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July 6, 2021

Via Hand Delivery and Electronic Mail

West Virginia State Tax Department
Attention: Mark Morton
P.O. Box 1005
Charleston, West Virginia 25324
taxlegal@wv.gov

Re: Public Comments to Draft Legislative Rule for the Valuation of Producing and Reserve Oil and Natural Gas Property for Ad Valorem Property Tax Purposes, W. Va. Code of St. R. §§ 110-1J-1 *et seq.*

Dear Mr. Morton:

Currently, producing and reserve oil and natural gas property is valued for ad valorem property tax purposes via W. Va. Code of St. R. §§ 110-1J-1 *et seq.* (the "Legislative Rule."). Draft amendments to the Legislative Rule (the "Draft Legislative Rule") were filed by the West Virginia State Tax Department (the "Tax Department") with West Virginia Secretary of State Mac Warner on June 4, 2021, and an Emergency Rule (the "Draft Emergency Rule") was filed with the Secretary of State on June 8, 2021.

Both the Draft Legislative Rule and Draft Emergency Rule are intended to provide guidance on changes to the valuation of oil, natural gas, and natural gas liquids for property tax purposes resulting from the passage of HB2581 during the 2021 regular legislative session. The Draft Legislative Rule and Draft Emergency Rule are virtually identical, and the provisions of the Draft Emergency Rule will be used by the Tax Department for the valuation of oil, natural gas, and natural gas liquids for property tax year 2022.

Antero Resources Corporation ("Antero") submits the following public comments to aid the Tax Department as it continues to review and revise the Draft Legislative Rule. While public comments are not required as part of the process for enactment of the Draft Emergency Rule, Antero's public comments to the Draft Legislative Rule equally apply to the Draft Emergency Rule.

- **Natural gas liquids**
  - Yield capitalization model – in public comments to the legislative rule that was introduced and then withdrawn in 2020, Antero raised concerns about using a price per barrel to value NGLs. The Draft Legislative Rule addresses these concerns, and values natural gas liquids using MCF as the production measurement. *See* definition of "Total Production" under § 3.46. Additionally, under §§ 4.3 and 5, it appears that the Tax Department intends to value the working interest for natural gas and natural gas liquids together, which Antero supports. However, § 9.1.1.d should be amended to reference MCF instead of "amount of NGLs."
  - Separate natural resource – amended W. Va. Code § 11-1C-10 establishes that natural gas liquids are a separate natural resource for property tax purposes, and the Draft Legislative Rule's definition of "natural gas liquids" under § 3.28 mirrors the definition now included under W. Va. Code § 11-1C-10(d)(3)(A). Since natural gas and natural gas liquids are separate commodities, the definition of "natural gas" under § 3.27 should read: "'Natural gas' means natural gas, coalbed methane, synthetic gas usable for fuel, or mixtures of natural gas and synthetic gas. Provided, that for purposes of the valuation of natural gas producing property under this rule, references to 'natural gas' shall include natural gas liquids and liquefied natural gas."

- **Actual annual operating costs; Arm's-length contracts**
  - Actual annual operating costs generally - W. Va. Code § 11-1C-10(d)(3) establishes that the fair market value for wells producing oil, natural gas, natural gas liquids, or any combination thereof, is based in application of a yield capitalization model to net proceeds, with net proceeds based on actual gross receipts, less royalties, and less actual annual operating costs. "Actual annual operating costs" are defined under both W. Va. Code § 11-1C-10(d)(3) and § 3.2 of the Draft Legislative Rule, with § 3.2 further stating that such costs "are limited to the actual costs incurred by the producer prior to the arm-length sale of the well output to a buyer[.]"
  - Reasonable actual annual operating costs – the Draft Legislative Rule consistently specifies that a producer can deduct "reasonable," actual annual operating costs, with no standards set forth to provide guidance on what is considered a "reasonable" operating cost. The Draft Legislative Rule should include guidance regarding the methodology used by the Tax Department in determining whether an actual operating cost is "reasonable."
  - Arm's-length contracts generally – the Draft Legislative Rule includes extensive provisions relating to arm's-length sales and contracts, agreements, or transactions between affiliated entities, including marketing affiliates.
  - Arm's-length contract burden – the Draft Legislative Rule places the burden on the producer to demonstrate that a contract is arm's-length for purposes of both the reporting of gross proceeds and the claiming of actual annual operating costs. *See* §§ 6.2 and 7.1.2. Little to no guidance is provided regarding how a producer can satisfy this burden aside from showing that the gross proceeds or actual operating costs are "reasonable compared to industry averages." The

Draft Legislative Rule should include guidance regarding how the Tax Department determines the "industry average" for purposes of allowing a producer to demonstrate that reported gross receipts and actual operating costs are "reasonable."

- **Miscellaneous**
  - Capitalization rate – for property tax years 2012-21, the capitalization rate has been approximately 15%, which is consistent with capitalization rates used in other states for valuing producing wells. The Draft Legislative Rule removes the property tax component, which will result in a decrease in the capitalization rate. The property tax component should be included in the Draft Legislative Rule and in the annual valuation variables released by the Tax Department. Additionally, § 5.4.2.b.2 contemplates the use of an income tax rate to modify the debt portion of the capitalization rate, based on surveys of published effective tax rates applicable to the industry. It is unclear what surveys are being relied upon for this purpose.
  - Sum of the Years Digit – the definition of this term under former § 3.27 has been deleted. This methodology uses a three-year weighted average for various calculations of the old version of the Legislative Rule, particularly for various components of the capitalization rate. Presumably, the "Build-up-Model" of the Weighted Average Cost of Capital (WACC) is intended to replace the sum of the years digits methodology, and that term should be defined and should include a description of how the WACC is calculated. The Tax Department's draft valuation variables document for tax year 2022 includes data for 2018-20, so it appears that a weighted average is being used; however, the concept is not well defined in the Draft Legislative Rule.
  - Transportation cost allocation- § 7.2.1 provides for the allocation of transportation costs between different products in their gaseous phase, clarification is needed regarding the methodology for all producers to provide a "cost allocation procedure" to the Tax Commissioner, as contemplated under § 7.2.4.
  - "Gas plant products" is defined under § 3.20 and "plant gas products" is defined under § 3.36. The definition of "plant gas products" should be deleted and the term "gas plant products" should be used throughout the Draft Legislative Rule.
  - Complete return - § 8 of the Draft Legislative Rule provides for alternative "default methods of valuation" when a producer does not file a "complete" return. This section should be amended to provide additional information and guidance regarding whether a filed annual property tax return is "complete." As drafted, this section provides exceedingly broad authority for the Tax Commissioner to deem a filed return "incomplete" and value a well based on the alternative valuation provisions under the section.

Antero appreciates the time and effort the Tax Department has put into the Draft Legislative Rule, and appreciates the Tax Department's consideration of the points raised by Antero in this

letter in order to ensure that the State of West Virginia has a valuation methodology that will value all producing wells based on their true and actual value.

Please feel free to contact me, or Kate Godowski, Tax Director for Antero Resources Corporation (303) 357-7310, kgodowski@anteroresources.com, if you have any immediate questions.

Very truly yours,

J. Kevin Ellis

Regional Vice President

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7/6/2021 12:58 pm

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July 7, 2021

Mark Morton
West Virginia State Tax Department
P.O. Box 1005
Charleston, West Virginia 25324-1005

VIA ELECTRONIC MAIL

(taxlegal@wv.gov)

Re: CNX Gas LLC Comments on Proposed Legislative Rule 110 WVCSR Series 1J

Dear Mr. Morton:

CNX Gas LLC ("CNX") has had the opportunity to review the proposed legislative rule regarding Series 1J (the "Rule"). CNX appreciates the West Virginia Tax Department's ("the Department") efforts to provide such detailed guidance to the industry. However, the timing of the passage of House Bill 2581 has made it difficult for individual producers to provide considerations to the Department prior to the filing of the Rule. CNX has some concerns it would like to make the Department aware of as we move forward.

West Virginia House Bill 2581 made many changes to the information requests and valuation considerations for oil and natural gas producing property. The Rule provided by the Department has requested producers provide actual revenues and expenses as part of their annual filing. The request of producers to provide actual well revenues has been long standing; however, House Bill 2581 expanded the definition of well revenues to be inclusive of post-processed plant gas revenues, such as natural gas liquids. The other major change reflected in House Bill 2581 was the inclusion of actual expenses and a shift away from industry average expenses. The net proceeds of a well (i.e., actual revenues minus actual expenses) are then valued through a yield capitalization model.

These changes are part of a long-standing effort by both the industry and the Legislative body to more accurately value oil and natural gas wells in a way that agrees the true and actual value of the property as prescribed in West Virginia Code Section 11-6K-1. The passing of House Bill 2581 was the Legislature's most recent attempt to provide clarity and minimize any outstanding debate over the valuation of these assets.

It seems evident to CNX that the Department anticipates a need to circumvent the actual data provided by producers and instead apply their own perceived reasonableness standard. This overriding tone is visible throughout the Rule and provides uneasiness to CNX. House Bill 2581 plainly states that a producer is to provide "actual" revenues and "actual" expenses to the Department annually. For the Tax Department to then review those revenues and expenses with a critical eye on their own perceived reasonableness, seems contrary to the intent of the Legislature.

Multiple times throughout the Rule, the Tax Department uses the word "reasonable" when describing actual revenues and expense allocations. The apparent intent is to allow the Department flexibility in accepting actual values. A quick search of the word "reasonable" in the Rule has 21 instances, "reasonable efforts," "reasonable compared to industry averages," "reasonable, actual costs," "determined to be unreasonable by the Tax Commissioner," etc. CNX believes that the Tax Department would be ill-equipped to make determinations of what is "reasonable" based on the data being provided.

Producers across the region operate very differently, and CNX would discourage the Department from making such comparisons in a vacuum. The main reversal of House Bill 2581 was to remove the previous cost survey which averaged producer costs and to enable producers to provide actual values in its stead. For the Department to then take those actual values and adjust them to reflect an artificial industry average seems to be contrary to the intent of the Legislature. It would be the position of CNX that any concern the Tax Department has about the values being provided should result in an audit of that taxpayer's return. The possibility (whether likely or unlikely) that the Tax Department could unilaterally change a taxpayer's revenue or expense amounts without notice or conference with the taxpayer is understandably concerning to CNX.

CNX is also concerned with the valuation methodology changes that are being presented by the Department. The Rule points out multiple changes to the State's valuation models: the substantial lowering of the capitalization rate, the elimination of the 3-year weighting, removal of the July 1st cutoff, etc. Taken on their own, all of these changes would increase the value of a producing property. The Department has not yet made available valuation models which reflect the Rule changes. Without these models, CNX is at a disadvantage and unable to determine the fiscal stability of their operations within the state.

CNX is a member of the GOWV industry group and as such, we are aware and fully support the concerns that have been articulated in their correspondence regarding the Proposed Legislative Rule 110 WVCSR Series 1J. We encourage and value the Department's efforts to provide clarity to the industry and are optimistic that our concerns detailed above will be given thoughtful consideration.

Respectfully,

Douglas Papa

Douglas Papa
Vice President - Tax

DC Malcolm Inc

July 2, 2021

Mark S. Morton
West Virginia State Tax Department
P. O. Box 1005
Charleston, WV 25324-1002

Via Electronic Mail to taxlegal@wv.gov and by U.S. Mail

Re: Comments on 110 WVCSR Series 1J Emergency Rule

Dear Mr. Morton,

I am writing on behalf D. C. Malcolm, Inc. to comment on the draft West Virginia Oil and Gas Producer/Operator Form (STC 12:35 rev. 06/2021) as issued under the new emergency rule regarding Series 1J. I appreciate the opportunity to comment on this form and also appreciate the Tax Department's efforts to issue the new emergency rule.

D. C. Malcolm, Inc. is a small operator of conventional natural gas wells which are situated in southern West Virginia. We operate approximately 180 wells, employ 5 people, and have operated in West Virginia since 1968.

I understand that this draft is not yet finalized but would like to take this opportunity to point out several concerns I have with its current form.

First, the information required in Schedule 1 includes the "Serial Number of Meter That is the First Point of Sale." In our business, "serial number" can have many different meanings and I believe a clarification of this requirement is needed. Is the Tax Department looking for an internal, manufacturer's serial number of the meter or the gas purchaser's meter identification number? The gas purchaser's ID number is readily available. Any other serial number is not easily ascertained. Also, what is the purpose of providing this "serial number"?

Second, also in Schedule 1, is the requirement for Meter Location, including City, State, and ZIP. Nearly all of our sales meters are situated in very remote locations and are nowhere near a paved road, much less, a city. Exactly what information does the Tax Department require in this case? Also, what is the purpose of providing this information?

Third, page 2 of the draft return requires the Social Security Number (SSN) of each of the Owners of the well being reported. While we have this information and have no problem disclosing it to the Tax Department, we have serious concerns about including SSNs on hard

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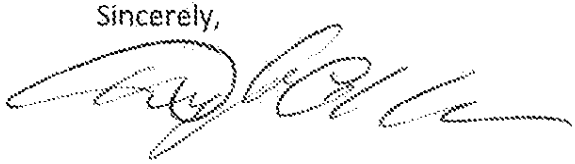
copies of the returns that are mailed to all the counties in which the wells are located. We believe that the security of this information is severely compromised when distributed in this manner.

Finally, while I realize that the Tax Department is struggling to meet the requirements and timelines imposed by House Bill 2581, I would like to remind you of the burdens this new form and compressed timeline imposes on the producing community—especially small producers. This new reporting form will require significant software changes at great expense to our company and also imposes time constraints that will be difficult, if not impossible, to meet. I would implore you to issue a 45-day extension to the filing deadline so that we can attempt to comply.

Again, thank you for the opportunity to comment. If I may answer any questions, please feel free to call me at 304-343-9593 or email me at doug@mountain.net.

Sincerely,



Douglas C. Malcolm
President

GAS & OIL ASSOCIATION
OF WEST VIRGINIA

July 6, 2021

Mark Morton
West Virginia State Tax Department
P.O. Box 1005
Charleston, West Virginia 25324-1005

VIA ELECTRONIC MAIL AND U.S. MAIL

(taxlegal@wv.gov)

Re: GOWV Comments on Proposed Legislative Rule 110 WVCSR Series 13

Dear Mark:

The Gas and Oil Association of WV, Inc. ("GOWV") truly appreciates the Tax Department's efforts to issue the proposed amendment to legislative rule regarding Series 13 (the "Rule"). We understand the compressed schedule dictated by House Bill 2581 resulted in the inability of the Tax Department to work with industry prior to the filing of the Rule. As a result, GOWV's tax committee, several GOWV's members and its Board of Directors reviewed the Rule, and, on their behalf, we submit the following general comments, followed by more specific comments for your consideration.

General Comments

Quite frankly, the deadlines imposed by House Bill 2581 ("2581") have made it impossible for the Tax Department and the industry to work together to develop regulations and tax forms that comply with 2581 and capture the information necessary for proper compliance by the industry. The industry understands the time pressures imposed upon the Tax Department. Likewise, the compressed timetable has also affected the industry's ability to review and comment on the Rule. Without the updated models or the proposed producer/operator forms that will be published by the Tax Department, our industry cannot reasonably ascertain the tax impact of the Rule and provide focused comments. Therefore, we must offer the broad comments that address many issues that may be resolved once the updated models and proposed forms are published by the Tax Department. It would be much more efficient for the Tax Department to provide a 30-45-day extension for the filing of comments to the Rule in order to allow industry to review the updated models and the proposed new producer/operator forms once they are available for review. Therefore, our first comment is that the Tax Department should provide a 30-45-day extension to the time period for receiving comments to the Rule, despite the dictates of the clear language of 2581 to the contrary.

As you know, Property Tax valuation has been the topic of much debate in our industry over the last several years. Article X, Section 1 of The West Virginia Constitution provides that "taxation shall be equal and uniform throughout the state, and all property, real and personal, shall be taxed in proportion to its value to be ascertained as directed by law." West Virginia Code Section 11-6K-1

states that "All industrial and natural resource property shall be assessed annually as of the assessment date at sixty percent of its true and actual value." West Virginia Code Section 11-3-1 defines true and actual value as "... a price for which the property would sell if voluntarily offered for sale by the owner thereof, upon the terms as the property, the value of which is sought to be ascertained, is usually sold, and not the price which might be realized if the property were sold at a forced sale." Gas and oil producers are required by law to have their wells taxed based on their true and actual value in the marketplace. Industry has not been afforded its legal rights in this regard for many years, as the State's valuation methodology has not been designed to reflect true and actual value. Our concern is that the Rule continues the historical failure of the State to value wells at their true and actual value as required by state law.

During the 2021 legislative session, the Legislature passed 2581, in an effort to create some clarity and resolve the debate over property tax valuation in the oil and gas industry. 2581 requires that the valuation of property producing oil, natural gas, natural gas liquids, or any combination thereof be based upon the fair market value calculated by applying a yield capitalization model to the net proceeds. Net proceeds is the actual gross proceeds determined from the actual price reported on the taxpayer's return, less royalties, and less actual annual operating costs as reported on the taxpayer's return. 2581 is simple and specific in its application and is based on the actual revenue and expenses reported by a taxpayer on its annual property tax return.

The overall tone of the Rule seems to contradict the plain language of 2581 and place the property tax valuation, not on the taxpayer's actual income and actual expenses as reported on its tax returns, but at the sole discretion of the Tax Commissioner. As a result, the Rule exceeds its statutory authority and, as drafted, would be unenforceable as the Supreme Court of Appeals has held that:

> Any rules or regulations drafted by an agency must faithfully reflect the intention of the Legislature, as expressed in the controlling legislation. Where a statute contains clear and unambiguous language, an agency's rules or regulations must give that language the same clear and unambiguous force and effect that the language commands in the statute.
>
> It is fundamental law that the Legislature may delegate to an administrative agency the power to make rules and regulations to implement the statute under which the agency functions. In exercising that power, however, an administrative agency may not issue a regulation which is inconsistent with, or which alters or limits its statutory authority

Syl Pts. 3 and 4, CNG Transmission v. Craig, Tax Commissioner, 211 W.Va. 170, 564 S.E.2d 167 (2002). Throughout the Rule there are references to the word "reasonable" rather than simply the actual data reported by the taxpayer on its tax return. For example, in Section 6.2 of the Rule it states that "The lessee has the burden of demonstrating that its contract is arm's length and the amount received is reasonable compared to industry average..." and Section 6.3 states that "If the gross proceeds claimed by the producer are not received pursuant to an arm's length contract or *are otherwise determined to be unreasonable* (emphasis added) by the Tax Commissioner, then the Tax

Commissioner shall adjust the amount of gross proceeds in accordance with the following methods:..." These sections give the Tax Commissioner the discretion to deem a producer's actual proceeds unreasonable and modify the amount of gross proceeds received by the producer and reported on its property tax returns. Further, the Tax Commissioner has the unilateral discretion to create "industry averages" for the producers, without the benefit of an industry survey that was required under the old law. This discretion granted to the Tax Commissioner in the Rule is contradictory to the powers granted in 2581.

