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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,
Nos. 22-ICA-111, 22-ICA-225, 22-ICA-226**

PETITIONER'S REPLY

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INTRODUCTION

Equinor's *Response Brief* confirms that the Intermediate Court of Appeals ("ICA") got the merits of its severance tax calculation wrong. Equinor can't start with a net value because the Code says the calculation of gas's wellhead value begins with gross proceeds before deductions are subtracted. Equinor's exclusive focus on the money it received for its gas is contrary to the statutory definition of gross proceeds, which also includes the value of services, and disregards the contract with its third-party processor, MarkWest Liberty Midstream & Resources LLC ("MarkWest"), which lists those value-adding services as consideration for the sale. Equinor also gets the available deductions wrong. It's already received millions of dollars of actual costs deductions for transportation, transmission, and processing. So, it can't get the alternative safe harbor deduction on top of that. Lastly, its theory that using the product value forces a deviation from its federal accounting methods isn't properly before this Court and is wrong anyway. Equinor hasn't presented any sound reason to affirm the ICA on the merits. This Court should reverse.

ARGUMENT

I. The Product Value Should Start The Calculation Of Equinor's Severance Taxes.

Like the ICA, Equinor tries to start the calculation of the taxable wellhead value of its gas with the wrong number. Instead of using the product value, which reflects its gross proceeds, it used a net value that didn't account for millions of dollars' worth of services and already had deductions taken out. Beginning at the wrong point throws off the entire calculation and would incorrectly give Equinor millions of dollars of extra refunds.

A. Equinor's gross proceeds must include the value of MarkWest's services.

Everyone agrees that producers of natural gas and natural gas liquids ("NGLs") are taxed on the "market value of the natural resource" "at the wellhead," W. VA. CODE § 11-13A-2(c)(6), (6)(G), which is "where [the gas] first emerges from the ground" in raw unprocessed form. *Leggett* *v. EQT Prod. Co.*, 239 W. Va. 264, 271, 800 S.E.2d 850, 857 (2017); Resp.9 ("[S]everance tax aims to tax value of natural gas . . . at the wellhead."). Equinor also seems to concede that it sells its gas "away from the wellhead," and that for these downstream sales, the tax formula employs a "netback" method. Resp.10. In the industry, this method starts with "the proceeds of a downstream sale and subtract[s] [certain] postproduction costs incurred between the well and the point of sale" to mathematically "workback" to an estimate of the gas's "market value at the well." *BlueStone Nat'l Res. II, LLC v. Randle*, 620 S.W.3d 380, 389 (Tex. 2021).

Where Equinor gets off track is in setting its starting proceeds number. The Code says that number should be the "gross proceeds derived from the sale" of a producer's gas. W. VA. CODE § 11-13A-3a(b). As the term's plain meaning suggests, that's supposed to be the "entire" proceeds amount, *Chesapeake Expl., LLC v. Hyder*, 483 S.W.3d 870, 874 (Tex. 2016), set before "any deduction . . . or expenses of any kind" are subtracted. W. VA. CODE § 11-13A-2(b)(5). Yet, Equinor still advocates for a "net value" starting number that already has all the costs of MarkWest's services taken out. Resp.11; A.R.611 (OTA: "The net value is the product value minus the fees and adjustments."). And it says the ICA was right to use that net amount because it "is the money the producer actually receive[d] in the sale of" its gas to MarkWest. Resp.11.

But the starting number isn't just money. It includes other types of value, too. The term's statutory definition proves this: "Gross proceeds" "means the value, whether in money or other property, actually proceeding from the sale . . . *or from the rendering of services*." W. VA. CODE § 11-13A-2(b)(5) (emphasis added). The definition of "sale" reinforces this inclusive meaning. A "sale" is "any transfer of the ownership or title to property, whether for money *or in exchange for* other property or *services*, or any combination thereof." *Id.* § 11-13A-2(b)(10) (emphasis added). Equinor flatly ignores the breadth of these definitions. It quotes the "rendering of services" portion of "gross proceeds'" definition twice in its brief. Resp.10, 11. But it provides no explanation (textual or otherwise) for its conclusion that "the touchstone of this calculation is the money." Resp.10. The statute confirms in multiple places that the "gross proceeds" that starts the tax formula is more than just money—it includes the value of services, too.

Besides that, the Code generally makes gross proceeds equivalent to gross value. It says, "gross value is the gross proceeds received or receivable by the taxpayer," W. VA. CODE § 11-13A-2(c)(6)(A), and that "the gross value" of natural gas is "shown by the gross proceeds," *id.* § 11-13A-3a(b). Value is "a broad term" that "may consist" of any "right, interest, profit or benefit . . . or some forbearance, detriment, loss or responsibility given, suffered, or undertaken." *Young v. Young*, 240 W. Va. 169, 174, 808 S.E.2d 631, 636 (2017). It includes "[e]very element of value" relevant to "a sale" "between private parties," *W. Va. Dep't of Transp. v. W. Pocahontas Props., L.P.*, 236 W. Va. 50, 62, 777 S.E.2d 619, 631 (2015), such as the value of "services rendered," syl. pt. 3, *Rauschenbach v. McDaniel's Estate*, 122 W. Va. 632, 633, 11 S.E.2d 852, 853 (1940).

