NO. 24-26

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

MATTHEW IRBY, STATE TAX COMMISSIONER OF WEST VIRGINIA,

Respondent below, Petitioner,

v.

EQUINOR USA ONSHORE
PROPERTIES, INC.,

Petitioner below, Respondent.

RESPONSE BRIEF OF EQUINOR USA ONSHORE PROPERTIES INC.

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STATEMENT OF THE CASE

A. Factual Background

This case involves the proper calculation of state severance tax imposed upon the natural gas liquids ("NGLs") found within the natural gas that Equinor USA Onshore Properties Inc. ("Equinor") extracts within this state. Equinor is a natural gas producer with operations across the United States, including West Virginia. A.R.0610; A.R.1595-A.R.1596 at ¶¶ 2-5. Through its production of natural gas, Equinor has contributed significant value to West Virginia's economy through job creation, infrastructure development, and the payment of taxes. Equinor has paid over [redacted] *See* A.R.0918-A.R.0919 (2014 tax return showing taxes paid to date); A.R.1614-A.R.1616 (2015 tax records showing the same); A.R.0910-A.R.0912 (2016); A.R.1977-A.R.1983 (2018-2019).

The process of severing and producing natural gas can be complicated, as can the resulting calculation of severance taxes. In its simplest form, Equinor originally severs natural gas from the ground at what the industry calls the "wellhead." *See Washington Cnty. Bd. of Equalization v. Petron Dev. Co.*, 109 P.3d 146, 149 (Colo. 2005) (noting that the wellhead is an industry term meaning, "the point where the mineral product is severed or removed from the ground"). At that time, the natural gas is an impure mix of various natural resources, water, and sediment. A.R.0610 at ¶3; A.R.0482. Equinor uses equipment it owns, operates, and maintains to minimally process the impure mix into what is known as "raw gas." A.R.0610 at ¶¶3-4; A.R.0482. It is only once natural gas becomes "raw gas" that it adheres to applicable pipeline specifications and can be transported to a purchaser's pipeline system. A.R.0784-A.R.1785 at § 7.1 (gas quality).

Equinor has entered into the [redacted] (collectively, the "Contracts") with MarkWest Liberty Midstream & Resources LLC ("MarkWest"). *See* A.R.0741-A.R.0763 (NGL Agreement); A.R.0765-A.R.0807 (Gas Processing Agreement). Equinor and MarkWest are two completely separate companies, unaffiliated by ownership, who negotiated these contracts at arms-length. A.R.1016; A.R.0483. According to these Contracts, Equinor delivers the raw gas it extracts in West Virginia to MarkWest at a specified area—the "Plant Inlet" of the processing plant owned, operated, and maintained by MarkWest. AR.0777 at ¶ 5.1; A.R.0483.

Once the raw gas leaves Equinor's wellsite and reaches the Plant Inlet [redacted] *See* A.R.0758 (¶7.4) [redacted] A.R.0741 at ¶1(B); A.R.0742 at ¶ 4(B); A.R.0792 at ¶14.2; A.R.1011-A.R.1012; A.R.0482; A.R.0496.[1] [redacted] A.R.1011-A.R.1012; A.R.0482-A.R.0483. [redacted] A.R.0611 at ¶6; A.R.0961-A.R.0962; A.R.0496-A.R.0497.

MarkWest then takes the raw gas through its processing plant, to break it down into its component parts: "raw make," which are unprocessed NGLs, and "residue gas."[2] A.R.0611 at ¶7; A.R.0954; A.R.0483. The raw make continues to MarkWest's fractionation plant to be fractionated into individual NGLs. A.R.0611 at ¶9; A.R.0483. Throughout processing and fractionation,

[1] Full citations and explanation of these title provisions is provided in Section V(C) *infra*.

[2] [redacted] The tax treatment of any residue gas is not at issue in this matter. A.R.0429. Only the tax treatment for NGLs is at issue. To the extent the Tax Commissioner considered or relied upon title or sale of the residue gas, it is in error.

MarkWest maintains title, custody, control, and possession of the raw make and the resulting NGLs. A.R.0758 at ¶7.1 (MarkWest's custody, control and possession of NGLs until sold to third party); A.R.0482-A.R.0483; A.R.0496-A.R.0497. All facilities used in processing and fractionation are exclusively owned and operated by MarkWest. A.R.0840-A.R.0841 (schematic); A.R.0952-A.R.0952 (testimony of Tomas Gaytan regarding schematic); A.R.1019-A.R.1020; A.R.0496 ("MarkWest owns and operates the fractionation plant"). Once fractionation is complete, MarkWest then markets and sells the NGLs to third parties. A.R.0611 at ¶9 (NGLs are "sold by the third parties who operate the plants"); A.R.0952-A.R.0952; A.R.0483. To effectuate this sale, MarkWest transports the NGLs from its plants to the final consumer through pipelines owned by MarkWest or third parties. A.R.0840-A.R.0841; A.R.0951-A.R.0953; A.R.0962-A.R.0965; A.R.0483; A.R.0496. MarkWest determines how to market the NGLs, who to sell the NGLs to, and what price to sell the NGLs for—Equinor has no role in, or control over, those processes. A.R.1013; A.R.0482-A.R.0483.

Each month, MarkWest authors a settlement statement listing the amount of component NGLs it processed from the raw gas it purchased from Equinor at the Plant Inlet. A.R.0611 at ¶¶10-11; A.R.0484. The settlement statements contain three key financial components: product value, fees, and net value (or net sales price). *See, e.g.,* A.R.0812-A.R.0818 (examples of settlement statements); A.R.0954-A.R.0959 (testimony of Tomas Gaytan regarding example settlement statements); A.R.0484. These financial components are defined in the Contracts as follows:

- [redacted]

- [redacted]
- [redacted]

[redacted] A.R.0720-A.R.0722 (Affidavit of Randy Aram and Swee Pang regarding federal tax reporting); A.R.0484 [redacted]

B. Procedural Background

Equinor, by and through its tax consultant firm Ryan, LLC, determined that Equinor had overpaid West Virginia severance taxes in certain tax years. The Intermediate Court of Appeals ("ICA") confirmed that Equinor had "significantly overstated the gross value" in initial severance tax filings, which led to Equinor properly amending its returns and petitioning the Tax Commissioner for a refund for tax years 2014, 2015, 2016, 2018 and 2019.

The Tax Commissioner took issue with aspects of the requested refund, [redacted] the Tax Commissioner denied part of the refund

request. A.R.0887 (2014 denial letter); A.R.1931 (2015); A.R.0856 (2016); A.R.2063 (2018); A.R.2026 (2019). In doing so, the Tax Commissioner asserted that [redacted] and that Equinor, therefore, was not eligible for the 15% safe harbor deduction because it had already done a reduction of the actual transportation costs. This effectively and incorrectly inflated the gross proceeds Equinor, as the producer, received from the sale of the natural gas from MarkWest, the purchaser. Higher gross proceeds would cause Equinor paying a greater amount of severance taxes.

Equinor appealed these denial letters to the West Virginia Office of Tax Appeals ("WVOTA"), arguing that the Tax Commissioner's calculation of severance taxes did not comply with the applicable statutes. *See, e.g.,* A.R.0879-A.R.907 (2014 petition to WVOTA); A.R.1912-A.R.1919 (2015); A.R.0848-A.R.877 (2016); A.R.2058-A.R.2089 (2018); A.R.2020-A.R.2051 (2019).[3] WVOTA assigned the following case numbers: No. 19-008 (tax year 2014), No. 20-111 (2015), No. 19-064 (2016), No. 20-222 (2018) and No. 22-023 (2019). These cases were consolidated before the WVOTA under a single lead case. A.R.0485. After an evidentiary hearing on April 28, 2021, a "Final Decision" was entered by WVOTA on August 18, 2022, affirming the Tax Commissioner's calculation of severance taxes in all respects. A.R.0609-A.R.0624. In particular, WVOTA concluded that the "market value of natural gas in the vicinity of the wellhead, as those terms are defined under West Virginia law, is the amount reflected as the product value

[3] Despite the Tax Commissioner's mischaracterization and/or insinuations otherwise, Equinor was in no way acting improperly by engaging a tax consultant, requesting a refund, or amending its tax return. All are well within its legal rights. *See, e.g.*, W.Va. Code § 11-10-14. As the ICA noted, Equinor "significantly overstated" its gross value and severance taxes when it first filed its tax returns. A.R.0494. Equinor therefore sought a refund for overpayment of its severance taxes consistent with its statutory rights. Equinor engaging a tax consultant, amending its returns, and/or seeking a refund does not suggest anything nefarious, or that its current position is incorrect—the statutory process of amendment and refunds exists for this specific reason.

on the settlement sheets introduced in this matter." A.R.0622 at ¶8. [redacted] A.R.0622 at ¶9. Overall, WVOTA upheld the Tax Commissioner's valuation of the severance tax and partial denial of Equinor's refund, and WVOTA's decision applied to all tax years in question. A.R.0609-A.R.0624.