Virtually every producer operates differently in this industry and there is no simple way to compare producers and create an artificial "industry average". One of the reasons that the industry requested that this law be changed was because the way the Tax Department calculated industry averages under the survey required in the old law could not be substantiated mathematically. 2581 is very clear on its face: value is determined from the actual price reported on the taxpayer's return, less royalties, and less actual annual operating costs as reported on the taxpayer's return. If the Tax Department has an issue with what is reported by a taxpayer, then it can audit the property tax returns. The way the Rule is written, the Tax Commissioner can unilaterally change what was reported by a taxpayer, without having to audit the taxpayer's return. This industry is complicated and diverse and that is why actual numbers taken from the tax returns was set forth in 2581. The Rule fails to recognize the differences and complexities common in the industry and appears to be taking a "one size fits all" approach to property tax valuation. This simply is not representative of the industry, nor will it calculate the true and actual valuation of property producing oil, natural gas, natural gas liquids, or any combination thereof for each taxpayer.

We are also concerned about the Annual Property Tax Returns as set forth in Section 9 when coupled with the Default method of Valuation set forth in Section 8 of the Rule. Section 9 contemplates significant changes to the reporting required with the annual property tax returns, and as the date of this letter the property tax returns, which historically are due August 1st, have not been formally published to the industry. Industry is concerned that the property tax returns may require information that is not readily ascertainable and that it may require new software or significant changes to existing software, and that there is simply not enough time to file the property tax returns in a timely fashion. In addition, Section 8 states that "When a producer does not file a *complete* (emphasis added) return for a well on or before the August 1st due date of the return, ..., the Tax Commissioner shall use the average industry price of the producing area...to estimate the value of the well." Taken literally, the Tax Department may not publish the new forms in time for producers to properly respond to the new information required and then the Tax Department can deem the return as "not complete" and unilaterally estimate a valuation for each well based on what the Tax Department deems "industry average".

There is also concern that the Tax Department is attempting to manipulate the value of a well by decreasing the cap rate that is used in the Discounted Cash Flow calculation, based upon the introductory language from the fiscal note attached to the Rule filing and set forth below:

This rule would offset the costs of fractionation to income from natural gas liquid production and would set a capitalization rate that is lower than the current rate. This would result in a minimal change in revenue. Administrative costs would be $25,000 for system changes in valuation models.

Historically the Tax Department has computed a capitalization rate over the past ten years that has averaged approximately 15%. The historical capitalization rate used in West Virginia is consistent with the capitalization rates used in Kentucky and Ohio to value producing oil and gas reserves. It is critical that West Virginia remain competitive with its surrounding states. The Tax Department published the tentative variables for the 2022 assessment year and estimates the capitalization rate to be 10.8%. This is over a 25% decrease from the 2021 assessment year. **Lower cap rates mean higher values!** Industry understands that the capitalization rate can fluctuate based on market changes and questions what specific market changes would cause the capitalization rate to drastically change from the historical 15% average. This is yet another item that appears to give too much discretion to the Tax Department when valuing a well.

The proposed Rule contains significant provisions disallowing the use of affiliate contractual arrangements for determining allowable revenues and expenses. Given industry regulation and current practices, our experience is that affiliate contracts should reflect market pricing at arm's length. As a result, we believe that affiliate contracts should be considered as a starting point with regard to the determination of gross proceeds when it can be supported that these contracts represent arm's length market pricing. Industry agrees that in the situations where a market gross price is reduced for incremental actual expenses (a common practice in the industry regardless of whether a marketing company is affiliated), a company should not report the expense adjustment separately on the property tax return if the expense is already reflected in the gross price received.

The intent of 2581 was to include all of the actual costs the industry must incur to achieve a sale. There are significant changes in the Rule that suggest the State's valuation models will change. As noted above the capitalization rate was one of the proposed changes. In addition, it appears the manner in which the gross revenues will be weighted and declined to the July 1st assessment period is changing. Historically the Tax Department weighted the prior 3 calendar years and declined the revenue to the 7/1 assessment date. The proposed Rule eliminates the 3-year weighting and removes the decline to the July 1st cutoff. Removal of the July 1st cutoff will increase values and not be reflective of the value as of the July 1st lien date. The industry requests the Tax Department publish the valuation models they intend to leverage outlined in subsection 10 of the Rule for the upcoming 2022 tax year. Without valuation models demonstrating the proposed changes, the industry will not be able to ascertain the actual impact to their property taxes.

The industry feels that the Rule changes are complex, affording too much discretion to the Tax Commissioner and in many places subject to misinterpretation which could lead to more property tax disputes. Specific questions and concerns raised to date by industry participants are enumerated below. The industry continues to read and assess the changes as they are significant and therefore may have additional comments accordingly.

Specific Comments and Questions

Section 1.1: The characterization of the valuation method as "mass appraisal" is an indication that the Rule strays from 2581's mandate that each well be valued based on its own actual income and expenses.

Section 3.2: These costs should not be limited prior to an arm's-length sale defined in section 3.4 if the affiliate transactions reflect market pricing at arm's length.

Sections 3.3 and 3.35: Appraised value includes real and personal property. Real property is not defined. Personal property appears to have changed from the industry standard of including personal property to the first point of sale. As it has been conveyed with the Tax Department's diagrams, historically the Tax Department advised companies that related party affiliate gathering assets were included in the affiliated working interest assessments when the gross proceeds were reported at a point of sale occurring subsequent to the affiliate gathering system. This shift in policy may increase companies' property tax burden.

Section 3.4: Arm's length should include affiliate transactions if the affiliate transactions reflect market pricing at arm's length.

Section 3.17: Sometimes a Farm-Use well is sold with the farm so that the user of the well is not the owner of the gas in place. Ownership should not be required for the classification of a well as a farm use well.

Section 3.19: Production beginning after December 31st and prior to the July 1st assessment date must be reported. The producer/operator property tax returns are due August 1st. Producers will not be able to provide actual production for July and possible prior months at the time of the August 1st deadline.

Section 3.21: Means the total income received for the production on any well, without reduction for any royalties, costs, allowances, expenses, or adjustments of any kind, determined at the point of a metered or measured first sale to an unrelated third party.... also includes, but is not limited to, payments and accruals to the operator for certain services such as metering, dehydration, liquids separation, measurement, and gathering, or any combination thereof. Monies and other consideration, to which an operator is contractually or legally entitled, but which the operator does not seek to collect through reasonable efforts, are also part of "gross receipts" or "gross proceeds."

Companies' points of sale vary based on underlying market rate contracts, and as such there could be various cost allowances contemplated in a gross payment to companies. The Tax Department should not be permitted to disallow any expense reductions in companies' gross proceeds. Companies should not be allowed to claim costs allowances in their gross proceeds twice, but the market-based reductions in gross proceeds should be permitted.

The language of the Rule appears to impermissibly allow the State to deviate from actual gross proceeds received by the producer. Accruals are not actual gross proceeds. The industry has a delay in accounting for production generated. Sophisticated accounting systems exist that distribute the actual revenues and expenses to individual wells and owners on wells. Industry does not have the means to account for accruals that may not be reflective of actual production at a well and/or owner level.

Further, services for metering, dehydration, liquids separation, measurement, and gathering are not reflective of the gross proceeds derived from the well production. These gross revenues are relevant to the specific assets to which they relate (liquids separation, gathering, etc).

Section 3.23: Sometimes a Home-Use well is sold with the home so that the user of the well is not the owner of the gas in place. Ownership should not be required for the classification of a well as a home use well.

Sections 4.2.2 and 4.3.2: Wells that produce less than average 1 BBL/day or 8 MCF/day are valued based on an annual percentage determined by the Tax Commissioner. What is the basis of the safe harbor average daily production? Industry request these thresholds align with severance tax at ½ BBL/day and 5 MCF/day. On what basis is the annual percentage to derive a safe harbor value derived?

Section 4.3: In order to make Section 4.3 consistent with Section 3.35 personal property should be Personal property at the well site or "on the lease or communitized area."

Section 4.3.3: What is the point of sale before or after processing looking to accomplish? If companies have NGLs and they sell prior to processing the NGLs are valued based on residue gas while if the point of sale is after processing, they are valued based on NGL proceeds. This could create uniformity discrepancies.

Section 4.4.2: States the commissioner will annually determine the working and royalty percentage interests on a per well basis. Operators have different royalty arrangements which may result in some operators having average royalty interest percentages that are higher than industry averages

Section 5.1: Weighting of the prior 3-year revenues and declining the calendar year revenues forward to the July 1st lien were removed. This would be a shift in administration that has nothing to do with HB 2581 which was intended to allow all actual revenues and expenses for oil and gas production. Removal of the July 1st cutoff will increase values and not be reflective of the value as of the July 1st lien date. The industry requests the Tax Department publish the valuation models they intend to leverage with the proposed Rule for the upcoming 2022 tax year. Without valuation models demonstrating the proposed changes, the Industry will not be able to ascertain the actual impact to their property taxes.

Section 5.2: States the minimum working interest no less than machinery and equipment value which is not clearly defined

Sections 5.4.2.a.4: A size premium adjustment to the capitalization rate is new and highly subjective affording entirely too much discretion to the Tax Department as to what an appropriate cap rate may be.

Section 6.1.3: Affiliate gross proceeds should be permissible when a company can demonstrate that the related party contract terms are predicated on arm's length pricing contracts and computations.

Section 6.2: This Rule puts a burden on the lessee to demonstrate that its contract "is reasonable compared to industry averages." The lessee negotiates its own deal and has no way of knowing what the industry average is. Each lessee negotiates its best deal based upon its specific facts and circumstances and it should not be held to a fictitious comparison to a fictious industry average.

Section 6.3: If the gross proceeds ...are otherwise determined to be unreasonable by the Tax Commissioner, then the Tax Commissioner shall adjust the amount of the gross proceeds in accordance with the following methods. There should not be discretion afforded to the Tax Commissioner as to what is reasonable when actual revenues and expenses are based on market rate contracts. Further the alternative methods outlined suggest leveraging comparable contracts. The oil and gas industry market is complex and sophisticated and it is not evident how the Tax Department will determine comparable amounts and adjustments. Actual gross proceeds received by the producer is the standard intended by the statute and should be reflected in the Rule.

Sections 7.1 and 7.1.2: 7.1 references "reasonable, actual annual operating costs" and 7.1.2 suggests that any related party transportation, processing, or fractionation costs will be disallowed if deemed unreasonable. As discussed above there is no one-size fits all approach for these costs and so long as they are based on contracts with market rates, they should be permissible. The industry feels that related party cost allowances should be permissible when a company can demonstrate that the related party contract terms are predicated on arm's length pricing contracts and computations. Further, the Tax Commissioner is not in a position to determine an industry average without knowing and then applying the specific circumstances surrounding a specific taxpayer's situation.

Sections 7.2, 7.2.1, 7.2.2 and 7.2.4: Allocation of Operating Cost among product types: The Tax Department is creating methods of cost allocation that may not be how the industry practically handles the allocations of costs. Why does the Tax Department have discretion on how to allocate costs when they aren't operating the assets? Sophisticated accounting systems exist that distribute the actual revenues and expenses to individual wells and owners on wells. The industry requests further guidance on the administration of the cost allocation procedure as it is not evident.

Section 7.2.3: No processing expense allowance for residue gas is wrong. Companies first incur processing costs for both residue gas and NGLs prior to any incremental transportation costs at

the outlet of the processing facility. Companies should be afforded a deduction for processing to derive the pure, marketable, and saleable residue gas, while the proposed Rule indicates the processing cost allowance is for NGLs gross proceeds only.

Sections 7.3.2.b, 7.3.3 et.al, 7.3.4.b and 7.4 et al: Costs are limited to certain types. There should not be limitations when companies are transacting business on an arm's length basis with underlying contracts. Additionally, depreciation of equipment purchased or acquired is an appropriate lease operating expense and should be allowed.

Section 8.1: If a producer does not file a complete return then the Tax Department will use average pricing. What is considered incomplete? What will the average pricing be based? What about the allowable expenses?

Section 9.1.1.h: States must report the location and serial number of the meter that is the first point of sale. Which serial number: an internal identifying number for the meter, the gas purchaser's identifying number for the meter, or the manufacturer's serial number on the meter? What is the intent of this requirement? Further this information may not be readily available.

Section 9.1.2: What is the statute of limitations on the proposed review/audit?

Section 9.1.3. The producer must also produce any records or documents that the Commissioner may require proving or verifying the gross proceeds or actual annual operating costs claimed. Companies should have the underlying contracts and invoices to support gross proceeds and costs, however there are sophisticated accounting systems that exist to distribute the actual revenues and expenses to individual wells and owners on wells. The request for support could be involved and voluminous and require additional administrative effort for companies. The Commissioner should not have the discretion to reject a property tax return if supporting details are not provided within a requested timeline as it could require weeks of effort for companies to compile supporting schedules and records.

Section 9.2: Stipulates an electronic property tax return must be filed for 25 or more wells. Industry supports electronic filing to eliminate paper waste, but the electronic filing requirements must be attainable for all companies. In the past the Tax Department's electronic filing requirements were regimented and required additional administrative burdens for companies to comply and therefore a limited number of companies were capable of e-filing. Companies need several months of lead time to prepare for the e-filing change and requirements.

We appreciate the opportunity to review and provide comments on the proposed Rule. As well as the opportunity to work together with the Tax Department to create a property tax system that encourages additional oil and gas development and investment our State. We know that the oil and natural gas industry is one dimension of hope for West Virginia at an extraordinary time when hope is at a premium.

Very truly yours,

Marc A. Monteleone
Co-Chair, GOWV Tax Committee

Very truly yours,

Elizabeth Burg
Co-Chair, GOWV Tax Committee

WV Tax Legal Division

From: Blashford, David <DBlashford@greylockenergy.com>
Sent: Tuesday, July 6, 2021 4:13 PM
To: WV Tax Legal Division
Subject: [External] RE: Comments On Emergency Rule, Title 110-01J, Draft STC 12:35 Producer Operator Return, 2022 Variables UPDATED

CAUTION: External email. Do not click links or open attachments unless you verify sender.

Please be advised my comments are directed towards the "regular proposed rule" and NOT the "Emergency Rule"

David A. Blashford, Tax Manager
Greylock Energy, LLC
500 Corporate Landing
Charleston, WV 25311
Phone: 304-925-6100, Ext. 1323
Fax: 304-925-8264

From: Blashford, David
Sent: Tuesday, July 6, 2021 3:53 PM
To: taxlegal@wv.gov
Subject: Comments On Emergency Rule, Title 110-01J, Draft STC 12:35 Producer Operator Return, 2022 Variables

To Whom It May Concern:

I would like to comment on the Emergency Rule for WV Personal Property Taxes for Oil and Gas well valuation, the proposed producer operator return, and the proposed oil and gas variables for the 2022 tax year.

Emergency Rule:

1) **Definitions, Section 3.21, Page 4:** The State has in this definition "at the point of a metered or measured first sale to an unrelated 3rd party". If we have legally binding sales contracts between our production and marketing companies is this acceptable? Also in this section the State defines gross receipts as including "accruals" which leads one to believe we might be taxed on general ledger accruals made for financial statement GAAP purposes. Accruals are estimated required for financial statement purposes only and are simply sales estimates. They should not be included in a definition of gross receipts. Also included in this section is the "monies and consideration" which the operator does not seek to collect through reasonable efforts is also concerning. Are we going to be taxed on amounts we haven't actually received or attempted to collect?

2) **Section 4.2.2 and 4.3.1, Page 8:** How did you determine the production amounts for the safe harbor provisions? One might refer to the production amounts as defined by the National Stripper Well Association and EIA which is much higher. What is the precise formula for the assessment percentage for these wells.

3) **Section 4.4.2, Page 9:** States the commissioner will annually determine the working and royalty percentage interests on a per well basis. I'm not sure why this section is here and what it will be used for. All operators have different royalty arrangements which may result in some operators having average royalty interest percentages that are higher than industry averages.

4) **Section 5.1, Page 14:** Why are you removing the decline adjustment to July 1st?. The intention of this section was to take our prior 12 month calendar year sales and decline them to arrive at a correct July 1st value. The State is using the prior *12 months calendar year sales and production* as a basis for valuation as of the July 1st assessment date. By removing this decline adjustment you are overstating their valuation (and our values) with an extra six months of value.

5) **Section 7.2, Page 18:** Allocation of Operating Cost among product types: How are we going to allocate common operating wells costs between product types? If we perform normal well-tending work on a well that produces both oil and gas we don't separate those costs. If we allocate all of those costs to one product type, will that not cause a higher discounted cash flow and appraised value for the product that doesn't get allocated those costs? Will you allow us to develop our own rational allocation of costs in these circumstances or will you develop your own allocation?

6) **Section 9.1.1.h, Page 22:** States we must report the location and serial number of the meter that is the first point of sale. Are you wanting our internal identifying number for the meter?, the gas purchaser's identifying number for the meter?, or the manufacturer's serial number on the meter? Not sure what the intent of this section is.

Reporting Form and Electronic Filing:

1) **Electronic Filing Template & Tax Form:**
   a. In Schedule 1 you are requiring land book acreage and lease acreage. The electronic filing template does not include columns for that. In addition I suspect most producers do not have exact acreage records for each well. At a minimum this could be a reporting issue.
   b. In Schedule 1 you are requiring a meter mailing address including city and state and zip. If the meter is located in a rural unincorporated area are producers to use the closest city with a zip code? I'd submit most producers will not have this information readily available and I'm not sure why the State will require this. Also I don't believe the electronic filing template has a column for that.
   c. In Schedule 2 you are requesting operating expenses by resource. As discussed above how are we going to allocate common operating wells costs between product types? If we perform normal well-tending work on a well that produces both oil and gas we don't separate those costs. If we allocate all of those costs to one product type, will that not cause a higher discounted cash flow and appraised value for the product that doesn't get allocated those costs? Will you allow us to develop our own rational allocation of costs in these circumstances or will you develop your own allocation? In addition the electronic filing template does not have columns for operating expenses.
   d. I am assuming an updated electronic filing template will be provided shortly?

Tentative Natural Resource Variables:

1) **Capitalization Rate:**
   a. Why have you switched to a 90 day treasury bill for the safe rate and the other components of the cap rate? Not sure why the switch from a 3 month constant maturity interest rate was made. Can this be explained?
   b. Why was the personal property tax component of the cap rate removed? Is this not an important component for producer business decisions and the proper calculation of a discounted cash flow?
   c. Why are you using a three year production average when the three year production average has been removed from the your rule? It seems there is a mismatch between what sales are being used in the yield capitalization model and the cap rate. This will result in a capitalization rate that does not reflect the true cash flow of our wells and will result in unusually large increases in values.
   d. The capitalization multipliers only go out 15 years. Are you assuming a well's useful life is only 15 years?

e. The current proposed capitalization rate goes from around 15% to around 10% which will result in a substantial increase in values and taxes which is not consistent with prior years and does not reflect the true discounted cash flows of our wells.

