

STATE OF MICHIGAN
COURT OF APPEALS

WARD LAKE DRILLING, INC.,

Petitioner-Appellant,

v

CHARLTON TOWNSHIP,

Respondent-Appellee,

and

MICHIGAN STATE TAX COMMISSION,

Intervening Appellee.

UNPUBLISHED

May 12, 1998

No. 197218

Michigan Tax Tribunal

LC Nos. 172865; 173162;

173166; 173167; 173168,

192536; 217207; and 222302

Before: Griffin, P.J., and McDonald and O'Connell, JJ.

PER CURIAM.

Petitioner Ward Lake Drilling, Inc., appeals as of right from the decisions of the Michigan Tax Tribunal (Tribunal) affirming respondent Charlton Township's valuation of Ward Lake Drilling, Inc.'s (Ward Lake) personal property used in connection with its gas and oil extraction operations for tax years 1992 through 1995. We affirm.

At issue is the value of equipment used in connection with Ward Lake's natural gas extraction operations, encompassing 327 operating gas wells and nineteen processing facilities on twenty separate parcels of leased land. The equipment includes all that is necessary to access, collect, compress, transport, refine and store the natural gas and involves apparatus that is located both above and below ground. After Ward Lake challenged the township's assessments for the tax years 1992-1995, the cases were consolidated due to the similarity of the properties and issues presented.

In a partial judgment entered on December 5, 1995, the Tribunal rejected as a matter of law Ward Lake's contentions that the equipment was exempt from taxation under the Severance Tax Act, MCL 205.315; MSA 7.365, and that the value of the equipment should be assessed to the owners of

the real estate. On July 31, 1996, the Tribunal entered its final opinion and order, which found that Ward Lake had failed to present sufficient evidence of the existence of a reliable market for used equipment of this type to justify use of the market approach to valuation and that the State Tax Commission (STC) multipliers provided a reliable method for determining the true cash value of the property. The Tribunal was unpersuaded by Ward Lake's arguments that installation costs should not be included in the valuation of the equipment, that economic obsolescence was insufficiently accounted for in the STC multipliers, and that the STC multipliers unconstitutionally taxed the equipment based on its "value-in-use." On appeal, Ward Lake argues that the Tribunal erred in connection with each of these rulings and by failing to make an independent determination of true cash value.

In the absence of fraud, this Court's review of a decision of the Tribunal is limited to whether the Tribunal committed an error of law or adopted a wrong principle. Const 1963, art 6, § 28; *Meadowlanes Ltd Dividend Housing Ass'n v Holland*, 437 Mich 473, 482-483; 473 NW2d 636 (1991); *Jones & Laughlin Steel Corp v City of Warren*, 193 Mich App 348, 352; 483 NW2d 416 (1992). The Tribunal's findings of fact will be affirmed if they are supported by competent, material and substantial evidence on the whole record. *Id.* The petitioner bears the burden in all cases of establishing the true cash value of the property. MCL 205.737(3); MSA 7.650(37)(3); *Jones & Laughlin, supra* at 353.

First, Ward Lake contends that the Tribunal erred as a matter of law in finding that the equipment at issue is not exempt from taxation under the Severance Tax Act, MCL 205.315; MSA 7.365. That section provides in relevant part:

The severance tax herein provided for shall be in lieu of all other taxes, state or local, upon the oil or gas, the property rights attached thereto or inherent therein, or the values created thereby; upon all leases or the rights to develop and operate any lands of this state for oil or gas, the values created thereby and the property rights attached to or inherent therein: Provided, however, Nothing herein contained shall in anywise exempt the machinery, appliances, pipe lines, tanks and other equipment used in the development or operation of said leases, or used to transmit or transport the said oil or gas

Ward Lake argues that the equipment comes within the scope of the exemption because its value is "created" by the existence of oil and gas deposits. In view of the express language of the statute stating that the exemption shall not apply to machinery or equipment, we find no error in the Tribunal's decision with regard to this issue.