Equinor timely appealed the WVOTA's decision to the ICA. *See, e.g.,* A.R.0004-A.R.0035 (Notice of Appeal for tax years 2014 and 2016); A.R.0136-A.R.170 (Notice of Appeal for tax year 2015); A.R.0343-A.R.377 (Notice of Appeal for tax years 2018 and 2019); Given the different tax years at issue, this resulted in three cases before the ICA (Case Nos. 23-ICA-111, 23-ICA-225, and 23-ICA-225), which were consolidated. A.R.0476-A.R.0478. The ICA benefitted from briefing and oral argument,[4] and issued a single memorandum opinion on November 15, 2023, which is the basis for the current appeal to this Court. In that opinion, the ICA reversed the WVOTA "Final Order," finding that "the Tax Commissioner and [WV]OTA failed to adhere to the applicable statutes and legislative rules when determining the taxable gross value of the NGLs at the wellhead in the context of Equinor's refund claims." A.R.0494. It further held that MarkWest's processing and fractionation fees on the settlement statements were not attributable to Equinor, that Equinor had not reduced its tax basis by any actual transportation and transmission costs, and Equinor was entitled to take the 15% safe harbor.[5] A.R.0494-A.R.0496. The Tax Commissioner appealed the ICA's decision as to tax valuation, bringing it before this Court.

[4] For Equinor's briefing before the ICA, see A.R.0039-A.R.0080 (Petitioner's Brief in Case No. 22-ICA-111); A.R.0110-A.R.0132 (Petitioner's Reply Brief in the same); A.R.0174-A.R.0216 (Petitioner's Brief in Case No. 22-ICA-225); A.R.0262-A.R.0310 (Petitioner's Reply and Response in Opposition to Cross-Appeal in the same); A.R.0338-A.R.0339 (Supplemental Authority Response Letter in the same); A.R.0381-A.R.426 (Petitioner's Brief in Case No. 22-ICA-226) and A.R.0453-A.R.0475 (Petitioner's Reply Brief in the same). Equinor's briefing before the WVOTA includes A.R.0691-A.R.0704 (Petitioner's Prehearing Statement) and A.R.1122-A.R.1200 (A Supplement to Petitioner's Prehearing Statement).

[5] The ICA also held that tax year 2015 was not timely appealed and that equitable estoppel did not apply. That portion of the ICA decision has been appealed by Equinor, and is currently before this Court as Case No. 23-460.

SUMMARY OF ARGUMENT

This case turns on statutory interpretation—how severance taxes are calculated. The applicable statutes and regulations in West Virginia Code § 11-13A-1 *et seq*. put forth a formula for calculating severance taxes, and this Court has determined the principles governing how to interpret those tax statutes and regulations. The Tax Commissioner's argument violates those statutes, regulations, and caselaw in numerous ways that results in an overvaluation of Equinor's gross proceeds and tax liability. Principally, it does so by: (a) valuing the natural gas based on what MarkWest, the initial purchaser, received from a subsequent sale of the natural gas to third parties, and not on the value Equinor, the producer, actually received, (b) misclassifying MarkWest's expenses as Equinor's actual transportation and transmission expenses, and (c) denying Equinor the 15% safe harbor set forth in the regulations to account for the transportation and transmission of the natural gas and NGLs through Equinor's system to the "Plant Inlet" where it sells the same to MarkWest. This response brief details those violations, and outlines how Equinor and the ICA correctly applied the undisputed facts of this case to the clear and unambiguous wording of the statutes and regulations to properly calculate the severance tax.

STATEMENT REGARDING ORAL ARGUMENT AND DECISION

Pursuant to Rule 18(a)(4) of the West Virginia Rules of Appellate Procedure, Equinor respectfully requests that this Court grant oral argument, as it believes the decision-making process in this case would be significantly aided by oral argument. Rule 19(a)(1) of the West Virginia Rules of Appellate Procedure states that a case is suitable for Rule 19 oral argument if it involves "assignments of error in the application of settled law . . . ." Here, all of the assignments of error have to do with the application of well-settled severance tax law in West Virginia.

Furthermore, Equinor respectfully requests entry of a decision through a signed opinion.

Because the Tax Commissioner is seeking a reversal of the ICA's decision, this case is not appropriate for a memorandum decision, which is only permitted in limited circumstances not present here, as set forth in Rule 21(d) of the West Virginia Rules of Appellate Procedure.

ARGUMENT

The ICA correctly decided the valuation of Equinor's NGLs for severance tax purposes, and this Court should affirm its decision in that respect.

I. Jurisdiction

Pursuant to West Virginia Code § 29A-6-1 and West Virginia Code § 51-11-10, this Court has jurisdiction over this matter as it is an appeal of a final decision of the ICA.

II. Standard of Review

This Court has outlined the standard of review applicable to this case as follows:

> In an administrative appeal from the decision of the West Virginia Office of Tax Appeals, this Court will review the final order of the circuit court pursuant to the standards of review in the State Administrative Procedures Act set forth in W. Va. Code § 29A-5-4(g) [1988]. Findings of fact of the administrative law judge will not be set aside or vacated unless clearly wrong, and, although administrative interpretation of State tax provisions will be afforded sound discretion, this Court will review questions of law *de novo.* West Virginia Code § 29A-5-4(g) provides, in relation to the circuit court's review:
>
> The court may affirm the order or decision of the agency or remand the case for further proceedings. It shall reverse, vacate or modify the order or decision of the agency if the substantial rights of the petitioner or petitioners have been prejudiced because the administrative findings, inferences, conclusions decision or order are:
>
> (1) In violation of constitutional or statutory provisions; or
> (2) In excess of the statutory authority or jurisdiction of the agency; or
> (3) Made upon unlawful procedures; or
> (4) Affected by other error of law; or

> (5) Clearly wrong in view of the reliable, probative and substantial evidence on the whole record; or
> (6) Arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.
>
> Further, "[t]he 'clearly wrong' and the 'arbitrary and capricious' standards of review are deferential ones which presume an agency's actions are valid as long as the decision is supported by substantial evidence or by a rational basis." Syl. Pt. 3, *In re Queen*, 196 W. Va. 442, 473 S.E.2d 483 (1996).

See Antero Res. Corp. v. Steager, 244 W. Va. 81, 84-85, 851 S.E.2d 527, 530-531 (2020).

III. The Operation and Calculation of the State Severance Tax Code

West Virginia imposes a tax upon producers, like Equinor, for the privilege of severing natural resources within its borders. W.Va. Code § 11-13A-3a(a). For gas and oil, this tax is equal to "five percent of the gross value of the natural gas or oil produced by the producer as shown by the *gross proceeds derived from the sale thereof by the producer* . . . ." W.Va. Code § 11-13A-3a(b) (emphasis added). The gross value of the natural gas therefore determines the amount of the severance tax owed to the state by the producer. *Id.* The statute and legislative rules further confirm that "gross value" for natural gas is the "value of the natural gas at the well head immediately preceding transportation and transmission." W.Va. Code R. § 110-13A-2a.10.1; W.Va. Code § 11-13A-2(c)(6)(G) (same); *see also* W. Va. Code R. § 110-13A-2.7 (definition of gross value of natural resources generally "means the market value of the natural resources product, in the immediate vicinity, where severed . . . ."). The severance tax therefore aims to tax the value of natural gas at a specific point in time—immediately upon severance from the earth—and at a specific geographic location known as the wellhead. *See, e.g.*, W.Va. Code § 11-13A-2(c)(8) ("gross value" generally is "the market value of natural resource product, *in the immediate vicinity, where severed*") (emphasis added); W.Va. Code R. § 110-13A-2a.10.1; W.Va. Code R. § 110-13A-2.7.

To value natural gas at this specific time and place, West Virignia Code § 11-13A-3a(b) directs us to look at the "gross proceeds derived from the sale thereof by the producer" of the natural gas. "Gross proceeds" is defined as "the value, whether in money or other property, actually proceeding from the sale or lease of tangible personal property, or from the rendering of services, without any deduction for the cost of property sold or leased or expenses of any kind." W.Va. Code. § 11-13A-2(b)(5). The code contains a similar definition of "gross value" specific to natural resources, where "gross value is the gross proceeds received or receivable by the taxpayer." W.Va. Code § 11-13A-2(c)(6)(A) Thus, the touchstone of this calculation is the money actually received in a sale of the natural gas by the producer (or taxpayer)—that money received constitutes gross value and gross proceeds and, ultimately, is key to determining the amount of severance tax owed.

This calculation of severance tax can be complicated by the current industry practice. Previously, natural gas was sold literally at the wellhead; nowadays, it is usually transported, minimally processed to comply with pipeline specifications, and then sold away from the wellhead. *See Leggett v. EQT Prod. Co.*, 239 W. Va. 264, 271, 800 S.E.2d 850, 857 (2017).

To address this valuation issue and to ensure the tax is applied uniformly to all wells, West Virginia's severance tax legislative rules provide four different methods by which a producer/taxpayer may calculate the wellhead value of the natural gas even when the natural gas is not literally sold at the wellhead. W.Va. Code. R. § 110-13A-4.8.1 *et seq*. These methods permit a producer to deduct from the gross proceeds from sale certain defined transportation and transmission costs associated with getting the natural gas from the wellhead to the point of sale, thereby performing a "netback" calculation of the value at the wellhead. *Id.*

This case addresses three aspects of calculating severance tax: (a) what figure on the settlement statements constitutes Equinor's gross proceeds; (b) whether fees on the settlement

statements qualify as Equinor's actual transportation and transmission costs under West Virginia Regulation § 110-13A-4.8.1 (hereinafter "Regulation 4.8.1"); and (c) whether Equinor may deduct the 15% safe harbor, which was the deduction method it selected.

