

BEFORE THE NEBRASKA TAX EQUALIZATION AND REVIEW COMMISSION

CM Production, LLC,
Appellant,

v.

Kimball County Board of Equalization,
Appellee,

Case Nos: 12M-015 & 12M-016

Decision and Order Affirming the
Determinations of the Kimball County
Board of Equalization

For the Appellant:

John Teff, President,
CM Production, LLC,
Pro Se

For the Appellee:

David L. Wilson,
Kimball County Attorney

These appeals were heard before Commissioners Robert W. Hotz and Nancy J. Salmon.

I. THE SUBJECT PROPERTY

The Subject Property consists of mineral interests relating to 13 oil wells known as the Jacinto Unit or Jacinto Field located in Kimball County, Nebraska. The legal description of the Subject Property is found at Exhibit 1. The property record card for the Subject Property is found at Exhibit 3.

II. PROCEDURAL HISTORY

In Case No. 12M-015, the Kimball County Assessor (Assessor) determined that the assessed value of the Subject Property was \$1,396,340 for tax year 2012. CM Production, LLC (the Taxpayer) protested this assessment to the Kimball County Board of Equalization (the County Board) and requested an assessed valuation of \$980,970. The County Board determined that the taxable value for tax year 2012 was \$1,396,340.¹

In Case No. 12M-016, the Kimball County Assessor (Assessor) determined that the assessed value of the Subject Property was \$420,980 for tax year 2012. CM Production, LLC (the

¹ Exhibit 1:1.

Taxpayer) protested this assessment to the County Board and requested an assessed valuation of \$310,000. The County Board determined that the taxable value for tax year 2012 was \$420,980.²

The Taxpayer appealed the decisions of the County Board to the Tax Equalization and Review Commission (Commission). Prior to the hearing, the parties exchanged exhibits as ordered by the Commission. The Commission held a hearing on June 26, 2013.

III. STANDARD OF REVIEW

The Commission's review of the determination by a County Board of Equalization is de novo.³ When the Commission considers an appeal of a decision of a County Board of Equalization, a presumption exists that the "board of equalization has faithfully performed its official duties in making an assessment and has acted upon sufficient competent evidence to justify its action."⁴

That presumption remains until there is competent evidence to the contrary presented, and the presumption disappears when there is competent evidence adduced on appeal to the contrary. From that point forward, the reasonableness of the valuation fixed by the board of equalization becomes one of fact based upon all the evidence presented. The burden of showing such valuation to be unreasonable rests upon the taxpayer on appeal from the action of the board.⁵

The order, decision, determination or action appealed from shall be affirmed unless evidence is adduced establishing that the order, decision, determination, or action was unreasonable or arbitrary.⁶ Proof that the order, decision, determination, or action was unreasonable or arbitrary must be made by clear and convincing evidence.⁷

² Exhibit 2:1.

³ See, Neb. Rev. Stat. §77-5016(8) (2012 Cum. Supp.), *Brenner v. Banner Cty. Bd. Of Equal.*, 276 Neb. 275, 286, 753 N.W.2d 802, 813 (2008). "When an appeal is conducted as a 'trial de novo,' as opposed to a 'trial de novo on the record,' it means literally a new hearing and not merely new findings of fact based upon a previous record. A trial de novo is conducted as though the earlier trial had not been held in the first place, and evidence is taken anew as such evidence is available at the time of the trial on appeal." *Koch v. Cedar Cty. Freeholder Bd.*, 276 Neb. 1009, 1019 (2009).

⁴ *Brenner v. Banner Cty. Bd. Of Equal.*, 276 Neb. 275, 283, 753 N.W.2d 802, 811 (2008) (Citations omitted).

⁵ *Id.*

⁶ Neb. Rev. Stat. §77-5016(8) (2012 Cum. Supp.).

⁷ *Omaha Country Club v. Douglas Cty. Bd. of Equal.*, 11 Neb. App. 171, 645 N.W.2d 821 (2002).

