

BEFORE THE UTAH STATE TAX COMMISSION	
PETITIONER, Petitioner, v. PROPERTY TAX DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL DECISION Appeal No. I 1-1655 Account No. ##### Tax Type: Property Tax /Centrally Assessed Tax Year: YEAR Judge: Chapman
COUNTIES, Petitioners, v. PROPERTY TAX DIVISION OF THE UTAH STATE TAX COMMISSION, ex rei. PETITIONER, Respondent.	Appeal No. 11-1535 Account No. ##### Tax Type: Property Tax /Centrally Assessed Tax Year: YEAR Judge: Chapman

This Order may contain confidential "commercial information" within the meaning of Utah Code Sec. 59-1-404, and is subject to disclosure restrictions as set out in that section and regulation pursuant to Utah Admin. Rule R861-1A-37. Subsection 6 of that rule, pursuant to Sec. 59-1-404(4)(b)(iii)(B), prohibits the parties from disclosing commercial information obtained from the opposing party to nonparties, outside of the hearing process.

Pursuant to Utah Admin. Rule R861-1A-37(7), the Tax Commission may publish this decision, in its entirety, unless the property taxpayer responds in writing to the Commission, within 30 days of this notice, specifying the commercial information that the taxpayer wants protected. The taxpayer must mail the response to the address listed near the end of this decision.

Presiding:

R. Bruce Johnson, Commission Chair
 D'Aicy Dixon Pignanelli, Commissioner
 Michael J. Cragun, Commissioner
 Robert P. Pero, Commissioner
 Kerry R. Chapman, Administrative Law Judge

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 APPEALS UNIT

Appearances:

For Petitioner: REPRESENTATIVE(S) FOR PETITIONER
For Respondent: REPRESENTATIVE(S) FOR RESPONDENT
For the Counties: REPRESENTATIVE(S) FOR THE COUNTIES

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on DATE. Based upon the evidence and testimony, the Tax Commission hereby makes its:

FINDINGS OF FACT

1. The tax at issue is property tax.
2. The tax year at issue is YEAR, with a lien date of January 1, YEAR.
3. At issue is the value that the Property Tax Division (the "Division") assessed to centrally-assessed property owned by PETITIONER ("PETITIONER" or "taxpayer").
4. For the YEAR tax year, the Division assessed PETITIONER's taxable property at\$\$\$\$\$. The Division obtained this value after reconciling its cost approach indicator of value of \$\$\$\$\$ and its income approach indicator of value of \$\$\$\$\$. The Division assigned%%% weight to its cost approach indicator and %%% weight to its income approach indicator to arrive at the final value of \$\$\$\$\$.¹
5. PETITIONER filed an appeal of the Division's YEAR assessment, and the matter was designated as Appeal No. 11-1655. COUNTIES ("Affected Counties" or "Counties") also filed an appeal of the Division's assessment, and this matter was designated as Appeal No. 11-1535.
6. All parties agreed for Appeal Nos. 11-1655 and 11-1535 to be heard together. All parties also agreed to waive an Initial Hearing and proceed to a Formal Hearing for the two YEAR appeals.²

Formal Hearing Exhibit ("Exhibit") I, p. 1.

² An Initial Hearing involving the same property had previously been held for the YEAR tax year under *USTC Appeal No. 10-1581* and *USTC Appeal No. 10-1720* (the "YEAR appeals"). The Commission issued an Initial Hearing Order in regards to the YEAR appeals on DATE. Both PETITIONER and the COUNTIES asked to proceed to a Formal Hearing on the YEAR appeals. Later, the parties agreed to stay the YEAR appeals while the YEAR appeals moved forward. On DATE, the

7. REDACTED.

8. REDACTED.

9. REDACTED.³

10. The property at issue is a pipeline that is owned by PETITIONER and located in the COUNTIES ("PIPELINE-3").

11. PIPELINE-3 was initially designed by a company called ENTITY-I. ENTITY-2, then a subsidiary of ENTITY-I, already owned and operated two pipelines that PIPELINE-3 was intended to replace in whole or in part, specifically an pipeline known as "PIPELINE-I" and a pipeline known as PIPELINE-2.⁴ Originally, ENTITY-I planned to construct th larger PIPELINE-3 in the same right of way that existed for PIPELINE-I.

12. At about the same time that ENTITY-I was planning a new pipeline, ENTITY-3 was also considering building a pipeline to the REFINERY-I area.⁵ ENTITY-3, however, abandoned the plans for its own pipeline and entered into a joint venture with ENTITY-2.

13. ENTITY-I's budget for PIPELINE-3 as of DATE was \$\$\$\$.⁶ This budget was based on the project commencing DATE and with the pipeline being completed and operations beginning DATE. It appears that this budget was for a pipeline that was to be built in the same right of way that already existed for ENTITY-2's smaller existing pipeline.

14. Construction of PIPELINE-3 began sometime between DATE and DATE.⁷

15. Near the end of DATE, OWNER-I acquired ENTITY-2 when it merged with ENTITY-I. OWNER-I continued ENTITY-I's plans for PIPELINE-3. In YEAR, OWNER-1 approved the first increase in PIPELINE-3 budget to \$\$\$\$\$. The Authorization for Expenditure ("AFE") approved in

Commission issued an order in which it stayed the YEAR appeals until it has issued a final decision for the YEAR appeals.

³ Exhibit 77, p. 5.

⁴ Exhibit 12.

⁵ Exhibit 16, p. 17.

⁶ Exhibit 14, p. 3.
Exhibit 29.

DATE indicates that "[t]his project was estimated under the erroneous assumption that multiple line rights in the LOCATION-1 would reduce total [right of way] costs."⁸

16. In YEAR, ENTITY-2 and ENTITY-3 entered into an agreement relating to the ownership of PIPELINE-3. Pursuant to the Master Formation Agreement, ENTITY-3 was required to contribute %%% of the cost of the construction of the pipeline, but no less than \$\$\$\$\$ and no more than \$\$\$\$\$, for a %%% interest in PETITIONER, with OWNER-1 required to pay the remainder of the cost of construction.⁹

17. By DATE, however, costs to build PIPELINE-3 had continued to mount, at which time the best estimate available had risen to "a total spend of \$\$\$\$\$ to complete the project." In an email,¹⁰ the Vice-president of Engineering for OWNER-1 provided a brief summary of the expenditure, as follows:

At the end of YEAR the project had been spending above estimate due to inefficiencies caused by delayed permits and easements causing the crews to jump from location to location, several reroutes required by landowners and permitting agencies, additional directional drills required for permits, delays caused by tight work requirements due to parallel pipelines, and the continuing general upward cost pressure on all supplies and equipment. Geologic conditions for directional drills also proved to be much more difficult and costly than predicted. The presence of large cobbles caused several drills to fail and others to take longer and cost more. In addition to these issues the work was undertaken on a 'time and material' basis by the contractors as they would not offer lump sum or unit pricing.

18. By DATE, the total estimated project cost had increased to \$\$\$\$\$, once a second supplemental AFE in excess of \$\$\$\$\$ was approved.¹¹ One of the reasons cited for the increase of costs was that "[t]he initial ENTITY-1 AFE was prepared using rates and multiple line rights for [right of way] acquisition and route, which in both cases were incorrect."

⁹ Exhibit 17.
¹⁰ Exhibit 57, p.22 of Master Formation Agreement.
¹¹ Exhibit 19.
Exhibit 21 & Exhibit 29

19. PIPELINE-3 was finished and became operational in DATE.¹² The final cost of the pipeline project was \$\$\$\$\$, which for the pipeline equates to approximately \$\$\$\$\$ per mile. The greatest increases between the original budget and the final cost were associated with REDACTED, which was originally budgeted at \$\$\$\$\$ and ended up costing \$\$\$\$\$, and with horizontal directional drilling ("HDD"), which was originally budgeted at \$\$\$\$\$ and ended up costing \$\$\$\$\$ because of "damaged and lost drill pipe."¹³

20. PIPELINE-3 has a throughput capacity of ###.# barrels per day. Transportation contracts have been executed with##### of the refineries in LOCATION-I for service on PIPELINE-3, including the REFINERY-2.¹⁴

21. PIPELINE-3 is regulated by the Federal Energy Regulatory Commission ("FERC"). Regulation for liquid pipelines differs from the traditional cost rate based regulated public utilities. A liquid pipeline has the choice between traditional cost-base tariffs, also known as indexed tariffs. Most liquid pipelines, including PETITIONER, choose market-based tariffs within the parameters set by FERC indexing.¹⁵ In all of the transportation agreements, shipping prices or tariffs are not set by FERC, but were instead set by contract. Annual adjustments to the shipping prices, however, are made under a methodology promulgated by FERC.¹⁶

22. PIPELINE-3 has a#####-year life.¹⁷

23. PIPELINE-3 operates as a unit across county lines. Accordingly, it is subject to assessment by the Division.¹⁸ Because PIPELINE-3 operates as a unit across county lines,

¹² Exhibit29.

¹³ Exhibit24.

¹⁴ Exhibit 106, p. I7.

¹⁵ DIRECTOR-I , who is the Director of Corporate Strategies for OWNER-1, testified on behalf of PETITIONER. DIRECTOR-I testified that PETITIONER charges prices up to the FERC ceiling.

¹⁶ Exhibit 37, pp. 7-9.

¹⁷ Exhibit 58 (OWNER-1 YEAR 10-K), p.F-14 (stating, "During YEAR, we extended the depreciable lives of several of our crude oil and other storage facilities and pipeline systems . . . to reflect current expectations given actual experience and current technology."); Exhibit 108 (PETITIONER 's YEAR Budgeted Income Statement) (forecasting straight-line depreciation of\$\$\$\$\$, or %%% of\$\$\$\$\$); DIRECTOR-I testified that PIPELINE-3's depreciation for YEAR was based on a#####-year life.

¹⁸ Utah Code Ann. §59-2-201(1)(a)(i).

PETITIONER's property is "unitary property" for purposes of Utah Admin. Rule R884-24P-62 ("Rule 62"), which provides guidance concerning the valuation of state assessed unitary properties.

24. Rule 62 provides that the preferred methods to determine fair market value of unitary properties are the historic cost less depreciation ("FICLD") cost approach and a yield capitalization income approach.¹⁹ However, the rule makes clear that the preferred valuation methods are rebuttable presumptions and can be challenged by any party who, by a preponderance of the evidence, shows that an alternative method establishes a more accurate estimate of fair market value.

25. All parties ask the Commission to establish a value for PIPELINE-3 that is different from the Division's original assessed value of \$\$\$\$\$. PETITIONER asks the Commission to reduce the YEAR value of its pipeline to \$\$\$\$\$. The Counties ask the Commission to increase the YEAR value to \$\$\$\$\$, while the Division asks the Commission to increase the YEAR value to \$\$\$\$\$.²⁰

26. All parties submitted appraisals for the Formal Hearing. PETITIONER relied on a revised appraisal prepared by independent appraiser APPRAISER-1²¹, in which he/she estimated PIPELINE-3's YEAR value to be \$\$\$\$\$.²² In this appraisal, APPRAISER-I derived an income approach value of \$\$\$\$\$ (based on a yield capitalization model), a cost approach value of \$\$\$\$\$ (based on replacement cost new less depreciation ("RCNLD")), and a sales comparison approach value ranging between \$\$\$\$\$ and \$\$\$\$\$. APPRAISER-I did not assign a specific weighting percentage to each of these indicators of value. However, he indicated that the "income approach is the most reliable indication of value as it is most heavily relied upon by market participants in pipeline transactions." APPRAISER-I stated that the "indication of the cost approach is also meaningful in this case" and that the "sales

¹⁹ Rule 62(4)(b) and (5)(a)(v).

²⁰ The final values proposed by the parties are found in their respective proposed Findings of Fact, Conclusions of Law, and Final Decisions, which they submitted subsequent to the Formal Hearing.

²¹ The appraisal was prepared not only by APPRAISER-I, but also by APPRAISER-2. For ease of reference and because APPRAISER-I testified at the hearing, the Commission will only refer to APPRAISER-I when referencing documents that APPRAISER-I and APPRAISER-2 prepared for PETITIONER.

²² Exhibit 88. In a prior appraisal (Exhibit 2), APPRAISER-I had estimated the pipeline's YEAR value to be \$\$\$\$\$.

comparison approach also warrants weight[.]"²³ APPRAISER-I reconciled the values shown by their three approaches and determined a final estimate of value of\$\$\$\$\$.

27. The Counties relied on an appraisal prepared by independent appraiser APPRAISER-3, in which he/she estimated PIPELINE-3's YEAR value to be \$\$\$\$\$. In this appraisal, APPRAISER-3 derived an income approach value of \$\$\$\$\$ (based on the yield capitalization approach) and a cost approach value of \$\$\$\$\$ (based on HCLD). APPRAISER-3 did not prepare a sales comparison approach. APPRAISER-3 stated that the "cost approach is normally not as relevant to investors in pipeline companies" such as PETITIONER and that the "income approach is usually the method most widely used by potential purchasers of an income-producing property." However, he noted that the two approaches he prepared are the preferred approaches set forth in Rule 62 and gave each approach %%% weight. As a result, APPRAISER-3 reconciled the values shown by his two approaches and determined a final estimate of value of\$\$\$\$\$.²⁴

28. The Division abandoned its original assessment and submitted a new appraisal for the Formal Hearing, in which Division appraiser APPRAISER-4 estimated PIPELINE-3's YEAR value at \$\$\$\$\$. In this appraisal, APPRAISER-4 derived an income approach value of \$\$\$\$\$ (based on the yield capitalization approach) and a cost approach value of\$\$\$\$\$ (based on HCLD). APPRAISER-4 also did not prepare a sales comparison approach. The Division abandoned the weighting percentages of%% for the income approach and%% for the cost approach that it had used for its original assessment. In the Division's new appraisal, APPRAISER-4 weighted each of his/her two approaches at %%% and determined a final estimate of value of\$\$\$\$\$.²⁵

29. Near the end of the Formal Hearing, an exhibit was submitted to show the effect on APPRAISER-4's income approach if property tax expenses were considered in the calculation of the capitalization rate instead of the calculation of cash flow. This change would reduce APPRAISER-4's

²³ Exhibit 88, p. 65.