2) **Operating Expenses:**
   a. Are we allowed to use the average operating expenses for our reporting? This conflicts with the emergency rule which allows for actual operating expenses.

Should you have questions or require further information or clarification, please feel free to contact me directly.

Thank you for your consideration,

Dave Blashford

David A. Blashford, Tax Manager
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Fax: 304-925-8264

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July 6, 2021

VIA EMAIL [mark.s.morton@wv.gov]
AND [taxlegal@wv.gov]
and REGULAR U.S. MAIL

Mark S. Morton, Esquire
General Counsel
West Virginia State Tax Department
1001 Lee Street, East
Charleston, West Virginia 25301

RE: Comments of the County Commissions of Doddridge County and Harrison County, West Virginia, on the West Virginia State Tax Commissioner's PROPOSED Legislative Rule Entitled "Valuation Of Producing And Reserve Oil, Natural Gas Liquids, And Natural Gas For Ad Valorem Property Tax Purposes" And Designated "Title 110/Series 01J"

Dear Mr. Morton:

On behalf of the County Commission of Doddridge County, West Virginia ("Doddridge County Commission"), and the County Commission of Harrison County, West Virginia ("Harrison County Commission") (the Doddridge County Commission and the Harrison County Commission are collectively referred to as "County Commissions"), I am hereby submitting comments on the West Virginia State Tax Commissioner's ("Tax Commissioner") proposed Legislative Rule entitled "Valuation Of Producing And Reserve Oil, Natural Gas Liquids, And Natural Gas For Ad Valorem Property Tax Purposes" and designated "Title 110/Series 01J," as filed with the Secretary of State of the State of West Virginia ("WVSOS") on June 4, 2021 ("PROPOSED Legislative Rule"). I have one overarching comment and a few specific comments on the Tax Commissioner's PROPOSED Legislative Rule.

The overarching comment on the PROPOSED Legislative Rule is that, unfortunately, it would appear as if the West Virginia State Tax Department ("Tax Department") cannot state what the impact of the PROPOSED Legislative Rule will be with regard to the tax revenues to be received by the County Commissions from oil and/or gas producers for ad valorem taxes. As I stated in my May 14, 2021 correspondence to you (a copy of which is attached hereto/enclosed herewith, made a part hereof, and incorporated herein), the County Commissions are very concerned about the potential decrease in ad valorem tax revenues to the County Commissions as a result of H.B.2581. Although said correspondence was written

in connection with the anticipated Emergency Rule to be promulgated by the Tax Commissioner pursuant to H.B. 2581, it was also intended to deal with the PROPOSED Legislative Rule presumably to be promulgated by the Tax Commissioner. In said correspondence, I specifically suggested, on behalf of the County Commissions, that the Tax Commissioner endeavor to minimize the potential adverse impact on the tax revenues to be received by the County Commissions, when he promulgated the Emergency Rule, as well as the PROPOSED Legislative Rule.

After the PROPOSED Legislative Rule was filed with the WVSOS on June 4, 2021 and the Emergency Rule was filed with the WVSOS on June 8, 2021, I sent certain correspondence to you, dated June 23, 2021, specifically asking about certain statements in the Emergency Rule and certain statements in the PROPOSED Legislative Rule, to the effect that they "would result in a minimal change in [tax] revenue[s]." By correspondence, dated July 1, 2021, Steven Stockton ("Mr. Stockton") responded to my June 23, 2021 correspondence. A copy of Mr. Stockton's July 1, 2021 correspondence is attached hereto/enclosed herewith, made a part hereof and incorporated herein. In said correspondence, Mr. Stockton noted that the PROPOSED Legislative Rule was mandated by H.B. 2581, which, as we all know, was passed on the last day of the 2021 session of the West Virginia Legislature. In addition, in said correspondence, Mr. Stockton noted that "[t]he fiscal notes that were prepared before H.B. 2581 became an enrolled bill simply do not reflect the revenue impact of the bill that was signed into law." Moreover, Mr. Stockton, in said correspondence, effectively noted that it was H.B. 2581, not the PROPOSED Legislative Rule, which would most likely result in a decrease in the ad valorem tax revenues to be received by the County Commissions from oil and/or gas producers. Finally, Mr. Stockon noted that "[a]ny change in [tax] revenue [received by the County Commissions] attributable to the [PROPOSED] Legislative Rule itself is judged to be minimal, as stated in the fiscal note" to the PROPOSED Legislative Rule.

Although I certainly appreciate Mr. Stockton's response to the inquiry in my June 23, 2021 correspondence to you, said response does not really address the overarching concern raised in my May 14, 2021 and my June 23, 2021 correspondence to you. In other words, it does not address the specific amounts of the tax revenues presumably to be lost by the Doddridge County Commission and the Harrison County Commission as a result of the PROPOSED Legislative Rule, whether the same be the result of the PROPOSED Legislative Rule itself or the result of H.B. 2581, which is why the PROPOSED Legislative Rule was promulgated by the Tax Commissioner in the first place. Is the loss to the county commissions in oil and gas producing counties (including the Doddridge County Commission and the Harrison County Commission) going to be $58.6 or $9.1 or some other dollar figure?

I would certainly think that you, as well as Mr. Stockton and the Tax Commissioner, would agree that the same is more than a fair question. Accordingly, on behalf of the County Commissions, I respectfully request that the Tax Commissioner amend and/or modify his PROPOSED Legislative Rule to deal with the potential adverse tax revenues impact to the County Commissions.

Also, I want to note that, after I received his July 1, 2021 correspondence to me, I spoke with Mr. Stockton in an effort to determine if there was any way to determine what the actual lost tax revenues impact was going to be with regard to the combined effect of H.B. 2581 and the Tax Commissioner's PROPOSED Legislative Rule. Mr. Stockton kindly directed me to the Property Tax Division of the West Virginia State Tax Department ("Property Tax Division") and, more particularly, to Travis Payne ("Mr. Payne"), its Acting Director.

Thereafter, on July 1, 2021, I spoke with Mr. Payne, and he informed me that, to the best of his knowledge, the Property Tax Division could not state what the amounts of the lost ad valorem tax revenues would be to the Doddridge County Commission and the Harrison County Commission as a result of the combined effect of H.B. 2581 and the Tax Commissioner's PROPOSED Legislative Rule. I assume you, as well as Mr. Stockton, Mr. Payne and the Tax Commissioner, would all agree that, knowing what those amount would be, is a reasonable part of the promulgation of the Tax Commissioner's PROPOSED Legislative Rule.

As to the specific comments to the Tax Commissioner's PROPOSED Legislative Rule:

1. In Section 3.2 thereof, in the third line, it is suggested that the words "directly and solely" be inserted between the word "costs" and the word "incurred";

2. With regard to the definition of "[e]conomic interests" set forth in Section 3.16 thereof and the use of the term "economic interests" in Section 3.38 thereof, it is suggested that the same are too broad and potentially open the door for abuse by the oil and gas producers;

3. With regard to the definition of "[p]roducer" and "[o]perator" in Section 3.38 thereof, it is suggested that the apparent effective inclusion of what are commonly referred to as "overriding royalty interest owners" be deleted;

4. As to Section 3.46 thereof (the definition of "Total Production"), there is a reference to "all oil, natural gas liquids and natural gas actually produced and sold from a single well that is developed and producing on the assessment date." What happens if the oil, natural gas liquids or natural gas is **not** sold on the "assessment date"? In other words, what if the oil, natural gas liquids or natural gas are produced, but **not** sold, on the "assessment date"? What if the oil, natural gas liquids or natural gas are produced on the "assessment date," but are effectively in storage on the "assessment date"? Does that mean that such oil, natural gas liquids or natural gas is not to be factored in in determining the ad valorem tax? It is suggested that these questions be answered as the Tax Commissioner continues to promulgate his PROPOSED Legislative Rule;

5. Section 4.4 thereof raises the question of what happens if the "lease or other arrangement" is **not** "typical"? It is suggested that one or more additional examples, other than the example given in Section 4.4.1 thereof, be provided by the Tax Commissioner as he continues to promulgate his PROPOSED Legislative Rule;

6. As to the "single state-wide capitalization rate for oil, natural gas, and natural gas liquids" mentioned in Section 5.4 thereof, exactly when and exactly how will that rate be determined? It is suggested that said "when" and said "how" be addressed as the Tax Commissioner continues to promulgate his PROPOSED Legislative Rule;

7. Section 6.2.1 thereof contemplates a possible "review and audit by the Tax Commissioner" of certain "data" retained by the oil and/or natural gas producers. What exactly are the Tax Commissioner's plans for conducting such "review[s] and audit[s]"? For example, will such "review[s] and audit[s]" be conducted with regard to every oil and gas producer in the State of West Virginia or will they be randomly conducted or will they be based upon some criteria predetermined by the Tax Commissioner and/or the Tax Department? If it is the latter, what will that predetermined criteria be? Also, what happens if the oil and/or gas producer has not retained the "data"? It is suggested that all of these questions be answered as the Tax Commissioner continues to promulgate his PROPOSED Legislative Rule;

8. As to Section 7.2.4 thereof, what "additional information" does the Tax Commissioner and/or the Tax Department believe will be "necessary"? It is suggested that this question be answered as the Tax Commissioner continues to promulgate his PROPOSED Legislative Rule;

9. As to Section 7.3.2 thereof, it is suggested that attorney fees and expenses be specifically excluded from "lease operating expenses." In a like manner, in Section 7.4 thereof, attorney fees and expenses should specifically be included in "non-allowable costs";

10. With regard to Section 7.3.2 thereof and Section 7.4 thereof, it is suggested that Section 7.3.2 thereof make clear reference to Section 7.4 thereof, to clarify that the various "non-allowable costs" set forth in Section 7.4 thereof are not to be included in the "actual operating costs" referenced in Section 7.3 thereof. In a like manner, it is suggested that Section 7.4 thereof make clear reference to Section 7.3.2 thereof; and

11. Is it possible for the concept set forth in Section 8.1 thereof to be the entire PROPOSED Legislative Rule with regard to valuing oil and/or gas wells for ad valorem tax purposes? It is suggested that the Tax Commissioner consider such possibility as he continues to promulgate his PROPOSED Legislative Rule.

Since there may be certain additional potential issues and/or problems with the PROPOSED Legislative Rule not yet identified and since the Tax Commissioner may make changes to his PROPOSED Legislative Rule based upon the comments set forth above or otherwise, on behalf of the County Commissions, I reserve the right to make additional comments with regard to the Tax Commissioner's PROPOSED Legislative Rule.

If you have any questions whatsoever about the comments set forth above, please do not hesitate to call me at (304) 720-4217 or email me at trodgers@kaycasto.com.

Sincerely,

R. Terrance Rodgers

RTR/spw
Attachments/Enclosures

VIA ELECTRONIC MAIL
cc: Jonathan Nicol, Esquire (w/atts.)
VIA REGULAR U.S. MAIL
cc: Mr. Travis Payne (w/encls.)
Stephen B. Stockton, Esquire (w/encls.)

KAY CASTO & CHANEY PLLC
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May 14, 2021

VIA EMAIL [mark.s.morton@wv.gov]
and REGULAR U.S. MAIL

Mark S. Morton, Esquire
General Counsel
West Virginia State Tax Department
1001 Lee Street, East
Charleston, West Virginia 25301

RE: Comments/Suggestions With Regard To Anticipated "Emergency Rules" Which Must Be Promulgated By West Virginia State Tax Commissioner Pursuant to the Newly Enacted W.Va. Code § 11-1C-10(d)(3)

Dear Mr. Morton:

Pursuant to our telephone conversation of Friday, April 30, 2021, on behalf of my clients, the County Commission of Doddridge County, West Virginia ("Doddridge County Commission"), and the County Commission of Harrison County, West Virginia ("Harrison County Commission") (the Doddridge County Commission and the Harrison County Commission are collectively referred to as "County Commissions"), I am hereby submitting our comments and suggestions with regard to the anticipated "emergency rules" which the West Virginia State Tax Commissioner ("Tax Commissioner") is required to promulgate under the newly enacted W.Va. Code § 11-1C-10(d)(3).

First, the County Commissions are very concerned about the potential adverse impact of the "emergency rules" to be promulgated by the Tax Commissioner, from the standpoint of the anticipated significant decrease in tax revenues to the Commissions. Accordingly, the County Commissions suggest that the Tax Commissioner, when he promulgates those "emergency rules," endeavor to minimize such potential adverse impact to the County Commissions.

Second, the County Commissions are concerned about what is meant by "taxpayer's returns" in the newly enacted W.Va. Code § 11-1C-10(d)(3). They are concerned because there is no clear definition of what is meant by those words. Is it an income tax return or is it a West Virginia Oil and Gas Producer/Operator Return or is it some other return? Accordingly, the County Commissions suggest that the Tax Commissioner's "emergency rules" define exactly what is meant by those words.

Third, the County Commissions suggest that the "emergency rules" to be promulgated by the Tax Commissioner authorize the Tax Commissioner and/or his representatives to audit the "taxpayer's returns" to ensure, among other things, that the "actual price received by the taxpayers as reported on the taxpayer's returns," are indeed, the "actual price received by the taxpayers." In addition, the County Commissions suggest that such auditing function allow for the Tax Commissioner and/or his representatives to determine that what the taxpayers are reporting on their "taxpayer's returns" with regard to "actual annual operating costs," is truly accurate.

Fourth, the County Commissions believe that the Tax Commissioner, in his "emergency rules," needs to clarify the "actual gross receipts on a sales volume basis" language in W.Va. Code § 11-1C-10(d)(3). In particular, the County Commissions are concerned that, without such clarification, the taxpayers may seek to avoid having to include certain derivative transactions (swaps, hedges, collars, etc.), which those taxpayers are not paying tax on in West Virginia because they are effectuating such derivative transactions outside of West Virginia. The County Commissions believe that not including such derivative transactions in the effective formula for determining a taxpayer's property tax assessments would be unreasonable because it is oil and gas being produced in West Virginia that is effectively the backing or collateral for such derivative transactions.

Fifth, the County Commissions are concerned that, without adequate clarification by the Tax Commissioner in his "emergency rules," taxpayers would have the potential to avoid including what is truly the "actual gross receipts" in situations where it sells the oil or natural gas it produces to an affiliated entity. For example, a taxpayer could sell oil or natural gas to an affiliated entity at a certain price and that affiliated entity could then sell that oil or natural gas to an unaffiliated entity at a higher price which is truly arms-length and commercially reasonable. In that instance, the taxpayer should not be able to utilize the lower price which it sold the oil or natural gas to its affiliated entity. Otherwise, taxpayers could offload their oil or natural gas to affiliated entities at a certain price, then those affiliated entities could sell that oil or natural gas downstream at a higher, truly arms-length and commercially reasonable price, and that truly arms-length and commercially reasonable price would not be included as part of the formula for valuing the property producing the oil or natural gas. That certainly is not what the West Virginia Legislature intended, but without clarification by the Tax Commissioner in his "emergency rules," the same could certainly occur.

Sixth, the County Commissions believe the "emergency rules" to be promulgated by the Tax Commissioner must take into account what the taxpayers are already effectively deducting from their royalty payments to the owners/lessors for "lease operating expenses,"

"lifting costs," "gathering," "compression," "processing," "separation," "fractionation" and "transportation charges" (as set forth in W.Va. Code § 11-1C-10(d)(3)(B)). In other words, taxpayers should not be able to fully deduct such "actual annual operating costs" if they are already effectively recovering all or some of those "actual annual operating costs" from the owners/lessors. Without proper clarification by the Tax Commissioner in his "emergency rules," taxpayers will effectively be able to "double dip" with regard to their "actual annual operating costs."

The Doddridge County Commission knows for a fact that a certain oil and gas producer (Antero Resources Corporation ("Antero")) passes along some, if not all, of the "actual annual operating costs," as defined in W.Va. Code § 11-1C-10(d)(3)(B), to it as an owner/lessor. As an example of the same, attached/enclosed please find a copy of certain documentation sent by Antero to the Doddridge County Commission for a certain well that Antero has drilled on Doddridge County Commission property. Said documentation includes a certain royalty check and "stub" for said royalty check showing the expenses which Antero effectively "passed along" to the Doddridge County Commission, and a certain "key" which Antero provided to the Doddridge County Commission, said "key" providing more detail relative to the aforementioned "stub."

Seventh, the County Commissions believe that the term "lease operating expenses" in W.Va. Code § 11-1C-10(d)(3)(B) is too broad and is in need of definition. Accordingly, the County Commissions suggest that the Tax Commissioner, when he promulgates his "emergency rules," clearly defines "lease operating expenses." In a like manner, the County Commissions believe there needs to be detailed definitions of "lifting costs," "gathering," "compression," "processing," "separation," "fractionation" and "transportation charges" in the Tax Commissioner's "emergency rules," to eliminate further, future disputes (and possible litigation) over issues related to interpretation of those terms in W.Va. Code § 11-1C-10(d)(3)(B).

Eighth, the County Commissions are concerned about how the Tax Commissioner and/or his representatives are going to be able to determine if a taxpayer's reported "actual annual operating costs" are truly accurate. As a general proposition, "gathering," "compression," "processing," "transportation charges," etc. fluctuate. In other words, they are variable, not fixed, costs or expenses which are often tied to variable/fluctuating markets, such as the oil and gas transportation markets. For example, a taxpayer may effectively purchase transportation capacity and then, because its transportation needs are not as high as it had expected, transfer that transportation capacity to a different oil and/or gas producer who needs transportation capacity. In that scenario, how is the Tax Commissioner going to

ensure the taxpayer does not include the entirety of its costs or expenses in obtaining that transportation capacity, even though it has transferred some of that transportation capacity to another oil and/or gas producer who has paid the taxpayer for that transportation capacity?

Ninth, the County Commissions believe the Tax Commissioner needs to clearly define when his "emergency rules" will become effective. As you and I discussed on Friday, April 30, 2021, the Tax Commissioner's "emergency rules" should apply to the assessment years beginning on or after July 1, 2022, not before.

Tenth, when you and I spoke about the Tax Commissioner's promulgation of "emergency rules" under W.Va. Code § 11-1C-10(d)(3), I asked if the Tax Commissioner was going to share a draft of his "emergency rules" before the same were actually filed with the West Virginia Secretary of State ("WVSOS"). You indicated the Tax Commissioner was not inclined to do so. While I certainly understood what you indicated to me, I am hereby renewing my request that the Tax Commissioner provide me and my clients, the County Commissions, with a draft of his "emergency rules" before he files them with the WVSOS. I do so because, quite frankly, as outlined in the "First" paragraph above, the potential adverse impact of the Tax Commissioner's "emergency rules" on the Doddridge County Commission and the Harrison County Commission, is much too significant for the County Commissions to not have some input on those "emergency rules" and, practically speaking, if the County Commissions are facing substantial deficits, they need to understand the same promptly for budgetary reasons.