A Taxpayer must introduce competent evidence of actual value of the subject property in order to successfully claim that the subject property is overvalued.⁸ The County Board need not put on any evidence to support its valuation of the property at issue unless the taxpayer establishes the Board's valuation was unreasonable or arbitrary.⁹

In an appeal, the commission “may determine any question raised in the proceeding upon which an order, decision, determination, or action appealed from is based. The commission may consider all questions necessary to determine taxable value of property as it hears an appeal or cross appeal.”¹⁰ The commission may also “take notice of judicially cognizable facts and in addition may take notice of general, technical, or scientific facts within its specialized knowledge...,” and may “utilize its experience, technical competence, and specialized knowledge in the evaluation of the evidence presented to it.”¹¹

IV. VALUATION

A. Law

Under Nebraska law,

[a]ctual value is the most probable price expressed in terms of money that a property will bring if exposed for sale in the open market, or in an arm’s length transaction, between a willing buyer and a willing seller, both of whom are knowledgeable concerning all the uses to which the real property is adapted and for which the real property is capable of being used. In analyzing the uses and restrictions applicable to real property the analysis shall include a full description of the physical characteristics of the real property and an identification of the property rights valued.¹²

“Actual value may be determined using professionally accepted mass appraisal methods, including, but not limited to, the (1) sales comparison approach using the guidelines in section 77-1371, (2) income approach, and (3) cost approach.”¹³ “Actual value, market value, and fair market value mean exactly the same thing.”¹⁴ Taxable value is the percentage of actual value subject to taxation as directed by section 77-201 of Nebraska Statutes and has the same meaning

⁸ Cf. *Josten-Wilbert Vault Co. v. Board of Equalization for Buffalo County*, 179 Neb. 415, 138 N.W.2d 641 (1965) (determination of actual value); *Lincoln Tel. and Tel. Co. v. County Bd. Of Equalization of York County*, 209 Neb. 465, 308 N.W.2d 515 (1981)(determination of equalized taxable value).

⁹ *Bottorf v. Clay County Bd. of Equalization*, 7 Neb.App. 162, 580 N.W.2d 561 (1998).

¹⁰ Neb. Rev. Stat. §77-5016(8) (2011 Supp.).

¹¹ Neb. Rev. Stat. §77-5016(6) (2011 Supp.).

¹² Neb. Rev. Stat. §77-112 (Reissue 2009).

¹³ *Id.*

¹⁴ *Omaha Country Club v. Douglas County Board of Equalization, et al.*, 11 Neb.App. 171, 180, 645 N.W.2d 821, 829 (2002).

as assessed value.¹⁵ All real property in Nebraska subject to taxation shall be assessed as of January 1.¹⁶ All taxable real property, with the exception of agricultural land and horticultural land, shall be valued at actual value for purposes of taxation.¹⁷

“The assessor shall determine the actual value of all mineral interests, whether producing or non-producing, in the county by use of the applicable factors listed in Neb. Rev. Stat. Section 77-112. The three standard approaches to value are cost, income, and sales comparison.”¹⁸

If an income approach is used to value a mineral interest, it requires an estimate of the amount of mineral in place, an estimate of the time of commencement and period of extraction, a net dollar value per unit of the extracted mineral, a determination of continuity of production and the selection of an appropriate capitalization rate. The selection of the capitalization rate shall be based on market factors, including capital costs and risks based on the certainty of the existence or quality of minerals or the commencement and continuity of an extraction operation. The determination of the dollar value per unit of mineral should be based upon the prevailing local lease/royalty rate per ton (or other appropriate measure) for similar mineral, and the existence of considerations of abnormal expenses of extraction such as depth of overburden or restoration of the property.¹⁹

“Working interest shall mean the remaining percentage after royalty interests and overriding royalty interests. Such working interest is commonly 87.5 percent (87.5%) or less and belongs to the lessee and others involved in the production in regard to oil, gas and petroleum production leases.”²⁰

In regard to oil, gas and petroleum production leases, royalty interest shall mean a share of not less than 12.5 percent of either the gross production or the market value of such gross production at the leased premises. Such royalty is paid to the owner-lessor of the mineral interests.²¹

“Overriding royalty interest shall mean a given percentage of the gross production at the surface carved out of the working interest.”²²

¹⁵ Neb. Rev. Stat. §77-131 (Reissue 2009).

¹⁶ See, Neb. Rev. Stat. §77-1301(1) (Reissue 2009).

¹⁷ Neb. Rev. Stat. §77-201(1) (Reissue 2009).

¹⁸ NAC Title 350, Chapter 13, §002.04.

¹⁹ NAC Title 350, Chapter 13, §002.07A.

²⁰ NAC Title 350, Chapter 13, §001.09.

²¹ NAC Title 350, Chapter 13, §001.05.

²² NAC Title 350, Chapter 13, §001.04.