²⁴ Exhibit 4, pp. 41-42.

²⁵ Exhibit 3, p. 16.

income approach value from \$\$\$\$\$ to \$\$\$\$\$.²⁶ Based on this reduction to its income approach value and weighting each of its approaches at%%%, the Division now proposes a value of\$\$\$\$\$.²⁷

30. Rebuttal reports were submitted in regards to the parties' respective appraisals. For PETITIONER, APPRAISER-I prepared a rebuttal report and appraisal review of the appraisal that APPRAISER-3 prepared for the Counties.²⁸ In addition, APPRAISER-I prepared a rebuttal report and appraisal review of the appraisal that APPRAISER-4 prepared for the Division.²⁹ APPRAISER-I determined that APPRAISER-3 and APPRAISER-4 each committed a series of errors and failed to arrive at fair market value in their respective appraisals. For the Counties, APPRAISER-3 prepared a review appraisal report of the appraisal that APPRAISER-I prepared for PETITIONER prior to the hearing (i.e., without the revisions that APPRAISER-I made during the hearing). APPRAISER-3 determined that APPRAISER-I made errors and incorrectly valued PIPELINE-3.³⁰ Lastly, for PETITIONER, EXPERT-3³¹ prepared comments in regards to the Division's original assessment and the appraisals prepared by APPRAISER-3 and APPRAISER-4 for the Formal Hearing. EXPERT-I concluded that the original assessment and APPRAISER-3's and APPRAISER-4's appraisals all contain fundamental appraisal errors.³²

Yield Capitalization Income Approach

31. All three parties' appraisers used the yield capitalization method, one of Rule 62's preferred valuation methods, to derive their respective income approaches to value. In the rule, the yield capitalization formula is shown as $CF/(k-g)$, where "CF" is a single year's normalized cash flow, "k" is the nominal, risk adjusted discount or yield rate, and "g" is the expected growth rate of the cash flow.³³

32. Using the $CF/(k-g)$ yield capitalization formula, APPRAISER-I determined an income approach value of\$\$\$\$\$. APPRAISER-3 determined a value of\$\$\$\$\$, and APPRAISER-4 determined a

²⁶ Exhibit 160.

²⁷ Division's Proposed Findings of Fact, Conclusions of Law & Final Decision, p. 109.

²⁸ Exhibit 5.

²⁹ Exhibit 6.

³⁰ Exhibit 8.

³¹ EXPERT-I, who also testified on behalf of PETITIONER, is a finance professor at SCHOOL-I.

³² Exhibit 7.

³³ Rule 62(5)(b).

value of\$\$\$\$\$. Although the parties' appraisers used the same general yield capitalization formula, they determined different values because for the most part, they used different cash flows, discount rates, and growth rates in the formula.

Cash Flow- CF.

33. Rule 62 provides that cash flow is "calculated as net operating income (NOT) plus non cash charges (e.g., depreciation and deferred income taxes), less capital expenditures and additions to working capital necessary to achieve the expected growth 'g.'"³⁴ The rule also provides that "NOT is defined as net income plus interest" and that "[c]apital expenditures should include only those necessary to replace or maintain existing plant and should not include any expenditure intended primarily for expansion or productivity and capacity enhancements."³⁵

34. The Commission will discuss the major differences in the parties' respective cash flow calculations. The following table illustrates each appraiser's calculation of cash flow:

	Division ³⁶	Countiel ⁷	PETITIONER ³⁸
Operating Revenue	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Less Operating Expenses	(\$\$\$\$\$)	(\$\$\$\$\$)	(\$\$\$\$\$)
Less Property Tax Expenses	\$\$\$\$\$	(\$\$\$\$\$)	\$\$\$\$\$
Less General Office Overhead	(\$\$\$\$\$)	(\$\$\$\$\$)	\$\$\$\$\$
Less Depreciation	(\$\$\$\$\$)	(\$\$\$\$\$)	(\$\$\$\$\$)
Less Interest	\$\$\$\$\$\$	\$\$\$\$\$	(\$\$\$\$\$)39
Taxable Operating Income	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Less Imputed Taxes	(\$\$\$\$\$)	(\$\$\$\$\$)	(\$\$\$\$\$)
Normalized Net Operating Income	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Add Depreciation	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

³⁴ Rule 62(5)(b)(i)(A).

³⁵ Rule 62(5)(b)(i)(A)(I) and (II).

³⁶ Exhibit 160 (APPRAISER-4's cash flow was adjusted to reflect the Division's proposed change concerning the treatment of property taxes).

³⁷ Exhibit 4, pp. 23-24.

³⁸ Exhibit 88, p. 49.

³⁹ The parties' respective cash flow calculations are not apple-to-apple comparisons. APPRAISER-I subtracted interest in his cash flow calculation based on an iterative calculation consistent with his final estimate of value. On the other hand, APPRAISER -3 and APPRAISER-4 tax adjusted their costs of debt to account for interest. Either approach appears to be acceptable, so long as the correct cost of debt is used. The costs of debt used by the parties to calculate their capitalization rates will be discussed later in the decision. In addition, the parties handled their treatment of property tax expense differently, which will be discussed in the immediately succeeding paragraphs.

Add Interest	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Less Capital Expenditures	(\$\$\$\$\$)	(\$\$\$\$\$)	(\$\$\$\$\$)
Less Changes to Working Capital	(\$\$\$\$\$)	(\$\$\$\$\$)	\$\$\$\$\$
Cash Flow	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

35. Property Tax Expenses. The appraisers handled the treatment of property taxes differently in their income approaches. When determining cash flow, APPRAISER-3 deducted the\$\$\$\$\$ of property taxes that PETITIONER had budgeted for YEAR.⁴⁰ APPRAISER-I, however, did not deduct property taxes when calculating cash flow. Instead, he accounted for property taxes by increasing his capitalization rate to reflect the property tax rate. APPRAISER-4 had originally treated PETITIONER's property tax expense the same way as APPRAISER-3 treated it. However, the Division now supports APPRAISER-I's treatment of property taxes and has revised its proposed value to reflect this change to APPRAISER-4's appraisal.

36. APPRAISER-I 's and the Division's treatment of the property tax expense produces a more accurate value. The property tax expense should reflect the value at which the property would most likely sell, not the seller's historical tax expense. In addition, if the %%% property tax rate that APPRAISER-I used for YEAR⁴¹ is applied to the Counties' proposed value of\$\$\$\$\$, property taxes would be\$\$\$\$\$, in contrast to the\$\$\$\$\$ number in APPRAISER-3's cash flow (before any adjustments for income taxes). As a result, APPRAISER-3 would be underestimating the property tax expense significantly if the pipeline's value were\$\$\$\$\$, as the Counties propose.

37. Operating Revenue and Expenses (Excluding Property Taxes). APPRAISER-I applied the pipeline's expected tariff rates to a projection of stabilized volume to estimate PETITIONER's YEAR operating revenue at \$\$\$\$\$. The taxpayer admitted that this revenue amount is slightly lower (about %%% lower) than PETITIONER's YEAR budgeted revenue of\$\$\$\$\$ (which is the revenue number APPRAISER-3 and APPRAISER-4 both used). The taxpayer contends the YEAR projected revenue

⁴⁰ Exhibit 25.

⁴¹ APPRAISER-I's use of a%% property tax rate for PIPELINE-3 for YEAR tax year was not refuted. Exhibit 2, p. 48 (actual rate); Exhibit 88,p. 48 (rate adjusted for income tax shield).

should be lower than PETITIONER's YEAR budgeted revenue, in part, because PETITIONER's actual revenues were lower than its budgeted revenues in both YEAR and YEAR.⁴² APPRAISER-I 's analysis and conclusions about revenues are more convincing than the other parties' use of budgeted numbers. For similar reasons, APPRAISER-I 's operating expenses and office overhead numbers are also more convincing.

38. Depreciation and Capital Expenditures . APPRAISER-I iterated a depreciation number for his/her income model that is dependent on his/her conclusion of value for the income approach. For this approach, APPRAISER-I deducted depreciation on a straight-line basis over the useful life of the pipeline, which he/she estimated at##### years. APPRAISER-I opined that fair market value requires that depreciation be tied to the final opinion of value because a willing buyer will only be able to expense depreciation based on its purchase price, not based on the depreciation of the prior owner.⁴³ APPRAISER-I also deducted a capital expenditures number that is equal to the iterated depreciation number .

39. For depreciation, APPRAISER-3 used PETITIONER's forecasted depreciation of \$\$\$\$\$.⁴⁴ This number appears to be a straight-line number based on the approximately \$\$\$\$\$ cost of PIPELINE-3 and a #####-year economic life for the pipeline.⁴⁵ For capital expenditures, APPRAISER-3 deducted \$\$\$\$\$, which is significantly less than his depreciation number. APPRAISER-3 noted that PETITIONER's level of capital expenditures for YEAR and YEAR was only \$\$\$\$\$ (before reimbursements reduced it to \$\$\$\$\$). Because PETITIONER will incur relatively small amounts for capital expenditures in the future, APPRAISER-3 assumed a "normalized" annual level of capital expenditures going forward of\$\$\$\$\$.⁴⁶

40. APPRAISER-3 deducts a depreciation amount that is applicable to the costs that PETITIONER incurred to construct the pipeline, but would not necessarily be applicable to a potential

⁴² Exhibit 25; Exhibit 6, p. 19.

⁴³ Exhibit 5, p. 19.

⁴⁴ Exhibit 4, pp. 22-23.

⁴⁵ \$\$\$\$\$times### equals\$\$\$\$\$, which is close to the\$\$\$\$\$ cost of the pipeline.

⁴⁶ Exhibit 4, pp. 23-24.

buyer (unless a potential buyer were to pay\$\$\$\$\$ for the pipeline). APPRAISER-I 's argument that a new purchaser's depreciable basis in the pipeline would not be the same as the seller's basis is convincing.⁴⁷ In addition, it is likely that the\$\$\$\$\$ of construction costs includes obsolescence because of cost overruns and because no party contends that a potential buyer would pay more than \$\$\$\$\$ for the almost new pipeline. As a result, APPRAISER-I 's iterative method to determine a depreciation number that corresponds to the value a purchaser would pay for the property is a better method than APPRAISER-3's reliance on a depreciation number that reflects the tax profile of the seller (i.e., PETITIONER) instead of the purchaser.

41. For depreciation, APPRAISER-4 used the same forecasted depreciation of\$\$\$\$\$ that APPRAISER-3 used, but multiplied it by##### to arrive at a depreciation number of\$\$\$\$\$ to capture accelerated "MACRS" depreciation .⁴⁸ APPRAISER-4 contends that because PETITIONER is a partnership for income tax purposes, the yield capitalization model fails to capture the present value benefit of electing accelerated MACRS tax depreciation for income tax purposes. Because PETITIONER is a partnership where the income is distributed to the partners, he contends that there are no deferred income taxes to add back to cash flow as a non-cash expense. As a result, APPRAISER-4 contends that the present value tax benefit of electing MACRS depreciation must be accounted for and that a depreciation number of \$\$\$\$\$ is needed in the cash flow calculation to recognize this benefit.⁴⁹ For capital expenditures, APPRAISER-4 deducted an amount of\$\$\$\$\$, which is the amount also used by APPRAISER-3.

42. APPRAISER-I 's method to derive a depreciation amount is more convincing than APPRAISER-4's approach for the same reasons addressed for APPRAISER-3's approach. Furthermore, the Commission is not convinced that APPRAISER-4's %%% increase to PETITIONER's forecasted depreciation for MACRS is appropriate. APPRAISER-4 admits that PETITIONER is the only company to which he/she has applied MACRS depreciation to appraise a property, and neither APPRAISER-! nor

⁴⁷ Exhibit 5, p. 19; Exhibit 6, p. 20.

⁴⁸ Modified Accelerated Cost Recovery System.

⁴⁹ Exhibit 3, p. 14.

APPRAISER-3 applied it. Moreover, PETITIONER showed that MACRS depreciation may be less than straight-line depreciation by year#####. Because MACRS depreciation is so much greater in the early years of a property than in later years, using MACRS depreciation to derive the normalized cash flow of a new property would suggest that this high amount of depreciation will exist throughout the property's life, which is not the case. The use of MACRS depreciation might be appropriate to determine value if used in a discounted cash flow ("DCF") analysis, where revenues and expenses are accounted for over a number of years. But, no party performed a DCF analysis of all revenues and expenses.⁵⁰ For these reasons, the Division's use of MACRS depreciation to calculate PETITIONER's normalized cash flow is not persuasive. APPRAISER-I's method to determine a depreciation number is better than APPRAISER-4's method.

