held that Equinor was entitled to the fifteen percent safe harbor deduction because it found that the fees that were subtracted from the "product value" to arrive at the "net value," didn't count as an actual cost deduction. *Id.* So, the court thought Equinor wasn't trying to take a second deduction when the rule only let it take one.

Lastly, the court remanded so that OTA could direct the Tax Commissioner to grant Equinor refunds in the 2014, 2016, 2018, and 2019 cases, *id.* --, 895 S.E.2d at 836, which for the four years totaled $4,645,085.54. The court also remanded the 2015 case, No. 22-ICA-225, to OTA with instructions to dismiss on jurisdictional grounds. Both Equinor and the Tax Commissioner appealed to this Court.

SUMMARY OF ARGUMENT

I. The Intermediate Court's opinion in 22-ICA-111 and 22-ICA-226 suffered from two errors related to setting Equinor's starting, gross proceeds number.

A. Instead of using the total amount that Equinor's processed NGLs obtained when MarkWest sold them to its customers, it began with the net amount that MarkWest paid Equinor in money. But that net value already had deductions for MarkWest's services taken out, and the statutory definition and common understanding both require that "gross proceeds" have no expenses subtracted yet. Those deductions are supposed to occur later on in the formula. And when properly taken, they ensure that producers are taxed only at the wellhead value of their gas and according to the contours of the constitution that concerned the Intermediate Court. But the formula still has to start with the gross number and include only the deductions the rule provides. The Intermediate Court erred in the beginning number, which threw its whole calculation off. This Court should reverse and direct that the gross proceeds required by the Severance Tax Code be used instead.

B. The Intermediate Court's starting number also disregarded the value of MarkWest's services. It thought that Equinor sold its NGLs to MarkWest before processing and that the only value it got back from that sale was the money reflected in the net value amount. But Equinor's contract lists the fees and charges for MarkWest's services as part of the consideration for the sale of its gas, too. And it requires Equinor to pay for those services even if the NGLs sell for nothing at the market. Plus, those services are clearly valuable: MarkWest charges Equinor millions of dollars for them each year and Equinor pays for those services by giving MarkWest the first cut of the price its NGLs sell for at the market. The severance tax formula is supposed to include the value of those types of services, but the Intermediate Court ignored that part of Equinor's sale when it based the tax on the net value. This was error as well.

II. The lower court also committed two errors in determining Equinor's deductions.

A. The legislative rule expressly disallows deductions for administrative and overhead expenses like marketing. Yet, the Intermediate Court effectively let Equinor remove these types of costs from its taxable value because MarkWest had already been paid for these services before it gave Equinor the remaining net value. It thought that was appropriate because, in its view, these charges shouldn't count as real deductions since they weren't incurred by Equinor and didn't relate to activities in Equinor's system. But that reasoning is flawed. Multiple places in the contract make Equinor responsible for paying these charges; and it does so by either writing MarkWest a check or by letting the processor take a cut of the gross proceeds off the top. The contract also makes these charges part of the consideration for MarkWest's receipt of Equinor's gas. So, they are a condition for the transfer of the gas from Equinor's system to MarkWest; and they are required to get the gas to its ultimate selling point. The Intermediate Court should've treated the charges for MarkWest's services as actual deductions and disallowed the portions for administration, marketing, and overhead as the rule requires.

B. Finally, the lower court should not have given Equinor the safe harbor deduction, too. The rule only lets producers take one type of deduction or the other—but not both. Equinor already received actual cost deductions associated with MarkWest's transportation, transmission, and processing services. And the record shows that it also received all the allowable cost deductions it submitted to the Tax Commissioner for expenses between the well and MarkWest's plant. Giving it the safe harbor on top of that violated the controlling legislative rule.

Altogether, these errors substantially affected the calculation of Equinor's severance tax liability and would result in the producer receiving millions of dollars in refunds the statute and rule don't allow. This Court should reverse the Intermediate Court of Appeals' opinion on each of these grounds and reinstate OTA's decisions in the 2014, 2016, 2018, and 2019 cases.

STATEMENT REGARDING ORAL ARGUMENT

The Tax Commissioner requests oral argument pursuant to Rule 20 of the Rules of Appellate Procedure because this case involves issues of high public importance regarding the State's severance tax system.

STANDARD OF REVIEW

This Court reviews a lower court's reversal of a decision from OTA under the standards set out in the Administrative Procedures Act, W. VA. CODE § 29A-5-4g (1988). *See* syl. pt. 1, *Griffith v. ConAgra Brands, Inc.,* 229 W. Va. 190, 191, 728 S.E.2d 74, 75 (2012). At this stage, OTA's findings of fact should "not be set aside or vacated unless clearly wrong." *Id.* While "questions of law" are reviewed "de novo," OTA's "interpretation of State tax provisions" should be "be afforded sound consideration," *id.,* and "given great weight unless clearly erroneous." Syl. pt. 2, *Keener v. Irby*, 245 W. Va. 777, 778, 865 S.E.2d 519, 520 (2021). West Virginia courts also give deference to the Tax Commissioner's interpretation and application of tax laws unless his position "is arbitrary, capricious, or manifestly contrary to the statute." *Steager v. Consol Energy, Inc*., 242 W. Va. 209, 223, 832 S.E.2d 135, 149 (2019) (cleaned up).

ARGUMENT

I. The Product Value Should Start The Calculation Of Equinor's Severance Taxes Instead Of The Net Value Used By The Intermediate Court.

The Intermediate Court of Appeals used the wrong number to begin the calculation of the wellhead value of Equinor's gas. It didn't start with the "gross proceeds" from the sale before "any deduction for . . . expenses of any kind" were taken out. W. VA. CODE § 11-13A-2(b)(5). Instead, it used a net value where the costs of MarkWest's services were already deducted. Using that number incorrectly set the wellhead value of Equinor's gas and excessively lowered its tax liability—giving Equinor millions of dollars in refunds it wasn't entitled to. That decision was in error and should be corrected by this Court.