IV. The "Net Value" on Settlement Statements Is the Proper Starting Point for the Valuation of the Natural Gas at the Wellhead and the Tax Commissioner's Argument for "Product Value" Violates Numerous Statutes and Regulations

The Tax Commissioner's Assignment of Error No. 1 opposes using the "net value" on the settlement statements, and he urges this Court to hold that the higher "product value" constitutes Equinor's gross value and gross proceeds, upon which the severance tax is imposed. This argument, however, is contrary to many of the clear and unambiguous statutes and regulations dictating how severance tax is calculated.

A. The Code Is Clear that Severance Tax Is Only Assessed on the Money Equinor Actually Received in Its Sale of Raw Gas to MarkWest

The starting point for calculating the gross value of the natural gas at the wellhead immediately upon severance is found in West Virginia Code § 11-13A-3a(b), which states that gross value is "shown by the gross proceeds derived from the sale thereof by the producer." W.Va. Code § 11-13A-3a(b). The regulations clarify that gross proceeds are "the value, whether in money or other property, *actually proceeding from the sale* or lease of tangible personal property, or from the rendering of services, without any deduction for the cost of property sold or leased or expenses of any kind." W.Va. Code. § 11-13A-2(b)(5) (emphasis added). When it comes to producers of natural resources, like Equinor, there is the added statute holding that "gross value is the gross proceeds received or receivable by the taxpayer." W.Va. Code § 11-13A-2(c)(6)(A). The legal framework is therefore consistent: the starting number for calculating severance tax is the money the producer actually receives in the sale of the natural resources.

Any doubt on this point is resolved by the severance tax legislative rules, which contain a hypothetical example of how to calculate gross value for natural gas: "A is a producer of natural gas within West Virginia. The entire output of natural gas from A's well is purchased at the well head by a public utility for $25,000. On his severance tax return, A will report $25,000 as gross income." W.Va. Code R. § 110-13A-2a.10.1. Given the amount of money actually received in the above example ($25,000) matches the gross value and gross proceeds reported for severance tax purposes ($25,000), the state rule provides further confirmation that the money *actually received in a sale* determines gross proceeds. *Id.*

When statutes and rules are, like these, "clear and unambiguous," they will be "applied and not construed." Syl. Pt. 1, in part, *State v. Elder*, 152 W. Va. 571, 165 S.E.2d 108 (1968). "Where the language of a statute is free from ambiguity, its plain meaning is to be accepted and applied without resort to interpretation." Syl. Pt. 2, *Crockett v. Andrews*, 153 W. Va. 714, 172 S.E.2d 384 (1970). "If the text of a statute, given its plain meaning, answers the interpretive question, the language must prevail and further inquiry is foreclosed." *Appalachian Power Co. v. State Tax Dep't of West Virginia*, 195 W.Va. 573, 587, 466 S.E.2d 424, 438 (1995). In light of this clear and unambiguous precedent, the money Equinor *actually receives* from MarkWest in the sale of raw gas should be the starting number for calculating severance tax.

We therefore consider what money Equinor actually received in the sale of its raw gas. It is undisputed that Equinor sells raw gas to MarkWest, and MarkWest authors monthly settlement statements. Those settlement statements recount the money MarkWest actually received for selling the NGLs to third parties (known as "product values"), detail the fees that MarkWest incurred in processing and selling the NGLs, and provide the "net value" that is ultimately paid by MarkWest to Equinor. A.R.0611 at ¶10-11; A.R.0812-A.R.0818 (examples of settlement statements);

A.R.0954-A.R.0959 (testimony of Tomas Gaytan regarding example settlement statements); A.R.0484. As recognized by WVOTA, "it is undisputed between the parties" that MarkWest pays Equinor, and Equinor actually receives, only the "net value" listed on the settlement statements in exchange for the raw gas. A.R.0612 at ¶14; A.R.0484; A.R.1017-A.R.1021 (testimony of Randy Aram regarding payment and verification of payment from MarkWest to Equinor). This is reflected in the NGL Agreement, which states that [redacted] A.R.0747 at ¶ 5(C)(i)-(ii). There is no factual dispute that Equinor is paid only the "net value" on the settlement statements, as clearly shown by testimonial and documentary verification of the funds actually received by Equinor. *See, e.g.*, A.R.0612 at ¶14; A.R.0720-A.R.0141 (Affidavit of Randy Aram and Swee Pang regarding payment to Equinor); A.R.1017-A.R.1021 (testimony regarding the same).

A straightforward application of these facts to the plain language of the statutes and regulations outlined above leaves only one result—Equinor's gross proceeds are equal to the "net value" on the settlement statements, because that is the only money that it actually receives in its sale of raw gas to MarkWest. Given that the applicable statute answers the question of which figure on the settlement statements is Equinor's gross proceeds, there is no need for interpretation or "further inquiry." This point resolves in Equinor's favor, as the ICA aptly explained: "the correct figure to determine the value of the NGLs at the wellhead for severance tax purposes is the *gross amount Equinor receives from MarkWest*, not the product value shown on the settlement statements." A.R.0494 (emphasis added). The ICA further noted that the product value reflects "MarkWest's sales of processed product to third parties" [redacted]" *Id.* The

product value therefore cannot be the gross value or gross proceeds of Equinor's natural gas at the wellhead because it is the money MarkWest (who is not the producer upon which severance tax is being assessed) receives in a secondary sale. *See* W.Va. Code § 11-13A-3a(b) ("gross proceeds derived from the sale thereof *by the producer*") (emphasis added). The ICA concluded that the Tax Commissioner's "attempt to extend the tax to greater values than amounts actually received by a producer from an unrelated third party" violated the applicable statutes, had to be tempered by judicial limits, and may have constitutional implications. A.R.0949.

In this appeal, the Tax Commissioner goes beyond the clear meaning of the severance tax statutes, ignores the ICA's gentle warnings, and still urges the Court to use the higher "product value" listed in settlement statements as Equinor's gross proceeds. There is no factual basis for doing so, only the Tax Commissioner's arbitrary and capricious desire to assess tax on a higher value. The "product value" is undisputedly the money MarkWest receives in a sale to third parties—it is *not* the money that Equinor receives. A.R.0494. A.R.0747 at ¶ 5(C)(i)-(ii) (emphasis added). This conforms with the testimony Equinor offered at the evidentiary hearing, namely that the product value is what MarkWest receives for the resale of NGLs. *See, e.g.*, A.R.0956. Equinor, at no time, is actually paid the often higher "product value" listed on the settlement statements. *See, e.g.*, A.R.0612 at ¶13 (compare $386,174.91 product value with $341,383.23 net value in the January 31, 2015 statement); A.R.0720-A.R.0141; A.R.1017-A.R.1021. Given these undisputed facts, the "product value" cannot be the starting point for the calculation of Equinor's severance tax calculation, because it is not the money that it, as the

producer, ever actually receives for the sale of its raw gas—the product value is money that goes elsewhere.

By attempting to persuade this Court to use the "product value" on the settlement statements, which is undisputedly not the money actually received by Equinor, the Tax Commissioner violates numerous statutes, including West Virginia Code § 11-13A-3a(b) ("gross value is shown by the gross proceeds derived from the sale thereof by the producer"), West Virginia Code § 11-13A-2(b)(5) (defining gross proceeds to be "the value, whether in money or other property, actually proceeding from the sale"), and West Virginia Code § 11-13A-2(c)(6)(A) (defining for producers of natural gas that "gross value is the gross proceeds received or receivable by the taxpayer."). As the ICA noted, the Tax Commissioner's argument violates the applicable statutes, may also exceed his authority, and could create constitutional boundary concerns. *See* A.R.0494-A.R.0495. Thus, the Tax Commissioner's argument is contrary to clear and well-settled law, and its Assignment of Error Nos. 1 and 2 are without merit. This Court should uphold the ICA's decision as the valuation of Equinor's NGLs for severance tax purposes.

B. The Tax Commissioner's Argument About Contractual Consideration Impermissibly Imposes Severance Tax on Conduct that the Statutes Clearly Mandate Are Not Severance

In order to try to combat the undisputed testimony that the "net value" on the settlement statements is the only money Equinor actually received from its sale of raw gas to MarkWest, the Tax Commissioner claims that other dollar figures on those statements should be attributable to Equinor, even if it they were not money it actually received. Specifically, the Tax Commissioner appears to argue that the "fees" on the settlement statement that are associated with MarkWest's processing, separating, and fractioning the raw make into NGLs should be part of Equinor's gross proceeds because those fees allegedly represent the "value of services" provided to Equinor. This,

however, would expand the severance tax beyond its permissible bounds into non-severance activities.