43. For capital expenditures, APPRAISER-I used a number in his/her cash flow calculation that is equal to his depreciation number. APPRAISER-I's approach is based on depreciation and capital expenditures being the same over the life of the property. APPRAISER-3 and APPRAISER-4, however, used a normalized capital expenditure number that is less than their depreciation numbers. They do so in an attempt to reconcile the fact that capital expenditures expended during the beginning of a new property's life are generally lower than depreciation for these years, with most capital expenditures occurring closer to the end of the property's life. As a result, they have calculated normalized cash flows that reflect a lower present value of capital expenditures in comparison to the present value of depreciation because of timing.

44. APPRAISER-3's and APPRAISER-4's theory about the timing and present value of capital expenditures is sound, especially for a new property like PIPELINE-3.⁵¹ However, there is no evidence to show that the \$\$\$\$ capital expenditure number they used in their cash flow calculations

⁵⁰ Rule 62(5)(b)(ii) recognizes that the DCF method "may be impractical to implement in a mass appraisal environment." However, once a property is appealed and the Commission is tasked with determining its fair market value, a DCF model may be helpful in establishing its value.

⁵¹ Exhibit 98 shows that the present value of capital expenditures primarily expended at the end of a #####-year property is less than the present value of the same amount of capital expenditures expended equally over the #####-year life of the property.

adequately captures the present values of PETITIONER's expected capital expenditures over the#####-year life of its pipeline. In addition, there are sometimes even large capital expenditures for a new property. PETITIONER showed that \$\$\$\$ was spent on a slope stabilization project in YEAR for its new pipeline.⁵² APPRAISER-4 admitted that this expense appeared to be a capital expenditure of which he was unaware. Furthermore, APPRAISER-4 admitted that the Division's practice is to assume capital expenditures to be equal to depreciation for other centrally-assessed properties and that it applied this assumption in assessing all pipelines in YEAR. Perhaps a DCF model where all of PETITIONER's revenues and expenses were discounted to the present could have been used to capture the timing effect for PETITIONER's capital expenditures and depreciation. However, no party produced such a model. For these reasons, the Commission is not convinced that the \$\$\$\$ capital expenditure amount that APPRAISER-3 and APPRAISER-4 used in their calculations of cash flow is correct. Instead, the Commission finds that APPRAISER-I 's capital expenditure approach is preferable, even though it most likely undervalues PETITIONER's new pipeline to some extent.

Capitalization Rate.

45. The capitalization rate, "k-g," is based on "k," the nominal, risk adjusted discount or yield rate, and "g," the expected growth rate of the cash flow. Pursuant to Rule 62, all parties based their discount rate ("k") on a weighted average cost of capital ("WACC") that considered market debt and equity yields (which are referred to as the "cost of debt" and "cost of equity"). The rule also provides for the WACC to reflect a typical capital structure for comparable companies within the industry.⁵³

46. If interest expense is included in computing cash flow, the WACC formula is $((EN * k(e)) + (DN * k(d)))$, where "k(e)" is the cost of equity, "k(d)" is the cost of debt, "EN" is the percentage of industry capital structure that is equity, and "DN" is the percentage of industry capital structure that is debt. If interest expense is not included in computing cash flow, the WACC formula is the same, except that the cost of debt $(DN * k(d))$ is multiplied by $(1 - T)$, where "T" is the marginal income tax rate. After

⁵² Exhibit 74, p. PETITIONER 001779; Exhibit 111 (in which rows 115-21 and J29-31 show the amoll11ts associated with the slope stabilization project).

⁵³ Rule 62(5)(b)(i)(B).

the WACC discount rate is calculated, the growth rate ("g") is subtracted from it to derive the capitalization rate. If property tax expense is not included in computing cash flow, the property tax rate (adjusted for income taxes) must be added to the capitalization rate.

47. The following table illustrates the components that each party's appraiser developed to calculate the capitalization rate he used in his income approach:⁵⁴

	Division ⁵⁵	Counties ⁵⁶	PETITIONER ⁵⁷
Cost of Equity (k(e))	%%%%%%%%	%%%%%%%%	%%%%%%%%
Cost of Debt (k(d))	%%%%%%%%	%%%%%%%%	%%%%%%%%
Weight of Equity (EN)	%%%%%%%%	%%%%%%%%	%%%%%%%%
Weight of Debt (D/V)	%%%%%%%%	%%%%%%%%	%%%%%%%%
WACC ("K")	%%%%%%%%	%%%%%%%%	%%%%%%%%
Marginal Income Tax Rate (T)	%%%%%%%%	%%%%%%%%	N/A
After-Tax WACC ("adjusted k")	%%%%%%%%	%%%%%%%%	N/A
Growth Rate ("g")	-% % % % %	-% % % % %	- % % % % %
Capitalization Rate	%%%%%%%%	%%%%%%%%	%%%%%%%%
Property Tax Rate (Adj. for Inc. Tax)	+ % % % % %	N/A	+ % % % % %
Capitalization Rate Adjusted for Property Taxes	%%%%%%%%	N/A	%%%%%%%%

48. Property Tax Adjustment. As discussed earlier, the Commission finds that the capitalization rate should be adjusted for the property tax rate instead of deducting the property tax expense in the calculation of cash flow in this case.⁵⁸ Accordingly, the decision of APPRAISER-I and the Division to adjust for property taxes in their capitalization rates is more convincing than APPRAISER-3's treatment of this expense, The Commission also finds that the % % % adjustment to the capitalization rate to account for property taxes, as derived by both APPRAISER-I and the Division, is

⁵⁴ The capitalization rate that each party used in its income approach is in bold. Similar to the cash flows discussed earlier, these capitalization rates are not an apple-to-apple comparison because the parties treated interest expense and property tax expense differently in their respective income approaches.

⁵⁵ Exhibit 160. The Division adjusted APPRAISER-4's capitalization rate to reflect its decision to account for property taxes in the capitalization rate instead of cash flow. The Division's capitalization rate also reflects APPRAISER-4's decision to account for interest expense in the cost of debt.

⁵⁶ Exhibit 4, p. 37 (also Ex. 3 of Exhibit 4). As discussed earlier, APPRAISER-3 did not adjust his capitalization rate for property taxes because he deducted this expense from cash flow. APPRAISER-3's capitalization rate also reflects his decision to account for interest in cost of debt.

⁵⁷ Exhibit 88, p. 48. APPRAISER-I deducted interest expense in his cash flow calculation. Accordingly, he did not adjust his cost of debt to account for interest. In addition, APPRAISER-I adjusted his capitalization rate for property taxes instead of deducting property taxes from cash flow.

⁵⁸ The Division explained that in many cases, the effect of deducting historical property taxes from cash flow would have minimal effect on value. The effect in the instant case, however, is significant.

correct. Because the property tax rate is %%% and because the property tax expense can be deducted for income tax purposes (based on an income tax rate of %%%), the property tax adjustment to the capitalization rate is determined with the formula %%%*(%%%), which equates to %%%.

49. Growth Rate ("g"). Rule 62 provides that "[t]he growth rate 'g' is the expected future growth of the cash flow attributable to assets in place on the lien date, and any future replacement assets." The rule also provides that "[i]f insufficient information is available ... to determine a rate, 'g' will be the expected inflationary rate in the Gross Domestic Product Price Deflator obtained in Value Line."⁵⁹

50. It does not appear that the Division deducted any growth rate ("g") from the discount rate ("k") when it derived its capitalization rate for PETITIONER in its original assessment.⁶⁰ No party contends that the Division's decision not to deduct any growth rate in the original assessment was correct. On the contrary, in the appraisals upon which the parties now rely, APPRAISER-1 deducted a growth rate of %%% and APPRAISER-3 and APPRAISER-4 each deducted a growth rate of %%% when determining their respective capitalization rates.

51. APPRAISER-1 used a growth rate of %%%, which is Value Line's YEAR forecast of the Gross Domestic Product Price Deflator.⁶¹ APPRAISER-1 concluded that the %%% "growth rate recommended by Rule 62 is reasonable" and that the %%% rate used by the other parties is "aggressive."⁶² He explained that he reached this conclusion after considering that the volume shipped by PETITIONER between YEAR and YEAR declined and because the FERC tariff, which results in upward adjustments most years, declined in YEAR.⁶³

52. The taxpayer also argued that the income growth experienced by pipelines feeding into PIPELINE-3 prior to the lien date supports a %%% growth rate better than a %%% growth rate. For example, the taxpayer explains that the Division's own property tax assessment for ENTITY-6 shows that

⁵⁹ Rule 62(5)(b)(i)(C).

⁶⁰ Exhibit 1, pp. 4-6.

⁶¹ Exhibit 88, p. 48.

⁶² Exhibit 6, p. 35.

⁶³ Exhibit 6, p. 35.

it experienced negative income growth of-%% for a #####-year period prior to YEAR.⁶⁴ The Commission, however, is not convinced that the expected future growth rate for PIPELINE-3 should be based on growth rates experienced by other pipelines during a period that included one of the greatest recessions in recent history. Furthermore, the Commission is not convinced that PETITIONER's future throughput will decrease because its throughput for one year decreased or because of increased Utah crude that is trucked to the LOCATION-I refineries, especially when APPRAISER-I concluded that PETITIONER's "volumes are expected to remain relatively stable for the foreseeable future."⁶⁵

53. In their appraisals, APPRAISER-3 and APPRAISER-4 both used a growth rate of%%. APPRAISER-3 concluded that a %% growth factor was reasonable given the increased tariffs and increased throughput (or volume) that is projected for the pipeline. APPRAISER-3 showed that PETITIONER's YEAR forecasted tariff was%% higher than its YEAR actual tariff. He also showed that PETITIONER's forecasted YEAR throughput or volume was %% higher than its actual YEAR throughput.⁶⁶ As previously discussed, however, PETITIONER's throughput projections for its new pipeline were overestimated for YEAR and YEAR. In fact, as the taxpayer pointed out, its actual throughput decreased a small amount from YEAR to YEAR.⁶⁷ Furthermore, although the FERC tariff increases in most years, APPRAISER-I claims that it declined in YEAR.⁶⁸ PIPELINE-3 is a relatively new property , and its performance in YEAR and YEAR was below the levels forecasted by PETITIONER. Because it is a new pipeline, there is little historical data with which to establish a definite trend from a comparison of actual and forecasted numbers. Furthermore, what little historical information exists indicates that PETITIONER has been overestimating the pipeline's forecasted throughputs and revenues, For these reasons, APPRAISER-3's reliance, at least in part, on PETITIONER's YEAR forecasted numbers to estimate a perpetual growth rate of%% for PETITIONER is questionable.

⁶⁴ Exhibit 65, p. 6.

⁶⁵ Exhibit 88, p. 28.

⁶⁶ Exhibit 4, pp. 35-37.

⁶⁷ Exhibit 25; Exhibit 6, p. 19.

⁶⁸ Exhibit 5, p. 33.

54. The Division's information, however, is more convincing. In APPRAISER-4's appraisal, he/she concluded that a %%% growth factor was reasonable because PETITIONER's transportation contracts provide that its tariffs will increase by the FERC multiplier and because the Producer Price Index for Finished Goods ("PPI-FG"), the Consumer Price Index, Value Line, and the FERC Multiplier suggest a growth component within the range of %%% to %%% percent.⁶⁹ PETITIONER indicates that the FERC Multiplier of %%% was not known until after the lien date. Regardless, with the exception of the %%% Value Line "default" growth rate and the %%% FERC Multiplier, the other rates relied upon by the Division better support a %%% growth rate than a %%% growth rate.

55. Specifically, the Division indicates that in December YEAR, FERC issued an indexing order in which it concluded that an index level of PPI-FG plus %%% should be established for the ##### year period commencing July 1, YEAR.⁷⁰ The Division also showed that from YEAR to YEAR, the mean and median change in the PPI-FG index alone was a positive %%% and %%%, respectively, and the mean and median change in the PPI-FG index plus any FERC adjustment was a positive %%% and %%%, respectively.⁷¹ Furthermore, the Division's YEAR Capitalization Rate Study ("YEAR Cap Rate Study") showed a long-term average price deflator of %%% from YEAR to YEAR, which would have also included years affected by the recent recession.⁷²

56. Based on the foregoing, the Commission finds that there is sufficient information available to determine a growth rate for PETITIONER and that its future growth rate is %%%. Because there is sufficient information available to determine a growth rate, the Commission need not rely on the default growth rate provided in Rule 62.

57. Cost of Equity and Size Premium. Rule 62 provides that "[t]he cost of equity is estimated using standard methods such as the capital asset pricing model (CAPM), the Risk Premium and Dividend Growth models, or other recognized models." It also provides that "[t]he CAPM is the

⁶⁹ Exhibit 3, p. 13.

⁷⁰ Exhibit 103.

⁷¹ Exhibit 131. It is also noted that these means and medians may underestimate future growth because their calculations include growth rates for years affected by the recent recession.

⁷² Exhibit 61, p. 3.

preferred method to estimate the cost of equity" and that if more than one method is used, "the CAPM method is weighted at least 50% in the correlation," The CAPM formula is $k(e) = R(f) + (\text{Beta} \times \text{Risk Premium})$, where $k(e)$ is the cost of equity and $R(f)$ is the risk free rate."⁷³

58. The charts below show the methods that the parties used to develop their costs of equity and whether or not a party added a size premium to cost of equity. APPRAISER-I added a size premium to his cost of equity, whereas APPRAISER-3 and APPRAISER-4 did not. In addition, APPRAISER-I used only the CAPM approach method to develop his cost of equity, whereas APPRAISER-3 used three methods and APPRAISER-4 two methods to develop their costs of equity.