A. The product value is Equinor's gross proceeds from the sale of its gas before any deductions are taken out.

The lower court thought OTA and the Tax Commissioner "failed to adhere to the applicable statutes and legislative rule when determining" the wellhead value of Equinor's gas because both used the "product value" on MarkWest's settlement statements instead of the net value. *Statoil*, 249 W. Va. --, 895 S.E.2d at 833. But the statute's formula starts with "gross process," W. VA. CODE § 11-13A-3a(b), and even Equinor's preferred number is derived from that gross product value. A.R.611 (OTA: "The net value is the product value minus the fees."). Starting with the lower, net-value number was incorrect.

Everyone agrees that severance tax is imposed on the "market value" of a natural resource "in the immediate vicinity where severed." W. VA. CODE § 11-13A-2(c)(6). "For natural gas" that point is "at the wellhead," *id.* § 11-13A-2(c)(6)(G), which is "where [the gas] first emerges from the ground" in raw unprocessed form. *Leggett*, 239 W. Va. at 271, 800 S.E.2d at 857. Gas's value, then, is "determined by the gross proceeds of sales" that occur "where production ends." W. VA. CODE R. § 110-13A-2.7. When the sale happens at the well, the calculation of its value is simple: the total price the gas sells for is reported "as gross income," W. VA. CODE R. § 110-13A-2a.10.1 (1992), and the producer pays five percent of that amount in taxes. W. VA. CODE § 11-13A-3a(b).

But Equinor doesn't sell its gas at the wellhead. *Statoil*, 249 W. Va. --, 895 S.E.2d at 832. And it doesn't price it there either. Instead, Equinor takes the raw gas from the ground at the well and transports it down the line to facilities owned by MarkWest. A.R.952-53. From there, the raw gas is processed and fractionated into separate marketable NGLs and sold to MarkWest's customers. A.R.962, 1133. Only then does anyone fix the value of the gas. MarkWest takes the average price per gallon it receives from its customers, A.R.1132, multiples it by the volume of each NGL it processed for Equinor, A.R.1133, and adds each value up for a gross monthly "product value." A.R.812. Then, it "deduct[s]" the fees it charges for its services and pays Equinor the "remaining" "net" value amount. A.R.1175.

But even in these downline sales, the calculation of the wellhead value still has to start with the gross proceeds—not the net proceeds—and then work back to the wellhead value. In all cases, the tax formula begins with "the gross proceeds derived from the sale . . . by the producer." W. VA. CODE § 11-13A-3a(b). "Gross proceeds" means "the value, whether in money or other property, actually proceeding from the sale . . . or from the rendering of services." *Id.* § 11-13A-2(b)(5). That starting number must also be "without any deduction for . . . expenses of any kind," *id.*, which is consistent with common understanding, *see Chesapeake Exploration, LLC v. Hyder*, 483 S.W.3d 870, 874, (Tex. 2016) (finding "gross production" in gas royalty contract meant "undiminished by deduction; entire" (cleaned up)).

But the calculation doesn't end at the gross proceeds. The Code says that "[t]he privileges of severing and producing . . . natural gas shall not include any conversion or refining process." W. VA. CODE § 11-13A-4(c). The rules say the same. W. VA. CODE R. § 110-13A-4.3. Both authorities also say that the wellhead value must exclude costs of "transportation and transmission," W. VA. CODE § 11-13A-2(c)(6)(G); W. VA. CODE R. § 110-13A-4.8. So, from the gross proceeds, the costs of transportation, transmission, and processing are deducted so that the gas is still taxed at "at the well-mouth" value. W. VA. CODE R. § 110-13A-4.3.

In the industry, this formula is "called a 'netback' or 'workback'" and "is [a] widely accepted" "means for estimating the market value of gas at the well where no such market exists." *Abraham v. BP Am. Prod. Co.*, 685 F.3d 1196, 1200 (10th Cir. 2012). To be sure, the method has received ample criticism from this Court in the context of calculating producers' royalty payments. *E.g., SWN Prod. Co. v. Kellum*, 247 W. Va. 78, 95-96, 875 S.E.2d 216, 233-34 (2022) (Hutchinson, C.J., concurring) (criticizing "vague, malleable, impossible-to-measure deductions" applied in work-back method in royalty calculation); syl. pt. 11, *Estate of Tawney v. Columbia Nat'l Res*. LLC, 219 W. Va. 266, 268, 633 S.E.2d 22, 24 (2006) (finding "at the well" or "similar language" in royalty contracts ambiguous and insufficient to allow producers to subtract "costs incurred between the wellhead and the point of sale"). But unlike in those royalty cases, in severance tax, the method is provided for expressly by legislative rule, W. VA. CODE R. § 110-13A-4.8.1, and that rule has "controlling weight." *Murray Energy Corp. v. Steager*, 241 W. Va. 629, 640, 827 S.E.2d 417, 428 (2019).

The method presumes that the unprocessed gas "is less valuable at the wellhead," that the downline processing "add[s] value to" it, and that any purchaser at the well would reduce the price they'd pay for the unprocessed gas because "it will have to incur the costs to remove impurities . . . to transport it from the wellhead, or otherwise to get it ready for sale to a downstream market or the general public." *Bluestone Nat. Res. II, LLC v. Randle*, 620 S.W.3d 380, 389 (Tex. 2021). So, the work-back method deducts those costs, *id.*, to estimate what the gas would've sold for at the well. *Anderson Living Trust v. Energen Res. Corp*., 886 F.3d 826, 833 (10th Cir. 2018).