With this correspondence, I am providing comments and suggestions with regard to the anticipated "emergency rules" of the Tax Commissioner. However, in my mind, that is not really a substitute for County Commissions having an opportunity to comment and make suggestions with regard to the "emergency rules" the Tax Commissioner files with the WVSOS before they are actually filed.

When we spoke, the reason you gave for the Tax Commissioner not being willing to provide me and my clients, the County Commissions, with a draft of the "emergency rules" before the same were finalized and filed with the WVSOS, was the concern about exactly to whom the Tax Commissioner should provide such a draft. To address that concern, the County Commissions suggest the Tax Commissioner provide a draft of his "emergency rules" to the Gas & Oil Association of West Virginia and the County Commissioners' Association of West Virginia, and those Associations could then disseminate said draft to their respective memberships and other impacted stakeholders.

If you have any questions whatsoever about the comments and/or suggestions set forth above, please do not hesitate to call me at (304) 720-4217 or email me at trodgers@kaycasto.com.

Sincerely,

R. Terrance Rodgers

RTR/spw
Attachment/Enclosure

VIA ELECTRONIC MAIL
cc: Jonathan Nicol, Esquire (w/att.)

ANTERO RESOURCES CORPORATION
1615 WYNKOOP STREET
DENVER, COLORADO 80202

Payee Name	Payee No.	Date	Check No	Check Total
COUNTY COMMISSION OF DODDRIDGE COUNTY	43126	Jan-28-2015	71732	$89,221.38

WELL# / SALE DATE	PC	INT TYP	PRICE	GROSS QUANTITY	GROSS VALUE	GROSS DEDUCTIONS	NET	INTEREST	PAID INT	OWNER VALUE	OWNER DEDUCTIONS	NET VALUE
[illegible]				[illegible]			WV	DODDRIDGE				
[illegible]			[illegible]	[illegible]	[illegible]	[illegible] SEV	[illegible]	[illegible]	[illegible]	[illegible]	0.00 SEV	[illegible]
[illegible]			[illegible]	[illegible]	[illegible]	[illegible] SEV	[illegible]	[illegible]	[illegible]	[illegible]	0.00 SEV	[illegible]
[illegible]			[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	0.00	[illegible]
				BTU FACTOR: [illegible]		[illegible]			[illegible]		0.00	
						[illegible]			[illegible]		0.00	
						[illegible]			[illegible]		0.00	
						[illegible] SEV			[illegible]		0.00 SEV	
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	OWNER GROSS	OWNER NET DEDUCTIONS	OWNER NET TOTALS
CURRENT CHECK	[illegible]	[illegible]	[illegible]
YEAR TO DATE	[illegible]	[illegible]	[illegible]

--------------------PRODUCTS/DEDUCTIONS--------------------

O - OIL / G - GAS / P - PLANT PRODUCTS / PRC2 - NGL PROCESSING FEES /

$ 11,364.89

TOTAL CHECK AMOUNT 89221.38

DETACH AND RETAIN FOR TAX PURPOSES

Antero Resources

WELLS FARGO
DENVER, CO

Check No. 71732

11-24 / 1210

ANTERO RESOURCES CORPORATION
1615 WYNKOOP STREET
DENVER, COLORADO 80202

400 - REV ACCT WELLS FARGO

VOID AFTER 90 DAYS

CHECK NUMBER	DATE	PAY EXACTLY
71732	Jan-28-2015	$89,221.38

PAY EXACTLY $89,221dols38cts
EIGHTY-NINE THOUSAND TWO HUNDRED TWENTY-ONE DOLLARS AND 38 CENTS

TO THE ORDER OF
COUNTY COMMISSION OF DODDRIDGE COUNTY
WEST VIRGINIA
108 EAST COURT STREET
WEST UNION, WV 26456

[signature]

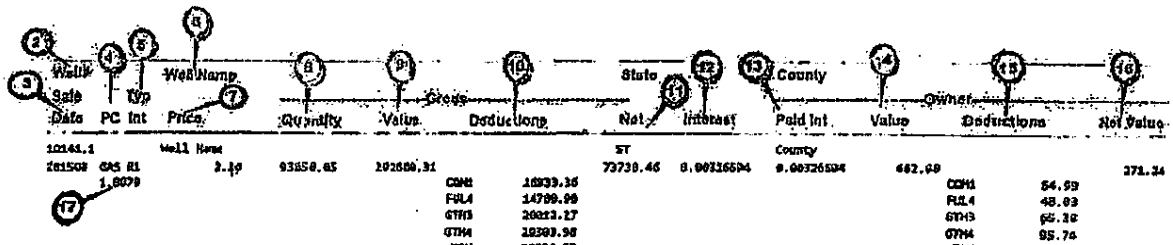
⑈071732⑈ ⑆[illegible]⑆ [illegible]⑈

DA0848

Antero Resources Corporation
1615 WYNKOOP STREET
DENVER, CO 80202

Payee No.: Owner Number (1)
Check Date: xx/xx/xxxx
Check No.:
Check Total:

000396 R3K6T2A
Owner Name
Owner Address
City, ST Zip



1. This number uniquely identifies your account with Antero Resources.
2. The number uniquely identifies the well in which you have an interest.
3. The year and month the production was sold (YYYYMM).
4. The product for which payment is being made.
   - GAS
   - OIL
   - PPR – Plant Products (NGLs)
5. The type of ownership interest for a property.
   - WI – Working Interest
   - RI – Royalty Interest
   - ORRI – Overriding Royalty Interest
   - NPRI – Non-Participating Royalty Interest
6. The name of the well in which you have an interest.
7. The price per unit of measurement (e.g. MCF for Gas, barrel for Oil and gallon for Plant Products).
8. The gross volume of gas and oil produced and plant products sold from a well.
9. Gross Value = Price x Quantity
10. Gross deductions from price for fees or other charges identified by abbreviation and corresponding description.
11. Gross Net = Gross Value – Deductions
12. Interest reflects your decimal interest as reflected on your division order.
13. Paid Interest reflects your proportionate share of production from a property and/or deductions.
14. Your proportionate ownership share (Paid Interest x Volume x Price).
15. Your proportionate ownership share of deductions (Paid Interest x Gross Deductions).
16. Owner Net Value = Owner Value - Owner Deductions
17. "BTU" is used to describe the heat value (energy content) of gas.

KAY CASTO & CHANEY PLLC
Attorneys at Law

1600 Chase Tower · 707 Virginia Street, E. · Charleston, WV 25301
Mailing Address: P.O. Box 2031 · Charleston, WV 25327
(304) 345-8900 · Fax: (304) 345-8909
www.kaycasto.com

June 23, 2021

VIA EMAIL [mark.s.morton@wv.gov]
and REGULAR U.S. MAIL

Mark S. Morton, Esquire
General Counsel
West Virginia State Tax Department
1001 Lee Street, East
Charleston, West Virginia 25301

RE: Inquiries/Requests With Regard to Certain "Notice Of Public Comment Period" Filed With the West Virginia Secretary of State on June 4, 2021, and With Regard to Certain "Notice Of An Emergency Rule" Filed With the West Virginia Secretary of State on June 8, 2021

Dear Mr. Morton:

As you know, my firm and I represent the County Commission of Doddridge County, West Virginia ("Doddridge County Commission"), and the County Commission of Harrison County, West Virginia ("Harrison County Commission") (the Doddridge County Commission and the Harrison County Commission are collectively referred to as "County Commissions"), in connection with the Emergency Rule which the West Virginia State Tax Commissioner ("Tax Commissioner") was required to promulgate under the newly enacted W.Va. Code § 11-1C-10(d)(3). We are also representing the County Commissions with regard to the proposed Legislative Rule the Tax Commissioner filed with the West Virginia Secretary of State ("WVSOS") on June 8, 2021.

The County Commissions and I have been reviewing the Notice Of Public Comment Period which the Tax Commissioner filed with the WVSOS on June 4, 2021, along with the proposed Legislative Rule which is part of said Notice. In addition, the County Commissions and I have been reviewing the Notice Of An Emergency Rule which the Tax Commissioner filed with the WVSOS on June 8, 2021, along with the Emergency Rule which is a part of said Notice.

In both the Notice Of Public Comment Period for the proposed Legislative Rule and the Notice Of An Emergency Rule for the Emergency Rule, under the "Economic Impact Of The Rule On The State Or Its Residents" and the "Explanation Of Above Estimates (Including Long-Range Effect)" parts thereof, there is the following statement:

> This rule would offset the costs of fractionation to income for natural gas liquid production and would set a capitalization rate that is lower than the current rate. This would result in a minimal change in revenue. Administrative costs would be $25,000[.00] for system changes in valuation models.

(Emphasis added). What is the basis for the statement that the proposed Legislative Rule and the Emergency Rule "would result in a minimal change in revenue"? Also, does said statement mean the County Commissions will see only "a minimal change in [their tax] revenue[s]" as a result of the proposed Legislative Rule and the Emergency Rule? Assuming so, does the Tax Commissioner have any documents demonstrating that, indeed, the County Commissions will see only "a minimal change in [their tax] revenue[s]" as a result of the proposed Legislative Rule and the Emergency Rule? If so, on behalf of the County Commissions, I am hereby requesting a copy of all such documentation. If the Tax Commissioner does not have any such documentation, please simply let me know that to be the case, but still provide me with a detailed explanation as to the basis of the statement in the proposed Legislative Rule and the Emergency Rule that they will only cause "a minimal change in [tax] revenue[s]" for the County Commissions. In the interest of transparency, I assume the Tax Commissioner will provide the documentation requested above (assuming there is any such documentation), as well as a detailed explanation as to the basis of the statement in the proposed Legislative Rule and the Emergency Rule that they "would result in a minimal change in [tax] revenue[s]" for the County Commissions.

If there will only be "a minimal change in [the tax] revenue[s]" to the County Commissions as a result of the proposed Legislative Rule and the Emergency Rule, the County Commissions' view of the proposed Legislative Rule and the Emergency Rule likely will be different than if the tax revenue reductions to be experienced by virtue of the proposed Legislative Rule and the Emergency Rule are more in line with the fiscal note for the original H.B. 2581 ($58.6 million statewide) and/or the fiscal note for Committee Substitute for H.B. 2581 ($9.1 million statewide).

If you have any questions about the inquiries/requests set forth above, please do not hesitate to call me at (304) 720-4217 or email me at trodgers@kaycasto.com. If I do not receive any such questions from you, I look forward to receiving your prompt response to the inquiries/requests set forth above.

KAY CASTO & CHANEY PLLC
Attorneys at Law

Sincerely,

R. Terrance Rodgers

RTR/spw

VIA ELECTRONIC MAIL
cc: Jonathan Nicol, Esquire

21-177

Dave Hardy
Secretary of Revenue

STATE TAX DEPARTMENT

Matthew Irby
State Tax Commissioner

July 1, 2021

R. Terrance Rodgers
Kay Casto & Chaney
1500 Chase Tower
707 Virginia Street, E.
Charleston, WV 25301

Re: Fiscal note for emergency rule

Dear Mr. Rodgers:

In your June 23, 2021 correspondence, you asked for an explanation of certain language in the fiscal note for the proposed amendments to Legislative Rule 110-01J. Specifically, you questioned the basis for the statement in the fiscal note that the proposed Rule "would result in a minimal change in revenue."

As you know, the proposed amendments to Legislative Rule 110-01J were mandated by the provisions of H.B. 2581, passed during the 2021 regular legislative session. You note in your correspondence that the fiscal note for H.B. 2581 as introduced stated an expected revenue impact of $58.6 million statewide, and the fiscal note for a subsequent Committee Substitute for H.B. 2581 stated an expected revenue impact of $9.1 million statewide.

Although the fiscal note for the Committee Substitute was the last fiscal note the Tax Department prepared for H.B.2581, the Committee Substitute was not the last iteration of the bill. The enrolled version of H.B. 2581 that was signed by Governor Justice was significantly different from the Committee Substitute with regard to the valuation of natural resources property. The enrolled bill that was signed by the Governor allows the Tax Department to change its capitalization model, which was not part of the Committee Substitute. The fiscal notes that were prepared before H.B. 2581 became an enrolled bill simply do not reflect the revenue impact of the bill that was signed into law.

The fiscal note that you asked about and cited in your correspondence is the fiscal note for the proposed Legislative Rule, not for the enrolled version of H.B. 2581. To the extent that H.B. 2581 allows producers of natural gas products to deduct actual annual operating costs when calculating net proceeds, that change would be attributable to the bill itself, and not the proposed Legislative Rule. Any change in revenue attributable to the proposed Legislative Rule itself is judged to be minimal, as stated in the fiscal note.

The Tax Department engaged the services of a 3rd party consulting firm to establish the baseline used for the projections. That firm analyzed production patterns over the last several years based

on reported or reportable production activities. We have not produced any documentation related to this.

Sincerely,

Stephen Stockton
Supervising Attorney

C.I. McKOWN & SON, INC.

Oil & Gas

P.O. Box 711
Newton, West Virginia 25266
Telephone: (304) 565-7318
Fax: (304) 565-3804

July 7, 2021

Mark Morton
West Virginia State Tax Department
P.O. Box 1005
Charleston, West Virginia 25324-1005

VIA ELECTRONIC MAIL AND U.S. MAIL

(taxlegal@wv.gov)

Re: Producer Comments on Proposed Legislative Rule 139 WVCSR Series 1J

Dear Mr. Morton:

C.I. McKown & Son, Inc. is a conventional producer based in Roane County WV and would like to submit the following comments regarding the proposed legislative rule.

General Comments

Property Tax valuation of oil and gas properties has been a concern in our industry over the last several years with many producers having seen their wells valued at amounts that do not reflect true and actual value. Many conventional wells actually operate at a loss. This is due to the low natural gas price environment we have experience for the last several years. West Virginia Code Section 11-6K-1 states that "All industrial and natural resource property shall be assessed annually as of the assessment date at sixty percent of its true and actual value." West Virginia Code Section 11-3-1 defines true and actual value as "... a price for which the property would sell if voluntarily offered for sale by the owner thereof, upon the terms as the property, the value of which is sought to be ascertained, is usually sold, and not the price which might be realized if the property were sold at a forced sale." The state's valuation methodology has not been reflective of true and actual value due in large part to the fact that the allowable expense amount is incorrect. The new proposed Rule only seems to allow continuance of the historical failure of the State to value wells at their true and actual value as required by state law. Actually, it seems the Rule will most likely result in inflated values which would be even less reflective of a well's true and actual value.

During the 2021 legislative session, the Legislature passed 2581, which had two primary goals: No.1- To allow for another avenue to appeal valuations via the Office of Tax Appeals and No.2 - To allow for use of actual operating expenses in determining net proceeds. The use of actual operating expenses was sought because the Tax Department's mass appraisal method of using surveys, industry averages, and caps/ limits, were not reflective of each individual producer's unique situation regarding expenses. HB 2581 was simple and had specific purpose while this Rule is extremely complex and goes well beyond the intent of the legislation requiring an emergency rule be filed.

The overall tone of the Rule seems to contradict the plain language of 2581 and place the property tax valuation not on the taxpayer's actual income and actual expenses as reported on its tax returns, but at the sole discretion of the Tax Commissioner. As a result, the Rule exceeds its statutory authority and as drafted, would likely be unenforceable if challenged.

Throughout the Rule there are references to the word "reasonable" rather than simply the actual data reported by the taxpayer on its tax return. Many sections of the rule give the Tax Commissioner the discretion to deem a producer's actual proceeds unreasonable and modify the amount of gross proceeds received by the producer and reported on its property tax returns. Further, the Tax Commissioner has the unilateral discretion to create "industry averages" for the producers without the benefit of an industry survey that was required under the old law. This discretion granted to the Tax Commissioner in the Rule is contradictory to the powers granted in 2581.

One of the reasons that the industry requested this law be changed was because of the way the Tax Department calculated industry averages for expenses. There is a wide discrepancy among producers' operating expenses based on how they operate, their size of operation and economies of scale. Our expenses will vary widely from a large unconventional producer for instance. Expenses should either be determined from actual amounts, which is typically what a large unconventional producer would do, or from a reasonable flat amount based on producer surveys, which is what we, as a small conventional producer, would likely choose. If the Tax Department has an issue with what is reported by a taxpayer, then it can audit the property tax returns. The way the Rule is written, the Tax Commissioner can unilaterally change what was reported by a taxpayer without having to audit the taxpayer's return. This would not result in a "true and actual value" for the property.

We are also concerned about the Annual Property Tax Returns and the significant changes to the information required with the revised returns. As you know, the returns, which historically are due August 1st, have not been formally published to the industry. Industry is concerned that the property tax returns may require information that is not readily ascertainable and that it may require new software or significant changes to existing software. The addition of several new items of information will require many changes and that will create an issue with producers being able to accurately complete the new form in a timely manner especially given such a short time frame to comply.

Finally there is concern that the Tax Department is attempting to manipulate the value of a well by decreasing the cap rate that is used in the Discounted Cash Flow calculation.

Historically the Tax Department has computed a capitalization rate over the past ten years that has averaged approximately 15%. The Tax Department published the tentative variables for the 2022 assessment year and estimates the capitalization rate to be 10.8%. This is over a 25% decrease from the 2021 assessment year and such a substantial reduction of the cap rates will result in much higher values.

The Rule changes are complex, with many of the sections not required by the new legislation. It appears that the Rule is attempting to find a multitude of new ways to increase the value of wells instead of establishing the proper way to calculate "true and actual" value. In some discussions between industry and Tax Department leadership, it has been mentioned that the focus of the department is on unconventional wells and their appropriate value. It was admitted that most conventional wells basically don't add up to much gross value to justify the administrative burden on both the Tax Department and conventional producers. One suggestion is to create an exemption from reporting if your value is below a certain threshold (i.e. a marginal well) or a very simplified form for conventional wells if not made exempt.

HB 2581 was sponsored to accomplish simplifying and cleaning up how the valuation of wells is calculated. This proposed Rule only complicates the matter with new complexities not justified by the statute.

We appreciate the opportunity to review and provide comments on the proposed Rule.

Sincerely,

C.J. McKown II
President

Denex Petroleum Corp.

ROUTE 5, BOX 560
BUCKHANNON, WV 26201

PHONE 304-472-2186
FAX 304 472-2187
July 7, 2021

~ Via US Mail and Electronic Mail to TaxLegal@wv.gov ~

Mark Morton, Esq.
West Virginia State Tax Department
P.O. Box 1005
Charleston, West Virginia 25324-1005

Re: Producer-Operator Comments on Proposed Legislative Rule 110 WVCSR Series 11

Dear Mr. Morton:

Denex Petroleum Corporation ("Denex") is a small conventional oil and gas producer based in Buckhannon, West Virginia, which has been in business for 37 years. I am the sole shareholder of Denex and a former member of the Property Valuation Training and Procedures Commission. I have forty seven years of experience in the oil and gas business in West Virginia. Set forth below are my comments to the captioned Proposed Legislative Rule.

