

BEFORE THE STATE ASSESSMENT REVIEW BOARD

STATE OF ALASKA

IN THE MATTER OF)
 DOYON DRILLING, INC.)
 DOYON PARKER JOINT VENTURE)
 NABORS ALASKA DRILLING, INC.)
 NORDIC-CALISTA SERVICES NO. 1)
 PARKER DRILLING, INC.)
 POOL ALASKA, INC.)
)
 OIL & GAS PROPERTY TAX (AS 43.56))
 1997 ASSESSMENT YEAR)
)

CERTIFICATE OF DETERMINATION

The State Assessment Review Board convened on May 12, 13 and 14, 1997 to hear the appeals of Doyon Drilling, Inc., Doyon Parker Joint Venture, Nabors Alaska Drilling, Inc., Nordic-Calista Services No. 1, Parker Drilling, Inc., and Pool Alaska, Inc. (Taxpayers) of the assessments issued to them under AS 43.56 by the Oil and Gas Audit Division. The appeals were consolidated for hearing.

Chairman Steven L. Van Sant and members Wayne D. Haerer, Jr., Christopher C. Follis and Richard Stovarsky were present, constituting a quorum as required by AS 43.56.130(b). The Taxpayers were represented at the hearing by Robin O. Brena, Brena & McLaughlin, P.C. The Oil and Gas Audit Division was represented by Assistant Attorney General John P. Griffin and by Ronald Bitzer, Appeals Officer. The North Slope Borough Intervened in the appeal. The Borough was represented by David D. Clark, Law Office of David D. Clark.

DISCUSSION

The Taxpayers appealed the assessments affirmed by the Oil and Gas Audit Division in Department Decision 97-56-05 (Doyon Drilling, Inc.), Department Decision 97-56-09 (Doyon Parker Joint Venture), Department Decision 97-56-08 (Nabors Alaska Drilling, Inc.), Department Decision 97-56-07 (Nordic-Calista Services No. 1), Department Decision 97-56-04) Parker Drilling, Inc., and Department Decision 97-56-06 (Pool Alaska, Inc.). The properties assessed include drilling rigs, camps, and machinery and equipment located in the North Slope Borough and in the Kenai Peninsula Borough.

Division's Assessment

The Oil and Gas Audit Division made no changes to its methodology for valuing drilling rigs from 1996 to 1997, except for one. It adjusted the economic obsolescence factor, based on its belief that the factors it has applied in recent years no longer reflect market conditions in Alaska. Economic obsolescence was first applied approximately ten years ago, following the downturn in the oil and gas industry in Alaska in the mid-1980's. In 1987 and in each succeeding year, the Division reduced its final assessment by an obsolescence factor, depending on the type of rig. It computed the factor based on either local sales on the North Slope, or, in the absence of these sales, comparable transactions in the Lower 48. The scarcity of actual bona-fide, arm's length sales proved to be a continuing problem in calculating the factor. See Letter from Richard Brewer dated February 5, 1996.

As economic conditions improved in the oil industry, the Division began to question its use of the economic obsolescence factor. Discussions ensued among Division personnel, rig owners, and representatives of the North Slope Borough, starting in 1992. The Borough supported the use of an income approach; industry officials opposed the use of approaches other than cost or market. The Division suggested that rig utilization, or days worked, might be an appropriate measure of economic obsolescence. See Prehearing Statement filed by Division May 2, 1997.

No agreement was reached by the parties. For the 1997 assessment year, the Division had, for the first time, no market data to confirm its economic obsolescence factor. In the absence of this or any other information supplied by the rig owners, the Division decided to use published information to determine drilling activity in the state as a basis for calculating a new economic obsolescence factor. The Department developed a rig activity data base using weekly drilling data for the years 1994, 1995 and 1996. Economic obsolescence factors were calculated for three categories of rigs, development, exploration, and workover, using the reciprocal of the three year average of the average percent of time available. Testimony of Richard Momarts.