PETITIONER:⁷⁴

Model	Model Rate	Model Weighting	Weighted Rate
Capital Asset Pricing Model (CAPM) Size Premium	5.00%	50%	2.50%
Cost of Equity (Including Size Premium)			5.00%

Capital Asset Pricing Model (CAPM)	5.00%	50%	2.50%
CAPM Ibbotson Supply Side	5.00%	50%	2.50%
Dividend Growth Model DGM	5.00%	50%	2.50%
Cost of Equity			5.00%

Division:⁷⁶

Capital Asset Pricing Model (CAPM)	5.00%	50%	2.50%
Dividend Growth Model (DGM)	5.00%	50%	2.50%
Cost of Equity			5.00%

59. There are two primary reasons why APPRAISER-I derived a higher cost of equity than either APPRAISER-3 or APPRAISER-4. The first involves APPRAISER-I 's addition of a size premium (which will be discussed later). The second reason is because APPRAISER-3 and APPRAISER-4

⁷³ Rule 62(5)(b)(i)(B)(IT).

⁷⁴ Exhibit 88, pp. 41-45.

⁷⁵ Exhibit 4, pp. 25-34.

⁷⁶ Exhibit 3, pp. 11-12, in which APPRAISER-4 explained that he/she used the WACC determined in the Division's annual YEAR Cap Rate Study (Exhibit 61) (which the Division has also used for the original assessment). Although the Division developed costs of equity with ##### different methods, it only used two of them, the CAPM and the Dividend Growth Model (each weighted at 50%), to reconcile a cost of equity of 5.00% for all liquid pipelines (Exhibit 61, p. 25).

derived CAPM's (%%% and %%) that were significantly lower than the %%% CAPM that APPRAISER-I derived.⁷⁷

60. To derive their respective CAPM's, all three appraisers used the same formula, CAPM = Risk Free Rate+ (Beta x Risk Premium). They used the same risk premium and a similar risk free rate in the CAPM formula.⁷⁸ The primary difference between their CAPM's is the beta that they used. APPRAISER-I used a beta of#####, whereas APPRAISER-3 and APPRAISER-4 each used a beta of#####.⁷⁹

61. Rule 62 provides that "[t]he beta should reflect an average or value-weighted average of comparable companies and should be drawn consistently from Value Line or an equivalent source."⁸⁰ APPRAISER-I selected the betas of##### companies to analyze and derive a beta for PETITIONER (Exhibit 88, p. 4I), as follows:

Company	Market Cap.(###s)	Cap. Categori	Beta
	\$\$\$\$\$	Large	#####
	\$\$\$\$\$	Small	#####
	\$\$\$\$\$	Mid	#####
	\$\$\$\$\$	Mid	#####
	\$\$\$\$\$	Lar_g_e	#####
	\$\$\$\$\$	Large	#####
	\$\$\$\$\$	Mid	#####
Average	\$\$\$\$\$	-	#####

62. For his comparables, APPRAISER-I used midstream pipeline companies with significant crude oil pipeline assets. The average of the companies' ##### betas, as reported by Value Line, is#####. APPRAISER-I, however, chose a beta of##### for PETITIONER, explaining that:⁸¹

Comparable betas range from##### to##### and average#####. Of these companies, Genesis Energy, Sunoco Logistics, and DESIGNER-3

⁷⁷ If APPRAISER-I's %%% CAPM were substituted into the other parties' cost of equity calculations, APPRAISER-3's cost of equity would be%%% and APPRAISER-4's would be%%% (the average of which would be%%%).

⁷⁸ APPRAISER-4 used a risk premium of%%% and a risk free rate of%%% (which are the rates used in the Division's Capitalization Rate Study (Exhibit 61, p. 25), whereas APPRAISER-I (Exhibit 88, p. 45) and APPRAISER-3 (Exhibit 4, at Ex. 3) each used a risk premium of%%% and a risk free rate of%%%.

⁷⁹ APPRAISER-I (Exhibit 88, p.45); APPRAISER-3 (Exhibit 4, at Ex. 3); APPRAISER-4 (Exhibit 61, p. 25).

Rule 62(5)(b)(i)(B)(II)(Dd).

⁸¹ Exhibit 88, pp. 41-43.

are most similar to the subject in terms of size. Additionally, each of these companies has significant crude oil pipeline infrastructure centered in a particular region. Betas for these companies range from ##### to ##### and average #####, which is slightly higher than the overall range. Beta for the subject is concluded at ##### . . .

63. Both APPRAISER-3 and APPRAISER-4 used a beta of #####, which is the same beta that had been derived for all liquid pipeline companies in the Division's YEAR Cap Rate Study.⁸² As a result, the ##### beta had also been used in the Division's original assessment of PETITIONER's pipeline.⁸³ APPRAISER-3 stated that to determine beta, he chose a group of ##### companies that have substantial holdings in liquid petroleum pipeline systems and that, in his opinion, are most comparable to PETITIONER.⁸⁴ APPRAISER-3 chose the same ##### comparables that were used for all liquid pipeline companies in the Division's YEAR Cap Rate Study and, thus, the same comparables relied upon by APPRAISER-4, as follows:⁸⁵

Com an	Beta
COMPNAME-1	#####
COMPNAME-2	#####
COMPNAME-3	#####
COMPNAME-4	#####
COMPNAME-5	#####
COMPNAME-6	#####
Avera e	

64. APPRAISER-I's comparables are more convincing than the comparables relied upon by APPRAISER-3 and APPRAISER-4. APPRAISER-I opines that the comparables found in the YEAR Cap Rate Study for liquid pipelines may be reasonable for mass appraisal of all liquid pipelines, but not for a single crude oil pipeline such as PIPELINE-3. APPRAISER-I stated that APPRAISER-3 and APPRAISER-4 used large cap companies and/or companies that have few crude oil assets. For example, APPRAISER-I stated that COMP NAME- I is a refined petroleum products company that ships little, if any, crude oil and has no assets in the western United States. He also stated that COMP NAME-5, whose beta is #####, is a huge corporation with a market capitalization of over \$\$\$\$ that is diversified

⁸² APPRAISER-3 (Exhibit 4, at Ex. 3); APPRAISER-4 (Exhibit 3, pp. 11-12; Exhibit 61, p. 25).

⁸³ Exhibit 1, p. 6; Exhibit 61, p. 25.

⁸⁴ Exhibit 4, p. 26.

⁸⁵ Exhibit 61, p. 25; Exhibit 4, pp. 26-27.

geographically and even internationally with significant natural gas assets. One of its subsidiaries is COMP NAME-6, whose beta is ##### and which owns a significant network of crude oil pipelines in the United States. APPRAISER-1 used COMP NAME-6 as a comparable because it is more comparable to PETITIONER than COMP NAME-5. APPRAISER-I also stated COMP NAME-2 has a market capitalization of over \$\$\$\$ and is diversified both geographically and in terms of products and services, with minimal crude oil pipeline assets, while COMP NAME-3 is a petroleum products and ammonia pipeline and terminal company with limited, if any, crude oil assets.⁸⁶

65. APPRAISER-4 testified that the Division's YEAR Cap Rate Study is designed for all liquid pipelines and that he did not perform a cap rate study exclusively with PETITIONER in mind.

66. Based on the foregoing, APPRAISER-I's beta of##### is more convincing than the #####beta that APPRAISER-I and APPRAISER-4 used to derive CAPM. The Commission believes that a purchaser of the subject pipeline will look at the risks with this asset in determining what returns it will require. As a result, the Commission considers it reasonable to use some smaller to medium size guideline companies when determining a beta for PETITIONER, especially where a number of the companies in the Division's YEAR Cap Rate Study are dissimilar to PETITIONER.

67. Size Premium. As mentioned earlier, APPRAISER-I added a size premium of%% to his cost of equity, whereas APPRAISER-3 and APPRAISER-4 did not add any size premium. APPRAISER-I obtained the%% size premium from the YEAR Ibbotson Yearbook, which provides that the size premium is%% for a micro-cap company (i.e., companies with market capitalizations from roughly \$\$\$\$ to \$\$\$\$).⁸⁷

68. Rule 62 does not specifically provide whether or not a size premium should be added to the cost of equity. APPRAISER-I, however, contends that a size premium is necessary because beta, which is used to capture specific market risk in the CAPM, does not account for what is commonly known as the "size effect," APPRAISER-I cites to the YEAR Ibbotson Yearbook, which states that

⁸⁶ Exhibit 5, pp. 21-23.

⁸⁷ Exhibit 88, p. 45. APPRAISER-I further testified that he could have applied an even higher size premium of%% because PETITIONER's value is less than\$\$\$\$.

"...the greater risk of small stocks does not, in the context of the capital asset pricing model (CAPM), fully account for their higher returns over the long term. In the CAPM only systematic, or beta risk, is rewarded; small company stocks have had returns in excess of those implied by their betas.'⁸⁸ APPRAISER-1 contends that the size premium is largely due to illiquidity of small stocks compared to large stocks and that investors require a greater return on assets that are more difficult to transfer and, thus, considered riskier.⁸⁹ For PETITIONER, EXPERT-I also supports the addition of a liquidity adjustment to the cost of equity."⁹⁰

69. APPRAISER-3 contends that APPRAISER-I has erred by adding a size premium to the cost of equity. APPRAISER-3 contends that APPRAISER-I is using the size of PETITIONER alone as the basis for his size premium adjustment, which assumes that the most probable and typical buyer of PETITIONER would be a standalone pipeline company the same size as PETITIONER. APPRAISER-3 disagrees with such an assumption. APPRAISER-3 explains that the highest and best use of PIPELINE-3 is to be a part of a large diversified company.⁹¹

70. APPRAISER-3 further explains that APPRAISER-1's size premium is inappropriate because his data source for the adjustment (the Ibbotson's Yearbook) does not break the information down by industry class, which is contrary to the basic valuation principles that provide for discount rates to be derived from guideline companies in the same industry class.⁹²

71. APPRAISER-3 also explained that in recent years, the database that Ibbotson relies upon to calculate the expected size adjustments has come under severe criticism by academics as to whether it contains bias and inaccuracies. He explains that many studies have been written that dispute the existence of the size premium. He cited several of the criticisms concerning the size effect adjustment, including the "delisting bias," the "January effect," and the effect of transaction costs. He also explained that the Ibbotson database includes securities from 1926 to the present and that if one, instead, studies the period

⁸⁸ Exhibit 88, pp.43-45.

⁸⁹ Exhibit 5, p. 25.

⁹⁰ Exhibit 7, p. 10-15.

⁹¹ Exhibit 8, p. 13.

⁹² Exhibit 8, p. 13.

of 1982 – 1996 (which resolved the delisting bias), the small firm premium disappears and actually reverses and becomes a large firm premium. He asserts that this makes sense because if the small firm premium actually existed, shareholders would be demanding that large firms be broken up into smaller firms so that shareholders could experience the larger returns.⁹³

72. The Division also contends that the addition of a size premium is inappropriate. However, even if it were appropriate, the Division contends that the willing seller and willing buyer requirement of "fair market value" would prevent application of size premium in this case. The Division argues that OWNER-1, PETITIONER's majority owner and the entity in control of PETITIONER,⁹⁴ is not a small firm and would not be a willing seller of PETITIONER to a buyer offering a price calculated with a size premium. As a result, the Division contends that it would need to be OWNER-I's size premium that should be considered in the event that it were found that a size premium should be used to calculate cost of equity.

73. APPRAISER-3 states that OWNER-1 has a market capitalization of close to\$\$\$\$\$ and that OWNER-1 would be considered a large cap company requiring no size premium.⁹⁵

74. Based on the foregoing, the Commission is not convinced and PETITIONER has not shown that a size premium should be added to the cost of equity to value PETITIONER individually in this case or to value properties assessed under Rule 62 generally. Accordingly, the Commission finds that APPRAISER-I's addition of a size premium to PETITIONER's cost of equity is inappropriate.

75. Cost of Debt. Rule 62 provides that "[t]he cost of debt should reflect the current market rate (yield to maturity) of debt with the same credit rating as the subject company."⁹⁶ APPRAISER-I

⁹³ Exhibit 8, pp. 14-15.

⁹⁴ See Exhibit 106, p. F-26 (OWNER-I's Form 10-K for fiscal year ended December 31, YEAR, in which OWNER-I states, "We own the remaining %%% interest in [PETITIONER] and control the joint venture, and therefore, have consolidated the financial results.")

⁹⁵ Exhibit 8, p. 14.