General Comments

Rules do not trump Statutes, even if such Rules are approved by the legislature. West Virginia Code §11-6K-1(a) provides the over-arching standard:

"All industrial property and natural resources property shall be assessed annually as of the assessment date at sixty percent of its true and actual value". [Underlining added.]

The West Virginia Legislature and the West Virginia Supreme Court have defined "true and actual value" as:

"...the price for which such property would sell if voluntarily offered for sale by the owner thereof, upon such terms as such property, the value of which is sought to be ascertained, **is usually sold**...". (West Virginia Code § 11-3-1(a)), (see also In re Tax Assessment of Foster Foundation's Woodlands Retirement Community, 672 SE2d 150, W.Va. 2008), supra). [Underlining added.]

The methodology outlined in the Proposed Legislative Rule does not in any way resemble how oil and gas wells are typically purchased and sold by and between operators in West Virginia. Rather, such purchase and sale prices are primarily determined based on past production and projections of future **net** income considering commodity price expectations and estimates of **actual operating expenses**.

For the past twenty years, operators have submitted "Producer Operator Returns" to the State Tax Department, which contain actual production and revenue data, along with related information (producing formations, date of first production, net revenue interests, etc.) to facilitate the revenue portion of a proper assessment procedure. However, the State Tax Department neither requested nor would accept the submission of actual operating expenses, opting instead to estimate the same using a percentage of revenue to determine expenses, with unsupported expense "caps". West Virginia Courts have determined and ruled that this "procedure" has resulted in inaccurate assessments. Clearly, the previous procedures ignored the "true and actual value" based "....upon such terms as such property..... is usually sold".

It is hoped that the State Tax Department will try to avoid making this same mistake in the future by promulgating Rules which incorporate the methodology customarily and routinely utilized by West Virginia oil and gas well owners and prospective buyers operating at arm's length. The only reasonable way to accomplish this is to incorporate in the calculation actual expected operating expenses based on historic expenses, using the same methodology that any willing and able buyer and seller would employ. Accordingly, future Producer Operator Returns should require the reporting of all actual operating expenses. Buyers and sellers consider expected **net revenues** in determining sales prices. The State Tax Department is obligated to follow the same procedures, as that will yield "true and actual value" based on how such properties are "usually sold".

The State Tax Department has proposed a reduction in the capitalization rate used to discount cash flow from 15% to just 10.8%, a decrease of about 28%. Given the nature and uncertainties of oil and gas production, and the volatility of commodity prices, 10.8% does not seem to be an appropriate rate. It seems like this system is NOT designed to calculate "true and actual value", but rather to artificially inflate the value of the properties to generate increased tax revenues. That is contrary to what is mandated under West Virginia Code §11-6K-1(a) or West Virginia Code § 11-3-1(a). Again, Rules do not trump Statutes. Rather, Rules should be promulgated to administer the Statutes in strict accordance with the intent thereof. It would seem likely that larger shale producers would be inclined to challenge this capitalization rate in court as being unjust and unreasonable.

It is discouraging to note that the State Tax Department waited until this late date to solicit input from parties required to submit Producer Operator Returns. Interested parties have yet to see a proposed Producer Operator Return, and there is much confusion over the content of the form and the need for taxpayers with more than twenty five wells to make digital filings. Digital filings will require software changes, and only the largest oil and gas operators have the information technology resources required to accomplish that task in such an abbreviated time frame. This does not bode well. In the interest of accuracy and getting this right, the State Tax Department should consider allowing taxpayers to file the same returns used in the past together with supplemental information regarding operating expenses for Tax Year 2022. Between now and early 2022, the State Tax Department could, in cooperation with producer-operators, design a Producer Operator Return (or develop a digital format) for future filings.

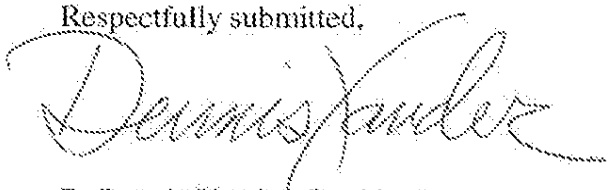
In recent weeks, the NYMEX price of natural gas has dramatically increased. However, that is the price of gas at Henry Hub, in Louisiana. Regrettably, due to capacity constraints on pipelines serving West Virginia and the other Appalachian states, prices for West Virginia gas are often as much as dollar below the NYMEX price. That "basis" is volatile, and peaked at $1.52 in July, 2015. Any methodology used to evaluate gas wells in West Virginia should consider the **net prices** for Appalachian production and should never be based on NYMEX pricing.

Small producers, like Denex, recognize that the aggregate value of their conventional wells is de miminis, especially given today's price for Appalachian gas. The real value is in the non-conventional horizontal shale wells. The number of non-conventional wells in West Virginia is quite small compared to the number of conventional wells. It would seem reasonable to use different forms for these different types of wells, at least initially.

The vast majority of conventional wells are currently operating at a loss, due primarily to the fact that natural gas prices are at historic lows, especially in capacity-constrained West Virginia. This may not be obvious to the State Tax Department, as it has failed in the past to consider actual operating expenses, opting instead to use 30% of gross income as expenses. As gas prices and production declined, gross revenues decreased significantly. This led to a substantial decline in the expense deductions allowed in the State Tax Department's calculations. Meanwhile, the operators' actual expenses did not decrease, and, in fact, the same increased over time. Accordingly, the State Tax Department assigned significant values to wells that were uneconomic and operating at a loss. Such wells have minimal, if any, value. The State Tax Department should consider exempting wells with minimal daily production, which would significantly decrease the burden on the State Tax Department while having minimal reductions in tax revenue.

The legislation as passed seems reasonable and straightforward. Any Rule promulgated to administer this legislation should be consistent with the intent of the legislation.

Respectfully submitted,



R. Dennis Xander, President

EQT CORPORATION
625 Liberty Ave | Pittsburgh, PA 15222-3111
P: 412.553.5700 | www.eqt.com

July 7, 2021

VIA ELECTRONIC MAIL/
U.S. MAIL TO FOLLOW
Mark Morton
West Virginia State Tax Department
P.O. Box 1005
Charleston, West Virginia 25325-1005

Re: Public Comments on 110 WVCSR Series 1J Legislative Rule

Dear Mr. Morton,

Thank you for providing us with an opportunity to provide comments on the recent proposed revision of Series 1J legislation rule (the Rule) on the Valuation of Producing and Reserve Oil, Natural Gas Liquids, and Natural Gas for Ad Valorem Property Tax Purposes.

EQT has agreed with the State Tax Department and industry groups that the Rule, in its current form, was outdated and no longer adequately reflected the status of the oil and gas industry and its business models. We appreciate the need to amend the Rule and the difficulties faced when promulgating a Rule to value tens of thousands of wells on an annual basis using a mass appraisal system. While we do appreciate the efforts in this regard, we do not believe that adequate time has been provided for a meaningful discussion between the industry and the State Tax Department regarding its recently drafted proposed Rule. To that end, EQT does have reservations regarding the proposed Rule and does not feel that it will remedy the concerns previously communicated by the industry and EQT which will likely result in more protests to the valuations. While the questions and concerns raised by industry members are many, the main concerns EQT views as essential to address are described herein.

The proposed Rule purposely disallows affiliated contractual arrangements in determining the gross receipts or gross proceeds to be considered for valuation purposes and further allows the Tax Commissioner discretion to adjust the gross proceeds if determined that the gross proceeds are unreasonable. Although it appears that the Rule provides for reasonable, actual annual operating costs, the Commissioner can use discretion to adjust these costs if determined to be unreasonable (without any definitions to support this analysis). These rules should be stricken, and gross proceeds should be defined to reflect the price that a willing Buyer and willing Seller would agree to in an arm's length transaction assuming the parties had opposing or adverse economic interests. This accomplishes the same goal of making sure the transactions are fair market value but does not simply ignore corporate structure and any associated affiliated agreements or give unsupported discretion to the Tax Commissioner.

Additionally, the governing statute, namely W. Va. Code §§11-lC-i et. seq., does not support the inclusion of gross proceeds from NGLs for purposes of the valuation of wells. More specifically, W. Va. Code §11-1C-10(a)(2) defines "natural resources property" to include "coal, oil, natural gas, limestone, fireclay, dolomite, sandstone, shale, sand and gravel, salt, lead, zinc, manganese, iron ore, radioactive minerals, oil shale, managed timberland as defined in section two of this article, and other minerals." NGLs are not specifically identified in the definition, and as such would have to fall within the category of "other minerals" to be properly included. NGLs are not "minerals" within the ordinary use of the term, but rather are byproducts of the processing of natural gas. An analogous situation would be the processing of gasoline and diesel fuel from oil. The income from these products is too far removed from the resources in their natural state to be included in "other minerals." The Supreme Court of Appeals has held that:

> In the construction of statutes, where general words follow the enumeration of particular classes of persons or things, the general words, under the rule of construction known as ejusdem generis, will be construed as applicable only to persons or things of the same general nature or class as those enumerated, unless an intention to the contrary is clearly shown.

See e.g. Syl. Pt. 4, *Ohio Cellular RSA Ltd Partnership v. Bd. of Public Works*, 198 W.Va. 416, 481 S.E.2d 722 (1996). NGLs are not "of the same general nature or class" as the enumerated natural resources in §11-1C-IO(a)(2). Not to mention that the natural gas being valued at the wellhead is based on the energy value or heat content of the natural gas (the BTU content)

which already encompasses the value of NGL's present in that gas. As a result, the proceeds from NGLs ought to be removed from the income stream of a natural gas well for property tax valuation[1].

Furthermore, there is also some introductory language from the fiscal note attached to the Rule filing and set forth below that we find to be of concern:

> This rule would offset the costs of fractionation to income from natural gas liquid production and would set a capitalization rate that is lower than the current rate. This would result in a minimal change in revenue. Administrative costs would be $25,000 for system changes in valuation models.

From a plain reading of this language, this could construe utilizing a capitalization rate in the Discounted Cash Flow calculation to achieve the State Tax Department's desired result by applying an "industry risk adjustment" to solve for a desired valuation target and property tax revenue stream. The State Tax Department indicates that the Rule will lower the current capitalization rate and hence raise the appraisal values. While we agree that a capitalization rate can fluctuate based on market changes, the State Tax Department has computed a capitalization rate of approximately 15% over the past ten years. This current capitalization rate used in West Virginia is consistent with the capitalization rate used in Kentucky and Ohio and we believe should remain consistent unless there is market data to support adjusting it. Such a change should not be left to the discretion of the State Tax Department.

Lastly, the Rule requests information that is not necessary to complete the valuation of the property in question, such as location and serial numbers of meters, invoices, and receipts. This new complexity and the updated electronic filing requirements add additional administrative compliance burdens. Additional time, beyond the 30-day granted extension, may be needed to prepare for the e-filing changes.

As noted previously EQT feels that the Rule changes are complex, and in many places subject to misinterpretation which could lead to more property tax disputes. We will continue to read and assess the many changes to the Rule, as they are significant, and therefore may have additional comments accordingly. We are available to discuss our comments and feel that it is imperative that the industry stakeholders, the State Tax Department and the Legislature have an opportunity to work together on the concerns addressed above to avoid future disputes.

Best regards,

Kimberlee Hoinkes
Manager, Corporate Tax

cc: Will Jordan, EVP & General Counsel
Thomas E. Quinlan, VP of Tax

DocuSigned by:
Kimberlee A. Hoinkes
[illegible]

[1] Additionally, as it pertains to NGLs, the proposed Rule would include the gross proceeds for NGLs which are to be measured at the first arm's length point of sale. Often, the first point of sale for NGLs occurs outside of West Virginia. The sourcing of the natural gas products proceeds from processing occurring outside of West Virginia to this State strains constitutional and interstate commerce limitations. In some cases, the processing of NGLs occurs at facilities outside of West Virginia. Computing the income of a West Virginia well to include the proceeds from the sale of NGLs which are processed in another state, in essence, impermissibly includes the value of the out of state processing facilities in the well valuation.

D. G. HANEY, INC.
POST OFFICE BOX 3810
CHARLESTON, W.VA. 25338

DAVID A. HANEY
PRESIDENT

Phone 304 344-191
FAX 304 344-08

July 7, 2021

Mark Morton
West Virginia State Tax Department
P.O. Box 1005
Charleston, West Virginia 25324-1005

SENT VIA E-MAIL TO:

(taxlegal@wv.gov)

Re: Producer Comments on Proposed Legislative Rule 110 WVCSR Series 1J

Dear Mr. Morton:

D. G. Haney, Inc. has been incorporated in the state of WV since 1975 as a conventional producer/operator based in Charleston, WV. We own and produce 17 wells and contract well-tend 3 others. It has been quite a challenge making ends meet with oil and gas prices over the last several years. The inflated values upon which our property taxes are based have not helped. HB 2581 was passed with the intention of bringing these values more in line with what State Tax Code calls for. This Rule seems to be taking us in the opposite direction from what HB 2581 states. I would like to express my concern by submitting the following comments regarding the proposed legislative rule.

General Comments

Property Tax valuation of oil and gas properties has been a concern in our industry over the last several years. Many producers have seen their wells valued at amounts that do not truly reflect **true and actual value** with many wells being operated at a loss due to poor natural gas prices for several years. West Virginia Code Section 11-6K-1 states that "All industrial and natural resource property shall be assessed annually as of the assessment date at sixty percent of its **true and actual value**." West Virginia Code Section 11-3-1 defines true and actual value as "... a price for which the property would sell if voluntarily offered for sale by the owner thereof, upon the terms as the property, the value of which is sought to be ascertained, is usually sold, and not the price which might be realized if the property were sold at a forced sale." The state's valuation methodology has not been designed to reflect true and actual value especially with not being allowed to claim actual operating expenses. The Rule only seems to allow continuance of the historical failure of the State to value wells at their true and actual value as required by state law. Actually, the Rule will most likely result in inflated values which would be even more remote from their true and actual value.

During the 2021 legislative session, the Legislature passed 2581, which had two primary goals: 1. To allow for another avenue to appeal valuations via the Office of Tax Appeals and 2. To allow for use of actual operating expenses in determining net proceeds. The use of actual operating expenses was sought because the Tax Department's mass appraisal method of using surveys, industry averages, and caps/ limits, were not reflective of each individual producer's unique situation regarding expenses. HB 2581 was simple and had specific purpose while this Rule is extremely complex and goes well beyond the intent of the legislation requiring an emergency rule be filed.

The overall tone of the Rule seems to contradict the plain language of 2581 and place the property tax valuation, not on the taxpayer's actual income and actual expenses as reported on its tax returns, but at the sole discretion of the Tax Commissioner. As a result, the Rule exceeds its statutory authority and as drafted, would be unenforceable if challenged.

Throughout the Rule there are references to the word "reasonable" rather than simply the actual data reported by the taxpayer on its tax return. Many sections of the rule give the Tax Commissioner the discretion to deem a producer's actual proceeds unreasonable and modify the amount of gross proceeds received by the producer and reported on its property tax returns. Further, the Tax Commissioner has the unilateral discretion to create "industry averages" for the producers, without the benefit of an industry survey that was required under the old law. This discretion granted to the Tax Commissioner in the Rule is contradictory to the powers granted in 2581.

Virtually every producer operates differently in this industry and there is no simple way to compare producers and create an artificial "industry average". One of the reasons that the industry requested that this law be changed was because the way the Tax Department calculated industry averages under the survey required in the old law could not be substantiated mathematically. Not only is there a wide discrepancy between producers' operating expenses based on how they operate and their size of operation and economies of scale. Our expenses will vary widely from Antero's for instance. Even within a producer's own operations, the expenses can be very disparate based on the location of the well/field, the gas outlet for those wells, and the gathering, transportation, and marketing contracts for each well. 2581 is very clear on its face: value is determined from the actual price reported on the taxpayer's return, less royalties, and less actual annual operating costs as reported on the taxpayer's return. If the Tax Department has an issue with what is reported by a taxpayer, then it can audit the property tax returns. The way the Rule is written, the Tax Commissioner can unilaterally change what was reported by a taxpayer, without having to audit the taxpayer's return.

We are also concerned about the Annual Property Tax Returns and the significant changes to the information required with the annual property tax returns. The returns, which historically are due August 1st, have not been formally published to the industry. Industry is concerned that the property tax returns may require information that is not readily ascertainable and that it may require new software or significant changes to existing software, and that there is simply not enough time to file the property tax returns in a timely fashion.

There is also concern that the Tax Department is attempting to manipulate the value of a well by decreasing the cap rate that is used in the Discounted Cash Flow calculation. Historically the Tax Department has computed a capitalization rate over the past ten years that has averaged approximately 15%. The Tax Department published the tentative variables for the 2022 assessment year and estimates the capitalization rate to be 10.8%. This is over a 25% decrease from the 2021 assessment year and such a substantial reduction of the cap rates will result in higher values.

The Rule changes are complex, with many of the sections not required by the new legislation. It appears that the Rule is attempting to find a multitude of new ways to increase the value of wells instead of establishing the proper way to calculate "true and actual" value. In some discussions within industry and with Tax Department leadership it has been mentioned that the focus of the department is on unconventional wells and their appropriate value. It was admitted that most conventional wells basically do not have much gross value to justify the administrative burden on both the Tax Department and conventional producers. One suggestion is to create an exemption from reporting if your value is below a certain threshold (i.e. a marginal well) or a very simplified form for conventional wells if not made exempt.

HB 2581 was sponsored to accomplish simplifying and cleaning up how the valuation of wells is calculated. This proposed Rule only complicates and muddies the waters with new complexities not justified by the statute. We appreciate this opportunity to review and provide comments on the proposed Rule.

Sincerely,

David Haney

David Haney
President

PILLAR ENERGY

July 7, 2021

Mark Morton
West Virginia State Tax Department
P.O. Box 1005
Charleston, West Virginia 25324-1005

Re: Producer Comments on Proposed Legislative Rule 110 WVCSR Series 1J

Dear Mr. Morton:

Pillar Energy, LLC is conventional producer based in Charleston, WV and would like to submit the following comments regarding the proposed legislative rule.

General Comments

Property Tax valuation of oil and gas properties has been a concern in our industry over the last several years. Many producers have seen their wells valued at amounts that do not truly reflect **true and actual value** with many wells being operated at a loss due to poor natural gas prices for several years. West Virginia Code Section 11-6K-1 states that "All industrial and natural resource property shall be assessed annually as of the assessment date at sixty percent of its **true and actual value**." West Virginia Code Section 11-3-1 defines true and actual value as "... a price for which the property would sell if voluntarily offered for sale by the owner thereof, upon the terms as the property, the value of which is sought to be ascertained, is usually sold, and not the price which might be realized if the property were sold at a forced sale." The state's valuation methodology has not been designed to reflect true and actual value especially with not being allowed to claim actual operating expenses. The Rule only seems to allow continuance of the historical failure of the State to value wells at their true and actual value as required by state law. Actually, the Rule will most likely result in inflated values which would be even more remote from their true and actual value.