This case is exclusively about severance tax, and that tax is only imposed on the *severance* of natural resources. *See* W.Va. Code § 11-13A-3a ("For the privilege of engaging or continuing within this state in the business of severing natural gas or oil for sale, profit or commercial use"). The tax code defines "severing" so that it "shall not include any separation process of oil and natural gas commonly employed to obtain marketable natural resource products." W.Va. Code § 11-13A-2(c)(6)(G). Similarly, the definition of "processed" or "processing" as applied to natural gas "shall not include any conversion or refining process." W.Va. Code § 11-13A-2(c)(9)(a). The same sentiment is echoed elsewhere in the code, like the statute addressing production of natural resources, which unequivocally states that "[t]he privileges of severing and producing oil and natural gas shall not include any conversion or refining process." W.Va. Code § 11-13A-4(c). These statutes uniformly confirm that severance, which is the fundamental basis of the tax at issue, shall not include the processing, separating, refining, converting, or fractioning that turns natural gas or raw gas into the much more marketable and valuable NGLs.

The Tax Commissioner seeks to use the "product value" because this allegedly includes the value of services MarkWest provided to Equinor. However, the Tax Commissioner's argument fails to consider what those services are for, and whether the services would even qualify as severance. [redacted] A.R.743-745 at ¶ 5(C)(i)-(ii); A.R.0611-A.R.0612 at ¶12. These fees include fractionation fees, marketing fees, pipeline fees, processing fees, electric fees, plant fuel fees, loading fees, and fees for use of the TEPPCO pipeline. *See* A.R.0743-745 at §5(A) (NGL Agreement); A.R.0729 (settlement statement). These fees are

incurred by MarkWest as it: (a) transports and processes the raw gas it purchased from Equinor into raw make and residue gas in its systems; (b) fractionates that raw make into individual NGLs in its systems; and (c) transports the converted NGLs to the point of sale to MarkWest's customers in its system or the system of those third-party customers. A.R.0656 (schematic); A.R.0743-745 at §5; A.R.0482-A.R.0483. Accordingly, all of these fees on the settlement statement arise from MarkWest's processing, compression, and fractionation of the raw gas into composite NGLs, and subsequent transportation of the finished NGLs to MarkWest's customers. A.R.741 at §1(B) & A.R.0743-A.R.0745 at §5(A) (NGL Agreement); A.R.0611-A.R.0612 at ¶12; A.R.0496 (ICA finding fees "reflect costs MarkWest incurred").

Under the clear and unambiguous language of the tax code quote above, none of this processing, compression, or fractionation of raw make into NGLs would fall within the statutory definition of severance—in fact, these actions are expressly *precluded* from being severance. *See* W.Va. Code § 11-13A-3a; W.Va. Code § 11-13A-2(c)(6)(G); W.Va. Code § 11-13A-2(c)(9)(a); W.Va. Code § 11-13A-4(c). Therefore, the fees on the settlement statements do not arise from the severance of natural resources, and severance tax cannot be imposed upon them.[6] The Tax Commissioner's argument on appeal fails to acknowledge the non-severance origin of these fees, or explain how these fees can be subject to severance tax despite not being within the statutory definition of severance. The Tax Commissioner's argument as to "value of services provided" therefore violates numerous statutes, and impermissibly seeks to impose severance tax on non-severance conduct. Accordingly, the Assignment of Error Nos. 1 and 2 are without merit, and this Court should uphold the ICA's decision as the valuation of Equinor's severance taxes.

[6] Though not explicitly addressed, the ICA did appear to acknowledge the difference between severance and later fractionation and separation of the NGLs, directing that gross value be determined "at an earlier step in the process—at the wellhead." A.R.0495.

C. The Tax Commissioner Impermissibly Moves Valuation Away from the Wellhead, Violating Numerous Code Provisions

We return our focus to the determinative issue in this case: the gross value of the natural gas at the wellhead immediately upon severance by Equinor. As acknowledged by the ICA, the severance tax is based upon the gross value of the natural gas *at the wellhead*. A.R.0495. All of the applicable statutes and regulations are designed to calculate the value at that specific time (immediately upon severance from the earth) and location (the wellhead where natural gas is severed from the earth). *See, e.g.*, W.Va. Code § 2(c)(6)(G) ("for natural gas, gross value is the value of the natural gas *at the wellhead* immediately preceding transportation and transmission") (emphasis added); W.Va. Code R. §110-13A-2a.10.1 ("The entire output of natural gas from A's well is purchased *at the well head*") (emphasis added); W. Va. Code R. § 110-13A-2.7 (definition of gross value of natural resources generally "means the market value of the natural resources product, *in the immediate vicinity, where severed* . . . .") (emphasis added); W.Va. Code § 11-13A-2(c)(8) ("gross value" generally is "the market value of natural resource product, *in the immediate vicinity, where severed*") (emphasis added). The wellhead is the geographic location where the natural gas is severed from the ground. *See, e.g.*, W.Va. Code § 11-13A-2(c)(8); W. Va. Code R. § 110-13A-2.7; *Petron*, 109 P.3d at 149. Together, the tax code provides a framework that consistently directs severance tax to be valued at the wellhead, immediately after severance.

To determine the value of the natural gas at the wellhead, we turn to the process by which Equinor severs natural gas. As WVOTA and ICA both recognized, the product that first emerges from the ground at the wellhead is an impure mixture of various natural resources, water, and sediment. A.R.0610 at ¶3; A.R.0494. After minimal processing and transport by Equinor in its own system, it is considered "raw gas" that conforms to pipeline specifications and is delivered to MarkWest at the Plant Inlet. A.R.0610-A.R.0611 at ¶¶4-5; A.R.0784 at § 7.1 (gas quality for

delivery); A.R.0952; A.R.0482. MarkWest then subjects the raw gas to various forms of processing to: (a) process the raw gas into its constitute parts of raw make and residue gas, and (b) fractionate the raw make into individual NGLs. A.R.0611 at ¶¶5, 7, 9; A.R.0840-A.R.0841 (schematic); A.R.0951-A.R.0952; A.R.0482-A.R.0483. All of this processing and fractionating is done in systems and facilities exclusively owned and operated by MarkWest, which are not geographically near the wellhead. A.R.0840-A.R.0841; A.R.0951-A.R.0953; A.R.0962-A.R.0965; A.R.0483; A.R.0496. After these processes, MarkWest sells the NGLs to third parties at prices MarkWest exclusively selects, negotiates, and executes. A.R.1013; A.R.0482-A.R.0483; A.R.0611 at ¶9 (NGLs are "sold by the third parties who operate the plants"); A.R.0952-A.R.0952; A.R.0483. The resulting settlement statements reflect the "product value" which MarkWest receives from third parties for the sale of MarkWest's NGLs, and the "Net Sales Price" which MarkWest pays to Equinor for MarkWest's purchase of the raw gas. A.R.0611-A.R.0612 at ¶12; A.R.0484; A.R.0494.

Applying these facts to the clear and unambiguous legal framework outlined above, the product value does not—and cannot—represent the value of natural gas *at the wellhead*, as statutorily required for two reasons: first, it is for a far different product than what emerges at the wellhead, and second, it reflects a secondary sale that occurs far downstream from the wellhead. Either is sufficient, on its own, to preclude the product value from constituting the gross proceeds.

As to the first, the "product value" is undisputedly the price paid for fully processed and fractionated NGLs. NGLs are a fundamentally different product than either the impure mix that emerges from the earth upon severance or the minimally processed raw gas Equinor sells to MarkWest. A.R.743-745 at ¶ 5(C)(i); A.R.0956-A.R.0958. Certainly, given the amount of processing and fractionation that MarkWest subjects the raw gas to in order to create the individual

NGLs that it sells (*see, e.g.*, A.R.0611 at ¶¶7, 9; A.R.0840-A.R.0841 (schematic of MarkWest's many fractionation and processing plants); A.R.0951-A.R.0954 (testimony about fractionation)), the NGLs and their correlating "product value" cannot be equated to what natural resources emerge at the wellhead upon severance. The ICA correctly noted that NGLs and freshly severed natural gas are fundamentally different, stating that "the product that first emerges from the ground is an impure mixture of various natural resources, water, and sediment" and that the product value is, instead, the sale price for a "processed product." A.R.0494. It further noted that what Equinor sold to MarkWest at the Plant Inlet was not processed NGLs. *Id.* Accordingly, the ICA found the product value should not be used "to determine the gross value of natural resources produced by Equinor." *Id.* (emphasis added).

As to the second, the product value is the result of a subsequent sale of NGLs between MarkWest and third parties. A.R.0494; A.R.0747 at ¶ 5(C)(i); A.R.0951-A.R.0956 (testimony of Tomas Gaytan). This sale does not occur at the wellhead or in Equinor's system, but in the system of either MarkWest or its purchaser. A.R.0482-A.R.0483; A.R.0840-A.R.0841. Additionally, this sale occurs only after MarkWest has completed significant processing and fractionation, both of which take time and space, and after additional transportation of the fully processed NGLs to MarkWest's point of sale. A.R.0482-A.R.0483; A.R.0840-A.R.0841; A.R.0951-A.R.0956; A.R.0962-A.R.0965. As a result, the sale upon which "product value" is based occurs far from the wellhead geographically and temporally.