Next, Ward Lake asserts that the Tribunal erred as a matter of law when it relied on MCL 211.8(d); MSA 7.8(d) to conclude that the underground pipes and other equipment were assessable to it and not to the owner of the parcel. Section 8(d) provides that buildings and improvements "located upon" leased lands are assessable to the lessee as personal property unless the value of the realty is also assessed to the lessee. Ward Lake contends that its underground equipment is not personal property "located upon" the parcels but is instead an improvement that is "installed and constructed" on the

leased property that, under subsection 8(h), can only be assessed as personal property to the extent that the improvements or structures add value to the real estate.

Although not directly applicable, we note that subsection 8(g), expressly provides that the mains, pipes, and lines of “natural gas companies” are assessable as personal property. At oral argument, the parties stipulated that Ward Lake is not a “natural gas company,” but is instead a natural gas drilling company. However, we find that subsection 8(g) is indicative of the Legislature’s intent that the value of natural gas lines, pipes and other equipment should be assessed as the personal property of the owner of the equipment who derives a direct commercial profit from its presence, in this case Ward Lake, rather than the landowner on whose property the equipment is located. Consequently, the Tribunal correctly concluded that Ward Lake’s equipment is assessable as personal property under MCL 211.8; MSA 7.8 regardless of whether it is affixed to the surrounding real property. Although Ward Lake contends in part that the underground equipment should not be assessed as personal property because it is abandoned once the well is exhausted, this Court has previously held that underground cable television transmission equipment is properly assessed as personal property even though it is not routinely removed when service is terminated. *Continental Cablevision of Michigan, Inc v City of Roseville*, 158 Mich App 60, 64-65; 404 NW2d 704 (1987), aff’d 430 Mich 727; 425 NW2d 53 (1988). Therefore, we find no error in the Tribunal’s disposition of this issue.

Ward Lake further argues that the Tribunal erred by failing to use a market or sales comparison approach to determine the property’s true cash value. The term “cash value” is defined at MCL 211.27(1); MSA 7.27(1) as “the usual selling price at the place where the property . . . is at the time of assessment” and is synonymous with fair market value. The value of property for tax assessment purposes is commonly determined by one of three methods: the market or sales comparison approach, the cost-less-depreciation approach, or the capitalization of income approach. *Meadowlanes, supra* at 484-485. Ward Lake contends that the evidence presented at the hearing demonstrated the existence of a viable market for the equipment at issue, and that the market approach would provide a more accurate method of determining the true cash value of the property than that provided by the use of the STC multipliers, which primarily rely on a cost-less-depreciation approach. However, we find that the Tribunal’s resolution of this issue was supported by the record.

While there was evidence presented of a limited¹ market for used or salvaged equipment, both experts who testified for Ward Lake admitted that the equipment was worth more installed and functioning as a producing well than it would be if dismantled and sold piecemeal. There is no dispute that, at the time of assessment, the equipment was in place and operating; thus, a valuation based on equipment not in use that has been disconnected and disassembled does not reflect the true cash value of the property “at the time of assessment” as required by § 27(1). Thus, while a market or sales comparison approach may be appropriate in cases such as this, the appropriate market would consist of comparable equipment sold as a unit in connection with the sale of an operating well. Neither party offered any evidence in this regard. Therefore, we conclude that the Tribunal did not err by failing to employ a market or sales comparison approach because there was no evidence to support the application of that approach.

Moreover, Ward Lake's valuation expert, Richard vonReichbauer, a dealer in used gas well equipment, admitted that not all the equipment was included in his valuation and that the values he placed on the equipment were not retail prices, or what the equipment would sell for, but salvage or wholesale prices that he would be willing to pay in the event of a dry well, a bankrupt operator or a faulty piece of equipment. He further conceded that the owner of an operating well would be unlikely to sell the equipment for the prices he quoted. Such a valuation does not meet the requirements of § 27(1) in establishing the "usual selling price" of the property at issue. Consequently, we find that the Tribunal's conclusion that Ward Lake failed to meet its burden of proof with regard to establishing the true cash value of its equipment was supported by competent, material and substantial evidence.