That's why the Intermediate Court's concerns about "extend[ing]" the tax beyond the "constitutional contours" of wellhead valuation are unfounded. *Statoil*, 249 W. Va. -- n.9, 895 S.E.2d at 833 n.9 (citing *Hope Nat'l Ga Co. v. Hall*, 274 U.S. 284 (1927), *Hope Nat'l Gas v. Hall*, 102 W. Va. 272, 135 S.E. 582 (1926), and *Soto v. Hope Nat'l Gas Co*., 142 W. Va. 373, 95 S.E.2d 769 (1956)). For one, dormant commerce clause analysis has shifted significantly away from the formalistic rules laid down in the 1920s and 1950s cases the Intermediate Court cited. *See*

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977). Some of these early 20th century cases have even been formally disapproved—particularly in the severance tax realm. *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 614, 617 (1981) ("disapprov[ing]" *Heisler v. Thomas Colliery Co.*, 260 U.S. 245 (1922) "and its progeny" including *Hope Nat'l Gas Co. v. Hall*, 274 U.S. 284 (1927)). But whether modern dormant commerce clause tests would allow for a different valuation point turns out largely irrelevant because the statute and rule already align the point of taxation with "the wellhead," W. VA. CODE § 11-13A-2(c)(6)(G), "the well-mouth," W. VA. CODE R. § 110-13A-4.3, and "the immediate vicinity where" the gas is "severed," W. VA. CODE § 11-13A-2(c)(6). And starting with the product value doesn't conflict with that statutory directive. Even where a producer's gross proceeds are derived from sales far away from the wellhead, the statute and rule provide for deductions that bring the valuation back to that right endpoint.

But to work correctly, the formula must "us[e] sales proceeds as [the] starting point," *cf. Bluestone*, 620 S.W.3d at 389, which are typically realized "after processing" when the "refined . . . NGLs" are sold "at the tailgate of the processing plant." *Anderson*, 886 F.3d at 833, *see* U.S. Energy Info. Admin., Glossary: "Tailgate" https://tinyurl.com/fksn5k29 (last visited, Apr. 18, 2024) (defining "tailgate" as "outlet of . . . processing plant"). That's because NGLs generally don't "become marketable" until "they are separated" into their refined commodities. *Corder v. Antero Res. Corp.*, 57 F.4th 384, 401 n.11 (4th Cir. 2023). So, no "gross" revenue "is realized or received" until they are sold to the customer. *Bluestone*, 620 S.W.3d at 391. That's why the "market value at the well" has to start with "the commercial market value." *Carl as Co-Trustee of Carl/White Trust v. Hilcorp Energy Co*., 91 F.4th 311, 315 (5th Cir. 2024) (per curiam). Only then can the "processing and transporting expenses . . . paid before the gas reaches the commercial market" be subtracted. *Id.* (cleaned up).

This case is no exception: Equinor's NGLs aren't valued until they are processed and sold at the market either. Yes, Equinor's contracts say that title to whatever NGLs are present in the raw gas pass to MarkWest upon receipt. A.R.1126, 1143. But the exact amount of NGLs in the raw make is unknown at that point, A.R.787-88 (describing gallons at receipt point as "theoretical"); *cf. CNX*, 2024 WL 1261813, *4 (recognizing "uncertainty in determining the ratio of methane, ethane, butane, and propane present in any unprocessed mixture"). And the quantity of NGLs "theoretical[ly]" received at the inlet value are subject to several adjustments which determine the number of processed NGLs Equinor is allocated. A.R.1172. Plus, neither MarkWest nor Equinor set a value on the gas when the title transfers. Certainly, no money changes hands at that point. Rather, the value of the gas isn't determined until after it's processed, refined into separate marketable NGLs, and sold to customers. A.R.962, 1133. Even then, the value isn't calculated on the "theoretical gallons" received but on the adjusted "settlement gallons" allocated to Equinor after processing. A.R.1172. The math on the December 2014 statements shows this: the $[redacted] per gallon price for propane isn't applied to the over [redacted] theoretical gallons of that product calculated at the receipt point but on the [redacted] "settlement gallons" available after processing. A.R.812. The value of the other NGLs is calculated in the same way—after processing.

What's more, before the refined NGLs are sold to the customer, their value is fairly volatile. The Intermediate Court realized this, too. It said that the "market prices for [NGLs] (especially prior to processing and delivery to an end-user) are dependent upon a number of market forces (supply, demand, futures markets, etc.)." *Statoil*, 249 W. Va. -- n. 9, 895 S.E.2d at 833 n.9. In practice, that means even "theoretical" NGLs that were valuable when MarkWest took title, could substantially dropped in price by the time they are sold to the customer. *Id.*

That's why even the Intermediate Court's preferred number is derived from the money MarkWest receives from selling the refined NGLs to customers. The lower court thought the "net value" on the settlement statements should be Equinor's "gross proceeds," *Statoil*, 249 W. Va. --, 895 S.E.2d at 833, but that number is just the "product value" minus certain "deduct[ions]." A.R.1175. MarkWest takes the average price per gallon it receives from its customers, A.R.1132, multiplies it by the volume of each NGL it processed for Equinor, A.R.1133, and adds each value up for a gross monthly "product value." A.R.812. Then, it "deduct[s]" the fees it charges for its services and pays Equinor the "remaining" "net" value amount. A.R.1175. As OTA put it: "The net value is the product value minus the fees and adjustments." A.R.611. So, the Intermediate Court's and Equinor's preferred calculation has to start with the product value, too. The Tax Commissioner's formula just takes that number "without any deduction for the cost of property sold . . . or expenses of any kind" as the statute requires. W. VA. CODE § 11-13A-2(b)(5). The Intermediate Court was wrong to ignore that statutory mandate.

B. Equinor actually received the benefit of the entire product value; so, that value is its gross proceeds from the sale.

Still, the Intermediate Court thought the "product value" was wrong because, in its view, Equinor never "actual receive[d]" that entire amount when it sold its gas to MarkWest. *Statoil*, 249 W. Va. --, 895 S.E.2d at 833. The court believed the sale occurred "at the inlet" of the plant when "MarkWest obtain[ed] title to the NGLs contained in the raw gas," *id.*, --, 895 S.E.2d at 829, and that the net value—the money MarkWest paid Equinor—was "the total amount of consideration" actually proceeding from that sale, *id.* --, 895 S.E.2d at 833.