Instead of representing the sale between Equinor and MarkWest, the "product value" captures the sale between MarkWest and a third-party of the processed NGLs. Simply put, NGLs are far more valuable than impure natural gas, as this Court has acknowledged. *See, e.g., Leggett*, 239 W.Va. at 271, 800 S.E.2d at 857 ("the sales price is enhanced . . . because it is now a

marketable, useable product . . . rather than the raw, "sour" gas which was sold from the wellhead."); *CNX Gas Co., LLC v. Irby*, No. 23-ICA-36, 2024 WL 1261813, at *2 (W. Va. Ct. App. Mar. 25, 2024) ("Usually when the mixture is sold at the wellhead, the producer receives a lower price from the sale than it would have if it had transported, stored, processed, and marketed the methane and processed NGLs, with the price reflecting its assumption of such costs and the product's increased value."). The WVOTA has recognized the same fact, notably in a February 5, 2004 decision in Case No. 03-106SV, in which an administrative law judge stated:

> Simply put, the well-mouth value of the natural gas severed by the Petitioners—that amount is the measure of the severance tax—does not include qualitative and place-utility values *added* by the various processing and transportation services employed by the purchasers of such gas. Rather, it is precisely because of those costs that just-extracted, unprocessed natural gas is worth *less* at the well-mouth than at any point closer to the final consumer.
>
> A.R.00833 (emphasis in original).

The settlement statements confirm that this fact holds true in this particular case as well: the "product value" that MarkWest receives for selling NGLs is usually much higher than the "net value" that Equinor receives for selling raw gas. *See, e.g.*, A.R.00612 at ¶13 (higher product value); A.R.0729-730 (same); A.R.0738 (same). This is precisely the benefit for which the parties negotiated, at arm's length, in the Contracts—MarkWest believed it could obtain higher prices for the sale of the NGLS after it processed it, and Equinor sought to sell the raw make without having to make the investment of processing it. A.R.0741-A.R.0763 (NGL Agreement); A.R.0765-A.R.0807 (Gas Processing Agreement). However, there can be some limited periods where the settlement statement fees (i.e., the cost of processing the NGLs) exceeds the value at which the NGLs can be sold third parties. The ICA correctly recognized that "market prices for a commodity (especially prior to processing and delivery to an end-user) are dependent upon a number of market

forces (supply, demand, futures markets, etc.) and are not dependent upon a producer's costs of production. In this particular month, the market price (value) of the commodity at the wellhead was less than zero, which is certainly not without precedent." A.R.0493 at fn. 9.[7]

Taking all of this together, given the well-recognized differences between processed NGLs and the impure mix of natural gas that emerges from the earth immediately upon severance—including their disparate composition, potential sale values, amount of processing, geographic location, and time elapsed since severance—the "product value" paid for those NGLs does not constitute value of natural gas *at the wellhead*, as required. *See* W.Va. Code R. §110-13A-1a.10.1; W.Va. Code R. §110-13A-2.7; W.Va. Code § 11-13A-2(c)(8); W.Va. Code § 11-13A-2(c)(6)(G). The ICA found the same to be true, finding that "the correct figure to determine *the value of the NGLs at the wellhead* for severance tax purposes is the gross amount Equinor receives from MarkWest, not the product value shown on the settlement statements." A.R.0494 [emphasis added]. The Tax Commissioner's argument that the "product value" should be used to calculate Equinor's severance tax impermissibly moves the valuation from the wellhead, as required by statute, until it is a very different product, much further downstream beyond the producer's system.

In contrast, the value of the natural gas as it exists at the wellhead immediately after severance is properly captured by the "net value" on the settlement statements. The product in that sale is raw gas, which is much closer in composition and sale value to the impure mixture of various natural resources, water, and sediment that originally emerge from the earth. A.R.0610 at ¶3. Raw gas is the result of only the minimal movement and processing necessary to comply with

[7] This scenario is also recognized by the Tax Commissioner in a similar case involving severance tax on NGLs before the ICA, as the Tax Commissioner in its brief to the ICA agreed that " [s]eparating the various components of wet gas (including NGLs) is expensive … the after-processing market price [of NGLs] is 'volatile'—'fluctuating significantly from year to year'—and at times may be less that the cost of processing." *CNS Gas Company LLC v. Irby*, No. 23-ICA-36, (June 21, 2023) (Appellant's Brief p. 23).

pipeline specifications. A.R.0610-A.R.0611 at ¶¶4-5; A.R.0784 at § 7.1; A.R.0952; A.R.0482. Thus, the "net value" on the settlement statement is the appropriate value of Equinor's natural gas not only because it is the amount of money Equinor actually receives from MarkWest, *see* Section V(A) *supra*, but because it most accurately reflects the value of the natural resources "at the wellhead" immediately preceding transportation and transmission.

Ultimately, the Tax Commissioner's argument conflicts with the statutory requirement to value natural resources at the wellhead. Assignment of Error Nos. 1 and 2 are therefore without merit, and this Court should affirm the decision of the ICA as to the valuation of severance taxes.

V. MarkWest's Fees on the Settlement Statement Are Not Attributable to Equinor Pursuant to the Regulations

Having confirmed that the net value on the settlement statements is the proper starting figure for Equinor's gross proceeds in its sale of raw gas to MarkWest, we turn to the remainder of the severance tax calculation. As explained above, the legislative rules provide four methods by which a taxpayer may compute gross value *at the wellhead* when the natural gas is not actually sold at the wellhead. Each permits the producer to deduct certain transportation and transmission costs from its gross proceeds, in order to calculate the value "back" at the wellhead. This is known as a "net back" method. This case involves two "net back" methods: (a) deducting from the value the producer's actual costs of transportation and transmission "through the system of the producer from the well-mouth point of severance and production to the point of sale" under Regulation 4.8.1, or in the alternative (b) taking a safe harbor equal to 15% of the gross proceeds of the natural gas under W.Va. Code R. § 110-13A-4.8.4 (hereinafter "Regulation 4.8.4"). It is undisputable that a natural gas producer may use only one deduction.

The parties disagree which deduction Equinor is permitted to take—Equinor argues it may take the 15% safe harbor under Regulation 4.8.4, while the Tax Commissioner argues it has already

received the actual transportation and transmission costs of Regulation 4.8.1 in the form of the fees on the settlement statements. To resolve the dispute, classic statutory interpretation is required. When doing so, the "clear and unambiguous" language of a statute is applied using its "plain" meaning, without "resort to interpretation." Syl. Pt. 1, *Elder*, 152 W. Va. at 571, 165 S.E.2d at 108; Syl. Pt. 2; *Crockett*, 153 W. Va. at 714, 172 S.E.2d at 384. When that plain language answers the question before the court, "the language must prevail and further inquiry is foreclosed." *Appalachian Power*, 195 W.Va. at 587, 466 S.E.2d at 438.

We consider first the actual transportation and transmission costs of Regulation 4.8.1, for which the Tax Commissioner argues. Regulation 4.8.1 states, in relevant part:

> [T]here shall be allowed a deduction in the amount of the costs of transportation or transmission of such gas *through the system of the producer from the well-mouth point of severance and production to the point of sale.* The deduction shall be limited to actual costs of transportation or transmission incurred without reference to items unrelated to transportation or transmission such as general administration, overhead, or return of investment.

W.Va. Code R. § 110-13A-4.8.1 (emphasis added).

The plain language of Regulation 4.8.1 therefore imposes several prerequisites before a cost can be deducted from gross proceeds: (a) the costs must arise as natural gas moves "through the system of the producer;" (b) the costs must be incurred between "the well-mouth point of severance" and "the point of sale;" and (c) the deduction shall be limited to actual costs of transportation or transmission incurred without reference to items unrelated to transportation or transmission such as general administration, overhead, or return of investment. W.Va. Code R. § 110-13A-4.8.1 There is no ambiguity in this language, as the regulation specifies a geographic (producer's system) and temporal (before sale) limit, and clarifies that only true transportation and transmission costs may be deducted.

The fees on the settlement statements between MarkWest and Equinor do not qualify as Equinor's actual transportation and transmission costs under the plain language of Regulation 4.8.1 for myriad reasons, including that they are not incurred: (a) by Equinor, (b) in Equinor's—the producer's—system, and (c) before Equinor sells to MarkWest. Any one of these reasons is sufficient, on its own, to preclude its application. This means the Tax Commissioner's position is contrary to nearly every aspect of Regulation 4.8.1.

A. The Expenses Were Not Actually Incurred by Equinor

The Tax Commissioner's argument is fatally flawed because the fees on the settlement statement were not *actually incurred* by Equinor at all, as contemplated by Regulation 4.8.1. [redacted] A.R.0747-748 at §5(C)(i) (emphasis added). The parties therefore contracted for these fees to be incurred by MarkWest, and that contractual term must be given legal effect.