We will next address the three ways in which Ward Lake contends the STC multipliers are deficient. According to Ward Lake, the STC multipliers do not provide an accurate method for determining the true cash value of its equipment because the multipliers improperly increase the value of the property based on its use rather than its market value, because they do not factor in economic obsolescence, and because installation costs are included in the assessment.

The Michigan Constitution mandates that property be assessed in a uniform manner. Const 1963, art 9, § 3. The STC manual sets forth the guidelines for the uniform assessment of property and must be utilized in preparing an assessment. MCL 211.10e; MSA 7.10(5). Under the guidelines, all personal property is placed into one of three categories: in use, idle, or obsolete/surplus. The manual recommends a 50% reduction from the cost-less-depreciation value of the property if the property is "idled" or a 75% reduction in value if the property is considered "obsolete or surplus." Ward Lake argues, as it did before the Tribunal, that this method is improper because it taxes personal property based on the use to which the property is put and not on the basis of its market value.

This Court recently rejected an identical argument in *Lionel Trains, Inc v Chesterfield Twp*, 224 Mich App 350; 568 NW2d 685 (1997). As indicated in that case, the existing use to which personal property is put is relevant to the fair market value of the property when it is indicative of the use a potential buyer may make of it. *Id.* at 352; see also MCL 211.27(1); MSA 7.27(1) (authorizing consideration of "existing use" in valuation of property); *Meadowlanes, supra* at 484; *Clark Equipment Co v Leoni Twp*, 113 Mich App 778; 318 NW2d 586 (1982); *Safran Printing Co v Detroit*, 88 Mich App 376, 382; 276 NW2d 602 (1979). Consideration of the use to which property is put is improper only when that use bears no relationship to what a buyer would pay for the property. *Safran Printing, supra* at 382. As has been noted, both experts who testified on behalf of Ward Lake admitted that the equipment at issue was worth more in place and operating than it would be if dismantled and removed. Consequently, we find the Tribunal's determination that the STC multipliers reflect valid considerations affecting the market value of the equipment at issue to be supported by competent and substantial evidence.

Ward Lake also asserts that the STC multipliers are inadequate because they fail to account for economic obsolescence. Two types of obsolescence, functional and economic, have been recognized as factors significant to the determination of the fair market value of property. *Fisher-New Center Co v State Tax Comm*, 380 Mich 340, 362; 157 NW2d 271 (1968); *Jones & Laughlin, supra* at 356. Functional obsolescence is a reduction in value that is the result of internal characteristics of the property

itself, such as poor design or inappropriate capacity. *Fisher-New Center Co*, *supra* at 362. Economic obsolescence, more properly called external obsolescence, is a reduction in value that is the result of outside conditions. *Id.* For example, external obsolescence would be a factor to consider with regard to the value of equipment such as that involved in this case if the natural gas well were to lose pressure or go dry, or if the price of natural gas were to drop significantly. Ward Lake argues that the STC multipliers fail to account for such external factors.

The evidence presented at the hearing demonstrated that, in addition to the reductions in value for idle, surplus or obsolete property, STC policy permits an additional reduction in assessed value for equipment used in connection with oil and gas wells that have lowered production, and in fact assigns a zero value to equipment associated with dry wells. The Tribunal correctly found that these considerations reflect a recognition of economic obsolescence caused by decreases in production as a factor affecting the market value of the equipment. Although Ward Lake also contended that the STC multipliers fail to account for drops in the price of natural gas that would also create economic obsolescence, there was no evidence whatsoever presented at the hearing demonstrating that Ward Lake had been adversely affected by fluctuations in the price of gas. Consequently, the Tribunal did not err in concluding that Ward Lake had failed to meet its burden of showing that the use of the STC multipliers resulted in an assessment in excess of the true cash value of the equipment.