⁹⁶ Rule 62(5)(b)(i)(B)(I).

derived a cost of debt of %%% for PETITIONER, while APPRAISER-3 and APPRAISER-4 each derived a cost of debt of %%%.⁹⁷

76. APPRAISER-I calculated his %%% cost of debt by first identifying the BOND-1, which was %%%, and adding to it %%%, an interpolated BOND-2 corporate bond spread derived from Reuters Corporate Bond Spread Tables appropriate for his ##### guideline companies (i.e., the same companies APPRAISER-I also used to determine his beta for the cost of equity, as identified in Finding of Fact

77. APPRAISER-3 and APPRAISER-4 each used a cost of debt of %%%, which they indicated to be the rate associated with a BOND-3 or credit rating for the guideline companies they had also used to derive beta.⁹⁹ This also happens to be the same cost of debt the Division used in its original assessment.¹⁰⁰

78. The credit ratings of the ##### guideline companies APPRAISER-I used to determine his cost of debt are, in general, lower than the credit ratings of the ##### guideline companies used by APPRAISER-3 and APPRAISER-4.¹⁰¹ Previously, the Commission found APPRAISER-I 's guideline companies to be more convincing because he also considered some small and mid cap companies in addition to large cap companies and because some of the comparables used by the other two parties were more dissimilar to PETITIONER. For these same reasons, the Commission finds APPRAISER-I 's comparables to be more convincing in detennining a cost of debt for PETITIONER. Accordingly, APPRAISER-I 's cost of debt of %%% is more convincing than the cost of debt of %%% that APPRAISER-3 and APPRAISER-4 used.

⁹⁷ APPRAISER-I (Exhibit 88, pp. 45-47); APPRAISER-3 (Exhibit 4, p. 34 & at Ex. 3); APPRAISER-4 (Exhibit 3, p. 12; Exhibit 6I, p. 3).

⁹⁸ Exhibit 88, pp. 46-47.

⁹⁹ APPRAISER-3 (Exhibit 4, p. 34 & at Ex. 3); APPRAISER-4 (Exhibit 3, p. 12).

¹⁰⁰ Exhibit I, p. 6 (except that the Division had not adjusted its %%% cost of debt for income taxes in the original assessment).

¹⁰¹ Comparing the credit ratings of the guidelines companies used by APPRAISER-I (Exhibit 88, p. 46) to the guidelines companies used by APPRAISER-3 and APPRAISER-4 (Exhibit 4, at Ex. 4).

79. Capital Structure. APPRAISER-I derived his WACC by weighting his cost of equity at %%% and his cost of debt at%%%. He derived this%%% equity-%%% debt capital structure by examining the capital structures of the seven guideline companies he used to derive his costs of equity and debt. APPRAISER-I showed that these companies were funded %%% to %%% equity, with an equity average of%%%, a median of%%%, and a weighted average of%%%.¹⁰²

80. APPRAISER-4 used the same %%% equity – %%% debt capital structure in his appraisal that the Division had derived for all liquid pipelines in its YEAR Cap Rate Study.¹⁰³

81. APPRAISER-3 examined the capital structures of the ##### guideline companies that he and the Division used to derive their costs of equity and debt and derived a capital structure of%%% equity – %%% debt for PETITIONER.¹⁰⁴ He showed that the##### guideline companies had an equity component that ranged between %%% and %%%, with averages and a median between %%% and %%%.¹⁰⁵

82. The %%% equity – %%% debt capital structure used by APPRAISER-I and APPRAISER-4 is preferable to APPRAISER-3's %%% equity-%%% debt capital structure. The##### guideline companies used by APPRAISER-I are funded, in general, with a higher percentage of equity than APPRAISER-3's ##### guideline companies. Previously, the Commission found APPRAISER-I's guideline companies to be more convincing because he also considered some small and mid cap companies in addition to large cap companies and because some of the comparables used by APPRAISER-3 were more dissimilar to PETITIONER. For these same reasons, the Commission's finds APPRAISER-I's comparables to be more convincing in determining a capital structure for PETITIONER. Accordingly, APPRAISER-I's and APPRAISER-4's capital structure of%%% equity-%%% debt is more convincing than APPRAISER-3's capital structure of %%% equity-%%% debt.

¹⁰² Exhibit 88, p. 47.

¹⁰³ Exhibit 3, p. 12; Exhibit 61, p. 2.

¹⁰⁴ Exhibit 4, p. 27.

¹⁰⁵ Exhibit 4, at Ex. 2.

83. Yield Capitalization Income Approach- Conclusion. With two exceptions concerning the size premium and the growth rate, the Commission finds PETITIONER's yield capitalization income approach to be more convincing than either the Counties' or the Division's yield capitalization income approaches. APPRAISER-I's cash flow calculation is more convincing, specifically in regards to his handling of property taxes and depreciation and capital expenditures. Furthermore, with the exception of the size premium and the growth rate, his capitalization rate is more convincing, specifically in regards to his handling of property taxes and the guideline companies he used to derive his capital structure, cost of debt, and beta for his CAPM cost of equity method. Accordingly, the income approach to be used to determine PETITIONER's YEAR value is APPRAISER-I's income approach, except that the size premium is to be removed from the calculation and the growth rate is to be increased to %%%.

84. The Commission recognizes that due to the timing of capital expenditure in relation to depreciation for a new property like PIPELINE-3, APPRAISER-I's use of a normalized capital expenditure amount that is equal to the depreciation amount may undervalue PETITIONER to some extent. Accordingly, this fact will be considered later when determining the reconciliation percentages to be applied to each valuation method eventually used to determine PETITIONER's YEAR value.

Cost Approach

85. All three appraisers developed a cost approach value. Rule 62 provides that "[c]ost is relevant to value under the principle of substitution, which states that no prudent investor would pay more for a property than the cost to construct a substitute property of equal desirability and utility without undue delay." The rule also provides that "[a] cost indicator may be developed under one or more of the following methods: replacement cost new less depreciation (RCNLD), reproduction cost less depreciation (reproduction cost), and historic cost less depreciation (HCLD)."¹⁰⁶

¹⁰⁶ Rule 62(5)(a).

86. HCLD. APPRAISER-3 and APPRAISER-4 each used HCLD to derive a cost approach value of \$\$\$\$ for PETITIONER.¹⁰⁷ APPRAISER-! used RCNLD to derive a cost approach value of \$\$\$\$.¹⁰⁸

87. In regards to the HCLD approach used by APPRAISER-3 and APPRAISER-4, Rule 62 provides that "[h]istoric cost is the original construction or acquisition cost as recorded on a firm's accounting records." It also provides that "RCNLD may be impractical to implement; therefore the preferred cost indicator of value in a mass appraisal environment for unitary property is HCLD." Nevertheless, Rule 62 provides that "[a] party may challenge the use of HCLD by proposing a different cost indicator that establishes a more accurate cost estimate of value."¹⁰⁹

88. Rule 62 provides that "[b]ook depreciation is typically applied to historic cost to derive HCLD."¹¹⁰ For the year ending December 31, YEAR, PETITIONER reported carrier property of \$\$\$\$ and accrued depreciation on this property of \$\$\$\$\$, resulting in net carrier property of \$\$\$\$\$. APPRAISER-3 and APPRAISER-4 each used this information to derive the HCLD cost approach value of \$\$\$\$\$.¹¹¹

89. However, other forms of depreciation may exist other than book (or accounting) depreciation. Rule 62 provides that physical deterioration, functional obsolescence, and external (or economic) obsolescence are forms of depreciation that are "typically applied to replacement or reproduction cost, but should be applied to historic cost if market conditions so indicate."¹¹²

90. APPRAISER-4 applied only book, or accounting, depreciation in his HCLD approach. He noted that PIPELINE-3 was less than two years old as of the YEAR lien date and that "[n]o additional depreciation beyond accounting depreciation is supported." He also noted that his appraisal "considers

¹⁰⁷ APPRAISER-3 (Exhibit 4, pp. 17-18 and at Ex. 1); APPRAISER-4 (Exhibit 3, pp. 9-10). The Division used HCLD to derive the same cost approach value in its original assessment (Exhibit 1, p. 1).

¹⁰⁸ Exhibit 88, pp. 57-63.

¹⁰⁹ Rule 62(5)(a)(iv) and (v).

¹¹⁰ Rule 62(5)(a)(i)(A).

¹¹¹ Exhibit 55 (PETITIONER YEAR FERC Form 6), pp. 110-111.

¹¹² Rule 62(5)(a)(i)(B).

the HCLD method versus a [RCNLD] method as the complexity of the RCNLD method is difficult to apply uniformly in mass appraisal."¹¹³

91. APPRAISER-3 also applied only book, or accounting, depreciation in his HCLD approach. APPRAISER-3 indicated that pursuant to his client's request, he prepared his appraisal to conform to Rule 62, which provides that the preferred cost approach is HCLD.¹¹⁴ APPRAISER-3 suggests that he did not adjust for obsolescence because of guidance received from the Western States Association of Tax Administrators ("WSATA") Appraisal Handbook, which provides:

HCLD cost indicators are generally not adjusted further to account for appreciation or depreciation. A deduction from HCLD for obsolescence is just as inconsistent as adding value to HCLD because some of the utility's property has increased in value since it was acquired, or because the utility's earnings are extraordinarily high for some reason (e.g., lax regulatory oversight). The practice of not adjusting HCLD for perceived obsolescence does not mean that obsolescence has not been considered and measured, since as noted previously, regulatory depreciation should, in theory, reflect all forms of obsolescence. The degree to which regulatory depreciation reflects accurate estimate of market depreciation for a particular property is taken into account when reconciling the value indicators.¹¹⁵

92. The HCLD approach is generally a reliable indicator of value for a property as new as PIPELINE-3. In this case, however, concern exists as to whether it produces a reasonable estimate of PETITIONER's value. The HCLD approach produces a value that is very close to the actual cost to construct the pipeline, which unexpectedly increased to more than \$\$\$\$ by its completion. Rule 62(5)(a)(i)(B) provides that all forms of depreciation, including obsolescence, "should be applied to historic cost if market conditions so indicate," No party has proposed a value or submitted another valuation approach that produces a value as high as the \$\$\$\$ value that APPRAISER-3 and

m Exhibit 3, p. 10. The Commission also notes that for a property under appeal, a party is not restricted to using mass appraisal valuation methods to estimate that property's value. The Commission would encourage all parties to use the valuation methods that produce the most accurate estimates of value.

¹¹⁴ Exhibit 4, pp. 1, 9 & 17-18 (as well as Letter of Transmittal).

¹¹⁵ Exhibit 4, p. 18 (citing *WSATA Appraisal Handbook – Unit Valuation of Centrally Assessed Properties* (2009), p. 11-13).

APPRAISER-4 calculated as the HCLD cost approach value.¹¹⁶ Accordingly, the HCLD cost approach contains obsolescence associated with the cost overruns that neither APPRAISER-3 nor APPRAISER-4 has deducted.

93. Based on the foregoing, the HCLD cost approach derived by APPRAISER-3 and APPRAISER-4 is not considered as reliable an indicator of PETITIONER's value as APPRAISER-I's yield capitalization income approach (once it is revised to remove the size premium and to change the growth rate to %%% as previously discussed). Accordingly, if the Commission decides to use the HCLD cost approach when reconciling a final value for PETITIONER, it should receive less weight in the reconciliation process than this revised income approach.

94. RCNLD. In regards to the RCNLD approach, Rule 62 provides that "[r]eplacement cost is the estimated cost to construct, at current prices, a property with utility equivalent to that being appraised, using modern materials, current technology and current standards, design, and layout." It also provides that "[t]he use of replacement cost instead of reproduction cost eliminates the need to estimate some forms of functional obsolescence."¹¹⁷

95. APPRAISER-I derived a RCNLD value of\$\$\$\$\$ for PIPELINE-3. In deriving this value, APPRAISER-I first calculated a replacement cost of \$\$\$\$\$. To this replacement cost, APPRAISER-I then applied physical depreciation of%%%(%%% per year) and obsolescence of%%% to derive his RCNLD value of \$\$\$\$\$.118

96. *APPRAISER-I's Replacement Cost Estimate of\$\$\$\$\$.* To estimate a replacement cost for PIPELINE-3, APPRAISER-I analyzed the costs of other projects, as well as the budgeted costs of the subject project. He also employed the use of cost publications such as Marshall Valuation Service. The following chart shows specific information that APPRAISER-I considered:¹¹⁹

¹¹⁶ In Exhibit 6, p. 37, APPRAISER-I indicates that the 13th edition of *The Appraisal of Real Estate* (p. 383) counsels that when the cost approach results in a vastly different value than that produced by the other approaches, it needs to be addressed in the reconciliation.

¹¹⁷ Rule 62(5)(a)(ii).

¹¹⁸ Exhibit 88, p. 63.

¹¹⁹ Exhibit 88, p. 60.

Source of Cost Information	Cost Per Mile	Cost Indicated for PIPELINE-3 ¹²⁰
PIPELINE-3 (1st Revised OWNER-I Budget)	\$\$\$\$\$	\$\$\$\$\$121
PIPELINE-3 (Original DESIGNER-I Budget)	\$\$\$\$\$	\$\$\$\$\$
VALUATION -Average	\$\$\$\$\$	\$\$\$\$\$
EXPERT-2 Estimate	\$\$\$\$\$	\$\$\$\$\$
Consultant Rule of Thumb	\$\$\$\$\$	\$\$\$\$\$
REDACTED Pipeline Estimated Costs	\$\$\$\$\$	\$\$\$\$\$
DESIGNER-3 Energy Pipeline Budget	\$\$\$\$\$	\$\$\$\$\$
Average	\$\$\$\$\$	\$\$\$\$\$

97. The Commission does not consider APPRAISER-I 's replacement cost estimate of\$\$\$\$\$ to be convincing for a number of reasons. APPRAISER-I appears to have given little, if any, weight to the actual costs of approximately \$\$\$\$\$ that were expended to construct PIPELINE-3 after he concluded that the actual costs included approximately \$\$\$\$\$ of "extraordinary cost overruns."¹²² In effect, the taxpayer is asking the Commission to accept APPRAISER-I 's opinion that within two years of PIPELINE-3's being built, it could have been replaced at a cost that is only about % % %¹²³ of the actual costs incurred to build it.