To be sure, a "sale" is "any transfer of the . . . title to property, whether for money or in exchange for other property or services, or any combination thereof." *Id.* § 11-13A-2(b)(10). And the contracts say title to whatever NGLs are present in the raw make transfers when the gas is delivered to MarkWest at the receipt point, A.R.1126, 1143—the inlet valve of the processing plant. A.R.966. But the same contracts also state that Equinor "shall sell all" of the NGLs to MarkWest later—at the outlet valve of the plant (*i.e.,* after processing), and that "MarkWest shall purchase all" of the processed NGLs at that point. A.R.1132. That later selling point makes more sense anyway given that the quantity of NGLs in the raw make is only "theoretical" at the inlet valve, A.R.788, and the "market prices" per gallon is unknown "prior to processing." *Statoil*, 249 W. Va. -- n. 9, 895 S.E.2d at 833 n.9. The money Equinor receives reflects this later sales point, too: both the product and net value are derived from the volume of NGLs available after processing, A.R.748, and not on the quantity "theoretical[ly]" received at the inlet value, A.R.788. That's also how the math on the settlement sheets work out: the price per gallon is multiplied by the settlement gallons available after processing and not by the theoretical gallons received at the inlet value. *E.g.*, A.R.813 (Dec. 2014 Statement: [redacted] settlement gallons multiplied by $[redacted] price per gallon equals $[redacted] product value for propane).

But even if the lower court was right on the point of sale, its conclusion that the "net value" is "the total amount of consideration that Equinor actually receives from Mark West," *Statoil*, 249 W. Va. --, 895 S.E.2d at 833, was wrong on the law and the facts. Equinor didn't just receive money from the sale; it also received millions of dollars' worth of services. Its "gross proceeds" should include that value, too.

Taking the law first: yes, a producer's "gross proceeds" is the "value" that "actually proceed[s] from the sale" of its gas. W. VA. CODE § 11-13A-2(b)(5). But the definition of "value" is broad. Certainly, "money and other property" count, but so does "rendering of services." *Id.* The meaning of "sale" also reinforces that inclusive definition of value: a "sale" can be "for money" or "for other property or services, or any combination thereof." *Id.* § 11-13A-2(b)(10).

That statutory definition is also consistent with common understanding of value. After all, "valuable consideration" "is a broad term" that "may consist" of any "right, interest, profit or benefit accruing to the one party or some forbearance, detriment, loss or responsibility given, suffered, or undertaken by the other." *Young v. Young*, 240 W. Va. 169, 174, 808 S.E.2d 631, 636 (2017). It normally includes "[e]very element of value" relevant to "a sale" "between private parties." *Cf. W. Va. Dep't of Transp. v. W. Pocahontas Props., L.P.*, 236 W. Va. 50, 62, 777 S.E.2d 619, 631 (2015) (defining fair market value in the eminent domain context). "[S]ervices rendered" plainly qualify as "consideration" under that broad common definition, syl. pt. 3, *Rauschenbach v. McDaniel's Estate*, 122 W. Va. 632, 633, 11 S.E.2d 852, 853 (1940), and this Court has found as much in various other contexts. For example, it found "medical attention and nurse services" rendered by a child sufficient "valuable consideration" for a contract in *Rauschenbach*, 122 W. Va. at 636, 11 S.E.2d at 855. It's held that lawyers have a well-recognized right to "recover" "reasonable value of services rendered" even when discharged with cause. *Kopelman & Assocs., L.C. v. Collins*, 196 W. Va. 489, 496, 473 S.E.2d 910, 917 (1996). And it's commonly understood that parties should pay "fair market value" for either "property or services" they receive. *Earl T. Browder, Inc. v. Cnty Ct. of Webster Cnty.*, 143 W. Va. 406, 415, 102 S.E.2d 425, 432 (1958).

Counting the value of processing services happens even in the oil and gas industry. Royalty valuation cases are a good example of this. Most producers throughout the country pay royalties to the owners of the land where they drill and extract gas. Like in severance tax, these royalties are often calculated on a percentage of the value of the gas "at the wellhead" or on producers' "gross proceeds." *Tawney*, 219 W. Va. at 272, 633 S.E.2d at 28. That said, several of this Court's decisions on royalty valuations turn on what deductions can be subtracted from the gross proceeds before determining the royalty. *E.g.*, syl. pt. 3-5, *SWN*, 247 W. Va. at 80, 875 S.E.2d at 218 (answering certified question on specificity for royalty lease agreements that permit deductions for costs of marketing and transportation). The question of whether the value of third-party processing services should be included in the initial gross proceeds amount doesn't always come up directly.

But the issue has arisen more directly in other courts; and several of these have included the value of third-party processing services in producers' gross proceeds count. For example, in *Corder*, the Court of Appeals for the Fourth Circuit found that Antero had to include the value from "processing, fractionating, and transporting NGLs," *id.* at 390, in some of its royalty payments even though much of that work occurred in MarkWest's processing and fractionation facilities, *id.* at 389; *see also id.* at 390 n.4 (noting that one deduction rejected by the district court was for the "cost of compressing gas at the Processing Plant"). Even royalty contracts that directed the valuation to be determined "at the well," "at the wellhead," or on "the gross proceeds received from the sale" didn't allow deductions for these costs in the Fourth Circuit's view. *Id*. at 393 & 396 ("None of the leases in this category satisfies" specificity requirements for allowing post-production cost deductions). So, the costs Antero paid for processing and fractionating its gas had to be included in these royalty calculations, *id*. at 397, even though some of the costs of these services occurred in MarkWest's facilities, *id.* at 389, 390.

Other courts have reached similar conclusions. In one of these, the Supreme Court of Texas found that valuations based on "gross value received" "refers to all consideration received" including "the amount of goods, services, or money" "delivered." *Bluestone*, 620 S.W.3d at 391 & n.51 (cleaned up). In another, the same court found "no dispute" that third-party processors' "cost adjustment for having transported and processed gas on the producers' behalf" should be added back into "the price the producers actually received" because those "expenses are consideration accruing to the producers' benefit and therefore part of the producers' 'gross proceeds'" under the royalty lease. *Devon Energy Prod. Co., L.P., v. Sheppard*, 668 S.W.3d 332, 338 (Tex. 2023).