Importantly, that contractual term is well grounded in fact. The NGL Agreement identifies the fees as being incurred by MarkWest because they, in reality, are incurred by MarkWest. These fees are all associated with the process of separating, processing, and fractionating the raw gas into NGLs. *See* A.R.0743-A.R.0745 ¶5 (NGL Agreement). These fees are incurred by MarkWest as it transports and processes (in its own system) the purchased raw gas into raw make and residue gas; further fractionates that raw make into NGLsl; and then transports the finished NGLs in its system or the systems of third parties to where MarkWest sells the products to its customers. A.R.0840-A.R.0841 (schematic); A.R.0951-A.R.0953 (testimony of Tomas Gaytan regarding schematic);

A.R.0962-A.R.0965; A.R.0483; A.R.1019-A.R.1020; A.R.0496 ("MarkWest owns and operates the fractionation plant"). Accordingly, all of these fees on the settlement statement arise from MarkWest separating, processing, and fractionating the raw gas into NGLs. A.R.0741 at ¶1(B); A.R.0743-A.R.0745 at §5(A); A.R.0610-A.R.0612 at ¶12. The attribution of the fees to MarkWest in the contract is therefore factually correct—it is the entity that actually incurred them. The ICA agreed, finding in several places that the fees were costs "incurred by MarkWest." A.R.0494-A.R.0496.

The Tax Commissioner attempts to side-step this dispositive fact by arguing that Equinor nonetheless "incurs" the fees through the NGL Agreement's calculation of price for raw gas. This is without merit. The Tax Commissioner cannot interpret the contract in such a way as to directly conflict with an express term of that same contract. *See* Syl. Pt. 3, *Cotiga Development Co. v. United Fuel Gas Co.*, 147 W.Va. 484, 128 S.E.2d 626 (1962) ("It is not the right or province of a court to alter, pervert or destroy the clear meaning and intent of the parties as expressed in unambiguous language in their written contract or to make a new or different contract for them."). The inclusion of fees in the payment formula for the sale of raw gas from Equinor to MarkWest does not, and cannot, void the parties' express clause that MarkWest incurs the fees. A.R.0743-745; *see, e.g.,* Syl. Pt. 3, *Moore v. Johnson Service Co.,* 158 W.Va. 808, 219 S.E.2d 315 (1975) ("specific words or clauses of an agreement are not to be treated as meaningless, or to be discarded, if any reasonable meaning can be given them consistent with the whole contract."). The ICA properly considered the NGL Agreement's provisions and found them to be dispositive on this issue, concluding that "[i]t is clear from the NGL Agreement that the fees listed on the settlement statement do not reflect the cost of natural resources moving through Equinor's system . . . .". . A.R.0496.

Additionally, the Tax Commissioner's argument impermissibly conflates two different sales—the first being Equinor's sale of raw gas to MarkWest governed by the Contracts, and the second being MarkWest's sale of NGLs to third parties. MarkWest incurs the fees during its processing and fractionation, when MarkWest holds title and exclusive possession, custody, and control over the raw gas and/or the NGLs contained therein. The fact that the fees were included in the payment formula in the NGL Agreement does not change or alter those facts: MarkWest, and MarkWest alone, incurred the fees when it processed the raw gas for which it held title. As the ICA properly found, the Tax Commissioner's "theory" that the fees were attributable to Equinor is "unavailing and inconsistent with the terms of the transaction between Equinor and MarkWest and market realities." A.R.0493 at fn. 9. Accordingly, the Tax Commissioner's argument is factually, practically, and legally deficient.

In conclusion, the fees at issue on the settlement statements were not actually incurred by Equinor and cannot constitute Equinor's actual transportation and transmission costs under Regulation 4.8.1. Assignment of Error No. 3 is therefore without merit. This Court should affirm.

B. The Expenses Were Not Incurred in the Producer's System, as Required

Even if the fees were somehow "incurred" by Equinor (which they were not), the remaining conditions of Regulation 4.8.1 are not satisfied. Regulation 4.8.1 is clear that the deduction is only for "the costs of transportation or transmission of such 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 (emphasis added). In fact, at the evidentiary hearing before the WVOTA, the Respondent's witness, Ms. Stacy Acree, agreed that "transportation and transmission expenses are supposed to occur within the producer's system." A.R. 1068.

Here, it is MarkWest—and not Equinor—that incurs the fees on the settlement statement when natural gas moves through (a) the processing and fractionation plants and systems MarkWest exclusively owns and operates, and (b) the transportation systems owned by third parties to whom MarkWest sells NGLs. The Tax Commissioner, WVOTA, and ICA all agree that these fees arise as natural gas moves through systems and plants owned by MarkWest and others. A.R.0483; A.R.0496 ("MarkWest owns and operates the fractionation plant"); A.R.0611 at ¶¶ 5, 7, & 9. This is backed by the undisputed schematics, contracts, and testimony provided at the evidentiary hearing—all fees were incurred in systems and facilities owned by MarkWest and others, being to the right of the "red line" on the schematic. A.R.0840-A.R.0841 (schematic); A.R.0951-A.R.0953 (testimony of Tomas Gaytan regarding schematic); A.R.0962-A.R.0965; A.R.0483; A.R.1019-A.R.1020; A.R.0743-745 (NGL Contract).

For these reasons, the fees listed in the settlement statements do not arise from natural gas moving through "the system of the producer," as required by Regulation 4.8.1. These fees instead arise from natural gas moving through systems and facilities undisputedly owned by MarkWest during its own processing and fractionation, and from MarkWest's processing facilities to MarkWest's secondary sale to third parties. None of these fees arise from natural gas moving through a system owned by Equinor. Thus, under the clear and unambiguous prerequisite language of Regulation 4.8.1, the fees on the settlement statements cannot be transportation and transmission costs of Equinor subject to deduction. The ICA found the same, holding "[i]t is clear from the NGL Agreement that the fees listed on the settlement statement do not reflect the cost of natural resources moving through Equinor's system, as contemplated by the rule, because MarkWest owns and operates the fractionation plan and owns (or contracts for the use of) facilities through which MarkWest's NGLs move after leaving MarkWest's plant." A.R.0496.

In conclusion, Regulation 4.8.1. is clear that only fees arising from natural gas moving *through the system of the producer* can be deducted, and it is undisputed that fees on the settlement statement arise when natural gas moves through systems owned by MarkWest and others. As such, the fees cannot constitute Equinor's actual transportation and transmission costs under Regulation 4.8.1. Assignment of Error No. 3 is therefore meritless. This Court should affirm.

C. The Expenses Did Not Occur Before Sale by Equinor, As Required

Regulation 4.8.1 also requires that actual transportation and transmission costs must be incurred after "the well-mouth point of severance" and before "the point of sale." W.Va. Code R. § 110-13A-4.8.1. In the severance tax code, a "sale" is defined as "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). Thus, a sale occurs when title passes, and any costs incurred after that sale do not qualify under Regulation 4.8.1.

We therefore consider the contracts to determine how title for the raw gas transfers from Equinor to MarkWest and, accordingly, when a sale occurs.[8] The ICA was exceedingly clear on this point: "it is undisputed that title to NGLs transferred to MarkWest at the receipt point which is designated as the Plant Inlet." A.R.0496 *see also* A.R.0493 fn. 9 ("There is no dispute that title passed at the Plant Inlet and that NGLs were thereafter the sole property of MarkWest."). The ICA further found that "[o]nce Equinor's raw gas reaches the Plant Inlet, MarkWest obtains title to the NGLs contained in the raw gas. From the Plant Inlet onward, MarkWest has exclusive custody, control, ownership, and possession of the raw gas NGLs. Equinor does not own, market, or sell the NGLs beyond the Plant Inlet." A.R.0482-A.R.0483.

[8] The Tax Commissioner claims that the ICA was wrong to consider the sale between Equinor and MarkWest as the sale "that counts." That sale, however, is the only one that Equinor is party to. The Respondent errs by advocating that what is in essence the second sale, *i.e.*, the sale of NGLs from MarkWest to third parties, is the sale "that counts," as this sale is not a sale by the producer (Equinor) and is even further removed from the required wellhead value.

The ICA's holding is supported by substantial contractual and evidentiary support. [redacted] A.R.0792 at ¶14.2. [redacted] A.R.0741 at ¶1(B). [redacted] A.R.0742 at ¶4(B); A.R.0777 at ¶ 5.1; A.R.0792 at ¶14.2. [redacted] A.R.0758 at ¶7.4.

This passing of title at the Receipt Point is confirmed by contractual language and testimony that MarkWest has the exclusive possession, custody, and control of the raw gas (including the constituent NGLs) after it enters MarkWest's pipeline system. A.R.0758 at ¶7.1 ("MarkWest and any of its designees shall be in custody, control and possession of the Raw Make hereunder after Raw Make is delivered at the Receipt Point and shall be in custody, control and possession of the Fractionated Products until they are sold to a third party"); A.R.0792 at ¶13.2; A.R.0929; A.R.1012. [redacted] A.R.0777 at ¶ 5.1. Thus, title to the raw make (from which NGLs are derived) from Equinor to MarkWest when the raw gas first enters MarkWest's system at the Plant Inlet. A.R.1010. This is precisely what the ICA found. A.R.0493-A.R.0496.