That's why every royalty case cited in the Tax Commissioner's initial brief included the value of third-party processing services in the initial gross proceeds number. Petr's Br.25-27. As the Texas Supreme Court found in one case, 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 that third-party processing "expenses are consideration accruing to the producers' benefit, and therefore, part of the producers' 'gross proceeds'" under the lease. *Devon Energy Prod. Co. v. Sheppard*, 668 S.W.3d 332, 338 (Tex. 2023). Even in one royalty case involving Equinor, its pre-deduction "gross proceeds" included processing services even when the producer "engage[d] others to provide such services." *Young v. Equinor USA Onshore Props.*, 982 F.3d 201, 203-04 (4th Cir. 2020).

To counter, Equinor says these royalty cases don't control in severance tax, and it thinks this Court said as much before. Resp.36 (quoting *Steager v. Consol Energy, Inc.*, 242 W. Va. 209, 223, n.20, 832 S.E.2d 135, 149 n.20 (2019)). But *Consol* is a property tax case (not a severance tax case) and at the time, that tax was based on a "field line point of sale" methodology. *Id.* at 222, 832 S.E.2d at 148. So, it makes sense that the distinct wellhead valuation method in royalty contracts wouldn't be directly applicable. Equinor also takes the Tax Commissioner's briefing in another case out of context. Resp.36. It's true that the Commissioner told the ICA in *CNX Gas Co. v. Irby*, No. 23-ICA-36, 2024 WL 1261813 (App. Ct. 2024) (mem. decision), that "royalty methodologies don't always translate neatly into tax cases." Resp.36. But he told this Court the same thing in his initial brief, Petr's Br.27, and in both, he went on to explain why "severance tax is different" from other taxes—it involves many of the same gross proceeds' definitions, wellhead valuation methods, and deductions as royalty cases. *Id.* Equinor offers no persuasive reason for turning a blind eye to these similarities. it also ignores prior business and occupation tax cases (severance's predecessor tax) where this Court relied on royalty cases to determine what qualified as "consideration" and "taxable production of gas." *United Fuel Gas Co. v. Battle*, 153 W. Va. 222, 231, 167 S.E.2d 890, 896-97 (1969). This Court should do the same thing here. These royalty cases are all instructive, and Equinor's failed attempts to dodge them is telling. They all confirm that processing services count as valuable, benefit the producer, and can be part of the gross proceeds for the sale of producers' gas. They should be part of Equinor's gross proceeds, too.

B. The entire product value was derived from the sale of Equinor's gas.

Equinor's claim, *see* Resp.11, that the product value doesn't "actually proceed[] from the sale" of its gas, W. VA. CODE § 11-13A-2(b)(5), or "derive[] from the sale thereof by the producer," *id*. § 11-13A-3a(b), missteps for similar reasons. Here again, Equinor only looks at the money. Resp.13 ("[T]he 'net value' . . . is the only money that [Equinor] actually receives."). But that part of the gross proceeds is undisputed. The Tax Commissioner said as much in his opening brief. Petr's Br.28 ("MarkWest pays Equinor the "net value" each month.").

But Equinor receives MarkWest's services, too; and the product value is the "combination" of the "money" and "services," W. VA. CODE § 11-13A-2(b)(10), from that sale. The contracts make that point plain. The NGL Agreement includes an entire section on consideration. Part of it details the formula for determining the product and net values. A.R.747. But another part of the same section sets out the fees that Equinor must pay MarkWest to process its NGLs. A.R.743. For each gallon of NGL MarkWest purchases, Equinor agrees to pay "a fractionation fee" A.R.743, a "marketing fee," A.R.744, as well as various receipt point, loading, and administrative fees. A.R.744-45, 747. Those various fees are all listed as part of the contract's "consideration." A.R.743. Equinor even concedes that "MarkWest negotiated . . . for these specific fees," Resp.4, and it can't claim that it receives MarkWest's services for free. The contract says these fees must "be paid by" Equinor "in connection with the receipt and exchange" of its gas. A.R.743.

MarkWest's services are also incredibly valuable. True, the fees are calculated at cents per gallon rates. A.R.743-45. But they add up to hundreds of thousands of dollars each month, *e.g.*, A.R.813, and over $[redacted] in 2016 alone, A.R.912.