Likewise, the United States Court of Appeals for the Fifth Circuit rejected a producer's attempt to pay its "gross proceeds" based royalties solely on the "revenue" from its processor. *Yturria v. Kerr-McGee Oil & Gas Onshore, LLC*, 291 Fed. Appx. 626, 634 (5th Cir. 2008) (per curiam). Instead, it set the royalty based on the "index price per gallon for all plant products"—a pricing method like the "product value" in this case—because it reflected the "total income produced," *id.* at 630, and was set "before deductions [were] made" by the processor "for transportation and fractionation fees," *id.* at 635. Along that same line, a federal bankruptcy court in Texas found that a producer's "royalty base" must include "more than just the proceeds" it "received . . . from the purchaser." *In re Chesapeake Energy Corp*., No. 20-33233, 2021 WL 4190266, *7 (S.D. Tex. 2021). The "transportation and fractionation fee" charged by its processor needed to be added back in to calculate the royalty. *Id.*

Even where the courts let producers deduct third-party processor services, the value of those services are still often included in the royalty formula's initial gross proceeds number. Equinor's own royalty litigation history shows this. For example, in *Young v. Equinor USA Onshore Props., Inc.*, the leases required Equinor and another producer to pay royalties on the "gross proceeds received by [the producers] from the sale of oil and gas minus post-production costs incurred by [the producers] between the wellhead and the point of sale." 982 F.3d 201, 203-04 (4th Cir. 2020). "[P]ost-production" costs counted as deductible under those leases whether

Equinor "use[d] its own pipelines and equipment" or "engage[d] others to provide such services." *Id.* at 204. So, the Fourth Circuit allowed the deductions even though Equinor had "contract[ed] with others to perform" some of these services. *Id*. at 204, 209. But no one questioned that the value of those services must be include in Equinor's initial "gross proceeds" amount or that these services were "costs incurred by [Equinor] between the wellhead and the point of sale*." Id*. at 204. Equinor's starting "gross proceeds" in that case had to include the value of third-party processor services otherwise they couldn't be deducted later on as costs.

Of course, royalties are typically matters of contract, where "the parties" can negotiate "for a different result" than "any of the default" rules or "guidelines" may dictate. *SWN*, 247 W. Va. at 91, 875 S.E.2d at 229 (Hutchinson, C.J., concurring). And some of these royalty cases involve "uncommon" lease language, *Chesapeake*, 2021 WL 4190266, *7, or "strong circumstantial evidence" from the parties' prior negotiations. *Yturri*, 291 Fed. App. at 634. Royalty methodologies also don't always translate neatly to all tax cases, *see Steager v. Consol Energy, Inc.*, 242 W. Va. 209, 223 n.20, 832 S.E.2d 135, 149 n.20 (2019) (explaining difference between "point of sale" methodology for property tax and "at the wellhead" value for flat-rate royalty payments). But severance tax is different because it involves many of the same "gross proceeds" definitions, wellhead valuation methods, and deductions relevant to royalties. That's why this Court relied on royalty principles when determining what qualified as "consideration" and "taxable production of gas" under severance's predecessor business and occupation tax statutes. *United Fuel Gas Co. v. Battle*, 153 W. Va. 222, 231, 167 S.E.2d 890, 896-97 (1969). It should do the same here. *Corder*, *Bluestone*, *Devon*, *Yturri*, *Chesapeake*, and *Young* all confirm that processing and fractionation services count as valuable, benefit the producer, and can be part of the gross proceeds for the sale of producers' gas. That's true even when these services are performed by third-party processors—including the same third-party that processed Equinor's gas in this case. These services should be treated as valuable for severance tax purposes, too.

The record below proves that treating MarkWest's services that way is correct. Like the producers in these royalty cases, Equinor receives both money and services in exchange for its gas. The money is undisputed: MarkWest pays Equinor the "net value" each month. A.R.1175; *see* A.R.959 (Gaytan: "the net value . . . that's what was actually received."); A.R.629 (OTA: "It is undisputed" that Equinor "receives payment from" MarkWest "in the amounts listed in the settlement statements as the net value"). But Equinor receives MarkWest's services, too. The contracts make that point plain. The NGL Purchase Agreement includes an entire section on consideration. Part of it details the formula for determining the product and net values, A.R.1132, but another part sets out the fees that Equinor has to pay MarkWest to process its NGLs. A.R.1128. Those "fractionation fees," "marketing fees," "loading fees" and "administrative fees" are also listed as part of the contract's "consideration." A.R.1128-29. And it's clear that these fees must "be paid by" Equinor "in connection with the receipt and exchange" of its gas. A.R.1128.

Nor is it debatable that those services are valuable. Equinor's witness conceded that MarkWest's processing and fractionation services were intended "to get those NGLs to market at a higher price" and helped "obtain a greater value for the NGLs." A.R.978 (Gaytan). Each fee is calculated as cents per gallon of either raw make MarkWest receives or processed NGLs it purchases. A.R.1129. But they add up to hundreds of thousands of dollars when applied to the millions of gallons of NGLs MarkWest processes for Equinor each month, *e.g.*, A.R.813 (showing $[redacted] in fees in Dec. 2014 Statement). In 2016 alone, MarkWest charged Equinor over $[redacted] million for those services. A.R.912. What's more, the record shows that Equinor receives the entire increased value resulting from those services. MarkWest is paid based on fixed, per gallon rates that don't fluctuate with the market price of NGLs. It gets its [redacted] per gallon fractionation fee, A.R.1128, whether its customers pay [redacted] for that product or nothing at all. A.R.974 (Gaytan: agreeing that Equinor owes MarkWest "those fees no matter what the product sells for"). And that's no hypothetical: on at least one occasion, the market price dropped so low that Equinor got nothing back from selling its gas and had to write MarkWest a nearly million-dollar check. A.R.633. Even the Intermediate Court recognized that Equinor bore the risk that the processing wouldn't yield a favorable return, *Statoil*, 249 W. Va. -- n.9, 895 S.E.2d at 833 n.9, but Equinor also receives the reward when it does. MarkWest's services are clearly valuable to Equinor.