98. APPRAISER-I indicates that the cost overruns were due to a number of reasons, including: 1) alleged overbilling by CONTRACTOR-I for a ##-mile section of the pipeline; 2) large boulders under ROAD that became a factor in urban areas because the Utah Department of Transportation ("UDOT") wanted directional drilling at depth instead of trenching; 3) narrow and rocky conditions near the bottom of LOCATION--4; 4) difficulties in securing rights-of-way from some County landowners; and 5) worse than typical winter weather.¹²⁴

99. APPRAISER-I explained that CONTRACTOR-I was hired to build a portion of PIPELINE-3 that "was reportedly of less complexity and difficulty to build than other sections" of the

¹²⁰ APPRAISER-I 's calculations were based on PIPELINE-3's being##### in length. The parties, however, agree that the pipeline is approximately ##### in length.

¹²¹ APPRAISER-I acknowledged that OWNER-1' first amended budget was approximately\$\$\$\$\$. However, he appears to have adjusted it to \$\$\$\$\$ to exclude cost overruns resulting from ENTITY-1 's poor planning. Exhibit 88, p. 51.

¹²² Exhibit 88, p. 52.

¹²³ \$\$\$\$\$(APPRAISER-I 's replacement cost) divided by \$\$\$\$\$ (actual cost) is % % %.

¹²⁴ Exhibit 88, pp.53-54.

pipeline.¹²⁵ CONTRACTOR-1's contracted target price to build this approximately ##### mile of pipeline was \$\$\$\$\$, or \$\$\$\$\$ per mile. However, CONTRACTOR-I 's total invoices to OWNER-I totaled \$\$\$\$\$, or \$\$\$\$\$ per mile, which led to litigation between OWNER-I and CONTRACTOR-I. OWNER-I retained a pipeline engineer, EXPERT-2, who concluded that invoices should not have been more than \$\$\$\$\$, or \$\$\$\$\$ per mile, for this section of the pipeline.¹²⁶

100. The litigation between OWNER-I and CONTRACTOR-I was resolved prior to the lien date. However, the final amount that OWNER-I paid CONTRACTOR-I was not disclosed to the Commission . Accordingly, the Commission does not know whether OWNER-I paid CONTRACTOR-I more than the\$\$\$\$\$ amount calculated by EXPERT-2. Furthermore, there is no evidence to show that the parties agreed that the costs determined by EXPERT-2 were the costs that were necessary to build this ##### mile section of the pipeline. For these reasons, the taxpayer has not shown that the \$\$\$\$\$ actual cost of PIPELINE-3 included any overbillings from CONTRACTOR-I or that the amount that OWNER-I paid CONTRACTOR-I would not be expended to build a replacement pipeline.

101. COUNSEL-1, who was counsel for OWNER-I during the construction of PIPELINE-3, testified at the hearing. COUNSEL-1 explained that prior to the merger of OWNER-I and ENTITY-I, ENTITY-I had originally planned for construction of the pipeline to begin in DATE and to conclude in DATE.¹²⁷ COUNSEL-1 handled problems associated with the building of PIPELINE-3, including ones that arose in regards to its rights-of-way in COUNTY and problems with getting permits from that county. COUNSEL-1 explained that it took a year to work out the issues in COUNTY. As a result of the delays in COUNTY, COUNSEL-1 stated that the pipeline could not be built "in order," which he claimed to be inefficient.

¹²⁵ Exhibit 88, p. 53.

¹²⁶ Exhibit 27 (EXPERT-2 report) at PETITIONER001822. It appears that CONTRACTOR-I was hired to construct this section of the pipeline, not to obtain rights-of-way. Accordingly, EXPERT-2's estimate of \$\$\$\$\$ per mile for this section of the pipeline does not appear to include any right-of-way costs. (In Exhibit 88, p. 58, APPRAISER-I estimated \$\$\$\$\$ per mile to capture actual right-of-way and pump costs).

¹²⁷ See also Exhibit 15, p. 8.

102. COUNSEL-1 was a credible witness who appears to have competently performed his duties as OWNER-I's counsel. As a result, it does not appear that the situation in COUNTY-I could have been resolved any more quickly than COUNSEL-1 was able to do so. Also, it is unclear that the same problems would not arise were PIPELINE-3 to be replaced. There is no evidence to show that a replacement pipeline would not be located in COUNTY. It is possible that some of the actual costs incurred by OWNER-I could have been avoided had the problems in COUNTY been foreseen and resolved beforehand so that construction could have proceeded in a more efficient order. However, the extent of any such savings is unknown. The evidence is insufficient to show that these savings would have accounted for the difference between the pipeline's actual costs of\$\$\$\$\$ and APPRAISER-I's estimated replacement cost of\$\$\$\$\$.

103. Furthermore, the Commission is not convinced that any additional costs associated with the large boulders under ROAD or with the conditions near the bottom of LOCATION-4 could have been avoided. COUNSEL-1 admitted that the same problems in REDACTED COUNTY would exist if PIPELINE-3 had been built on the lien date. A significant amount of the pipeline's actual costs was related to the directional drilling that was required in REDACTED.¹²⁸ The evidence is insufficient to show that a replacement pipeline would be built over a different route or, if it was, that most of these same problems would not exist with a different route. No one explained how the pipeline could end up at LOCATION-I without REDACTED. APPRAISER-I did not suggest a different route and appears to have used PIPELINE-3's actual route in his replacement cost analysis because he used the pipeline's own length when he calculated a replacement cost for it.¹²⁹

104. COUNSEL-1 also admitted that the route of PIPELINE-3 was chosen because the taxpayer already owned the rights-of-way for that route. Little, if any, information was provided to show

¹²⁸ DESIGNER -I originally budgeted horizontal directional drilling (HDD) costs of approximately \$\$\$\$\$. However, the actual ID-ID costs were approximately \$\$\$\$\$, an increase of \$\$\$\$\$ over the original budget (Exhibit 24).

¹²⁹ Exhibit 88 (APPRAISER-I's revised appraisal). On page 2 of this appraisal, APPRAISER-I stated that PIPELINE-3 was##### miles in length. On page 60 of this appraisal, APPRAISER-I estimated a replacement cost of \$\$\$\$\$, which he equated to \$\$\$\$\$ per mile. This is based on a replacement pipeline length of ##### miles (\$\$\$\$\$divided by##### miles is \$\$\$\$\$ per mile).

the costs that would be incurred to purchase rights-of-way over a different route and how these hypothetical costs would have impacted the actual cost to construct or replace the subject pipeline.

105. APPRAISER-I also indicated that PIPELINE-3's actual costs were extraordinary because of worse than typical winter weather. EXPERT -2, however, concluded in his report for OWNER-1:¹³⁰

CONTRACTOR-I suggests in its interrogatory responses that weather contributed to delays in its work. I have examined a 30-year weather history of the project area, particularly at LOCATION-S. There was nothing peculiar about the weather in LOCATION-S during the time of the project, DATE to DATE. Exhibit EE provides a plot of the 30-year temperature history for LOCATION-5 . A comparison of the 30 year low temperature to the project daily low temperature reveals that the project temperature was not unusual , except perhaps for being unusually warm, with only ## days with low temperatures below ## F

I have also examined the ##-year snowfall history for LOCATION-S in comparison to snowfall during the time period CONTRACTOR-I was on the OWNER-I project. Exhibit FF illustrates that the snowfall experienced during the project was slight compared to the ##-year maximum snowfalls for LOCATION-S

106. As a result, the Commission finds that the evidence does not support APPRAISER-I 's conclusion that worse than typical winter weather also made construction of PIPELINE-3 difficult. The evidence is insufficient to show that because of weather, the costs to replace PIPELINE-3 would be lower than the \$\$\$\$ of costs that OWNER-1 actually incurred.

107. The Commission is not convinced that a majority of the actual costs incurred to build PIPELINE-3 could have been avoided and would not be incurred again if the pipeline were replaced.

108. Based on the foregoing, the Commission is not convinced that the original ENTITY-I budget of\$\$\$\$ or the first revised OWNER-I budget of \$\$\$\$ that APPRAISER-I considered are particularly relevant in determining a replacement cost of PIPELINE-3. In fact, the\$\$\$\$ actual cost of PIPELINE-3 appears to be as relevant, and most likely more relevant, than these preliminary budget amounts.

¹³⁰ Exhibit 27, pp. PETITIONER001854-55.

109. The Commission is *also* not convinced that the *estimated* construction costs of two other pipeline projects show the costs that would be incurred to replace PIPELINE-3. First, APPRAISER-I considered PIPELINE-4, whose project cost, as of the lien date, was estimated at roughly \$\$\$\$\$. The PIPELINE-4 is a ##### mile, ##### inch diameter pipeline with terminals that was planned to deliver refined products from the LOCATION-2 to terminals in LOCATION-4 and LOCATION-S. For this #####mile pipeline, the\$\$\$\$\$ estimated project cost equates to\$\$\$\$\$ per mile.¹³¹

110. APPRAISER-I 's use of the PIPELINE-4 project's estimated costs does not convincingly show the costs that would be incurred to replace the subject project. The actual costs ofPIPELINE-4 were unavailable so that they could be compared with its preliminary estimated cost. Furthermore, APPRAISER-I did not make adjustments to PIPELINE-4's estimated costs to account for differences between it and PIPELINE-3. It is unknown how much of the estimated cost of PIPELINE-4 is for its terminals. In addition, APPRAISER-I also did not make any adjustment for the smaller, ##### inch pipe used for PIPELINE-4 in comparison to the larger, ##### inch pipe used for PIPELINE-3. Moreover, PIPELINE-4 is between##### and##### times the length ofPIPELINE-3. APPRAISER-I indicated that "[i]t is well established, and indicated by Marshall, that shorter pipelines typically cost more per mile than otherwise similar longer pipelines, and vice-versa."¹³² Furthermore, PIPELINE-4 was built on terrain from LOCATION-2 to LOCATION-? that does not appear to have the same challenges (at least on a per mile basis) as the terrain affecting significant portions of PIPELINE-3. With the exception of the terminals, it would appear that PIPELINE-4's estimated cost of\$\$\$\$\$ per mile would need to be adjusted upward to arrive at a replacement cost for PIPELINE-3, Accordingly, this comparable does not show that APPRAISER-I 's estimated replacement cost of\$\$\$\$\$ for PIPELINE-3 is correct.

III. Nor is the pipeline that ENTITY-3 planned, but never built, a convincing comparable. APPRAISER-I considered that in YEAR, ENTITY-3 planned to build a\$\$\$\$\$ inch, ##### mile pipeline that, had it been built, would have competed with PIPELINE-3. As discussed earlier, ENTITY-3

¹³¹ Exhibit 88, p. 59.

¹³² Exhibit 88, p. 58.

abandoned this project when it acquired %%% of the subject project (upon completion). APPRAISER-I indicated that although the route for the proposed ENTITY-3 pipeline was different, the starting and ending points were similar to PIPELINE-3. APPRAISER-I indicated that this #####mile pipeline was estimated to cost \$\$\$\$\$, which equates to \$\$\$\$\$ per mile.¹³³ The difference between the initial budgeted cost and the actual cost of PIPELINE-3, however, shows that the initial estimated cost of a proposed pipeline may have little relationship with its actual cost. No information was available to show whether or not pipeline projects are typically completed at their initially estimated costs. For these reasons, the Commission is not convinced that the estimated cost of a pipeline that was never built shows that PIPELINE-3 could be replaced for \$\$\$\$\$.

112. APPRAISER-I also indicated that EXPERT-2 estimated that the overall PIPELINE-3 project should have cost somewhere in the range of \$\$\$\$\$, which equates to \$\$\$\$\$ per mile.¹³⁴ There is no evidence to show how EXPERT-2 estimated the overall costs for PIPELINE-3 and what he considered in reaching this conclusion. This information is not convincing and does not show that PIPELINE-3 could be replaced for either the \$\$\$\$\$ indicated by EXPERT-2 or for the \$\$\$\$\$ estimated by APPRAISER-I.

113. APPRAISER-I also indicates that he relied on information he received from energy consultants who did not have direct knowledge of the subject project. He explained that one of the consultants stated that a general rule-of-thumb of \$\$\$\$\$ per mile is often used in the industry.¹³⁵ Perhaps this information would be useful to estimate a value for all pipelines for mass appraisal purposes without consideration of a property's specific circumstances. However, once a property is under appeal, the Commission is interested in the value of that specific property. A general rule-of-thumb number provided by a consultant with no knowledge of the subject project is not convincing evidence of that project's value. Accordingly, this evidence does not show that APPRAISER-I's estimated replacement cost of \$\$\$\$\$ for PIPELINE-3 is correct.

¹³³ Exhibit 88, p. 59.

¹³⁴ Exhibit 88, p. 58.

¹³⁵ Exhibit 88, p. 59.