The Tax Commissioner attempts to throw doubt on when title passes by pointing to language that MarkWest will "purchase" the NGLs from Equinor after they are processed. A.R.1132. This, however, is a red herring. Under the statutory definition of "sale" found in West Virginia Code § 11-13A-2(10), a sale occurs when title passes, and the Contracts are clear and consistent in demonstrating that the title to the raw gas passes from Equinor to MarkWest at the Plant Inlet. *See* A.R.0758 (¶7.4) [redacted] A.R.0741 at ¶1(B) [redacted] A.R.0742 at ¶ 4(B) [redacted] A.R.0792 at ¶14.2 [redacted] A.R.1011-A.R.1012; A.R.0482 [redacted] A.R.0496 [redacted]

A generic reference to an option to "purchase" in kind will not overcome those specific title provisions that satisfy the statutory definition of a sale—a definition the Tax Commissioner does not address in his brief.[9] Here, the "purchasing" language presented by the Tax Commissioner is out of context; that language is solely confined to how Equinor may be paid in kind, if it so elects, for its sale of raw gas to MarkWest. [redacted] *See* A.R. 0745. The language upon which the Tax Commissioner rests his argument

[9] In a somewhat dismissive statement, the Tax Commissioner argues "But regardless of where the sale occurs, Equinor still pays these fees as part of that sale" as if the timing and location of the same were not determinative under Regulation 4.8.1—which they absolutely are. *See* "Petitioner's Brief" at p. 34.
[10] Equinor did not take NGLs in kind during any tax year in question. A.R.0961.

therefore deals only with describing the two "in-kind" v. "purchase" payment options; nothing else. The ICA squarely addressed and settled this point, finding that because Equinor "chose to sell for cash" instead of in-kind, "once Equinor delivered raw gas to MarkWesk at the Plant Inlet, Equinor no longer has title to or control of the resulting production which MarkWest sold to third parties at prices determined by MarkWest in its judgment." A.R.0483. fn. 2. Thus, the Tax Commissioner's argument about title is without merit.

Moreover, a full review of the provisions cited by the Tax Commissioner only reaffirms Equinor's point and the ICA's conclusion that title had *already* passed to MarkWest at the Plant Inlet. The NGL Agreement holds that if Equinor had elected to take in-kind, which it did not, then title to the NGLs would transfer from MarkWest *back* to Equinor at a designated location. A.R.0758 at ¶7.4. Clearly, MarkWest cannot transfer title of NGLs to Equinor for an in-kind exchange if MarkWest does not already hold that title; nor can Equinor have title that it already holds transferred back to it. Consequently, the language cited by the Tax Commissioner only further confirms that MarkWest takes title to the NGLs when they arrive at the Plant Inlet. Accordingly, a sale occurs from Equinor to MarkWest at the Plant Inlet.

With this sale at the Plant Inlet in mind, we return to Regulation 4.8.1, which holds that only transportation and transmission costs that occur *after* the well-mouth point of severance and *before* the point of sale may be deducted. W.Va. Code R. § 110-13A-4.8.1. Thus, only fees that occur *after* the well-mouth and *before* the raw gas enters MarkWest's system at the Plant Inlet (point of sale) may qualify. Here, the fees on the settlement statements unequivocally do not fall within that permissible time period. Those fees are incurred during MarkWest's processing and fractionation at its facilities, which occurs *after* Equinor has sold and delivered the natural gas to MarkWest's system at the Plant Inlet, where the two systems first connect. *See, e.g.*, A.R.0611 at

¶¶ 5, 7, & 9; A.R.0741 at¶1(B); A.R.0743-A.R.0745 at ¶5(A); A.R.0747-A.R.0748 at ¶ 5(C)(i); A.R.0770 (definition of Plant Inlet); A.R.0840-A.R.0841 (schematic); A.R.0951-A.R.0952. This is also common sense, as MarkWest cannot process (or incur fees related to processing) natural gas that it has not yet received. As the fees are incurred *after* Equinor delivers natural gas to MarkWest at the Plant Inlet, they occur *after the sale*. The ICA agreed, finding that "the fees shown the settlement statements are incurred *after* the point of sale and Equinor delivers the natural gas to MarkWest at the Plant Inlet." A.R.0496 (emphasis in original). Accordingly, the fees cannot qualify as Equinor's actual costs under Regulation 4.8.1. Assignment of Error No. 2 is without merit, and this Court should affirm.

D. The Tax Commissioner Improperly Overvalued Equinor's Gross Proceeds by Adding MarkWest's Marketing and Administrative Fees.

The Tax Commissioner denied the marketing and administrative fees, which appear on the MarkWest settlement statements, on the theory that these costs are not allowable pursuant to Regulation 4.8.1. More specifically, the Tax Commissioner asserts that these marketing and administrative fees are general administration and overhead, and are thus excluded from allowable actual costs per Regulation 4.8.1. Equinor disagrees that the marketing and administrative fees appearing on the MarkWest settlement statements are Equinor's actual costs of transportation and transmission pursuant to Regulation 4.8.1. In order for costs to be classified as actual costs of transportation and transmission pursuant to Regulation 4.8.1, the costs must be incurred in the system of the producer, which was not the case here. *See* Section V(C) *infra*. In fact, Equinor has never claimed, and cannot claim, that the marketing and administrative fees appearing on the MarkWest settlement statements are Equinor's actual costs of transportation and transmission. This is because the marketing and administrative fees are expenses incurred by MarkWest, and, as a result, have nothing at all to do with the actual costs incurred by Equinor in transporting the

natural gas through Equinor's own system from the point of production to the point of sale. Rather, in an effort to artificially inflate Equinor's severance tax liability, the Tax Commissioner is improperly trying to add these fees to what Equinor actually was paid by MarkWest for the gas.

E. The Tax Commissioner's Other Arguments Regarding Actual Transmission and Transportation Costs are Meritless

The Tax Commissioner makes other, disparate arguments in support of his theory that the fees on the settlement statement are attributable to Equinor. These are not based upon the application of the facts to the language of Regulation 4.8.1. and, therefore, are immaterial. Out of an abundance of caution, however, Equinor will address each.

First, the Tax Commissioner argues that the fees on the settlement statements should be attributed to Equinor because Equinor does not get "value" out of raw gas until MarkWest fractionates and sells the NGLs. This expands Regulation 4.8.1 well beyond its limits. Regulation 4.8.1 expressly limits itself to costs of transportation and transmission in the producer's own system occurring *before a sale,* and the applicable tax statute defines a sale to occur *when title passes*—not when value from a sale is realized, or when consideration for a sale is paid. Given this legal framework, when value is "realized" or "paid" is irrelevant. The ICA correctly considered this statutory definition of a sale. A.R.0496. This argument is without merit.

Second, the Tax Commissioner posits that the deduction of actual transportation and transmission costs should be allowed because it is "better" for Equinor. This is strongly disputed, as the "better" or "best" calculation of Equinor's severance taxes is one that complies with the severance tax statute and regulations, *i.e.*, where Equinor's severance tax is based upon "net value" on the settlement statements, being the actual value it received for the sale of its natural gas, with the 15% safe harbor deduction. This is the calculation that the ICA found to comply with applicable laws and regulations. This is the only calculation that accurately determines the wellhead value as

the law requires. Furthermore, this is a refund case—all disputed money has already been paid by Equinor as severance taxes to the Tax Commissioner. The Tax Commissioner is not extending any kindness or favor to Equinor by providing only a partial refund, denying millions of dollars in refunds, and mischaracterizing processing, fractionation, and transportation fees as Equinor's actual cost of transporting and transmitting the gas from the wellhead to the point of sale to MarkWest. As the ICA properly noted, the denied refund was the Tax Commissioner's attempt to apply the severance tax beyond its bounds. A.R.0494. This argument is without merit.

Third, the Tax Commissioner argues that considering the MarkWest settlement statement fees to be actual transmission and transportation costs aligns with how Equinor handles royalty payments. To be clear, there absolutely is no evidence in the record of this case as to how royalty payments are handled for these specific wells—this alone precludes the comparison urged by Tax Commissioner. Equally important, however, is the fact that severance tax and royalty payments are fundamentally different creatures. There are meaningful differences as to the parties (*i.e.*, government v. private parties), the sources of law (*i.e.*, tax statutes v. natural resources statutes v. royalty contracts v. oil and gas leases), and contract terms (*i.e.*, purchase of NGLs or lease of property). Critically, severance tax and royalty payments are governed by different legal standards and considerations. Royalties arise from contracts in which parties may contract for any term they wish. Although royalty contract interpretation cases may conclude that processing performed by third parties can, under certain factual circumstances, be considered when determining a producer's gross proceeds, this is of no benefit in interpreting the severance tax statute because that statute, as discussed herein, makes it clear that (a) only the gross proceeds actually received by the producer constitute the beginning basis for the severance tax calculation, and (b) value added by processing, fractionation and transportation cannot increase the tax base.

Overall, given these factual and legal dissimilarities, this Court has recognized in *Steager v. Consol Energy, Inc.*, 242 W. Va. 209 no. 20, 224, 832 S.E.2d 135, 150 no. 20 (2019) that the analysis of whether to include post-production fees when calculating royalty payments is "inapplicable" to calculating severance tax, "despite general similarity of the issue." Though the Tax Commissioner did not argue about royalty payments below in this case (and, thus the ICA had no opportunity to consider), the Tax Commissioner has done so in other, recent severance tax case, *CNX Gas Company LLC v. Irby*, No. 23-ICA-36 (June 21, 2023), in which he conceded that "royalty methodologies don't always translate neatly into tax cases." *See CNX Gas Company LLC v. Irby*, No. 23-ICA-36, (June 21, 2023) (Appellant's Brief p. 25). Accordingly, the royalty cases cited by the Tax Commissioner are speculative, irrelevant, and distinguishable. They in no way support his violation of the severance tax statute and regulations by improperly inflating Equinor's gross proceeds and denying Equinor the 15% safe harbor (and therefore not allowing Equinor to deduct its cost of transporting and transmitting the gas from the wellhead to the point of sale.).