Those services also allow Equinor to get a higher return on its gas. As its witness conceded at OTA, MarkWest's 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). That's why producers pay for those services. "[O]il and gas production is less valuable at the wellhead," *BlueStone*, 620 S.W.3d at 389, because the NGLs aren't "marketable" until they are processed, *Corder v. Antero Res. Corp.*, 57 F.4th 384, 401 n.11 (4th Cir. 2023), and the quantity of NGLs in the raw mixture is only "theoretical" until processing is complete, A.R.788. So, "any arm's length purchaser will" pay less for unprocessed gas at the well because “it will have to incur the costs to remove impurities from the production, to transport it from the wellhead, or otherwise to get it ready for sale to a downstream market.” *BlueStone*, 620 S.W.3d at 389 (cleaned up). Beyond that, wellhead purchasers often demand even greater discounts to account for “the risk of uncertainty in . . . the ratio of [NGLs] present in any unprocessed mixture.” *CNX*, 2024 WL 1261813, *4.

Yet, Equinor tries to disclaim all these benefits. It says the deal with MarkWest was an attempt “to sell the raw make without having to make the investment in processing” the gas into NGLs. Resp.21. And it claims that what it sold to MarkWest was “raw gas, which is much closer in composition and sale value to the impure mixture . . . that originally emerges” at the well. Resp.22. So, it thinks its gross proceeds should be set more like a wellhead sale without accounting for any of the added value of downstream processing.

But Equinor doesn’t sell its gas “at the wellhead,” *Statoil USA Onshore Props. v. Irby*, 249 W. Va. 424, --, 895 S.E.2d 827, 832 (App. Ct. 2023), and it doesn’t price it either at the wellhead or when it’s transferred to MarkWest at the plant inlet. It could’ve. The rule provides alternative methods based on Federal Energy Regulatory Commission (“FERC”) data, or “same pool” “average purchase price” numbers, W. VA. CODE R. §§ 110-13A-4.8.2, 4.8.3. Equinor didn’t do that. Instead, it negotiated a contract for MarkWest to process its gas into NGLs, A.R.743, and it paid MarkWest to transport, market, and sell those more valuable NGLs at “the most favorable” price “MarkWest can obtain.” A.R.748. Equinor also agreed to use the “average sales price” from the market sales of those fully processed NGLs to set the baseline for its payment. A.R.747.

Starting with the product value isn’t “captur[ing]” the wrong sale, either. Resp.20. True, the product value reflects the money MarkWest receives from selling the processed NGLs to its customers. But even Equinor’s preferred net value is derived from that downstream sale. After all, the monthly net value is the "weighted average sales price per gallon" MarkWest receives from its customers multiplied by the volume of each NGL it processed for Equinor "less all applicable fees and charges," A.R.747-48. In simple terms: it's just "the product value minus the fees." A.R.611.

Equinor also received all the value added by MarkWest's services. Yes, it paid MarkWest before getting any money back. But MarkWest is paid based on fixed, per gallon rates that don't fluctuate with the market price of NGLs. Its "$[redacted]" fractionation fee is based on the amount of NGLs "actually made available to" Equinor after processing, A.R.743-44, and doesn't fluctuate with the market forces that affect the commercial sales price. MarkWest gets its fees whether the customer pays $2.50 for propane or 50 cents. A.R.974 (Gaytan: agreeing that Equinor owes MarkWest "those fees no matter what the product sells for").

So, Equinor didn't have to take a discount on the sales price to account for uncertainty in the quantity of NGLs in its raw make. Nor did MarkWest pay less because the market price could fluctuate while the raw gas was being processed and transported to the downstream customer. No, Equinor received the entire risk and reward of a downstream sale of fully processed NGLs even though it paid a third-party to do most of the heavy lifting.

The risk is clear: when the market price dropped so low that MarkWest's fees exceeded the product value, Equinor was on the hook, and had to write MarkWest a nearly million-dollar check to cover its processing services. A.R.633. But the reward is, too. When the gross product value exceeds the price of MarkWest's services (which happened most of the time), Equinor received part of the product value as monthly net payments—as money. But it received 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 "equivalent to payment" in other contexts. *Cf. Kenny v. Liston*, 233 W. Va. 620, 630, 760 S.E.2d 434, 444 (2014) (finding "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”). It should in this case, too. After all, a “sale” can be “for money,” “other property or services, or any combination thereof.” W. VA. CODE § 11-13A-2(b)(10). All that means that the entire product value was “derived from” and “actually proceeded” from the sale of Equinor gas.

C. Starting with the product value doesn’t violate wellhead value mandates.

Using the product value also doesn’t impose severance tax on “processing, separating, refining, converting, or fractionating” that don’t qualify as taxable “severance” activities. Resp.16. Nor does it move the point of valuation away from the wellhead. Resp.18. To be sure, gas producers are supposed to be taxed on “the value of the natural gas at the wellhead” and not on the value added by downstream “transportation and transmission” or “processing” like “conversion or refining” of the gas. W. VA. CODE § 11-13A-2(c)(6)(G), (9)(A). And the record is clear that most of MarkWest’s services relate to transporting, processing, fractionating, and refining Equinor’s raw gas into NGLs, *e.g.*, A.R.813—although it charges Equinor “marketing,” A.R.744, and “administration fees,” too, A.R.747.