The valuation of mineral interests shall be evaluated each year as part of the valuation process by the assessor for changes in the underlying assumptions contained in the present value calculation, such as the ongoing nature of the extraction operation, the likelihood of near term extraction of minerals, or a change in the quality and rate of extraction.²³

“The net present value of the potential cash flow will be calculated based on the summation of the estimate of the individual cash flows discounted for time of production and time until commencement of extraction.”²⁴

B. Summary of the Evidence

John Teff testified on behalf of the Taxpayer. Teff was the President of CM Production LLC at all relevant times. Teff holds a degree in petroleum engineering. He testified that he had previously been employed by three different public companies in the oil industry and that he has had experience with the valuation of oil reserves on a daily basis for about 17 years. Teff testified that he founded CM Production LLC in approximately 2007, and that the Taxpayer has operated in six States, including Nebraska.

Teff asserted that the Taxpayer did not dispute the assessment regarding the valuation of the land component or the improvement component of the Subject Property, rather the Taxpayer’s protest and appeal related to the mineral interests only. Teff testified that the Taxpayer owned the working interest²⁵ and that ownership of the royalty interest²⁶ and overriding royalty interest²⁷ was pooled by persons other than the Taxpayer.

The Taxpayer argued that the assessed value of the mineral interest was too high based upon three assertions regarding the Income Approach used by the Appraiser to value the mineral interests: that the price escalation was too high, that the life value was too long, and that the decline curve was too flat.

²³ NAC Title 350, Chapter 13, §002.07B.

²⁴ NAC Title 350, Chapter 13, §002.07C.

²⁵ See NAC Title 350, Chapter 13, §001.09.

²⁶ See NAC Title 350, Chapter 13, §001.05.

²⁷ See NAC Title 350, Chapter 13, §001.04.

First, Teff testified that the price escalation was too high. He asserted both that the current price was too high, and that the prediction of going forward prices escalated too much. He testified that in none of his prior employment in the oil industry was it ordinary to predict future price increases. The Taxpayer also offered an email memorandum from the Cargill Company, dated June 19, 2013.²⁸ The Cargill email indicated price predictions, known as calendar swaps, for the last half of calendar year 2013 and each of the calendar years 2014 and 2015. The prices were applicable to a crude oil market known in the industry as WTI (West Texas Intermediate). Teff opined that the WTI market closely trends the market relevant to the Subject Property, but that the market for the Subject Property tended to track at \$7 to \$9 less per barrel than the WTI market. He also asserted, based upon his experience, that the pricing utilized in the assessment was too high. On cross examination, Teff conceded that the Cargill price predictions shown in Exhibit 17 were made or published more than one year after the effective date of the assessment.²⁹ It is important to note that the Cargill price predictions were not made as of January 1, 2012, based on information and data known at that time, but rather, Exhibit 17 appears to be based upon what was known in the market at least one year after the effective date.

Second, the Taxpayer asserted that in the income approach used by the Appraiser to value the mineral interests the life value was too long. Teff testified that based upon his knowledge and experience it would be unreasonable to expect the life of the mineral interest to exceed 25 years after 2012.

Third, Teff testified that the decline curve used in the income approach used by the Appraiser was too flat. In other words, Teff asserted that the oil wells of the Subject Property would produce fewer barrels of oil over time than predicted by the Appraiser. He suggested in his testimony that Exhibit 17 was demonstrative of the fact that future prices tend to fluctuate up and down, rather than consistently increase. Teff also cautioned against the use of an EIA (Energy Information Administration) survey³⁰ which predicted consistent increases in oil production. He further cautioned against the unreasonableness of assumptions regarding the life of the steel casings of the wells and other equipment.

²⁸ Exhibit 17.

²⁹ The effective date relating to these appeals is January 1, 2012. See, Neb. Rev. Stat. §77-1301(1) (Reissue 2009).

³⁰ See Exhibit 16.

Based upon his knowledge and experience Teff's testimony was credible. However, other than the price predictions in Exhibit 17, the Taxpayer offered no evidence to quantify the value of the mineral interests of the Subject Property.

John Rutledge testified on behalf of the County Board. Rutledge testified that he held a degree in geology and that he had been an assistant district manager and district geologist since 1988 with Pritchard & Abbot, appraisers specializing in oil and gas appraisals. He testified that he had been appraising mineral interests for Nebraska County Assessors since 1994, including the mineral interests in Kimball County.