During the 2021 legislative session, the Legislature passed 2581, which had two primary goals: 1. To allow for another avenue to appeal valuations via the Office of Tax Appeals and 2. To allow for use of actual operating expenses in determining net proceeds. The use of actual operating expenses was sought because the Tax Department's mass appraisal method of using surveys, industry averages, and caps/ limits, were not reflective of each individual producer's unique situation regarding expenses. HB 2581 was simple and had specific purpose while this Rule is extremely complex and goes well beyond the intent of the legislation requiring an emergency rule be filed.

The overall tone of the Rule seems to contradict the plain language of 2581 and place the property tax valuation, not on the taxpayer's actual income and actual expenses as reported on its tax returns, but at the sole discretion of the Tax Commissioner. As a result, the Rule exceeds its statutory authority and as drafted, would be unenforceable if challenged.

1244 Martins Branch Road
Charleston, WV 25314
(681) 205-8599

Throughout the Rule there are references to the word "reasonable" rather than simply the actual data reported by the taxpayer on its tax return. Many sections of the rule give the Tax Commissioner the discretion to deem a producer's actual proceeds unreasonable and modify the amount of gross proceeds received by the producer and reported on its property tax returns. Further, the Tax Commissioner has the unilateral discretion to create "industry averages" for the producers, without the benefit of an industry survey that was required under the old law. This discretion granted to the Tax Commissioner in the Rule is contradictory to the powers granted in 2581.

Virtually every producer operates differently in this industry and there is no simple way to compare producers and create an artificial "industry average". One of the reasons that the industry requested that this law be changed was because the way the Tax Department calculated industry averages under the survey required in the old law could not be substantiated mathematically. Not only is there a wide discrepancy between producers' operating expenses based on how they operate and their size of operation and economies of scale. Our expenses will vary widely from Antero's for instance. Even within a producers own operations, the expenses can be very disparate based on the location of the well/field, the gas outlet for those wells, and the gathering, transportation, and marketing contracts for each well. 2581 is very clear on its face: value is determined from the actual price reported on the taxpayer's return, less royalties, and less actual annual operating costs as reported on the taxpayer's return. If the Tax Department has an issue with what is reported by a taxpayer, then it can audit the property tax returns. The way the Rule is written, the Tax Commissioner can unilaterally change what was reported by a taxpayer, without having to audit the taxpayer's return.

We are also concerned about the Annual Property Tax Returns and the significant changes to the information required with the annual property tax returns. The returns, which historically are due August 1st, have not been formally published to the industry. Industry is concerned that the property tax returns may require information that is not readily ascertainable and that it may require new software or significant changes to existing software, and that there is simply not enough time to file the property tax returns in a timely fashion. Our software, called SOGAS, is set up to populate all the information to compete the returns as they currently exist. This allows us to efficiently create and submit numerous returns. However, the addition of several new items of information will require a change to that system and that could take some time. There will definitely be an issue with producers being able to accurately complete the new form in a timely and efficient manner especially given such a short time frame to comply.

There is also concern that the Tax Department is attempting to manipulate the value of a well by decreasing the cap rate that is used in the Discounted Cash Flow calculation. Historically the Tax Department has computed a capitalization rate over the past ten years that has averaged approximately 15%. The Tax Department published the tentative variables for the 2022 assessment year and estimates the capitalization rate to be 10.8%. This is over a 25% decrease from the 2021 assessment year and such a substantial reduction of the cap rates will result in higher values.

The Rule changes are complex, with many of the sections not required by the new legislation. It appears that the Rule is attempting to find a multitude of new ways to increase the value of wells instead of establishing the proper way to calculate "true and actual" value. In some discussions within industry and with Tax Department leadership it has been mentioned that the focus of the department is on unconventional wells and their appropriate value. It was admitted that most conventional wells basically don't add up to much gross value to justify the administrative burden on both the Tax Department and conventional producers. One suggestion is to create an exemption from reporting if your value is below a certain threshold (i.e. a marginal well) or a very simplified form for conventional wells if not made exempt.

HB 2581 was sponsored to accomplish simplifying and cleaning up how the valuation of wells is calculated. This proposed Rule only complicates and muddies the waters with new complexities not justified by the statute. We appreciate the opportunity to review and provide comments on the proposed Rule.

Sincerely,

Jeff Isner, CEO

Reserve Oil & Gas Inc.

July 7, 2021

Mark Morton
West Virginia State Tax Department
P.O. Box 1005
Charleston, West Virginia 25324-1005

VIA ELECTRONIC MAIL AND U.S. MAIL

(taxlegal@wv.gov)

Re: Producer Comments on Proposed Legislative Rule 110 WVCSR Series 1J

Dear Mr. Morton:

Reserve Oil & Gas, Inc. is conventional producer based in Spencer WV and would like to submit the following comments regarding the proposed legislative rule.

General Comments

Property Tax valuation of oil and gas properties has been a concern in our industry over the last several years. Many producers have seen their wells valued at amounts that do not truly reflect **true and actual value** with many wells being operated at a loss due to poor natural gas prices for several years. West Virginia Code Section 11-6K-1 states that "All industrial and natural resource property shall be assessed annually as of the assessment date at sixty percent of its **true and actual value.**" West Virginia Code Section 11-3-1 defines true and actual value as "... a price for which the property would sell if voluntarily offered for sale by the owner thereof, upon the terms as the property, the value of which is sought to be ascertained, is usually sold, and not the price which might be realized if the property were sold at a forced sale." The state's valuation methodology has not been designed to reflect true and actual value especially with not being allowed to claim actual operating expenses. The Rule only seems to allow continuance of the historical failure of the State to value wells at their true and actual value as required by state law. Actually, the Rule will most likely result in inflated values which would be even more remote from their true and actual value.

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The overall tone of the Rule seems to contradict the plain language of 2581 and place the property tax valuation, not on the taxpayer's actual income and actual expenses as reported on its tax

returns, but at the sole discretion of the Tax Commissioner. As a result, the Rule exceeds its statutory authority and as drafted, would be unenforceable if challenged.

Throughout the Rule there are references to the word "reasonable" rather than simply the actual data reported by the taxpayer on its tax return. Many sections of the rule give the Tax Commissioner the discretion to deem a producer's actual proceeds unreasonable and modify the amount of gross proceeds received by the producer and reported on its property tax returns. Further, the Tax Commissioner has the unilateral discretion to create "industry averages" for the producers, without the benefit of an industry survey that was required under the old law. This discretion granted to the Tax Commissioner in the Rule is contradictory to the powers granted in 2581.

Virtually every producer operates differently in this industry and there is no simple way to compare producers and create an artificial "industry average". One of the reasons that the industry requested that this law be changed was because the way the Tax Department calculated industry averages under the survey required in the old law could not be substantiated mathematically. Not only is there a wide discrepancy between producers' operating expenses based on how they operate and their size of operation and economies of scale. Our expenses will vary widely from Antero's for instance. Even within a producers own operations, the expenses can be very disparate based on the location of the well/field, the gas outlet for those wells, and the gathering, transportation, and marketing contracts for each well. 2581 is very clear on its face: value is determined from the actual price reported on the taxpayer's return, less royalties, and less actual annual operating costs as reported on the taxpayer's return. If the Tax Department has an issue with what is reported by a taxpayer, then it can audit the property tax returns. The way the Rule is written, the Tax Commissioner can unilaterally change what was reported by a taxpayer, without having to audit the taxpayer's return.

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There is also concern that the Tax Department is attempting to manipulate the value of a well by decreasing the cap rate that is used in the Discounted Cash Flow calculation. Historically the Tax Department has computed a capitalization rate over the past ten years that has averaged approximately 15%. The Tax Department published the tentative variables for the 2022 assessment year and estimates the capitalization rate to be 10.8%. This is over a 25% decrease from the 2021 assessment year and such a substantial reduction of the cap rates will result in higher values.

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a certain threshold (i.e. a marginal well) or a very simplified form for conventional wells if not made exempt.

HB 2581 was sponsored to accomplish simplifying and cleaning up how the valuation of wells is calculated. This proposed Rule only complicates and muddies the waters with new complexities not justified by the statute. We appreciate the opportunity to review and provide comments on the proposed Rule.

Sincerely,

Doug Douglass, Counsel

929 Charleston Road • Spencer, WV 25276 • Tel: (304) 927-5228 • www.reserveoilandgas.com

PUBLIC COMMENTS AND RESPONSES

110CSR01J

VALUATION OF PRODUCING AND RESERVE OIL, NATURAL GAS LIQUIDS, AND NATURAL GAS PROPERTY FOR AD VALOREM PURPOSES

Regarding the proposed amendments to Legislative Rule 110 C.S.R. 24, the State Tax Department received comments from R. Terrance Rodgers on behalf of the County Commissions of Doddridge County and Harrison County, West Virginia; Marc Monteleone and Elizabeth Burg, co-chairs of the Tax Committee of the Gas & Oil Association of West Virginia; Douglas C. Malcolm, President of D.C. Malcolm, Inc.; David A. Blashford, Tax Manager of Greylock Energy, LLC; Douglas Papa, Vice President – Tax of CNX Gas LLC; Kimberlee Hoinkes, Manager, Corporate Tax of EQT Corporation; Jeff Isner, CEO of Pillar Energy; David A. Haney, President of D.G. Haney, Inc.; C.I. McKown II, President of C.I. McKown & Son, Inc.; Doug Douglass, Counsel of Reserve Oil & Gas Inc.; and J. Kevin Ellis, Regional Vice President of Antero Resources.

Comments are summarized with the Tax Department's responses below:

Several commenters made argumentative "General Comments" that are essentially identical, and which will be responded to in only general terms. They begin with a summarized recitation of the West Virginia Constitution and West Virginia Code requirements that ad valorem property taxation must be equal and uniform and must reflect the property's true and actual value. The comments then go on to state that "Industry has not been afforded its legal rights in this regard for many years, as the State's valuation methodology has not been designed to reflect true and actual value. Our concern is that the Rule continues the historical failure of the State to value wells at their true and actual value as required by state law."

Response: The proposed rule is designed to result in valuation of oil, natural gas, and natural gas liquids property that complies with state law.

The "General Comments" proceed to characterize H.B. 2581, passed by the 2021 regular legislative session and signed into law by the Governor, as requiring that "the valuation of property producing oil, natural gas, natural gas liquids, or any combination thereof be based upon the fair market value calculated by applying a yield capitalization model to the net proceeds." The comments then claim that the "overall tone" of the rule "seems to contradict the plain language of [H.B.] 2581 and place the property tax valuation, not on the taxpayer's actual income and actual expenses as reported on its tax returns, but at the sole discretion of the Tax Commissioner. As a result, the Rule exceeds its statutory authority and as drafted, would be unenforceable if challenged."

Response: Inclusion of the word "reasonable" in the rule simply makes explicit that which an unbiased reader would ordinarily consider implicit in the language of H.B. 2581, inasmuch as the Legislature should not be considered to have sanctioned the use of unreasonable costs and

expenses when calculating net proceeds. In seeking removal of the word "reasonable," the commenters are implicitly asking for *carte blanche* to claim patently unreasonable amounts.

The "General Comments" further state that "If the Tax Department has an issue with what is reported by a taxpayer, then it can audit the property tax returns. The way the Rule is written the Tax Commissioner can unilaterally change what was reported by a taxpayer without having to audit the taxpayer's return."

Response: The taxpayer always has the burden of proving that its return reflects reality; and every taxpayer should expect that its tax returns are examined for accuracy, even if that examination is not identified as an audit.

The "General Comments" take issue with a capitalization rate set forth in a publication of tentative variables for the 2022 assessment year.

Response: The tentative variables are not set forth in the rule, so no response is necessary. The tentative variables have been published in the State Register and taxpayers have an opportunity to comment on those variable before they become final.

Beyond the "General Comments," several commenters offered specific comments:

Gas & Oil Association of West Virginia comment regarding section 1.1:
The characterization of the valuation method as "mass appraisal" is an indication that the Rule strays from [H.B.] 2581's mandate that each well be valued based on its own actual income and expenses.

Response: The term "mass appraisal" accurately describes the methodology for valuing producing and reserve oil, natural gas liquids and natural gas property for ad valorem purposes. The term "mass appraisal" is a generally accepted term to describe the process of valuing a group of properties, such as all oil and gas properties, as of a given date and using standardized methods.

Gas & Oil Association of West Virginia comment regarding section 3.2:
These costs should not be limited prior to an arm's-length sale defined in section 3.4 if the affiliate transactions reflect market pricing at arm's length.

Response: The burden is always on the taxpayer to prove that the price it claims is the result of market pricing at arm's length. Transactions between affiliates are not at arm's length. However, if the affiliate transactions reflect market pricing at arm's length, the Rule, as written, already allows the producer to take such costs under the provisions of section 7.1.2, as the Tax Commissioner would not have to adjust the price to industry averages.

Gas & Oil Association of West Virginia comment regarding section 3.3 and 3.35:
Appraised value includes real and personal property. Real property is not defined. Personal property appears to have changed from the industry standard of including personal property to the

first point of sale. As it has been conveyed with the Tax Department's diagrams, historically the Tax Department advised companies that related party affiliate gathering assets were included in the affiliated working interest assessments when the gross proceeds were reported at a point of sale occurring subsequent to the affiliate gathering system. This shift in policy may increase companies' property tax burden.

Response: The proposed Rule does not change that the fact that the valuation of oil and gas producing properties is based upon the gross receipts and costs to the point of sale as is evidence in sections 6 and 7 of the Rule. However, the Tax Department has to use the actual point of sale because HB 2581 requires the assessment to be on the actual price received by the sale and actual operating costs rather than an earlier measuring point. The Tax Department has amended the definition personal property to make it clear that the property is to the point of sale.

Gas & Oil Association of West Virginia comment regarding section 3.4:
Arm's length should include affiliate transactions if the affiliate transactions reflect market pricing at arm's length.

Response: Transactions between related parties are not at arm's length. However, if the affiliate transactions reflect market pricing at arm's length, the Rule, as written, already allows the producer to take such costs under the provisions of section 7.1.2, as the Tax Commissioner would not have to adjust the price to industry averages.

Gas & Oil Association of West Virginia comment regarding section 3.17:
Sometimes a Farm-Use well is sold with the farm so that the user of the well is not the owner of the gas in place. Ownership should not be required for the classification of a well as a farm use well.

Response: The definition of "farm-use well" will be changed to reflect its application to a scenario where the user of the gas receives the right to that use under a "farm-use" agreement in a gas lease, regardless of whether the user of the gas owns the gas in place.

Gas & Oil Association of West Virginia comment regarding section 3.19:
Production beginning after December 31st and prior to the July 1st assessment date must be reported. The producer/operator property tax returns are due August 1st. Producers will not be able to provide actual production for July and possible prior months at the time of the August 1st deadline.

Response:
Section 3.19 of the proposed rule is not new. The section does not require producers to provide "actual production for July." The section expressly states that "[p]roduction beginning after December 31st and *prior to* the July 1st assessment date must be reported." Additionally, this provision specifically relates to flush production, and is meant to capture production on a well that

has begun producing income after the preceding calendar year has closed, but prior to the assessment date. The well is a producing well and should be valued as such.

Gas & Oil Association of West Virginia comment regarding section 3.21:
Companies' points of sale vary based on underlying market rate contracts, and as such there could be various cost allowances contemplated in a gross payment to companies. The Tax Department should not be permitted to disallow any expense reductions in companies' gross proceeds. Companies should not be allowed to claim costs allowances in their gross proceeds twice, but the market-based reductions in gross proceeds should be permitted.

The language of the Rule appears to impermissibly allow the State to deviate from actual gross proceeds received by the producer. Accruals are not actual gross proceeds. The industry has a delay in accounting for production generated. Sophisticated accounting systems exist that distribute the actual revenues and expenses to individual wells and owners on wells. Industry does not have the means to account for accruals that may not be reflective of actual production at a well and/or owner level.

Further, services for metering, dehydration, liquids separation, measurement, and gathering are not reflective of the gross proceeds derived from the well production. These gross revenues are relevant to the specific assets to which they relate (liquids separation, gathering, etc.).

Response: The definition of gross receipts mirrors in many ways the definition of "gross receipts" for federal income tax purposes, including the use of the term accrue. The definition will be amended to make clear that a taxpayer should use the method of accounting used for federal income tax purposes.

With regard to the discussion that the Tax Department not be permitted to disallow expenses, it is unclear to the agency the point of this comment related to this definition. Section 5.2.1 clearly indicates that in determining the value of the working interest, the gross receipts shall be reduced by the actual annual operating expenses as required by H.B. 2581.

Gas & Oil Association of West Virginia comment regarding section 3.23:
Sometimes a Home-Use well is sold with the home so that the user of the well is not the owner of the gas in place. Ownership should not be required for the classification of a well as a home use well.

Response: The definition of "home-use well" will be changed to reflect its application to a scenario where the user of the gas receives the right to that use under a "home-use" agreement in a gas lease, regardless of whether the user of the gas owns the gas in place.

Gas & Oil Association of West Virginia comment regarding section 4.2.2 and 4.3.2:
Wells that produce less than average 1 BBL/day or 8 MCF/day are valued based on an annual percentage determined by the Tax Commissioner. What is the basis of the safe harbor average

daily production? Industry requests these thresholds align with severance tax at ½ BB day and 5 MCF/day. On what basis is the annual percentage to derive a safe harbor value derived?

Response: The Tax Department has offered a safe harbor for small producers that may not be able to calculate their actual operating costs. The Tax Department will amend this language so that anyone who does not wish to calculate their operating costs may use the safe harbor. This is an option that taxpayers may choose. The safe harbor amount will be average industry operating expenses as set forth in the natural resource property variables published in the State Register.

Gas & Oil Association of West Virginia comment regarding section 4.3:
In order to make Section 4.3 consistent with Section 3.35 personal property should be Personal property at the well site or "on the lease or communitized area."

Response: With the understanding that the well site is necessarily within the leased or communitized area, Section 4.3 will be changed to read:

> 4.3. *Method for valuing natural gas producing property.* – Except as otherwise provided in this section, the appraised value of a producing gas well on assessment dates beginning on and after the effective date of this rule, including personal property on the lease or communitized area necessary to recover the gas, shall be determined under this section.

Gas & Oil Association of West Virginia comment regarding section 4.3.3:
What is the point of sale before or after processing looking to accomplish? If companies have NGLs and they sell prior to processing the NGLs are valued based on residue gas while if the point of sale is after processing, they are valued based on NGL proceeds. This could create uniformity discrepancies.