But starting the calculation with the product value doesn’t tax these downstream transportation and processing activities at all. As the ICA explained in *CNX*, these non-taxable “activities are addressed through a cost deduction for transportation, pipeline transmission, and processing costs.” 2024 WL 1261813, *4. That’s how this Court has dealt with non-taxable parts of natural resources’ gross value in the past—by giving producers cost deductions for them. *Kanawha Eagle Coal, LLC v. Tax Comm’r of State*, 216 W. Va. 616, 623, 609 S.E.2d 877, 884 (2004) (finding “charges paid by a coal producer to a third party to transport” coal didn’t count as “mining” and so “are costs which are deductible from the gross proceeds”); *U.S. Steel Min. Co. v. Helton*, 219 W. Va. 1, 3, 631 S.E.2d 559, 561 (2005) (noting that “any transportation costs” “are deducted from the actual sales price” “for purposes of establishing . . . value for severance tax calculation”). That’s what should happen here, too. Yes, the value of these services should be included in the starting gross proceeds number. But most of them get subtracted out in the next step. That’s why the Tax Commissioner let Equinor take every one of MarkWest’s fees related to transportation, transmission, and processing as actual costs deductions—$[redacted] in 2016 alone, A.R.1062, and similar refunds in the other years as well, Petr’s Br.8.

Those cost deductions are designed to remove the cost of non-taxable services from the value-base so that producers only pay taxes on “the worth of the [NGLs] before those services were rendered.” *Carl as Co-Trustee of Carl/White Trust v. Hilcorp Energy Co.*, 91 F.4th 311, 316 (5th Cir. 2024) (per curiam). The value of these services must be included in the gross proceeds number for the formula to work correctly. Like in all the royalty cases (including Equinor’s), processing services must be included in the starting “gross proceeds” amount otherwise they can’t be deducted later on as costs. *Young*, 982 F.3d at 203-04. But Equinor doesn’t have to pay taxes on these services. The calculation of the “market value at the well” just begins with “the commercial market value” so that only “processing and transportation expenses that must be paid before the gas reaches the commercial market” can be deducted at the right time. *Hyder*, 483 S.W.3d at 873. As a former justice put it, taxing “the actual sale in the marketplace” less a “deduction” for “actual transportation costs” is “as fair and accurate a measure as can be devised” for severance tax. *Helton*, 219 W. Va. at 27-28, 631 S.E.2d at 585-86 (Albright, J., concurring).

The deductions also resolve Equinor’s vague suggestion that using the product value could trigger “constitutional boundary concerns.” Resp.15. Those concerns are outdated anyway. *See* Petr’s Br.19-20. The Supreme Court of the United States formally “disapproved” strict territorial boundaries on state severance taxes over forty years ago, *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 614, 617 (1981). Now, “interstate commerce may be made to pay its way” like any other business. *Oregon Waste Sys, Inc. v. Dep't of Env't Quality of State of Or*., 511 U.S. 93, 102 (1994). The modern test looks to whether the state discriminates against interstate commerce by "tax[ing] a transaction or incident more heavily when it crosses state lines," *Armco Inc. v. Hardesty*, 467 U.S. 638, 642 (1984), and not whether it taxes the out-of-state activity at all.

That's why last year, this Court even found that refusing to let a property taxpayer "deduct the expenses associated with transporting" its "product to its chosen [interstate] marketplace" didn't violate modern constitutional boundary limits. *Antero Res. Corp. v. Irby*, No. 22-48 et al., 2023 WL 3964054, *4 (June 13, 2023) (mem. decision). Surely, granting Equinor millions of dollars of transportation and processing deductions doesn't either. Even where Equinor'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—*i.e*., the point of severance at the well. The deductions ensure that "[t]he subsequent processing of the NGLs, wherever it may take place, is not subject to taxation." *CNX*, 2024 WL 1261813, *5. So, even the stricter outdated limits on severance taxes would be satisfied. Modern constitutional hurdles are easily cleared as well.

II. Equinor Shouldn't Get Deductions The Statute And Legislative Rule Don't Allow.

The net value the ICA used already incorporated actual cost deductions for all MarkWest's services—even administration and overhead costs the rule expressly disallows. Making matters worse, the ICA also gave Equinor the safe harbor even though that's a mutually exclusive alternative to the actual cost deduction. Equinor's *Response* doesn't justify the ICA's decision.

A. The ICA erred by letting Equinor take deductions the rule expressly disallows.

Even Equinor seems to agree that administration, overhead, or return on investment aren't allowable costs. Resp.33 ("Equinor has never claimed, and cannot claim, that the marketing and administrative fees . . . are Equinor's actual costs of transportation and transmission."). Yet, it says the ICA got its deductions right anyway because MarkWest's fees aren't "attributable" to Equinor as actual costs under the rule. Resp.23. That rule "allow[s] a deduction in the amount of the costs of transportation or transmission of . . . 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. The deduction is "limited to actual costs . . . incurred." *Id.* Equinor thinks the fees it pays for MarkWest's services don't qualify under three distinct parts of the rule. It's wrong.