For the rigs at issue in this appeal, the Division's new economic obsolescence factors resulted in a total assessment of \$151,450,186.00. The 1996 assessed valuation of these same rigs was \$59,280,758.00, representing an increase of approximately 155% from 1996 to 1997. Exhibits 2 & 3.

Taxpayers' Argument

The Taxpayers argue that the Division's use of drill rig utilization to determine economic obsolescence is arbitrary. They maintain that under AS 43.56 the Division must determine "full and true value." This term means "the

estimated price that the property would bring in an open market and under the then prevailing market conditions in a sale between a willing seller and a willing buyer both conversant with the property and the prevailing general price levels. AS 43.56.060(c). 15 AAC 56.090(a) provides:

Market data including recent sales in the area of like property will be used where there is reliable information available. In the absence of sufficient reliable market data other accepted appraisal techniques will be applied.

Taxpayers' Volume I, Statement of the Case.

Other acceptable appraisal techniques are, according to the Taxpayers, the sales comparison approach and the cost approach. Of these, they argue that the sales comparison approach is the preferred approach, when sales data are available. If there is not enough information to support a market approach, the cost approach is typically applied. Economic obsolescence, an important factor in the cost approach, is derived from the market. It arises from economic forces external to the property, and may be caused by any number of factors, including availability of raw materials, labor supply, market accessibility, and industry economics. Taxpayers' Volume I, Theoretical Analysis.

The Division used a cost model, which, according to one of the Taxpayers' expert witnesses, was not in accord with standard appraisal techniques. The Division used local rig utilization to determine economic obsolescence, which may be a component which affects a market, but the market does not react on a linear basis to utilization. The Division used no cross check to the market based on sales, and other components were not considered. Utilization is not, by itself, the measurement for deriving economic obsolescence. Testimony of Leslie H. Miles.

The Taxpayers conducted their own appraisal to determine full and true value, using primarily a sales comparison approach. In considering comparables, the sales of drilling rigs and their major components in Alaska were taken into consideration as well as in the Lower 48. Testimony of J. Michael Clarkson.

The dates of transaction for the Alaska rig transactions ranged from June 1993 to June 1996. Exhibit 9. As for market activity in the Lower 48, company transactions within one year of the date of appraisal were used. The total valuation for North Slope rigs was determined to be \$55,730,990.00, and for all of the rigs at issue \$62,701,950.00. Exhibit 3.

Intervenor's Case

The North Slope Borough advocates the use of an Income approach. The Borough asserts that reliance on an Income approach is precluded, however, because there is no reliable Alaska market information, nor has information on the income generated by the specific properties been provided by the drill owners. The Borough argues that it needs information on current day rates and expenses and other income information in order to do an complete income analysis for valuation purposes. NSB's Prehearing Statement.

The Borough filed a request with the Board, asking that administrative subpoenas be issued by the Board compelling the rig owners to submit the financial information necessary for an income appraisal. The Borough's request was denied by the Board.

The Borough hired Harvey A. Davis, an appraiser with HADCO International, Inc., to value the rigs located within the Borough. His valuation was based on data from on site inspections, the HADCO International data base, and market research. In estimating the value, Mr. Davis used the cost approach, the market approach and the income approach. The values arrived at from each of the three approaches were weighted to arrive at a final estimation of value. The market approach was given the most weight, because it is a good indicator of value when there is an active market for sales. The cost approach was given the second greatest weight in value. The income approach was given less weight because of the lack of verifiable data for each of the subject rigs. The Appraiser relied on data from a published source and comments by employees of the rig owners to estimate income, because income information from the rig owners was lacking. Testimony of Harvey A. Davis.

The total fair market value of all the rigs located in the North Slope Borough was determined to be \$93,294,000.00. NSB's Appraisal Opinion Report.

CONCLUSIONS

Under AS 43.56.130(e), the appellant bears the burden of proof at a hearing before the State Assessment Review Board. The only grounds for adjustment of assessed value is proof of unequal, excessive or improper valuation, or valuation not determined in accordance with the standards set out in AS 43.56. AS 43.56.130(f).