Response: The purpose of looking at the point of sale before or after processing is exactly what you state. Those companies that sell unprocessed gas and do not receive revenue from any NGLs, should report as gas, but not residue gas. Presumably, the value of the NGLs is part of the proceeds received for the wet gas. If companies have NGLs within their wet gas and they sell after processing, the NGLs are valued based on NGL proceeds and the gas valued as residue gas. If there are companies that sale their gas prior to processing, but pursuant to their agreements or contracts, receive the value of the NGLs and the residue gas stated separately then they should report like those companies that sale their gas after processing. The Tax Department will revise this section to clarify.

Gas & Oil Association of West Virginia comment regarding section 4.4.2:
States the commissioner will annually determine the working and royalty percentage interests on a per well basis. Operators have different royalty arrangements which may result in some operators having average royalty interest percentages that are higher than industry averages.

Response: The text of section 4.4.2 is an existing provision in the current rule. The only proposed change is to strike the words "or operator" from the text. This change is simply one of consolidation, since "producer" and "operator" are treated as synonymous. This section of the rule does not mention "industry averages," and so the meaning of the comment is unclear.

Gas & Oil Association of West Virginia comment regarding section 5.1:
Weighting of the prior 3-year revenues and declining the calendar year revenues forward to the July 1st lien were removed. This would be a shift in administration that has nothing to do with HB 2581 which was intended to allow all actual revenues and expenses for oil and gas production. Removal of the July 1st cutoff will increase values and not be reflective of the value as of the July 1st lien date. The industry requests the Tax Department publish the valuation models they intend to leverage with the proposed Rule for the upcoming 2022 tax year. Without valuation models demonstrating the proposed changes, the Industry will not be able to ascertain the actual impact to their property taxes.

Response: The provisions regarding the weighting of the prior 3-year revenues was removed because HB 2581 requires the Tax Department to use actual gross receipts. The net proceeds are "the actual gross receipts on sales volume basis determined from the actual price received by the taxpayers" with some deductions as listed in the bill. A weighted 3-year average is not the actual gross proceeds as required by HB 2581.

Likewise, the declining of the calendar year revenues forward is not reflective of the plain language of the statute indicating that the value be determined based upon the actual gross receipts.

Gas & Oil Association of West Virginia comment regarding section 5.2:
States the minimum working interest no less than machinery and equipment value which is not clearly defined.

Response: This is not a deviation from prior practice. The Tax Department has provided this minimum valuation as a part of its variables for a number of years.

Gas & Oil Association of West Virginia comment regarding section 5.4.2.a.4:
A size premium adjustment to the capitalization rate is new and highly subjective affording entirely too much discretion to the Tax Department as to what an appropriate cap rate may be.

Response: Premiums and adjustments are subjective by their nature. The factors in the new capitalization rate are not any more subjective that those used in the previous capitalization rate. Mass appraisal is not an exact science, and the Tax Department must have discretion in order to arrive at a fair and equitable valuation.

Gas & Oil Association of West Virginia comment regarding section 6.1.3:

Affiliate gross proceeds should be permissible when a company can demonstrate that the related party contract terms are predicated on arm's length pricing contracts and computations.

Response: Transactions between related parties are, by definition, not arm's length transactions. However, if the affiliate transactions reflect market pricing at arm's length, the Rule, as written, already allows the producer to take such costs under the provisions of section 7.1.2, as the Tax Commissioner would not have to adjust the price to industry averages.

Gas & Oil Association of West Virginia comment regarding section 6.2:
This Rule puts a burden on the lessee to demonstrate that its contract "is reasonable compared to industry averages." The lessee negotiates its own deal and has no way of knowing what the industry average is. Each lessee negotiates its best deal based upon its specific facts and circumstances and it should not be held to a fictitious comparison to a fictious industry.

Response: The taxpayer always has the burden of proving the reasonableness of expenses it claims. If the producer's costs or revenues are out-of-line with industry averages, the producer should be able to explain why their costs are so high or revenues so low. This does not mean that the Tax Department will automatically deny gross receipts or costs that are out-of-line with industry averages.

Gas & Oil Association of West Virginia comment regarding section 6.3:
If the gross proceeds ... are otherwise determined to be unreasonable by the Tax Commissioner, then the Tax Commissioner shall adjust the amount of the gross proceeds in accordance with the following methods. There should not be discretion afforded to the Tax Commissioner as to what is reasonable when actual revenues and expenses are based on market rate contracts. Further the alternative methods outlined suggest leveraging comparable contracts. The oil and gas industry market is complex and sophisticated and it is not evident how the Tax Department will determine comparable amounts and adjustments. Actual gross proceeds received by the producer is the standard intended by the statute and should be reflected in the Rule.

Response: Section 6.3 of the proposed rule reflects the necessary discretion afforded to the Tax Department when confronted with non-arm's length contracts or unreasonable claims of gross proceeds. The burden of proof is always on the taxpayer to show that claimed amounts are reasonable, and the Tax Department has the duty to determine reasonable valuation when the taxpayer fails to do so.

Gas & Oil Association of West Virginia comment regarding section 7.1 and 7.1.2:
7.1 references "reasonable, actual annual operating costs" and 7 .1.2 suggests that any related party transportation, processing, or fractionation costs will be disallowed if deemed unreasonable. As discussed above there is no one-size fits all approach for these costs and so long as they are based on contracts with market rates, they should be permissible. The industry feels that related party cost allowances should be permissible when a company can demonstrate that the related party contract terms are predicated on arm's length pricing contracts and computations. Further, the Tax

Commissioner is not in a position to determine an industry average without knowing and then applying the specific circumstances surrounding a specific taxpayer's situation.

Response: Any claimed amount, regardless of its genesis, will be disallowed if it is unreasonable or unsupported. Related party transactions are, by definition, not arm's length transactions, and will not be considered to reflect actual costs. Industry averages are resorted to only when actual costs claimed by taxpayers are rejected as unreasonable.

Gas & Oil Association of West Virginia comment regarding section 7.2, 7.2.1, 7.2.2 and 7.2.4:
Allocation of Operating Cost among product types: The Tax Department is creating methods of cost allocation that may not be how the industry practically handles the allocations of costs. Why does the Tax Department have discretion on how to allocate costs when they are not operating the assets? Sophisticated accounting systems exist that distribute the actual revenues and expenses to individual wells and owners on wells. The industry requests further guidance on the administration of the cost allocation procedure as it is not evident.

Response: The Tax Department will accept any allocation method, based upon generally accepted accounting principles, that the operator chooses to use.

Gas & Oil Association of West Virginia comment regarding section 7.2.3:
No processing expense allowance for residue gas is wrong. Companies first incur processing costs for both residue gas and NGLs prior to any incremental transportation costs at the outset of the processing facility. Companies should be afforded a deduction for processing to derive the pure, marketable, and saleable residue gas, while the proposed Rule indicates the processing cost allowance is for NGLs gross proceeds only.

Response: The Tax Department has amended the Rule so that processing of NGLs cannot be applied against the residue gas.

Gas & Oil Association of West Virginia comment regarding section 7.3.2.b, 7.3.3 *et al.*, 7.3.4.b and 7.4 *et al*:
Costs are limited to certain types. There should not be limitations when companies are transacting business on an arm's length basis with underlying contracts. Additionally, depreciation of equipment purchased or acquired is an appropriate lease operating expense and should be allowed.

Response: HB 2581 states that actual annual operating costs are limited to lease operating expenses, lifting costs, gathering, compression, processing, separation, fractionation, and transportation charges. Therefore, the costs are statutorily limited to certain types of costs.

Gas & Oil Association of West Virginia comment regarding section 8.1:

If a producer does not file a complete return then the Tax Department will use average pricing. What is considered incomplete? What will the average pricing be based? What about the allowable expenses?

Response: This question is more about the return than the proposed rule. Further guidance on what is required to be included in the return will be forthcoming with form instructions.

Gas & Oil Association of West Virginia comment regarding section 9.1.1.h:
States must report the location and serial number of the meter that is the first point of sale. Which serial number: an internal identifying number for the meter, the gas purchaser's identifying number for the meter, or the manufacturer's serial number on the meter? What is the intent of this requirement? Further this information may not be readily available.

Response: This question is more about the return than the proposed rule. Further guidance on what is required to be included in the return will be forthcoming with form instructions.

Gas & Oil Association of West Virginia comment regarding section 9.1.2:
What is the statute of limitations on the proposed review/audit?

Response: The time frames are statutory and are not set forth in this Rule.

Gas & Oil Association of West Virginia comment regarding section 9.1.3:
The producer must also produce any records or documents that the Commissioner may require proving or verifying the gross proceeds or actual annual operating costs claimed. Companies should have the underlying contracts and invoices to support gross proceeds and costs, however there are sophisticated accounting systems that exist to distribute the actual revenues and expenses to individual wells and owners on wells. The request for support could be involved and voluminous and require additional administrative effort for companies. The Commissioner should not have the discretion to reject a property tax return if supporting details are not provided within a requested timeline as it could require weeks of effort for companies to compile supporting schedules and records.

Response: The return does not require supporting schedules and records. However, if the Tax Department has questions about amounts claimed, then the operator must provide requested supporting details.

Gas & Oil Association of West Virginia comment regarding section 9.2:
Stipulates an electronic property tax return must be filed for 25 or more wells. Industry supports electronic filing to eliminate paper waste, but the electronic filing requirements must be attainable for all companies. In the past the Tax Department's electronic filing requirements were regimented and required additional administrative burdens for companies to comply and therefore a limited

number of companies were capable of e-filing. Companies need several months of lead time to prepare for the e-filing change and requirements.

Response: The Tax Department recognizes the severe time limitations imposed on all parties by H.B. 2581. The Tax Department will attempt accommodate taxpayers this year regarding their method of filing due to the time limitations.

Antero Resources Corporation comment regarding section 9.1.1.d:
Yield capitalization model – in public comments to the legislative rule that was introduced and then withdrawn in 2020, Antero raised concerns about using a price per barrel to value NGLs. The Draft Legislative Rule addresses these concerns, and values natural gas liquids using MCF as the production measurement. See definition of "Total Production" under § 3.46. Additionally, under §§ 4.3 and 5, it appears that the Tax Department intends to value the working interest for natural gas and natural gas liquids together, which Antero supports. However, § 9.1.1.d should be amended to reference MCF instead of "amount of NGLs."

Response: Section 9.1.1.d will be amended as suggested in the comment.

Antero Resources Corporation comment regarding section 3.27:
Separate natural resource – amended W. Va. Code § 11-1C-10 establishes that natural gas liquids are a separate natural resource for property tax purposes, and the Draft Legislative Rule's definition of "natural gas liquids" under § 3.28 mirrors the definition now included under W. Va. Code §11-1C-10(d)(3)(A). Since natural gas and natural gas liquids are separate commodities, the definition of "natural gas" under § 3.27 should read: "'Natural gas' means natural gas, coalbed methane, synthetic gas useable for fuel, or mixtures of natural gas and synthetic gas. Provided, that for purposes of the valuation of natural gas producing property under this rule, references to 'natural gas' shall include natural gas liquids and liquefied natural gas."

Response: Section 3.27 will be amended as suggested in the comment such that natural gas liquids and liquefied natural gas will be included in the definition of natural gas, so long as they are sold as a single component. Natural gas liquids and liquefied natural gas are not natural gas if they are sold after processing and separation.

Antero Resources Corporation comment regarding actual annual operating costs:
Actual annual operating costs generally - W. Va. Code § 11-1C-10(d)(3) establishes that the fair market value for wells producing oil, natural gas, natural gas liquids, or any combination thereof, is based in application of a yield capitalization model to net proceeds, with net proceeds based on actual gross receipts, less royalties, and less actual annual operating costs. "Actual annual operating costs" are defined under both W. Va. Code §ll-1C-10(d)(3) and § 3.2 of the Draft Legislative Rule, with § 3.2 further stating that such costs "are limited to the actual costs incurred by the producer prior to the arm-length sale of the well output to a buyer[.]"

Reasonable actual annual operating costs - the Draft Legislative Rule consistently specifies that a producer can deduct "reasonable," actual annual operating costs, with no standards set forth to

provide guidance on what is considered a "reasonable" operating cost. The Draft Legislative Rule should include guidance regarding the methodology used by the Tax Department in determining whether an actual operating cost is "reasonable."

Response: The taxpayer always has the burden of proving the reasonableness of expenses it claims. If the producer's costs or revenues are out-of-line with industry averages, the producer should be able to explain why their costs are so high or revenues so low. This does not mean that the Tax Department will automatically deny gross receipts or costs that are out-of-line with industry averages; it means that the Tax Department will have questions regarding the costs or gross receipts and require supporting documentation.

Antero Resources Corporation comment regarding arm's-length contracts:
Arm's-length contracts generally - the Draft Legislative Rule includes extensive provisions relating to arm's-length sales and contracts, agreements, or transactions between affiliated entities, including marketing affiliates.

Arm's-length contract burden - the Draft Legislative Rule places the burden on the producer to demonstrate that a contract is arm's-length for purposes of both the reporting of gross proceeds and the claiming of actual annual operating costs. See §§ 6.2 and 7.1.2. Little to no guidance is provided regarding how a producer can satisfy this burden aside from showing that the gross proceeds or actual operating costs are "reasonable compared to industry averages." The Draft Legislative Rule should include guidance regarding how the Tax Department determines the "industry average" for purposes of allowing a producer to demonstrate that reported gross receipts and actual operating costs are "reasonable."

Response: If the producer's costs or revenues are out-of-line with industry averages, the producer should be able to explain why their costs are so high or revenues so low. This does not mean that the Tax Department will automatically deny gross receipts or costs that are out-of-line with industry averages; it means that the Tax Department will have questions regarding the costs or gross receipts and require supporting documentation.

Antero Resources Corporation comment regarding capitalization rate:
Capitalization rate - for property tax years 2012-21, the capitalization rate has been approximately 15%, which is consistent with capitalization rates used in other states for valuing producing wells. The Draft Legislative Rule removes the property tax component, which will result in a decrease in the capitalization rate. The property tax component should be included in the Draft Legislative Rule and in the annual valuation variables released by the Tax Department. Additionally, § 5.4.2.b.2 contemplates the use of an income tax rate to modify the debt portion of the capitalization rate, based on surveys of published effective tax rates applicable to the industry. It is unclear what surveys are being relied upon for this purpose.

Response: This Rule uses a capitalization rate based on a "Build-up-Model" of the Weighted Average Cost of Capital (WACC). The WACC provides an estimate of the overall expected rate of return required by industry equity participants and financial investors to continue to invest in the relevant ongoing industry, and in comparison to other investment options. The Tax

Department believes this to be a more accurate way of valuing oil and gas than the previous capitalization rate. The basis for the capitalization rate factors is annually set forth in the variables published on the State Register and entities have an opportunity to comment on the factors prior them becoming final.

Antero Resources Corporation comment regarding sum of the year's digits:
Sum of the Years Digit - the definition of this term under former § 3.27 has been deleted. This methodology uses a three-year weighted average for various calculations of the old version of the Legislative Rule, particularly for various components of the capitalization rate. Presumably, the "Build-up-Model" of the Weighted Average Cost of Capital (WACC) is intended to replace the sum of the year's digits methodology, and that term should be defined and should include a description of how the WACC is calculated. The Tax Department's draft valuation variables document for tax year 2022 includes data for 2018-20, so it appears that a weighted average is being used; however, the concept is not well defined in the Draft Legislative Rule.

Response: The variables published in the State Register are currently tentative and entities have an opportunity to comment on the factors prior them becoming final.

Antero Resources Corporation comment regarding transportation cost allocation:
Transportation cost allocation - § 7.2.1 provides for the allocation of transportation costs between different products in their gaseous phase, clarification is needed regarding the methodology for all producers to provide a "cost allocation procedure" to the Tax Commissioner, as contemplated under § 7.2.4.

Response: The Tax Department will accept any allocation method, based upon standard accounting principles, that the operator chooses to use.

Antero Resources Corporation comment regarding duplicate definitions:
"Gas plant products" is defined under § 3 .20 and "plant gas products" is defined under§ 3.36. The definition of "plant gas products" should be deleted and the term "gas plant products" should be used throughout the Draft Legislative Rule.

Response: The change suggested in the comment will be made.

Antero Resources Corporation comment regarding complete returns:
Complete return - § 8 of the Draft Legislative Rule provides for alternative "default methods of valuation" when a producer does not file a "complete" return. This section should be amended to provide additional information and guidance regarding whether a filed annual property tax return is "complete." As drafted, this section provides exceedingly broad authority for the Tax Commissioner to deem a filed return "incomplete" and value a well based on the alternative valuation provisions under the section.

Response: Further guidance will be forthcoming with form instructions.

EQT comment regarding reasonable discretion:
The proposed Rule purposely disallows affiliated contractual arrangements in determining the gross receipts or gross proceeds to be considered for valuation purposes and further allows the Tax Commissioner discretion to adjust the gross proceeds if determined that the gross proceeds are unreasonable. Although it appears that the Rule provides for reasonable, actual annual operating costs, the Commissioner can use discretion to adjust these costs if determined to be unreasonable (without any definitions to support this analysis). These rules should be stricken, and gross proceeds should be defined to reflect the price that a willing Buyer and willing Seller would agree to in an arm's length transaction assuming the parties had opposing or adverse economic interests. This accomplishes the same goal of making sure the transactions are fair market value but does not simply ignore corporate structure and any associated affiliated agreements or give unsupported discretion to the Tax Commissioner.

Response: Inclusion of the word "reasonable" in the rule simply makes explicit that which an unbiased reader would ordinarily consider implicit in the language of H.B. 2581, inasmuch as the Legislature should not be considered to have sanctioned the use of unreasonable costs and expenses when calculating net proceeds. In seeking removal of the word "reasonable," the comment implicitly asks for *carte blanche* to claim patently unreasonable amounts. Transactions between related parties are, by definition, not arm's-length transactions.

However, if the affiliate transactions reflect market pricing at arm's length, the Rule, as written, already allows the producer to take such costs under the provisions of section 7.1.2, as the Tax Commissioner would not have to adjust the price to industry averages.

EQT comment regarding NGLs:
Additionally, the governing statute, namely W. Va. Code §§11-lC-l et. seq., does not support the inclusion of gross proceeds from NGLs for purposes of the valuation of wells. More specifically, W. Va. Code §11-1C-10(a)(2) defines "natural resources property" to include "coal, oil, natural gas, limestone, fireclay, dolomite, sandstone, shale, sand and gravel, salt, lead, zinc, manganese, iron ore, radioactive minerals, oil shale, managed timberland as defined in section two of this article, and other minerals." NGLs are not specifically identified in the definition, and as such would have to fall within the category of "other minerals" to be properly included. NGLs are not "minerals" within the ordinary use of the term, but rather are byproducts of the processing of natural gas. An analogous situation would be the processing of gasoline and diesel fuel from oil. The income from these products is too far removed from the resources in their natural state to be included in "other minerals." The Supreme Court of Appeals has held that:

> In the construction of statutes, where general words follow the enumeration of particular classes of persons or things, the general words, under the rule of construction known as ejusdem generis, will be construed as applicable only to persons or things of the same general nature or class as those enumerated, unless an intention to the contrary is clearly shown.