True, Equinor rarely writes MarkWest a check to cover those services. The gross product value almost always exceeds the price of MarkWest's services. A.R.1175. So, most of the time, MarkWest "deduct[s]" its fees "from the amounts payable to" Equinor (*i.e.*, the "gross" product value), A.R.1142, and pays Equinor the "net" remainder. A.R.1175. But that normal payment arrangement only confirms that Equinor receives the entire benefit of the monthly product value. It receives part of the product value as monthly net payments—as money. But it receives the rest as an offset of the cost of MarkWest's services that it would otherwise have to pay for out-of-pocket. These offsets are seen as "equivalent to payment" in other contexts. *Cf. Kenny v. Liston*, 233 W. Va. 620, 629, 760 S.E.2d 434, 443 (2014) (noting that "write-down" of medial bill or "partial forgiveness of debt" is "equivalent to payment" in a number "of contexts" such as "income tax, credit bids at foreclosure").[3] It should in this context, too. After all, a "sale" can be "for money," "other property or services, or any combination thereof." *Id.* § 11-13A-2(b)(10).

[3] Along the same lines, the Intermediate Court's finding that "Equinor established" that it "reported" the "net values" as "'gross proceeds' for federal income tax" isn't quite right, either. *Statoil*, 249 W. Va. --, 895 S.E.2d at 829 n.3. For one thing, the court never explained why this was relevant to its opinion (if at all). *Id.* The lower court may have thought this responsive to Equinor argument below that OTA required it to diverge from the accounting method used on its federal income returns. *E.g.*, A.R.61

All that confirms that OTA was right to be "unpersuaded" by Equinor's claim "that the only factor in determining its gross proceeds [was] the amount of the check it receives for its sales." A.R.639. The Intermediate Court should've been just as skeptical. The law counts the entire value from the sale of natural resources—not just the money producers receive. And the facts show that Equinor sold its gas for a combination of money and services. The product value captures both parts of the value of the sale. So, it should be used as the starting number for calculating Equinor's severance taxes. The Intermediate Court was wrong to hold otherwise. It should be reversed, and this Court should remand with directions to start the calculation with the product value.

II. The Lower Court Gave Equinor Deductions The Statute And Legislative Rule Don't Allow.

The Intermediate Court also gave Equinor too large of a cost deduction. The net value it started with already included deductions for all the fees MarkWest charged Equinor. And part of those fees were for administrative and overhead costs, which aren't deductible under the rule. Yet, the lower court compounded that error by letting Equinor take the alternative safe harbor deduction on top. This Court should reverse on this ground as well.

(Equinor's Initial Brief in 22-ICA-111); *see* W. VA. CODE § 11-13A-7. But the Intermediate Court never explained this connection. Plus, OTA never made a finding on that issue. And the evidence Equinor presented on this point was sparse at best. All it put on the record was a letter from its federal income tax preparers stating the "aforementioned values" on MarkWest's settlement statements "flow though Equinor's accounting system and are ultimately utilized in the determination of Taxable Income on the Federal Income Tax Return." A.R.721. But Equinor never provided its federal income tax filings, A.R.721, and using values to determine taxable income is far different than the lower court's implication that Equinor reported those precise numbers exactly on a federal return. Besides that, it is unclear if those "values" referenced include only the "net value" or net value and "list of fees" that are also "aforementioned" in the letter. A.R.721. Regardless, the statements in the letter were never subject to cross-examination and were insufficient on their own to meet the "preponderance of the evidence" "standard of proof" taxpayers must generally meet on all factual issues whether at OTA or on "appeal." W. VA. CODE § 11-10A-10(h) (2021).

A. The Intermediate Court let Equinor take administrative and overhead deductions disallowed by the rule.

Again, severance tax is laid on the value of the gas "at the wellhead." W. VA. CODE § 11-13A-2(c)(6)(G). When the gas is sold away from that point, especially after processing, the tax formula works back to wellhead value by giving producers deductions to account for the costs from the wellhead to the point of sale.

That's because the transportation, processing, and refinement that occurs after the gas is severed from the ground "add[s] value," *Bluestone*, 620 S.W.3d at 389, which must be accounted for "through a cost deduction." *CNX Gas*, 2024 WL 1261813, *4. The rule sets out four of these, which are each designed "to arrive at the well-mouth value" of the gas by giving "deduction[s] from the gross proceeds of the sale" for "transportation or transmission expenses incurred by producers." W. VA. CODE R. § 110-13A-4.8. The statute is also clear that the tax doesn't apply to "conversion or refining processes" either, W. VA. CODE §§ 11-13A-4(c), 11-13A-2(c)(9), so deductions are given to cover the cost of downline processing, too. *CNX*, 2024 WL 1261813, *4.

Two of the rule's deduction options are relevant in this case: the actual cost deduction and the safe harbor. The first lets producers subtract "the amount of the costs of transportation or transmission of [natural gas] through the system of the producer from the well-mouth point of severance and production to the point of sale." W. VA. CODE R. § 110-13A-4.8.1. Only "actual costs" qualify for this deduction and "general administration, overhead, or return on investment" are expressly disallowed. *Id.* The other option lets producers deduct "15% of the gross proceeds of the natural gas severed and produced." W. VA. CODE § 110-13A-4.8.4. This alternative acts as a "safe harbor," A.R.629, because producers don't have to prove actual costs. But these deductions are designed as "alternative methods," which means producers are allowed to take only "one" of them. W. VA. CODE § 110-13A-4.8. The rule "reserve[s]" some "discretion" to the Tax

Commissioner to determine which deduction is appropriate, *id*., so, he generally gives producers the "more advantageous" option. A.R.1080.

That's what the Tax Commissioner did here: He let Equinor take most of MarkWest's fees as actual costs deductions—$[redacted] in 2016 alone, A.R.1062, and nearly $13 million in refunds overall, *see* Statement § III, *supra*. Most of the fees MarkWest charged Equinor fell within the definition of actual transportation, transmission, or processing costs. For example, the fees labeled as "fractionation," "receipt point," or "loading" were all counted as allowable costs, A.R.1129-30, and the Tax Commissioner gave Equinor deductions for each of these when he calculated each year's refund. A.R.1059. But MarkWest's fees also included costs that were labeled as administrative, "marketing," or "demand" fees. A.R.1062, 1032. For example, one of the December 2014 settlement statements included an over $[redacted] marketing fee, A.R.813, another statement from the same period included a marketing fee of over $[redacted], A.R.814. In 2016, these nondeductible fees amount to nearly $[redacted]. A.R.1062. The Tax Commissioner didn't allow these as deductions because they all count as nondeductible "general administration [or] overhead" under the rule. W. VA. CODE R. § 110-13A-4.8.1.