First, it argues that MarkWest's fees weren't "incurred by Equinor." Resp.25. The ICA said the same thing: "[t]he fees . . . reflect costs incurred by MarkWest." *Statoil*, 249 W. Va. --, 895 S.E.2d at 834. Equinor believes a single paragraph from the NGL Agreement stating that "MarkWest shall include and deduct" certain costs "*incurred by MarkWest* to determine" the net value proves this point, Resp.25 (quoting A.R.748), and controls this Court's analysis. But the contract must be read "as a whole," *Chesapeake Appalachia, LLC v. Hickman*, 236 W. Va. 421, 436, 781 S.E.2d 198, 213 (2015), as even Equinor acknowledges. Resp. 26. And even this lone paragraph has the opposite effect of the one Equinor intends. Truly, it shows that Equinor took on those costs by letting MarkWest "deduct," A.R.748, them from the product value that would otherwise be "payable," A.R.757, to Equinor as the price of its gas. That's a cost Equinor incurred.

A cost is "incurred" under the term's plain meaning if its "br[ought] on oneself (a liability or expense)." BLACK'S LAW DICTIONARY, "Incur" (11th ed. 2019). Other dictionaries provide the same definition. Merriam-Webster defines "incurred" as "to become liable or subject to" such as to "incur expenses," MERRIAM-WEBSTER DICTIONARY, https://www.merriam-webster.com/dictionary/incur (last visited June 24, 2024), and the Cambridge Dictionary says it means to "have to pay a charge" such as "fine" or "fee," CAMBRIDGE DICTIONARY, https://dictionary.cambridge.org/dictionary/english/incur (last visited June 24, 2024). That's why this Court has found that an "insured person" "incurred" "medical expenses" "at the time the" provider's "services are rendered," *Auto Club Prop. Cas. Ins. Co. v. Moser*, 246 W. Va. 493, 501, 874 S.E.2d 295, 303 (2022), and that a litigant "incurred litigation costs for subpoena requests, subpoena service, document copying, . . . and other necessary litigation costs." *Landis v. Landis*, 223 W. Va. 325, 327, 674 S.E.2d 186, 188 (2007). In both cases, these were costs, expenses, or fees the patient or litigant were "liable for" or "responsible for" paying. *Auto Club*, 246 W. Va. at 501-02, 874 S.E.2d at 303-04 ("The definition of incur is 'to become liable for.'" (cleaned up)).

The same is true in Equinor's case. It incurs the costs of MarkWest's services because it agreed to pay for them. The whole contract treats each fee as "consideration" that "shall be paid by [the] Producer to MarkWest in connection with the receipt and exchange" of Equinor's gas. A.R.743. Other parts describe them as "charges" Equinor must pay for MarkWest's services. A.R.743 ("MarkWest will charge a fractionation fee"); A.R.744 ("MarkWest will charge Producer a marketing fee"). And Equinor's witness at OTA agreed that Equinor "owe[s] [MarkWest] those fees no matter what the product sells for," A.R.974, as shown by the nearly million-dollar check Equinor wrote on one occasion to cover these fees. A.R.633. Even setting that one check aside, Equinor still incurs each of these fees. It lets MarkWest "deduct fees owed by" Equinor from the gross product value before it pays Equinor the net, A.R.790, which is just an alternative way for Equinor to pay "the fees" and "charges" it "owe[s]." A.R.743-44. 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 to cover the charges it must pay one way or the other.

What's more, to be an incurred cost, it doesn't matter that the fees are for work Equinor didn't perform directly. To be sure, Equinor doesn't process or fractionate its gas itself. Nor does it market and sell it to customers. It lets MarkWest do that work. But the patient in *Auto Club* didn't perform the medical services she had to pay for—the doctors she visited did. 246 W. Va. at

497-98, 874 S.E.2d at 299-300. That didn't stop this Court from finding that she incurred these medical costs anyway. After all, she was "liable to pay her medical providers." *Id.* at 504, 874 S.E.2d at 306. Likewise, the litigant in *Landis* didn't "incur[] litigation costs" because she was out serving subpoenas herself. 223 W. Va. at 327, 674 S.E.2d at 188. These were costs she incurred because she was paying for them. *Id.* That's true for Equinor as well. As OTA put it, if Equinor "is writing a million-dollar check," A.R.633, and otherwise "pays these costs" by letting MarkWest take the first cut of the product value, "they clearly become [Equinor's] expenses." A.R.639.