See e.g. Syl. Pt. 4, Ohio Cellular RSA Ltd Partnership v. Bd. of Public Works, 198 W.Va. 416, 481 S.E.2d 722 (1996). NGLs are not "of the same general nature or class" as the enumerated natural resources in §11-1C-IO(a)(2). Not to mention that the natural gas being valued at the wellhead is based on the energy value or heat content of the natural gas (the BTU content) which already encompasses the value of NGL's present in that gas. As a result, the proceeds from NGLs ought to be removed from the income stream of a natural gas well for property tax valuation. Fn1

Fn1 Additionally, as it pertains to NGLs, the proposed Rule would include the gross proceeds for NGLs which are to be measured at the first arm's length point of sale. Often, the first point of sale for NGLs occurs outside of West Virginia. The sourcing of the natural gas products proceeds from processing occurring outside of West Virginia to this State strains constitutional and interstate commerce limitations. In some cases, the processing of NGLs occurs at facilities outside of West Virginia. Computing the income of a West Virginia well to include the proceeds from the sale of NGLs which are processed in another state, in essence, impermissibly includes the value of the out of state processing facilities in the well valuation.

Response: HB 2581 provides specific statutory authority for the Tax Department to subject natural gas liquids to property tax. The statutes provides that for purposes of the emergency rules regarding valuation of property producing oil, natural gas, natural gas liquids, or any combination thereof, fair market value shall be determined through the process of applying a yield capitalization model to the net proceeds. This puts the property taxation in line with the West Virginia Severance Tax, which also looks at the price received from the sale of NGLs. The NGLs are in the natural gas in the well reserve and are part of what is severed at the well. To only include the gross proceeds of the residue gas would significantly under value the well.

EQT comment regarding capitalization rate:
Furthermore, there is also some introductory language from the fiscal note attached to the Rule filing and set forth below that we find to be of concern:

> This rule would offset the costs of fractionation of income from natural gas liquid production and would set a capitalization rate that is lower than the current rate. This would result in a minimal change in revenue. Administrative costs would be $25,000 for system changes in valuation models.

From a plain reading of this language, this could construe utilizing a capitalization rate in the Discounted Cash Flow calculation to achieve the State Tax Department's desired result by applying an "industry risk adjustment" to solve for a desired valuation target and property tax revenue stream. The State Tax Department indicates that the Rule will lower the current capitalization rate and hence raise the appraisal values. While we agree that a capitalization rate can fluctuate based on market changes, the State Tax Department has computed a capitalization rate of approximately 15% over the past ten years. This current capitalization rate used in West Virginia is consistent with the capitalization rate used in Kentucky and Ohio and we believe should remain consistent unless there is market data to support adjusting it. Such a change should not be left to the discretion of the State Tax Department.

Response: This Rule uses a capitalization rate based on a "Build-up-Model" of the Weighted Average Cost of Capital (WACC). The WACC provides an estimate of the overall expected rate of return required by industry equity participants and financial investors to continue to invest in the relevant ongoing industry, and in comparison to other investment options. The Tax Department believes this to be a more accurate way of valuing oil and gas than the previous capitalization rate. The State Tax Department does not have a "desired result" beyond fairly and accurately valuing oil and gas production property.

EQT Corporation's comment regarding information requirements:
Lastly, the Rule requests information that is not necessary to complete the valuation of the property in question, such as location and serial numbers of meters, invoices, and receipts. This new complexity and the updated electronic filing requirements add additional administrative compliance burdens. Additional time, beyond the 30-day granted extension, may be needed to prepare for the e-filing changes.

Response:
Pursuant to W. Va. Code §11-6K-1, the maximum filing extension is one month. The Tax Department has, pursuant to Administrative Notice 2021-17 provided an extension to file these returns until September 1, 2021. The Tax Department cannot extend beyond that date, or it will not have sufficient time to process the returns in order to meet other statutory deadlines.

CNX Gas LLC comment regarding reasonableness:
It seems evident to CNX that the Department anticipates a need to circumvent the actual data provided by producers and instead apply their own perceived reasonableness standard. This overriding tone is visible throughout the Rule and provides uneasiness to CNX. House Bill 2581 plainly states that a producer is to provide "actual" revenues and "actual" expenses to the Department annually. For the Tax Department to then review those revenues and expenses with a critical eye on their own perceived reasonableness, seems contrary to the intent of the Legislature.

Multiple times throughout the Rule, the Tax Department uses the word "reasonable" when describing actual revenues and expense allocations. The apparent intent is to allow the Department flexibility in accepting actual values. A quick search of the word "reasonable" in the Rule has 21 instances, "reasonable efforts," "reasonable compared to industry averages," "reasonable, actual costs," "determined to be unreasonable by the Tax Commissioner," etc. CNX believes that the Tax Department would be ill-equipped to make determinations of what is "reasonable" based on the data being provided.

Producers across the region operate very differently, and CNX would discourage the Department from making such comparisons in a vacuum. The main reversal of House Bill 2581 was to remove the previous cost survey which averaged producer costs and to enable producers to provide actual values in its stead. For the Department to then take those actual values and adjust them to reflect an artificial industry average seems to be contrary to the intent of the Legislature. It would be the position of CNX that any concern the Tax Department has about the values being provided should

result in an audit of that taxpayer's return. The possibility (whether likely or unlikely) that the Tax Department could unilaterally change a taxpayer's revenue or expense amounts without notice or conference with the taxpayer is understandably concerning to CNX.

Response:
Inclusion of the word "reasonable" in the rule simply makes explicit that which an unbiased reader would ordinarily consider implicit in the language of H.B. 2581, inasmuch as the Legislature should not be considered to have sanctioned the use of unreasonable costs and expenses when calculating net proceeds. In seeking removal of the word "reasonable," the comment implicitly asks for *carte blanche* to claim patently unreasonable amounts.

If CNX believes that "the Tax Department would be ill-equipped to make determinations of what is 'reasonable' based on the data being provided," then the Tax Department is interested in knowing what data CNX believes should be provided in order to determine reasonableness. If the producer's costs or revenues are out-of-line with industry averages, the producer should be able to explain why their costs are so high or revenues so low

CNX Gas LLC comment regarding valuation methodology:
CNX is also concerned with the valuation methodology changes that are being presented by the Department. The Rule points out multiple changes to the State's valuation models: the substantial lowering of the capitalization rate, the elimination of the 3-year weighting, removal of the July 1st cutoff, etc. Taken on their own, all of these changes would increase the value of a producing property. The Department has not yet made available valuation models which reflect the Rule changes. Without these models, CNX is at a disadvantage and unable to determine the fiscal stability of their operations within the state.

Response:
The Tax Department provides a valuation spreadsheet on its website to assist taxpayers, but it is not statutory obligated to do so. However, the Tax Department is in the process of updating the valuation spreadsheet and it should be forthcoming.

Greylock Energy, LLC comment regarding section 3.21:
The State has in this definition "at the point of a metered or measured first sale to an unrelated 3rd party". If we have legally binding sales contracts between our production and marketing companies is this acceptable? Also in this section the State defines gross receipts as including "accruals" which leads one to believe we might be taxed on general ledger accruals made for financial statement GAAP purposes. Accruals are estimated required for financial statement purposes only and are simply sales estimates. They should not be included in a definition of gross receipts. Also included in this section is the "monies and consideration" which the operator does not seek to collect through reasonable efforts is also concerning. Are we going to be taxed on amounts we have not actually received or attempted to collect?

Response: By definition, a transaction between related parties is not an arm's-length transaction. However, if the affiliate transactions reflect market pricing at arm's length, the Rule, as written,

already allows the producer to take such costs under the provisions of section 7.1.2, as the Tax Commissioner would not have to adjust the price to industry averages.

There are three generally accepted approaches to valuing property that may be considered when estimating the market value of property tax purposes. These are cost, market, and income approaches. The income approach to value is based upon the assumption that a property is worth the future income, discounted to present worth, that it will generate for a prospective buyer. This is the approach used by the state in value natural resource properties. It is not an income tax. If the producer does not attempt to collect money due it, it does not change the value of the well.

Greylock Energy, LLC comment regarding sections 4.2.2 and 4.3.1:
How did you determine the production amounts for the safe harbor provisions? One might refer to the production amounts as defined by the National Stripper Well Association and EIA which is much higher. What is the precise formula for the assessment percentage for these wells?

Response: The Tax Department has offered a safe harbor for small producers that may not be able to calculate their actual operating costs. The Tax Department will amend this language so that anyone who does not wish to calculate their operating costs may use the safe harbor. This is an option that taxpayers may choose. The safe harbor amount will be average industry operating expenses as set forth in the natural resource property variables published in the State Register.

Greylock Energy, LLC comment regarding section 4.4.2:
States the commissioner will annually determine the working and royalty percentage interests on a per well basis. I'm not sure why this section is here and what it will be used for. All operators have different royalty arrangements which may result in some operators having average royalty interest percentages that are higher than industry averages.

Response: The text of section 4.4.2 of the proposed rule is part of the existing rule. The only proposed change is to strike the words "or operator" from the text. This change is simply one of consolidation, since "producer" and "operator" are treated as synonymous. This section of the rule does not mention "industry averages," and so the meaning of the comment is unclear.

Greylock Energy, LLC comment regarding section 5.1:
Why are you removing the decline adjustment to July 1st? The intention of this section was to take our prior 12-month calendar year sales and decline them to arrive at a correct July 1st value. The State is using the prior 12 months calendar year sales and production as a basis for valuation as of the July 1st assessment date. By removing this decline adjustment you are overstating their valuation (and our values) with an extra six months of value.

Response: The changes to the valuation methodology in HB 2581 make clear that the value of the well shall be determined based upon the actual gross receipts. This change is necessary to comport with that requirement.

Greylock Energy, LLC comment regarding section 7.2:
Allocation of Operating Cost among product types: How are we going to allocate common operating wells costs between product types? If we perform normal well-tending work on a well that produces both oil and gas we don't separate those costs. If we allocate all of those costs to one product type, will that not cause a higher discounted cash flow and appraised value for the product that doesn't get allocated those costs? Will you allow us to develop our own rational allocation of costs in these circumstances or will you develop your own allocation?

Response: The Tax Department will accept any allocation method, based upon standard accounting principles, that the operator chooses to use.

Greylock Energy, LLC comment regarding section 9.1.1.h:
States we must report the location and serial number of the meter that is the first point of sale. Are you wanting our internal identifying number for the meter?, the gas purchaser's identifying number for the meter?, or the manufacturer's serial number on the meter? Not sure what the intent of this section is.

Response: Further guidance will be forthcoming with form instructions.

Denex Petroleum Corp. comment regarding capitalization rate:
The State Tax Department has proposed a reduction in the capitalization rate used to discount cash flow from 15% to just 10.8%, a decrease of about 28%. Given the nature and uncertainties of oil and gas production, and the volatility of commodity prices, 10.8% does not seem to be an appropriate rate. It seems like this system is NOT designed to calculate "true and actual value", but rather to artificially inflate the value of the properties to generate increased tax revenues. That is contrary to what is mandated under West Virginia Code §l l-6K-l(a) or West Virginia Code §11-3-1 (a). Again, Rules do not trump Statutes. Rather, Rules should be promulgated to administer the Statutes in strict accordance with the intent thereof. It would seem likely that larger shale producers would be inclined to challenge this capitalization rate in court as being unjust and unreasonable.

Response: The capitalization rate is set forth in a list of tentative natural resource variables, not in the proposed rule, and so no response to this comment is necessary.

Denex Petroleum Corp. comment regarding NYMEX pricing:
In recent weeks, the NYMEX price of natural gas has dramatically increased. However, that is the price of gas at Henry Hub, in Louisiana. Regrettably, due to capacity constraints on pipelines serving West Virginia and the other Appalachian states, prices for West Virginia gas are often as much as dollar below the NYMEX price. That "basis" is volatile, and peaked at $1.52 in July 2015. Any methodology used to evaluate gas wells in West Virginia should consider the net prices for Appalachian production and should never be based on NYMEX pricing.

Response: The proposed rule does not mention NYMEX pricing, so no response to this comment is necessary.

Denex Petroleum Corp. comment regarding de minimis exemption:
Small producers, like Denex, recognize that the aggregate value of their conventional wells is de minimis, especially given today's price for Appalachian gas. The real value is in the non-conventional horizontal shale wells. The number of non-conventional wells in West Virginia is quite small compared to the number of conventional wells. It would seem reasonable to use different forms for these different types of wells, at least initially.

The vast majority of conventional wells are currently operating at a loss, due primarily to the fact that natural gas prices are at historic lows, especially in capacity-constrained West Virginia. This may not be obvious to the State Tax Department, as it has failed in the past to consider actual operating expenses, opting instead to use 30% of gross income as expenses. As gas prices and production declined, gross revenues decreased significantly. This led to a substantial decline in the expense deductions allowed in the State Tax Department's calculations. Meanwhile, the operators' actual expenses did not decrease, and, in fact, the same increased over time. Accordingly, the State Tax Department assigned significant values to wells that were uneconomic and operating at a loss. Such wells have minimal, if any, value. The State Tax Department should consider exempting wells with minimal daily production, which would significantly decrease the burden on the State Tax Department while having minimal reductions in tax revenue.

Response: The Tax Department will consider a *de minimis* exemption, including whether it has authority to establish such an exemption absent Legislative direction.

R. Terrance Rodgers, of the law firm Kay Casto and Chaney PLLC, submitted comments on behalf of the county commissions of Doddridge County and Harrison County.

Rodgers comment regarding section 3.2:
In Section 3.2 thereof, in the third line, it is suggested that the words "directly and solely" be inserted between the word "costs" and the word "incurred."

Response: The suggested change in section 3.2 will be made.

Rodgers comment regarding sections 3.16 and 3.38:
With regard to the definition of "[e]conomic interests" set forth in Section 3.16 thereof and the use of the term "economic interests" in Section 3.38 thereof, it is suggested that the same are too broad and potentially open the door for abuse by the oil and gas producers.

Response: The Tax Department disagrees that the term "economic interests" is overly broad in its definition or application.

Rodgers comment regarding section 3.38:
With regard to the definition of "[p]roducer" and "[o]perator" in Section 3.38 thereof, it is suggested that the apparent effective inclusion of what are commonly referred to as "overriding royalty interest owners" be deleted.

Response: The Tax Department does not see where that term is included in section 3.38.

Rodgers comment regarding section 3.46:
As to Section 3.46 thereof (the definition of "Total Production"), there is a reference to "all oil, natural gas liquids and natural gas actually produced and sold from a single well that is developed and producing on the assessment date." What happens if the oil, natural gas liquids or natural gas is not sold on the "assessment date"? In other words, what if the oil, natural gas liquids or natural gas are produced, but not sold, on the "assessment date"? What if the oil, natural gas liquids or natural gas are produced on the "assessment date," but are effectively in storage on the "assessment date"? Does that mean that such oil, natural gas liquids or natural gas is not to be factored in in determining the ad valorem tax? It is suggested that these questions be answered as the Tax Commissioner continues to promulgate his PROPOSED Legislative Rule.

Response: HB 2581 requires the assessment to be on the actual price received from the sale, therefore, it is unclear how the State Tax Department has statutory authority to consider gas that is severed but not sold.

Rodgers comment regarding section 4.4:
Section 4.4 thereof raises the question of what happens if the "lease or other arrangement" is not "typical"? It is suggested that one or more additional examples, other than the example given in Section 4.4.1 thereof, be provided by the Tax Commissioner as he continues to promulgate his PROPOSED Legislative Rule.

Response: The Tax Department will consider providing additional guidance on any issue, if necessary, in the form of administrative notices, TSDs, or filing instructions.

Rodgers comment regarding section 5.4:
As to the "single state-wide capitalization rate for oil, natural gas, and natural gas liquids" mentioned in Section 5.4 thereof, exactly when and exactly how will that rate be determined? It is suggested that said "when" and said "how" be addressed as the Tax Commissioner continues to promulgate his PROPOSED Legislative Rule.

Response: The state-wide capitalization rate is determined annually, as set forth in section 5.4 of the proposed rule. The basis for the capitalization rate factors is annualy set forth in the variables published on the State Register. The tentative variables have been filed and individuals have an opportunity to comment on the factors prior them becoming final.

Rodgers comment regarding section 6.2.1:
Section 6.2.1 thereof contemplates a possible "review and audit by the Tax Commissioner" of certain "data" retained by the oil and/or natural gas producers. What exactly are the Tax Commissioner's plans for conducting such "review[s] and audit[s]"? For example, will such "review[s] and audit[s]" be conducted with regard to every oil and gas producer in the State of West Virginia or will they be randomly conducted or will they be based upon some criteria predetermined by the Tax Commissioner and/or the Tax Department? If it is the latter, what will that predetermined criteria be? Also, what happens if the oil and/or gas producer has not retained the "data"? It is suggested that all of these questions be answered as the Tax Commissioner continues to promulgate his PROPOSED Legislative Rule;

Response: The Tax Department will review returns to see if additional information or clarification is necessary. It is based upon this process that audits will be completed if necessary.

Rodgers comment regarding section7.2.4:
As to Section 7.2.4 thereof, what "additional information" does the Tax Commissioner and/or the Tax Department believe will be "necessary"? It is suggested that this question be answered as the Tax Commissioner continues to promulgate his PROPOSED Legislative Rule.

Response: Whether and what additional information is necessary will be contingent on what information is included in the proposal. By definition, it can only be determined on a case-by-case basis.

Rodgers comment regarding sections 7.3.2 and 7.4:
As to Section 7.3.2 thereof, it is suggested that attorney fees and expenses be specifically excluded from "lease operating expenses." In a like manner, in Section 7.4 thereof, attorney fees and expenses should specifically be included in "non-allowable costs." With regard to Section 7 .3 .2 thereof and Section 7.4 thereof, it is suggested that Section 7.3.2 thereof make clear reference to Section 7.4 thereof, to clarify that the various "non-allowable costs" set forth in Section 7.4 thereof are not to be included in the "actual operating costs" referenced in Section 7.3 thereof. In a like manner, it is suggested that Section 7.4 thereof make clear reference to Section 7.3.2 thereof;

Response: This clarification will be made in the Rule

Rodgers comment regarding section 8.1:
Is it possible for the concept set forth in Section 8.1 thereof to be the entire PROPOSED Legislative Rule with regard to valuing oil and/or gas wells for ad valorem tax purposes? It is suggested that the Tax Commissioner consider such possibility as he continues to promulgate his PROPOSED Legislative Rule.

Response: The Tax Department considers the more expansive amendments to the existing Series 01J of Title 110 to be necessary to carry out the intent of the Legislature and provide guidance to taxpayers and counties.