No one argues that the administrative, marketing, or overhead charges on the settlement sheets count as an actual cost of transportation, transmission, or processing. Nor is there any question that the legislative rule gets "controlling weight" in this analysis. *Murray*, 241 W. Va. at 640, 827 S.E.2d at 428. But by using the net value, the Intermediate Court effectively let Equinor deduct those costs anyway because each of these fees were already "deduct[ed]" from the product value before MarkWest paid Equinor the remaining net value each month. A.R.1175. The lower court didn't think that violated the rule for several reasons. Yet, each is wrong.

First, the Intermediate Court's belief that these fees weren't "costs incurred by Equinor," *Statoil*, 249 W. Va. --, 895 S.E.2d at 834, is at odds with the facts. Equinor's contract certainly treats these fees as "consideration" that "shall be paid by [the] Producer to MarkWest." A.R.1128. Other similar contract provisions describe the fees as "charges" Equinor must pay for MarkWest's services. A.R.1128 ("MarkWest will charge a fractionation fee"); A.R.1129 ("MarkWest will charge Producer a marketing fee"); A.R.1129 ("Producer shall pay MarkWest a rail loading fee"); A.R.1173 ("MarkWest will charge Statoil a processing fee").

Considering all that, it's no surprise that the Intermediate Court's treatment of these charges as "costs incurred by MarkWest" finds no support in the record. *Statoil*, 249 W. Va. --, 895 S.E.2d at 834. Nothing in the contracts directly correlates the charges to MarkWest's actual costs. Sure, MarkWest likely uses some part of these fees to pay for its operations. But as Equinor even acknowledged below, these fees likely include some "profit margins," too. A.R.60 n.7. It also pointed out that the fees are set at a "flat rate per gallon and increase[] according to national oil and gas price indices." A.R.59-60 n.7. So, they aren't "MarkWest's *actual expenditures or costs that are simply being reimbursed*." A.R.59 n.7 (emphasis in original).

Instead, they are costs Equinor pays MarkWest to process and sell its gas. It is undisputed that Equinor "owe[s] [MarkWest] those fees no matter what the product sells for," A.R.973, and on one occasion, wrote MarkWest nearly a million dollar check to cover these fees. A.R.633.

Even setting that one check aside, Equinor still incurs each of these fees. Most of the time, MarkWest "deduct[s]" them from the gross product value before it pays Equinor the net. A.R.1175. But that's just an alternative way for Equinor to pay "the fees" and "charges" it "owe[s]." A.R.1175. Instead of receiving a check for the entire product value and writing MarkWest a check to cover its services, Equinor lets MarkWest take its cut off the top. But those fees are still "charge[s]" Equinor "owe[s]" and must "pay" in one form or another. A.R.1129. So, they are costs Equinor incurs. As OTA put it: "once [Equinor] pays these costs they clearly become [its] expenses." A.R.639.

Second, the Intermediate Court believed MarkWest's fees weren't related to moving gas "through Equinor's own system" because "MarkWest owns and operates" the plants where the NGLs are processed. *Statoil*, 249 W. Va. --, 895 S.E.2d at 834. But the contracts show that Equinor wouldn't be able to move its gas through its system and into MarkWest's unless it agreed to pay these fees. Many of the fees are expressly related to the "receipt" of Equinor's gas. For example, Equinor must pay a "[redacted]" when its gas is received at that pipeline, A.R.1129, and a "[redacted]" when received in a different line. A.R.1130. Even the fees for fractionation, marketing, and administration must be "paid . . . in connection with the receipt" of the gas. A.R.1128. So even if these fees pay for processing activities in MarkWest's plants, Equinor still must pay them to transport and transmit the gas from its system into MarkWest's.

Third, the lower court thought these fees weren't associated with activities "from the wellhead to the Plant Inlet" point of sale. *Statoil*, 249 W. Va. --, 895 S.E.2d at 834. Here, the court believed it key that the title passed where MarkWest received the unprocessed gas (*i.e.*, at the inlet of the processing plant). *Id.* But this focus missed other parts of the contract that place the point of sale later on—after processing—at the "delivery point." A.R.1132. That's where the contract says "MarkWest shall purchase all or a portion of the [NGLs] from Producer," and it's where the "Producer shall sell all or a portion of its [NGLs] to MarkWest." A.R.1132.

But regardless of where the sale occurs, Equinor still pays these fees as part of that sale. Again, the contracts expressly list these fees and charges as the "consideration" MarkWest receives in the sale. A.R.743. Equinor's witness admitted as much in the hearing. A.R.973 (Winter: "[T]he only thing MarkWest receives in compensation . . . is the fees." Gaytan: "I would agree, yeah."). Equinor also pays these fees to get its gas from the well to a more valuable selling point at the market. "The market value of gas is typically lower at the wellhead than it is at a downstream point of sale." *Hilcorp Energy*, 91 F.4th at 315. NGLs in particular aren't "marketable" until they are processed, *Corder*, 57 F.4th at 401 n.11—not unless producers are willing to take a significant discount to offset the buyer's "uncertainty" about the "ratio" of products "in any process mixture." *CNX*, 2024 WL 1261813, *4. As Equinor's own witness admitted, producers pay for processing to "obtain[] a greater value for the NGLs" and so they can be sold "to market at a higher price." A.R.978. Courts across the county have similarly recognized that downstream marketing, compression, and processing "generally make production more valuable," *Hilcorp Energy*, 91 F.4th at 315, and they treat the cost of these activities as "investments" made by the producer to ensure a higher market price. *Devon*, 668 S.W.3d at 336.