Ward Lake further argues that use of the STC multipliers results in an inflated assessment because installation costs are taken into account. The Tribunal rejected this argument, finding that “under normal conditions, personal property similar to the subject property in this case is sold in working order as part of an operating well or central processing facility.” For this reason, it concluded that “installation costs are properly included as part of the ‘usual selling price at the place where the property to which the term is applied is at the time of assessment’” Review of this issue is inappropriate because it was not raised in Ward Lake’s statement of questions presented. *Marx v Dep’t of Commerce*, 220 Mich App 66, 81; 558 NW2d 460 (1996); *Orion Twp v State Tax Comm*, 195 Mich App 13, 18; 489 NW2d 120 (1992). However, we briefly note that in *Lionel Trains*, *supra* at 354-355, this Court rejected a similar argument and observed that the Tribunal’s determination of the extent to which installation costs are included in the market value of the property is entitled to deference.

Finally, Ward Lake argues that because it met its burden of going forward with evidence, the Tribunal erred by failing to make an independent valuation of the property using the methodology espoused by Ward Lake’s other expert witness, J. Michael Clarkson. We disagree.

Once a petitioner in a tax case meets his burden of going forward with evidence challenging the assessment, “[t]he tribunal may not automatically accept a respondent’s assessment, but must make its own findings of fact and arrive at a legally supportable conclusion.” *Jones & Laughlin*, *supra* at 355. However, this does not bar the Tribunal from finding that a respondent’s valuation accurately reflects the fair market value of the property. *Id.* at 356. In this case, Clarkson was not listed as a valuation witness and presented no appraisal, but merely testified with regard to his methodology for determining the value of oil and gas drilling equipment, one that he claimed adequately accounted for economic obsolescence. Even if the Tribunal had accepted Clarkson’s theory of valuation, his formula was of little

practical use in the absence of a corresponding appraisal that would have provided a factual foundation for evaluation.² Consequently, Clarkson's testimony served only to raise an issue of fact with regard to whether the STC multipliers and corresponding policy bulletins provided a reliable method of determining the true cash value of property. The Tribunal's analysis of the adequacy with which the STC multipliers and policy bulletins account for economic obsolescence satisfied its obligation to make an independent determination based on the facts of the case, particularly in view of the fact that the only appraisal submitted to the Tribunal meeting the requirements of § 27(1) was that provided by the township. As we have determined, the Tribunal's determination that the assessment adequately reflected the property's fair market value, including adjustments that were sufficient to account for any economic obsolescence that was demonstrated in this case, was supported by competent, material and substantial evidence.

In conclusion, we find that the Tribunal did not commit an error of law when it concluded that the equipment at issue was not exempt under the Severance Tax Act or when it determined that the property was properly assessed to Ward Lake and not to the owners of the real estate on which it is located. Further, we find that the Tribunal's determination that the STC multipliers provide an appropriate and reliable method for determining the fair market value of the property at issue in this case was supported by competent, material and substantial evidence.

Affirmed.

/s/ Richard Allen Griffin

/s/ Gary R. McDonald

/s/ Peter D. O'Connell

¹ The evidence demonstrated that the cost of excavating much of the equipment would have far exceeded its value as scrap, that many pieces were simply not reusable, and that some of the equipment would have to undergo costly treatment to remove contaminants, including naturally occurring radioactive material, before it could be resold.

² The Tribunal properly granted respondents' motion to strike the supplemental material submitted with Ward Lakes' corrected exhibit P-8, which was amended to include Clarkson's appraisal after the hearing. Prior to the hearing, both sides exchanged appraisals as required by the Tribunal's administrative rules. Ward Lake's appraisal at that time consisted solely of vonReichbauer's valuations. At the hearing, after it was determined that errors existed in the appraisal, the Tribunal ordered Ward Lake to submit a corrected version. Following the hearing, Ward Lake submitted an amended exhibit P-8 that not only corrected the errors but also included Clarkson's valuation of the property. Because this attempt to submit a written appraisal by an unlisted expert after the hearing violated TTR 252(2) and TTR 270(3)(d) and (6), the Tribunal did not err in excluding the additional material. *Alhi Development Co v Orion Twp*, 149 Mich App 319, 324; 385 NW2d 782 (1986).