114. Lastly, APPRAISER-I considered Marshall Valuation Service ("Marshall") cost information to estimate a replacement cost for PIPELINE-3. APPRAISER-I indicated that Marshall provides a range of pipeline costs broken down by pipe diameter. He used the cost range for ##### pipe to derive a replacement cost of\$\$\$\$\$ per mile for the subject project as follows:¹³⁶

Quality	Reported Cost (per mile)	Normal Cost Range (per mile)	
		≈ ≈ ≈	≈ ≈ ≈
Low	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
<u>Average</u>	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Good	\$\$\$\$\$1	\$\$\$\$\$	\$\$\$\$\$
Overall Average	\$\$\$\$\$		
plus right-of-way and pump costs	+ \$\$\$\$\$		
Final Cost	\$\$\$\$\$		

115. APPRAISER-I's development of an overall average cost per mile based on low, average, and good quality may, again, be useful for mass appraisal purposes where the specific characteristics of a pipeline are not considered. In this case, however, such an approach may underestimate the replacement value of the subject property. First, COUNSEL-1 stated that the pipe that was used for PIPELINE-3 had a special coating on it. Second, when determining a ##### year physical life for the subject project, APPRAISER-1 assumed that it had good quality materials and workmanship.¹³⁷ This suggests that Marshall's good-quality cost numbers may best reflect the replacement cost of the subject project. In any case, there is no information to suggest that the low-quality costs should even be considered when estimating a replacement cost for the subject project.

116. Furthermore, as previously discussed, the evidence indicates that the costs to construct a pipeline like the subject project REDACTED may be more than the average cost per mile.¹³⁸ No party showed that a different route could have been chosen that would have reduced costs. For these reasons,

¹³⁶ Exhibit 88, p. 59.

¹³⁷ Exhibit 88, p. 58.

¹³⁸ Marshall indicates that "the shorter the run, the more difficult, complex or REDACTED the site, the higher the costs" (Exhibit 62).

the Commission finds that the Marshall numbers at the high end of the "normal cost range" would best estimate the costs that would be incurred to replace PIPELINE-3.

117. Marshall shows that for average quality, the cost at %%% of reported costs (i.e., at the high end of the normal range) is\$\$\$\$ per mile before adding APPRAISER-I 's estimated costs of\$\$\$\$ per mile for rights-of-way and pump costs. When the right-of way and pump costs are included, the average-quality costs are\$\$\$\$ per mile, which would equate to\$\$\$\$ for the##### mile PIPELINE-3.

118. However, it may be even more appropriate to consider the good-quality costs reported by Marshall, given APPRAISER-I 's assumption of good quality materials and workmanship for the subject pipeline. Marshall shows that for good quality, the cost at%% of reported costs (i.e., at the high end of the normal range) is\$\$\$\$ per mile before adding APPRAISER-I's estimated costs of\$\$\$\$ per mile for rights-of-way and pump costs. When the right-of way and pump costs are included, the good-quality costs are\$\$\$\$ per mile, which would equate to\$\$\$\$ for the##### mile PIPELINE-3.

119. The Commission finds the Marshall information to be the most convincing replacement cost evidence that APPRAISER-I considered. From the Marshall information, the replacement cost of the pipeline is most likely at the higher end of a values obtained from %%% of average quality costs (which is\$\$\$\$) and %%% of good quality costs (which is\$\$\$\$). If the average quality costs are weighted %%% and good quality costs are weighted %%%, the Marshall information would show a replacement cost of\$\$\$\$ for PIPELINE-3.

120. Based on the foregoing, APPRAISER-I 's replacement cost estimate of\$\$\$\$ is not convincing and underestimates the costs that would be incurred to replace PIPELINE-3.

121. *APPRAISER-I 's Obsolescence Adjustment of%%.* From his estimated replacement cost of\$\$\$\$, APPRAISER-I deducted physical deterioration depreciation of%% (\$\$\$\$), which produces a cost estimate of\$\$\$\$ before any consideration for obsolescence. APPRAISER-I then

determined that this \$\$\$\$ amount should be reduced by %%% to account for obsolescence, which results in his final RCNLD estimate of\$\$\$\$ (rounded to \$\$\$\$).¹³⁹

122. APPRAISER-I indicated that PIPELINE-3 was built to solve bottlenecking issues and to add capacity. He determined that PIPELINE-3's capacity of##### barrels per day seems excessive, based on historic throughput not exceeding ##### barrels per day from YEAR through YEAR (pre-construction). He stated that the ##### barrels per day capacity makes more sense if the growth of MARKETS (which are trucked to LOCATION-I) was not fully appreciated,¹⁴⁰ For these reasons, APPRAISER-I concludes that the demand for crude oil carried over PIPELINE-3 is lower than anticipated, which suggests external obsolescence. He/she also concludes that the subject's designed capacity exceeds historical throughput volumes, which suggest superadequacy or functional obsolescence.¹⁴¹

123. APPRAISER-I notes that PIPELINE-3's current throughput of##### barrels per day is only %%% of its capacity of##### barrels per day, which results in an underutilization ratio of%%%. However, he stated that operating below capacity does not automatically translate to obsolescence equal to the underutilization ratio, and he concluded an obsolescence factor of%%%.¹⁴²

124. The Commission is not convinced that APPRAISER-I's obsolescence adjustment of %%% for underutilization is appropriate. First, APPRAISER-I's stabilized volume projection of ##### barrels per day is "[b]ased primarily on actual volumes shipped in 2009 and YEAR."¹⁴³ The Division points out that these years happen to fall in the wake of the greatest economic recession of the

¹³⁹ Exhibit 88, p. 63.

¹⁴⁰ COUNSEL-I stated that the ENTITY-3 pipeline was proposed around YEAR or YEAR, around the same time that ENTITY-I proposed the subject pipeline. The production of crude oil in Utah had already increased about %%% between YEAR and YEAR. Exhibit 42. The Commission doubts that neither OWNER-I nor ENTITY-3 was unaware of this trend when they both proposed new pipelines around YEAR or YEAR. In addition, Exhibit 42 shows that other historical oil production increases in Utah have typically been temporary in nature. As a result, it is not at all clear that the most recent increases in Utah production from the MARKETS production will continue and not decrease.

¹⁴¹ Exhibit 88, p. 62.

¹⁴² Exhibit 88, p. 63.

¹⁴³ Exhibit 88, p. 37.

past 80 years.¹⁴⁴ As of the lien date, the subject project had been in operation for less than ##### years, which is an insufficient amount of time to see how business cycles will affect the throughput of the pipeline through its #####-year life and too speculative to show that the pipeline will suffer from%% underutilization into the future.

125. Second, APPRAISER-I's obsolescence analysis is based on his stabilized throughput estimate of ##### barrels per day, which appears to be an average daily utilization. This analysis, however, does not appear to adequately consider peak or seasonal utilization. The parties did not indicate whether the average daily utilization differed from season to season. Furthermore, PIPELINE-3 indicated that the peak throughput in YEAR was as high as##### barrels per hour (which would equate to##### barrels per day).¹⁴⁵ PIPELINE-3 contends that peak throughput on an hourly basis does not provide any meaningful measure of annual volume. Nevertheless, peak utilization does provide 'a meaningful measure of the pipeline capacity that has actually been employed. Many properties are built to accommodate the peak demand of their customers. Little, if any, information was provided to show how many times a year PIPELINE-3's peak throughput was near the maximum YEAR throughput of##### barrels per hour. The Commission is not convinced that obsolescence necessarily exists where an average daily usage is lower than peak usage. For these reasons, APPRAISER-I 's obsolescence adjustment for underutilization is excessive and may be entirely unwarranted.

126. Based on the foregoing, the Commission is not convinced that any obsolescence adjustment for underutilization should be applied when determining a cost approach value for PIPELINE-3.

¹⁴⁴ The demand for refined products in Utah dropped more than %%% between YEAR and YEAR with most of the decrease occurring between YEAR and YEAR. Exhibit 42. The amount of crude oil refined in Utah also decreased during this period. It seems reasonable that both the demand for refined products in Utah and the amount of crude oil refined in Utah may increase as the economy improves, which may lead to greater utilization of the subject pipeline in the future. In any case, Exhibit 42 shows that with the exception of two recessions, demand for refined products and the amount of crude oil refined in Utah have both been steadily increasing since YEAR. It also shows that beginning in the late YEAR's, the gap between the amount of crude oil refined in Utah and the demand for refined products in Utah has narrowed. These trends suggest that PIPELINE-3 may be utilized to a greater extent in the future than it was during the recent recession.

¹⁴⁵ Exhibit 119, p.

127. In summary, APPRAISER-I 's RCNLD approach estimate of \$\$\$\$\$ is unconvincing because he underestimates the replacement costs that would be incurred to replace PIPELINE-3 and because his obsolescence adjustment of %%% for underutilization is unwarranted. As a result, PETITIONER has not shown that its proposed alternative cost approach value of \$\$\$\$\$ establishes a more accurate estimate of PIPELINE-3 's fair market value than Rule 62's preferred HCLD cost approach value of \$\$\$\$\$.

128. Nevertheless, the HCLD cost approach value of \$\$\$\$\$ appears to contain obsolescence associated with cost overruns. No party has proposed a value for the pipeline that is as high as this amount. Earlier, the Commission determined that APPRAISER-I 's income approach, once the size premium is removed and the growth rate is increased to %%%, should be the income approach used in reconciling a value for PETITIONER. The Commission, however, noted that this income approach most likely underestimates PETITIONER's value. Accordingly, it may be appropriate to determine a value for PETITIONER by reconciling this income approach, which likely underestimates PETITIONER 's value, with the HCLD cost approach, which overestimates its value. However, the HCLD approach is considered less reliable than this income approach. Accordingly, the HCLD cost approach, if used in the reconciliation process, should receive a weight of only %%%.

129. On the other hand, the Commission is more confident that an RCNLD cost approach based on a replacement cost of \$\$\$\$\$ (as derived in Finding of Fact #119) would better estimate the fair market value of PIPELINE-3 than the HCLD cost approach, which more clearly contains obsolescence due to cost overruns. If APPRAISER-I 's physical depreciation adjustment of %%% is applied to a replacement cost of \$\$\$\$\$, it produces an RCNLD approach value of \$\$\$\$\$. The Commission also considers this RCNLD cost approach value less reliable than APPRAISER-I 's income approach (once it is revised to remove the size premium and to change the growth rate to %%%). However, it is more reliable than the HCLD cost approach. Accordingly, this RCNLD cost approach value of \$\$\$\$\$, if used

in the reconciliation process, should receive a weight of %%% (which is the weight the Division gave the cost approach in its original assessment¹⁴⁶).

Sales Comparison Approach

130. The sales comparison approach is not one of the "preferred" methods to determine fair market value under Rule 62. Nevertheless, Rule 62 provides that "[o]ther generally accepted appraisal methods may also be used when it can be demonstrated that such methods are necessary to more accurately estimate fair market value."¹⁴⁷

131. In YEAR, OWNER-I (ENTITY-2) and ENTITY-3 agreed to form the PIPELINE-3 joint venture in which ENTITY-2 would be a%% owner and ENTITY-3 a%% owner. In the agreement, ENTITY-3 agreed to contribute%% of the costs to construct PIPELINE-3 with its contribution to be no lower than \$\$\$\$\$, but no higher than \$\$\$\$\$.¹⁴⁸

132. APPRAISER-I determined that the YEAR agreement shows that OWNER-I and ENTITY-3 believed that 114 of the subject pipeline was worth between \$\$\$\$\$ and \$\$\$\$\$, which indicates that the worth of the entire project was between \$\$\$\$\$ and \$\$\$\$\$. APPRAISER-I concludes that ENTITY-3's agreement to purchase a %% interest in the project, before cost overruns, for an overall value of \$\$\$\$\$ to \$\$\$\$\$ is a sale that provides a meaningful indication of PIPELINE-3's value.¹⁴⁹

133. APPRAISER-I further concludes that this \$\$\$\$\$to\$\$\$\$\$ sales price range needs to be adjusted downward to reflect a value for PIPELINE-3 as of the YEAR lien date. APPRAISER-I concludes that the price negotiated by OWNER-1 and ENTITY-3 in YEAR reflected better market conditions that existed at that time. He also concludes that the subject pipeline suffers from physical deterioration and obsolescence not present and/or anticipated when the sale was negotiated in YEAR. For these reasons, he concludes, at a minimum, a market condition adjustment of%% should be applied to

¹⁴⁶ Exhibit I. The Commission recognizes that no party relies on the original assessment and that it no longer has the presumption of correctness. That, however, does not mean that all elements of that assessment are unreliable.

¹⁴⁷ Rule 62(4)(b)(i).

¹⁴⁸ Exhibit 57, p. PETITIONER000033.

¹⁴⁹ Exhibit 88, p. 64.

the YEAR sales price range, which results in a sales comparison approach to value of\$\$\$\$\$ to \$\$\$\$\$.¹⁵⁰ When reconciling a final value for PIPELINE-3, APPRAISER-I determined that his sales comparison approach also warrants weight, although less weight than his income approach and cost approach.¹⁵¹

134. Neither APPRAISER-3 nor APPRAISER-4 considered ENTITY-3's acquisition of a %%% interest in PETITIONER to be a sale that should be considered when determining PETITIONER's fair market value.¹⁵²

135. APPRAISER-3 contends that ENTITY-3's YEAR agreement to acquire a portion of the subject project poses a number of problems when detennining if it represents a relevant indicator of value as of the YEAR lien date. He points out that the parties negotiated the transaction between ###1#1 and ##### years prior to the YEAR lien date and that during this period, the Producer Price Index for pipeline transportation of crude oil increased as much as %%%. He also points out that ENTITY-3 acquired a minority interest in the subject project and contends that a much better indicator of market value of the entire property would be a tJ:ansaction involving a relatively more valuable controlling interest. Moreover, he points out that the transaction price is suspect because in addition to ENTITY-3's agreeing to pay between \$\$\$\$\$ and \$\$\$\$\$ for its %%% interest, it agreed not to build another pipeline that would have served the same area. As a result, APPRAISER-3 contends that DESIGNER-3 's consideration was more than \$\$\$\$\$ and that it would be difficult to measure the value of this additional consideration.¹⁵³ Furthermore, APPRAISER-3 points out that APPRAISER-I 's sales comparison approach is based on an analysis of this one transaction only and that his downward adjustment of %%% to the transaction price appears to mimic the underutilization adjustment he made in his cost approach.¹⁵⁴

¹⁵⁰ Exhibit 88, p. 64.