Add to all that, there is no direct correlation between the fees Equinor must pay and any cost MarkWest incurs. Nothing in the record identifies how much MarkWest spends to process, fractionate, or market Equinor's gas. Instead, the contracts reflect amounts that MarkWest charges Equinor for those services (*e.g.*, "$[redacted]" for fractionation, and "$[redacted]" for marketing, A.R.743-44). But as Equinor admitted to the ICA, these fees likely include some "profit margins," too. A.R.59 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). Rather, these fees are "actual costs" Equinor "incurs," W. VA. CODE R. § 110-13A-4.8.1, because Equinor pays them.

Second, Equinor echoes the ICA's critique that these fees didn't "arise from" gas "moving through the 'system of the producer'" as both thought the rule required. Resp.28. Here, Equinor says the fact that "MarkWest owns and operates the fractionation plant" is dispositive. Resp.28. But this argument suffers from the same misunderstanding of "incur" that plagued its last one. What matters is that the costs are "incurred" in moving the gas "through the system of the producer." W. VA. CODE R. § 110-13A-4.8.1. These fees are. Again, a cost is "incurred," by definition, when a person "becomes liable for" it. *Auto Club*, 246 W. Va. at 502, 874 S.E.2d at 304. And under the NGL Agreement, Equinor becomes liable for all these fees "in connection with the receipt and exchange" of its gas. A.R.743. Many of the fees are even expressly related to the "receipt" of Equinor's gas at different locations. A.R.744 ([redacted]). So, Equinor wouldn't be able to move its gas through its system and into MarkWest's unless it agreed to pay all these fees—a reality Equinor never disputes.

Third, and finally, Equinor contends that these fees aren't incurred "before the point of sale." Resp.29. Here, it highlights the fact that the title passed where MarkWest received the unprocessed gas (*i.e.*, at the inlet of the processing plant), and it thinks this fact is decisive because MarkWest processes the gas after that point. Resp.29. It isn't. For one, wherever the sale between Equinor and MarkWest occurs, these fees are part of it. The contract makes them "consideration" for the sale that must be "paid by" Equinor "to MarkWest in connection with the receipt and exchange" the gas, A.R.743—that's true whether the sale happens at the inlet value or downstream.

Still, a downstream point of sale fits better with other parts of the contract which expressly place the sale after processing—at the "delivery point." A.R.747. 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.747.

Equinor tries to distance itself from this adverse contract language. It says that section only governs the take-in-kind option, Resp.31,—*i.e.*, where MarkWest pays Equinor by delivering processed NGLs for Equinor to market and sell on its own, A.R.745—an option that wasn't exercised in these tax years. A.R.984. But that's a misreading. Equinor's take-in-kind rights are governed by another section of the NGL Agreement—Section 5.B. A.R.745. The "purchase" and "sell" "at the Delivery Point" language appears in the "Purchase Arrangement" section—Section 5.C—which is only triggered when Equinor declines its take-in-kind rights. A.R.747 (applying Section 5.C. "unless Producer elects to take all or a portion of its [NGLs] in kind in accordance with Section 5.B"). That's also the same section of the NGL Agreement that Equinor cites for the calculation of "the net sales price"—the money MarkWest pays Equinor for the purchase of its gas. Resp.4 (citing A.R.747 (Section 5.C)). And that same section bases the product value and net value numbers on "the [NGLs] delivered to Producer at the Delivery Point." A.R.748.

Setting the "sale" at the delivery point also fits better with the definition in the Code. The term means "any transfer of the ownership or title to property, whether for money or in exchange for other property or services, or any combination thereof." W. VA. CODE § 11-13A-2(b)(10). While Equinor focuses only on the words "transfer of . . . title," Resp.29, it forgets to read on. The rest of the subdivision defines a sale as a "transfer of . . . title . . . for" some consideration—*i.e.*, "money," "property," "services, or any combination thereof." W. VA. CODE § 11-13A-2(b)(10). And Equinor doesn't receive the consideration for this sale until long after the title transfers. That doesn't happen until after processing and after the gas is sold to customers at the market. Only then does MarkWest deduct its fees and pay Equinor the remainder. A.R.962, 747. In fact, before processing is completed, the quantity of NGLs MarkWest is buying is unknown. The contract describes the amount of NGLs at the receipt point as "theoretical," A.R.787-88, because "the ratio of methane, ethane, butane, and propane present in any unprocessed mixture" is "uncertain" until after processing. *CNX*, 2024 WL 1261813, *4. Add to that, when MarkWest ultimately pays Equinor, even the money isn't based on the "theoretical" quantities at the inlet valve. The product value and net value are based on the "settlement gallons" allocated to Equinor after processing. Petr's Br.21 (discussing math on settlement sheets based on processed gallons of propane).

None of that is an attempt to "throw doubt on when the title passes." Resp.31. Nor does that make the sale to the customer the one that "counts." Resp.29 n.8. Rather, it shows that the sale between Equinor and MarkWest isn't completed when the title passes. The Code's definition isn't met until “money, property, or services” are given in exchange. That doesn’t happen until after processing. And the value of MarkWest’s services is part of the consideration for that sale.