Based on the written evidence and testimony presented to it, the Board concluded by unanimous vote that the Taxpayers carried their burden of proof. The Taxpayers' appraisal, taken in conjunction with the Intervenor's appraisal, was, in the opinion of the Board, sufficient to show that the Division's assessment was excessive. The Board was not convinced, however, that the appraisal put

forth by the Taxpayers represents the full and true value of the rigs.

The Taxpayers' appraiser failed to consider weatherization and heating, and transportation to the North Slope, both of which are important and unique factors in Alaska. Further, the Taxpayers' appraiser relied on local market data dating back to 1993, which included sales which were not shown to be arm's length transactions.

The Board found the Borough's appraisal to be more credible than the Taxpayers' appraisal. The Borough's appraisal accounted for Arctic features, mobility, and transportation and insurance costs, and used more realistic remaining useful life factors. The market data used was generally more complete than that used by the Taxpayers, and it applied a weighting approach which was, in the opinion of the Board, appropriate and useful.

The Board did not approve of one aspect of the Borough's appraisal. The Borough's appraiser basically rejected economic obsolescence as a valid factor in determining depreciation under the cost approach. The Board has consistently upheld the use of an economic obsolescence factor by the Division over the years. In this assessment year, however, the Board was unable to approve the Division's method for arriving at an economic obsolescence factor. The Division used rig utilization alone to determine economic obsolescence. This is just one factor, however, in economic obsolescence and cannot, in the opinion of the Board, be the only factor.

The Division was forced to rely on a single factor in determining economic obsolescence this year because it lacked market data. The lack of market data resulted from, at least in part, a pattern of under-funding and under-staffing that has plagued the property tax function in the Oil and Gas Audit Division for the past several years. The Board wishes to express its concern over this situation. It is apparent to the Board that the Division simply does not have sufficient resources to conduct a complete appraisal. This observation is not intended as a criticism of those involved in preparing the Division's assessments. It is equally apparent to the Board that those responsible for the assessments are doing the best they can with what resources they have. The Board is making this observation solely in the hope that the problem will be rectified, and that adequate funding will be sought and granted so that the property tax function can be performed in a professional and reliable manner.

The Board accepts the Intervenor's appraisal as the best evidence before it of the full and true value of the drilling rigs located in the North Slope Borough. The Board has no similar acceptable alternative for the rigs located in the Kenai Peninsula Borough. The Division's valuation is excessive, and the Taxpayers' valuation suffers from the inadequacies discussed above. The Board is unable,

however, with the time constraints imposed by law, to develop its own valuation which would more accurately reflect the values of the Kenai area rigs. It accepts therefore, with reservations, the Taxpayers' valuation of these rigs as the best evidence before it of the value of the rigs located in the Kenai Peninsula Borough.


The valuations accepted by the Board are those shown in Taxpayers' Exhibit 3, entitled "Valuation Comparisons - All Rigs," with two corrections. The Borough value for Parker 245 should be \$11,196,000.00. The value for D/P J.V. 141 should be \$11,744,000.00. This results in a total Borough valuation of the North Slope rigs of \$93,294,000.00. With those exceptions, the valuations shown in the last column entitled "Borough (Corrected)" on Exhibit 3 are accepted as the 1997 assessed values for the North Slope rigs at issue in this appeal. For the Kenai area rigs, the valuations shown in the column entitled "Contractors" on Exhibit 3 are accepted as the 1997 assessed valuations.

The Division's assessments and the Taxpayers' appeals included some properties which were not drilling rigs and related properties. No evidence was presented on these miscellaneous properties at the hearing. The Board concludes therefore that the Taxpayers did not carry their burden of proof on these properties, and the Division's assessments are accepted without adjustment.

CERTIFICATION

Pursuant to AS 43.56.130(g), the undersigned, on behalf of, and as Chairman of, the State Assessment Review Board, certifies to the Department of Revenue, State of Alaska, that the Board has made its determination as stated in this Certificate of Determination.

DATED: May 21, 1997


Steven L. Van Sant, Chair
State Assessment Review Board