In conclusion, the Tax Commissioner impermissibly strays from the severance tax code into inapplicable and unpersuasive arguments. Assignment of Error No. 3 is without merit.

F. Conclusion on Actual Transportation and Transmission Costs

As delineated above, a straightforward application of the facts to Regulation 4.8.1 leads to one conclusion: the fees on the MarkWest settlement statements are not Equinor's actual transportation and transmission costs. These fees fail to qualify under several of Regulation 4.8.1's clear and unambiguous conditions because they were incurred by MarkWest, in non-producer-owned systems, and/or after sale by Equinor. Any one failure is sufficient, on its own, to preclude the Tax Commissioner's argument. Assignment of Error No. 3 is without merit. This Court should affirm the ICA's decision as to valuation of severance taxes.

VI. The ICA Properly Concluded that Equinor May Take The 15% Safe Harbor

Having established that Equinor did not deduct its actual transportation and transmission fees under Regulation 4.8.1, we turn to the final question in this case: may Equinor claim the 15% safe harbor deduction under Regulation 4.8.4? All parties agree that under Regulation 4.8, a taxpayer is entitled to claim a transportation and transmission deduction by utilizing only one of the four available deduction methodologies. Equinor has elected to use the 15% safe harbor method to calculate its taxable value of the natural gas at the well-mouth pursuant to Regulation 4.8.4. The Tax Commissioner denied this request, claiming Equinor had "already" deducted its actual transportation and transmission costs in the form of the fees on the settlement statements pursuant to Regulation 4.8.1, and could not "also" receive the 15% safe harbor under Regulation 4.8.4. A.R.0887 (2014 refund denial letter); A.R.1931 (2015); A.R.0856 (2016); A.R.2063 (2018); A.R.2026 (2019). The Tax Commissioner's argument on the safe harbor therefore rises and falls with the determination of whether the fees on the settlement statements are Equinor's actual transportation and transmission costs under Regulation 4.8.1.[11]

For the reasons stated in Section V *supra*, the fees on the settlement statement are not the actual transportation and transmission costs of Equinor; those fees are solely attributable to MarkWest and do not comply with the requirements of Regulation 4.8.1. Accordingly, Equinor has not "already" deducted costs, and the ICA held the same. A.R.0497. This leaves Equinor free

[11] The Tax Commissioner's argument (on pages 37-38 of his Petitioner's Brief) regarding invoices related to actual costs is incorrect and misleading. None of these invoices pertain to costs incurred to transport or transmit gas through Equinor's own system, and therefore, by definition, cannot be actual costs pursuant to Section 4.8.1 of the Regulations. The invoices at issue do not pertain to MarkWest settlement statements and refer to production which was not sold to MarkWest and does not flow through MarkWest facilities. A.R.0995-A.R.0998 ("Q: It wouldn't be on a MarkWest settlement statement, then, correct? A: Correct. Different Area. Q: Different area. So, where did – so, these fees and adjustments do not come from the MarkWest settlement statements? A: No."). The Tax Commissioner relies upon invoices that are not supported by the record—for example, the contracts related to these invoices are not in the record, and neither those contracts nor those purchasers were discussed at the evidentiary hearing. This argument was made by the Tax Commissioner to the ICA, and the ICA correctly found that Equinor did not receive a deduction for actual costs and was, therefore, entitled to the 15% safe harbor deduction. A.R.0497.

to claim the 15% safe harbor. As the ICA succinctly held: "Equinor was entitled to assert the safe harbor deduction." *Id*. Assignment of Error No. 4 is without merit. This Court should affirm.

VII. The Accounting Statute Is Also Determinative

Though the record is replete with reasons why the Tax Commissioner's argument is without merit and the ICA was correct in determining the valuation of its severance taxes, Equinor would be remiss if it did not also briefly address how West Virginia Code § 11-13A-7 is also dispositive of Assignment of Error Nos. 1-2. This code provision deals with the accounting methods related to severance tax and states, in relevant part: "A taxpayer's method of accounting under this article shall be the same as the taxpayer's method of accounting for federal income tax purposes." W.Va. Code § 11-13A-7(c)(1). Thus, how a producer accounts for income for state severance tax and federal income tax purposes must be the same. This Court has held that when the Tax Commissioner forces a deviation in accounting methods, it is erroneous and a violation of statute. *See Charleston Area Med. Ctr., Inc. v. State Tax Dep't of W. Virginia*, 224 W. Va. 591, 598, 687 S.E.2d 374, 381 (2009) (speaking of identical language in healthcare tax code).

Here, the ICA found that Equinor "established that the net values on the settlement statements are reported as "gross proceeds" for federal income tax reporting purposes" A.R.0484 at fn. 3. The Tax Commissioner's appeal seeks to use a different figure—the product value on the settlement statements—for state severance tax purposes. This would cause an impermissible divergence for Equinor, with federal income tax income being based on the net values, and state severance tax income being based on product values. This divergence is erroneous and a violation of the statute, as recognized in this Court's decision in *CAMC*. Accordingly, Assignment of Error Nos. 1-2 are without merit.

The Tax Commissioner's only defense is to claim that Equinor did not sufficiently establish how it reports income for federal tax purposes, because it submitted an affidavit instead of the actual tax returns. This is baseless. The WVOTA has previously used affidavits to establish how a taxpayer reports federal income tax income, without issue. *See* A.R.0821-A.R.0837 (taxpayer provided testimony as to how it reported gross income for federal income tax purposes "by way of sworn affidavit" from taxpayer's accountant); A.R.0934. The affidavit in this case was completed by the proper individuals—Equinor's tax consultants who are responsible for completing and filing Equinor's state and federal income tax returns. A.R.0720-A.R.0722 (Affidavit of Randy Aram and Swee Pang regarding federal tax reporting). The affiants jointly confirm that Equinor reports the "net sales price" as reflected in the MarkWest contract, or "funds received" that are "ultimately paid to [Equinor]," for purposes of both state severance tax and federal income tax reporting. *Id.*; *see also* Section IV(A) *supra* (net value as money actually paid). The affidavit even explains why the actual tax returns cannot be produced—Equinor files consolidated federal income tax returns, in which income figures from multiple entities nationwide are aggregated, meaning no line item arises solely from Equinor or the wells at issue. A.R.0720-A.R.0722. Thus the Tax Commissioner's argument is not persuasive. The Tax Commissioner violates West Virginia Code § 11-13A-7 when it forces Equinor to report income for state severance taxes in a different manner, consistent with the persuasive holding in *CAMC*.

VIII. The Tax Commissioner Deserves No Deference

The Tax Commissioner alludes to deference to the agency in his brief. No deference is due here because the severance tax statute is clear and unambiguous. Syl. Pt. 3, *Appalachian Power Co. v. State Tax Dep't of W. Virginia*, 195 W. Va. 573, 578–79, 466 S.E.2d 424, 429–30 (1995) ("If the intention of the Legislature is clear, that is the end of the matter, and the agency's position

only can be upheld if it conforms to the Legislature's intent. No deference is due the agency's interpretation at this stage."). Even if the severance tax statute were ambiguous, which it is not, the Tax Commissioner's interpretation is arbitrary, capricious, and manifestly contrary to the statute for the reasons listed above. This again precludes deference. *Steager v. Consol Energy, Inc.*, 242 W. Va. 209, 223, 832 S.E.2d 135, 149 (2019). Finally, as described below, the Tax Commissioner's position in this case is contrary to his position in other cases on severance tax. To the extent the Tax Commissioner's position here constitutes a litigation argument and/or deviates from his usual practice, it is afforded no deference. *Appalachian Power*, 195 W. Va. 573 at fn 17, 588, 466 S.E.2d 424, 439; *see also Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 213, 109 S.Ct. 468, 474, 102 L.Ed.2d 493, 503 (1988).

CONCLUSION

The Tax Commissioner's argument violates numerous statutes and regulations severance tax, and is contrary to the largely undisputed evidence. For the reasons listed above, and for those in Equinor's briefs to the WVOTA and the ICA listed in Footnote 4 above, Equinor respectfully requests this Court: (a) uphold the November 15, 2023 decision of the ICA as to the issue of calculation of severance tax in all tax years; and (b) grant such other and further relief as it deems just and proper.

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NO. 24-26

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

MATTHEW IRBY, STATE TAX COMMISSIONER OF WEST VIRGINIA,

Respondent below, Petitioner,

v.

EQUINOR USA ONSHORE
PROPERTIES, INC.,

Petitioner below, Respondent.

CERTIFICATE OF SERVICE

I, Chelsea E. Thompson, counsel for Equinor USA Onshore Properties Inc., do hereby certify that service of the foregoing **RESPONSE BRIEF** has been made upon counsel for the Respondent on June 3, 2024, by causing a true copy of the same to be transmitted through the File and Serve X-Press system which will send notification of the same to all counsel of record.

/s/ Chelsea E. Thompson
Chelsea E. Thompson, Esq. (WV Bar No. 12565)

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