All that means the portions of MarkWest’s fees related to transportation, transmission, and processing count as Equinor’s actual deductible costs under the statute and rule. They 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. But the fees related to marketing, administration, and overhead shouldn’t be deducted as well. Those are disallowed by the legislative rule. *Id.* The Tax Commissioner already gave Equinor millions of dollars of actual cost deductions for each year. A.R.1062. Equinor shouldn’t be given additional deductions the rule prohibits. But that’s what the ICA did by treating the net value as Equinor’s gross proceeds. This Court should reverse.

B. Equinor isn’t entitled to the safe harbor deduction.

Here, Equinor agrees that the rule lets a producer “use only one deduction,” Resp.23—*i.e.*, either the actual cost one or the safe harbor. W. VA. CODE R. § 110-13A-4.8. So, if the product value is the right number to start the tax calculation, and MarkWest’s transportation, transmission, and processing fees are Equinor’s deductible costs, there should be no dispute that the ICA erred by granting Equinor the safe harbor. Equinor doesn’t disagree with this. Resp.37 (saying the safe harbor “rises and falls with” the decision on “whether the fee[s]” “are Equinor’s actual” costs).

What Equinor does contest is whether it received actual cost deductions in addition to those related to MarkWest’s services. It’s true, as Equinor notes, Resp.37 n.11, that the ICA suggested that Equinor hadn’t received any cost deductions from the wellhead to MarkWest’s plant inlet. *Statoil*, 249 W. Va. --, 895 S.E.2d at 834. But that suggestion was an error. The record shows that it did. The allowable fees on the settlement sheets weren’t the only actual costs Equinor was given. Petr’s Br.37. In fact, Equinor received millions of dollars of refunds aside from these disputed fees. Petr’s Br.8 (explaining nearly $13 million in refunds unrelated to the contested fees). And some of these refunds were for actual costs that occurred in what is indisputably Equinor's system. Ms. Acree confirmed that there were invoices for transportation, transmission, gathering, and processing costs in the immediate vicinity of the wellhead and they were "allow[ed]" as actual cost deductions. A.R.1041. And Equinor didn't challenge that fact at OTA—it just said it may have other invoices beyond those in the record, A.R.1077-78.

Now, it counters by pointing to transcript testimony unrelated to these actual cost invoices, Resp.37 n.11 (quoting A.R.995-998 related to OTA Joint Ex. 2, A.R.909-911), and it argues the "invoices" it was given deductions for "do not pertain to MarkWest settlement statements," Resp.37 n.11. But that's the point. They are actual cost deductions Equinor received that weren't part of the fees MarkWest charged it. They were for gathering and processing in the immediate vicinity of the well, A.R.1041—costs that Equinor's counsel at OTA describes as "lease operating expenses," A.R.1077—an industry term related to costs "prior to delivery for processing or transportation out of the field" including for "heaters, dehydrators, [and] field compressors." Energy Info. Admin., Glossary: "Lease Operations," https://tinyurl.com/y3f9avh3 (last visited June 24, 2024)—equipment Equinor admitted it owns, A.R.952 (Gaytan: listing "separators, line heaters, three-phrase separators, dehydrators, and the gas compressors" as Equinor's equipment).

Nor does it matter that the contracts related to these other invoices aren't in the record. Resp.37 n.11. Equinor's had the burden of proof at OTA, W. VA. CODE § 11-10A-10(e), and so should've put these other contracts into the record if they were relevant. It didn't. Regardless, the testimony at OTA was that the Tax Commissioner received several invoices related to Equinor's gathering and processing costs in the immediate vicinity of the well, A.R.1040-48, and that each of these costs were "allow[ed]" as actual cost deductions. A.R.1041. Equinor shouldn't get the safe harbor deduction on top of those it's already received. This Court should reverse here, too.

III. Equinor Wouldn't Be Forced To Use Different Accounting Methods.

As an alternative theory, Equinor believes starting with the product value and giving it deductions for the actual allowable costs MarkWest charged for services violates West Virginia Code Section 11-13A-7 by forcing it to report different income amounts on its state severance and federal income returns. But the ICA didn't mention this statute.[1] OTA didn't either. A.R.609. So, Equinor's arguments here should be disregarded out of hand because this Court "will not consider, for the first time on appeal, a matter that has not been determined by the lower court from which the appeal [is] taken." *In re Michael Ray T.*, 206 W. Va. 434, 444, 525 S.E.2d 315, 325 (1999).