It's also clear from the record that Equinor doesn't realize or receive any value from its NGLs until MarkWest processes and sells them to the customer. The product value isn't set until MarkWest processes, fractionates, and sells the NGLs. A.R.747. And the net value derived from that gross product value isn't determined until MarkWest is paid its fees. A.R.790. Besides that, "prior to processing and delivery to an end-user," the price of NGLs is hypothetical and "dependent upon" volatile "market forces." *Statoil*, 249 W. Va. -- n.9, 895 S.E.2d at 833 n.9. So, these fees are paid by Equinor to get its gas from the wellhead to the more valuable selling point at the market. MarkWest's fees are incurred by Equinor to get its gas "from the well-mouth point of severance and production to the point of sale." W. VA. CODE § 110-13A-4.8.1. So, those costs related to transportation, transmission, and processing are deductible under the legislative rule.

What's more, treating the transportation, transmission, and processing part of these fees as deductible ultimately lowers Equinor's taxable value. So, it is better for Equinor anyway. Remember, the net value Equinor wants to start with is just the product value minus all of these fees. A.R.611. The Tax Commissioner allowed most of them already—$[redacted] in 2016 alone, A.R.1062—because subtracting these (as actual costs) from the product value was "more advantageous" to the producer than applying the safe harbor. A.R.1080. If the product value is the right starting point, *see* Arg. I, *supra*, it's better for Equinor if some of MarkWest's fees count as deductible actual costs.

If all that's not enough, treating MarkWest's charges as deductible costs aligns better with the way Equinor handles deductions in some of its royalty calculations. The royalty contracts in *Young*, for example, allowed Equinor to deduct "post-production costs" whether Equinor "engage[d] others to provide such services" or "use[d] its own pipelines and equipment." 982 F.3d at 204. Equinor never complained there that the services provided by others weren't their actual costs of post-production. And that makes sense because it "contract[ed]" with the third-party processors in that case "to perform the post-production operations," *id.*, and deducting these costs ultimately reduced its royalty payments.

Similar logic applies here. Equinor has engaged MarkWest to process, fractionate, transport, and sell its NGLs. It pays MarkWest for these services by either writing the processor a check or letting it take the first cut of the product value. It has to agree to pay those fees as part of the receipt and sale of the NGLs. A.R.743. And those fees are part of the expense Equinor incurs to get its gas to the point of sale where it can get money back from its production efforts. For severance tax, Equinor is allowed to deduct the costs that it incurs related to transportation, transmission, and processing. But it can't deduct all MarkWest's fees because they include charges for administrative, marketing, and overhead—which the rule doesn't allow. W. VA. CODE § 110-13A-4.8.1. The Intermediate Court erred by letting Equinor take all MarkWest's fees out of its gross proceeds and by treating the subtraction as anything other than an actual cost deduction. This Court should reverse on this point as well.

B. Equinor can't deduct the safe harbor and its actual costs.

The Intermediate Court also erred by giving Equinor the safe harbor deduction. The rule sets out the four transportation, transmission, and processing deductions as "alternatives methods" for obtaining "well-mouth value" when natural gas is sold away from the well. W. VA. CODE R. § 110-13A-4.8. That means producers can take "one" deduction type—not two. *Id.* The Intermediate Court never disputed that. *Statoil*, 249 W. Va. --, 895 S.E.2d at 834 ("[T]he producer may *either* deduct the actual costs of transportation and transmission *or* a flat 15% deduction, known as the 'safe harbor' deduction." (emphasis added)). Equinor doesn't seem to either: it just argues that the fees already deducted from the net value aren't its actual costs, A.R.1077. So, if the product value is the right starting point and the transportation, transmission, and processing fees MarkWest charged Equinor are deductible costs, there should be no question that Equinor shouldn't receive the safe harbor deduction as well.

Still, the lower court suggested that Equinor needed to receive the safe harbor anyway because it hadn't been allowed to deduct any costs it incurred from the wellhead to MarkWest's plant inlet. *Statoil*, 249 W. Va. --, 895 S.E.2d at 834. But that's not true. The allowable fees on the settlement statements weren't the only actual cost deductions Equinor received. The Tax Commissioner already gave Equinor millions of dollars of refunds even aside from these disputed fees. *See* Statement § III, *supra*. And some of these refunds were for actual costs that occurred in what is indisputably Equinor's system. Ms. Acree testified to several of the invoices related to these costs at the hearing before OTA, A.R.1040-48, and she confirmed that the transportation, transmission, gathering, and processing costs identified in each were "allow[ed]" as actual cost deductions. A.R.1041.

Of course, Equinor suggested at OTA that it may have "additional actuals" that it didn't provide to the Tax Commissioner. A.R.1077-78. But that hardly met its burden of proving such actual costs at OTA or on appeal. W. VA. CODE § 11-10A-10(h) (2021) ("[T]he standard of proof which a taxpayer must meet at all levels of review and appeal shall be a preponderance of the evidence."). Equinor never claimed that it submitted expenses for actual transportation, transmission, or processing costs between its wells and MarkWest's system that were denied. And even if Equinor had actual allowable costs that were either unsubmitted or improperly denied, it wouldn't be entitled to the safe harbor. At best, Equinor could include those expenses in the actual cost deduction it already received.

The Intermediate Court was wrong to give Equinor the safe harbor. This Court should reverse and correct that mistake, too.

CONCLUSION

For the foregoing reasons, this Court should reverse the Intermediate Court of Appeals' opinion in Appeal Nos. 22-ICA-111 and 22-ICA-226, and remand with directions to reinstate the refund denials in 2014, 2016, 2018, and 2019.

Respectfully submitted,

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**IN THE SUPREME COURT OF APPEALS
OF WEST VIRGINIA**

NO. 24-26

MATTHEW R. IRBY, STATE TAX COMMISSIONER OF WEST VIRGINIA,

Respondent Below, Petitioner,

v.

EQUINOR USA ONSHORE PROPERTIES, INC.,

Petitioner Below, Respondent,

**On Appeal from the Intermediate Court of Appeals of West Virginia,
No. 22-ICA-111, 22-ICA-225, 22-ICA-226**

CERTIFICATE OF SERVICE

I, Sean M. Whelan, do hereby certify that on this 18th day of April 2024, the foregoing Petitioner's Brief of Matthew Irby, State Tax Commissioner of West Virginia was electronically filed with the Clerk of the Court using the File & Serve Xpress system, which constitutes service on the following:

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