Rutledge explained that he used the income approach to value the Subject Property for tax year 2012. In order to determine price, Rutledge testified that he reviewed crude oil bulletins, focusing on WTI (West Texas Intermediate) and DJ Basin markets as being applicable to the Subject Property. He explained that the DJ Basin prices during the relevant time period were about \$13 per barrel less than the WTI prices.³¹ Rutledge explained that he used the DJ Basin price of \$80.65 per barrel as the base when valuing the Subject Property using the income approach.

Rutledge testified that he relied upon a monthly production history for calendar year 2011 to determine the outputs of the Subject Property as of January 1, 2012. During calendar year 2011, the Subject Property produced between 497 and 813 barrels of crude oil per month, averaging 22.9 barrels of crude oil per day for the calendar year.³² In his income approach, Rutledge testified that he used 21 barrels of oil per day as the factor to determine the production of crude oil at the Subject Property.³³

In calculating expenses, Rutledge testified that he relied upon a Nebraska Lease Information worksheet that had been completed by the Taxpayer in February, 2012, and was submitted to the

³¹ Exhibit 13:2.

³² Exhibit 12:1.

³³ See Exhibit 8:1.

Assessor at the request of the Assessor. In the worksheet, the Taxpayer stated expenses relating to the Subject Property for calendar year 2011 at \$150,153.³⁴

Regarding the decline curve, Rutledge testified that the actual decline relating to the Subject Property was 3.82%, but that he called a 9% decline curve in his income approach.³⁵ Rutledge explained that Exhibit 8 also showed projected production, anticipated prices as adjusted for inflation,³⁶ and expected inflationary operating expense increases.

Rutledge opined that the income approach he used properly anticipated projecting escalatory prices. He also testified that he uses the same approach procedure for all other mineral interest properties he appraises for County Assessors in Nebraska.

Based on his income approach analysis, Rutledge determined the working interest value of the mineral interest of the Subject Property to be \$1,396,340 and the combined royalty interest and overriding royalty interest value at \$420,980.³⁷

We find that the testimonial evidence of John Teff that was offered by the Taxpayer was that of a person who had both knowledge and experience relating to the production of oil reserves and is competent evidence to rebut the presumption in favor of the determination by the County Board. However, the Taxpayer offered no clear and convincing evidence quantifying the value of the Subject Property.

V. CONCLUSION

The Commission finds that there is competent evidence to rebut the presumption that the County Board faithfully performed its duties and had sufficient competent evidence to make its determination. However, the Commission finds that there is not clear and convincing evidence that the determination of value by the County Board was arbitrary or unreasonable.

³⁴ Exhibit 7:1. The Commission notes, however, that Teff testified that these expenses were understated in that some allowed expenses may not have been included on the worksheet due to a misunderstanding regarding the scope of the request. The Taxpayer testified that in subsequent tax years this misunderstanding would be rectified.

³⁵ Exhibit 8:1. This exhibit is cryptic on its face. Rutledge testified that "OP EXP \$/YR" designated operating expenses per year, and that "OIL BOPD" meant barrels of oil per day. He explained that the indication of the decline curve of 9.0 was just below those designations.

³⁶ It is unclear in the evidence received whether Rutledge or Teff specifically explained the use of a capitalization rate in each respective approach to value the Subject Property.

³⁷ Exhibit 8:1.

For all of the reasons set forth above, the decisions of the Kimball County Board are affirmed.

VI. ORDER

IT IS ORDERED THAT:

1. The decision of the Kimball County Board of Equalization determining the value of the Subject Property for tax year 2012 is affirmed.
2. The taxable value of the Subject Property for tax year 2012 is:

Case No. 12M-015
Total: \$1,396,340

Case No. 12M-016
Total: \$ 420,980
3. This Decision and Order, if no appeal is timely filed, shall be certified to the Kimball County Treasurer and the Kimball County Assessor, pursuant to Neb. Rev. Stat. §77-5018 (2012 Cum. Supp.).
4. Any request for relief, by any party, which is not specifically provided for by this Decision and Order is denied.
5. Each party is to bear its own costs in this proceeding.
6. This Decision and Order shall only be applicable to tax year 2012.
7. This Decision and Order is effective for purposes of appeal on July 18, 2013.

Signed and Sealed: July 18, 2013

Robert W. Hotz, Commissioner

SEAL

Nancy J. Salmon, Commissioner

Appeals from any decision of the Commission must satisfy the requirements of Neb. Rev. Stat. §77-5019 (2012 Cum. Supp.) and other provisions of Nebraska Statutes and Court Rules.