But Equinor misreads the law anyway. Section 11-13A-7 doesn't mandate the same starting gross number for state severance tax and federal income tax. Instead, the statute only provides that a severance "taxpayer's *method of accounting* . . . shall be the same as the taxpayer's method of accounting for federal income tax purposes." W. VA. CODE § 11-13A-7(c)(1) (emphasis added). "[M]ethod of accounting" here is a term of art that refers to "the way of keeping the taxpayer's books," *Huntington Sec. Corp. v. Busey*, 112 F.2d 368, 370 (6th Cir. 1940), and the "accounting treatment of any item," *In re Heilig Meyers Co.*, 232 Fed. Appx. 240, 246 (4th Cir. 2007). The federal income tax cross-referenced provides several options here: "(1) the cash receipts and disbursements method;" or "(2) an accrual method," or a combination of these. 26 U.S.C. § 446(c)(1)-(4). These diverge on the type and time transactions are counted. The accrual method counts "all obligations . . . as expenditures, whether paid that year or not, and all obligations to it incurred by others . . . as income," whereas, the cash method counts "actual cash received and paid out within the taxable year." *C.I.R. v. S. Tex. Lumber Co.*, 333 U.S. 496, 498 (1948).

[1] The ICA found that "Equinor established" that it "reported" the "net values" as "'gross proceeds' for federal income tax," *Statoil*, 249 W. Va. --, 895 S.E.2d at 829 n.3, but it never referenced Section 11-13A-7 or suggested that meant using the product value independently violated the accounting methods statute.

The federal accounting methods statute doesn't substantively define "income" for federal tax purposes—that's done by other parts of the income tax code. *See* 26 U.S.C. §§ 61 through 291. It doesn't "entitle[]" "a taxpayer" "to a deduction not allowed [elsewhere] merely because it set up such a deduction on its books." *J.I. Case Co. v. United States*, 65 F. Supp. 464, 469 (Ct. Cl. 1946). Nor does it trump substantive tax laws that may "contraven[e]" "generally accepted . . . accounting principles." *Thor Power Tool Co. v. C.I.R.*, 439 U.S. 522, 541 (1979) (cleaned up).

The state accounting methods statute applies the same way. It expressly sets "the accrual method" as the default method. W. VA. CODE § 11-13A-7(c)(1). Like its federal counterpart, it doesn't define a taxpayer's gross proceeds or the available deductions—that's done by parts of the Severance Tax Code. It only says the Tax Commissioner can't force a severance taxpayer to use a different method of accounting than the one used for federal income tax.

Charleston Area Med. Ctr., Inc. v. State Tax Dep't of W. Va. doesn't help Equinor, either. To be sure, in that case, the Court held that the Tax Commissioner was forcing the hospital "to deviate from the accounting method it uses for federal tax purposes" in violation of a similar statute in the healthcare provider tax. 224 W. Va. 591, 598, 687 S.E.2d 374, 381 (2009). But that's because the transactions at issue—"accounting entries associated with self-insur[ed] benefit" to hospital employees—were "non-cash items," *id.*, that it "never billed" the patient or any "insurance company" for, *id.* at 594, 687 S.E.2d at 377. "[N]or did it receive any monetary payment for those costs in any other form." *Id.* So it couldn't be forced to include those entries as "gross receipts" when it didn't federally account for these transactions at all. *Id.* at 598, 687 S.E.2d at 381.

That's not this case. Tellingly, Equinor never says what method of accounting it uses on its federal returns. Nor does it claim that the sale of its gas doesn't count as a taxable transaction for federal income tax purposes. So, any claim that it'd be forced to switch accounting methods fails for that reason alone. Beyond that, what Equinor refers to as an "affidavit" submitted to OTA from two of its tax preparers, Resp.39, certainly isn't that. It's just a letter written to the Tax Commissioner, A.R.721, and it isn't even signed, A.R.722. That's a significant difference. *State v. S.W.*, No. 20-319, 2022 WL 163882 *4 (Jan. 18, 2022) (mem. decision) (finding "unsigned letter" wasn't a "duly sworn affidavit"). An "affidavit" must be "sworn to before someone who is authorized to administer an oath," *Pfeil v. Rogers*, 757 F.2d 850, 859 (7th Cir. 1985), such as a "notary public," W. VA. CODE § 57-5-9. Equinor's letter isn't; so, it doesn't "qualify as an affidavit," *Pegues v. Hooks*, No. 1:19-cv-610, 2020 WL 85103, *14 n.13 (M.D.N.C. 2020).

The letter doesn't even say Equinor "reported" the "net values" as "'gross proceeds' for federal income tax" as the ICA thought. *Statoil*, 249 W. Va. --, 895 S.E.2d at 829 n.3. All it said was that the "values" on MarkWest's settlement sheets "flow though Equinor's accounting system" and are used to determine federal "Taxable Income." A.R.721. That's because Equinor files "consolidated federal income tax returns" using aggregate figures "from multiple entities nationwide." Resp.39. So, its federal income and severance tax numbers are always going to be different. Starting Equinor's severance tax calculation with its gross proceeds as defined by the Code and giving it only the deductions the rule allows isn't forcing Equinor to use different numbers on its state and federal returns. Equinor's reliance of the accounting methods statute is not properly before this Court, is misplaced, and should be rejected.

CONCLUSION

This Court should reverse the ICA's 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 24th day of June 2024, the foregoing *Reply 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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