¹⁵¹ Exhibit 88, p. 65.

¹⁵² Exhibit 4, pp. 39-40 (APPRAISER-3 's appraisal); Exhibit 3, p. 9 (APPRAISER-4 's appraisal).

¹⁵³ Exhibit 4, pp. 39-40.

¹⁵⁴ Exhibit 8, p.p. 18-19.

136. APPRAISER-4 determined that it would be "unreasonable" to consider ENTITY-3's acquisition for a sales comparison market approach to value. He concludes that the documentation that has been provided suggests that the transaction is not consistent with a fair market value standard.¹⁵⁵

137. The Commission is not convinced that ENTITY-3's YEAR agreement to purchase a %%% interest in the subject project for\$\$\$\$\$ to\$\$\$\$\$ is a reliable comparable with which to derive a sales comparison value. First, the transaction was negotiated in YEAR, between ##### and #fff.## years prior to the lien date. Although APPRAISER-1 suggests that market conditions declined between YEAR and YEAR, the Division points out that the Producer Price Index for pipeline transportation of crude oil had increased during this period. Furthermore, the Commission notes that Marshall shows that pipeline costs increased approximately %%% from DATE to DATE.¹⁵⁶ For these reasons, it is unclear whether pipeline values increased or decreased between YEAR and YEAR. Accordingly, APPRAISER-1's %%% downward adjustment to account, in part, for better market conditions in YEAR is not supported.

138. Second, the Commission is not convinced that APPRAISER-1's %%% downward adjustment to the \$\$\$\$\$ to \$\$\$\$\$ price range to account, in part, for external obsolescence not present and/or anticipated in YEAR is warranted. Earlier, the Commission found that APPRAISER-I's %%% downward adjustment to his cost approach for obsolescence associated with underutilization was unwarranted.

139. Third, the Commission is not convinced that a single transaction produces a reliable sales comparison indicator of value where the parties to that transaction were also entering into a transportation or shipping agreement,¹⁵⁷ where the buyer (ENTITY-3) was giving up its plans to build its own

¹⁵⁵ Exhibit 3, p. 9.

¹⁵⁶ Exhibit 62.

¹⁵⁷ DIRECTOR-I testified that the ENTITY-3 refinery signed a transportation agreement to ship on the subject pipeline before ENTITY-3 acquired its %%% interest in the subject pipeline. However, the timeline of events related to the construction of the subject pipeline shows that the parties signed the Master Formation Agreement and that OWNER-2 signed on as the fifth shipper on the same day, DATE (Exhibit 29). Furthermore, in its YEAR Form K-10, OWNER-I indicated that "[in] the first quarter of YEAR, we executed an agreement in which we sold a %%% interest in this line to ENTITY-4. As part of this agreement, ENTITY-5 also entered into a #-year transportation agreement making it the # refmery to commit" (Exhibit 106, p. 17). *See also* Exhibit 57, p. 1 (Recital F) and p. 17 (Section 2.10).

pipeline,¹⁵⁸ and where the seller (OWNER-I) was eliminating possible competition from an ENTITY-3 pipeline.¹⁵⁹

140. Fourth, the transaction negotiated between OWNER-I and ENTITY-3 in YEAR does not reflect the subsequent cost overrun-s that were experienced when building the pipeline or the final cost of the pipeline. In Utah law, "fair market value" is defined to mean "the amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and **both having reasonable knowledge of the relevant facts**" (emphasis added). In this appeal, the Commission is tasked with determining the subject pipeline's value as of January 1, YEAR. On this lien date, the relevant facts would include the knowledge of the cost overruns experienced *in* building the pipeline and its final cost. These relevant facts were unknown when the \$\$\$\$ to \$\$\$\$ price range for a %%% interest in the project was negotiated in YEAR. Accordingly, the transaction that OWNER-I and ENTITY-3 entered into in YEAR is not a reliable sale with which to determine PIPELINE-3's fair market value as of the YEAR lien date.

141. Fifth, PETITIONER contends that the built-in loss allocation taken by ENTITY-2 under Internal Revenue Code ("IRC") Section 704(c)¹⁶⁰ supports its argument that the price ENTITY-3 paid to acquire its %%% interest in PETITIONER presents its fair market value. The taxpayer also pointed out that ENTITY-2 recognized a \$\$\$\$ loss for the sale of the %%% interest in accordance with Generally Accepted Accounting Principles ("GAAP"), further supporting its contention that ENTITY-2 considered the fair market value of the subject pipeline to be\$\$\$\$ at the time ENTITY-3 acquired its%%% interest. The Commission is not convinced that these tax and accounting principles show that the price ENTITY-3

¹⁵⁸ At a conference in DATE, ENTITY-3 indicated that it was considering a pipeline project that would bring crude to LOCATION-I area refiners. Exhibit 16, p. 17.

¹⁵⁹ The Division submitted a spreadsheet prepared by OWNER-I analyzing the financial impact of PIPELINE-3 project under various scenarios, on which OWNER-I indicated that the "worst case" scenario would occur if OWNER-I and ENTITY-3 each built separate pipelines and the "expected case" scenario would occur if OWNER-I (%%%) and ENTITY-3 (%%%) entered into a joint venture agreement. Exhibit 114.

¹⁶⁰ PETITIONER indicates that IRC §704(c)(1)(C) requires that when contributed property that has a built-in loss is sold, that built-in loss can only be allocated to the contributing partner and not to the partnership as a whole. PETITIONER further indicates that IRC §704(c)(1)(C)(ii) requires that the basis of the contributed property shall be treated as being equal to its fair market value at the time of the contribution and that fair market value will be determined by grossing-up the cash contributed.

negotiated in YEAR, before the actual cost of the pipeline was known, is relevant to PETITIONER's fair market value as of the YEAR lien date, once all relevant facts concerning the construction costs were known.

142. Sixth, APPRAISER-3's argument that sales of controlling or majority interests are a much better indicator of market value for an entire property than sales of minority interests is convincing. Because the transaction between OWNER-I and ENTITY-3 was for a minority interest in PIPELINE-3, it is questionable whether it should be used to estimate the entire value of the property.

143. Based on the foregoing, the Commission does not find APPRAISER -1's sales comparison approach to be convincing. The Commission agrees with APPRAISER-3 and APPRAISER-4 that ENTITY-3's transaction to acquire a %%% interest in the subject project in YEAR is not a meaningful indicator of value and that a sales comparison approach should not be used to reconcile a final value for PETITIONER.

Reconciliation of PIPELINE-3's Final Value

144. Rule 62 provides that "[w]hen reconciling value indicators into a final estimate of value, the appraiser shall take into consideration the availability, quantity, and quality of data, as well as the strength and weaknesses of each value indicator."¹⁶¹

145. Earlier, the Commission found that APPRAISER-I's income approach value (once it is revised to remove the size premium and to change the growth rate to %%%) should be used to reconcile a final value for PETITIONER. The Commission finds that either the RCNLD approach value of \$\$\$\$ it derived in Finding of Fact #129 or the HCLD cost approach value of \$\$\$\$ proposed by the Counties and the Division should also be used to reconcile PETITIONER's final value. Earlier, the Commission also found that APPRAISER-I's sales comparison approach should not be used to reconcile a final value for PETITIONER .

146. The Commission has determined that APPRAISER-I's income approach value (once revised to remove the size premium and to change the growth rate to %%%) most likely underestimates

¹⁶¹ Rule 62(5)(d).

PETITIONER's value due to the timing of capital expenditures in relation to depreciation for a new property like the subject pipeline. Nevertheless, the Commission finds APPRAISER-I 's income approach value (once revised to remove the size premium and to change the growth rate to%%%) to be a more convincing indicator of value than either the RCNLD approach value derived in Finding of Fact #129 or the HCLD cost approach value proposed by the Counties and the Division. Accordingly, APPRAISER-I 's income approach value (once revised to remove the size premium and to change the growth rate to %%%) should receive more weight in the reconciliation process than either of these cost approaches.

147. The Commission finds the RCNLD cost approach value it derived in Finding of Fact #129 to be a better reflection of PETITIONER's fair market value than the HCLD cost approach value proposed by the Counties and the Division. Accordingly, this RCNLD value of\$\$\$\$\$ should be used to reconcile PETITIONER's final value, and it should receive%%% weight in the reconciliation process.

148. Accordingly, PETITIONER's YEAR value is to be determined by reconciling the values derived with APPRAISER-I 's income approach (once it is revised to remove the size premium and to change the growth rate to%%%), at a weighting of%%%, and an RCNLD cost approach value of\$\$\$\$\$, at a weighting of%%%.

APPLICABLE LAW

1. Article XIII, Section 2(1) (YEAR)¹⁶² of the Utah Constitution provides as follows:

(1) So that each person and corporation pays a tax in proportion to the fair market value of his, her, or its tangible property, all tangible property in the state that is not exempt under the laws of the United States or under this Constitution shall be:

- (a) assessed at a uniform and equal rate in proportion to its fair market value, to be ascertained as provided by law; and
- (b) taxed at a uniform and equal rate.

2. Utah Code Ann. §59-2-103(1) provides that "[a]ll tangible taxable property shall be assessed and taxed at a uniform and equal rate on the basis of its fair market value, as valued on January 1, unless otherwise provided by law."

¹⁶² All cites are to the YEAR version of Utah law.

3. UCA §59-2-201 provides that the Commission shall assess the following property, as follows in pertinent part:

(1) (a) By May 1 of each year the following property, unless otherwise exempt under the Utah Constitution or under Part 11, Exemptions, Deferrals, and Abatements, shall be assessed by the commission at 100% of fair market value, as valued on January 1, in accordance with this chapter:

(i) except as provided in Subsection (2), all property which operates as a unit across county lines, if the values must be apportioned among more than one county or state;

4. "Fair market value" is defined in UCA §59-2-102, as follows:

(12) "Fair market value" means the amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts. For purposes of taxation, "fair market value" shall be determined using the current zoning laws applicable to the property in question, except in cases where there is a reasonable probability of a change in the zoning laws affecting that property in the tax year in question and the change would have an appreciable influence upon the value.

5. Utah Admin. Rule R884-24P-62 ("Rule 62") provides guidance concerning the valuation of state assessed unitary properties, as follows in pertinent part:

(1) Purpose. The purpose of this rule is to:

(a) specify consistent mass appraisal methodologies to be used by the Property Tax Division (Division) in the valuation of tangible property assessable by the Commission; and

(b) identify preferred valuation methodologies to be considered by any party making an appraisal of an individual unitary property.

(2) Definitions:

(a) "Cost regulated utility" means any public utility assessable by the Commission whose allowed revenues are determined by a rate of return applied to a rate base set by a state or federal regulatory commission.

(b) "Fair market value" means the amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts. Fair market value reflects the value of property at its highest and best use, subject to regulatory constraints.

(c) "Rate base" means the aggregate account balances reported as such by the cost regulated utility to the applicable state or federal regulatory commission.

(d) "Unitary property" means operating property that is assessed by the

Commission pursuant to Section 59-2-201(1)(a) through (c).

(i) Unitary properties

include:

(A) all property that operates as a unit across county lines, if the values must be apportioned among more than one county or state; and

(B) all property of public utilities as defined in Section 59-2-102.

(ii) These properties, some of which may be cost regulated utilities, are defined

under one of the following categories.

(B) "Energy properties " include the operating property of natural gas pipelines, natural gas distribution companies, liquid petroleum products pipelines, and electric corporations, including electric generation, transmission, and distribution companies, and other similar entities.

(3) All tangible operating property owned, leased, or used by unitary companies is subject to assessment and taxation according to its fair market value as of January 1, and as provided in Utah Constitution Article XITI, Section 2. Intangible property as defined under Section 59-2-102 is not subject to assessment and taxation.

(4) General Valuation Principles. Unitary properties shall be assessed at fair market value based on generally accepted appraisal theory as provided under this rule.

(a) The assemblage or enhanced value attributable to the tangible property should be included in the assessed value. See *Beaver County v. WilTel, Inc.*, 995 P.2d 602 (Utah 2000). The value attributable to intangible property must, when possible, be identified and removed from value when using any valuation method and before that value is used in the reconciliation process.

(b) The preferred methods to determine fair market value are the cost approach and a yield capitalization income indicator as set forth in Subsection (5).

(i) Other generally accepted appraisal methods may also be used when it can be demonstrated that such methods are necessary to more accurately estimate fair market value.

(iii) Preferred valuation methods as set forth in this rule are, unless otherwise stated, rebuttable presumptions, established for purposes of consistency in mass appraisal. Any party challenging a preferred valuation method must demonstrate, by a preponderance of evidence, that the proposed alternative establishes a more accurate estimate of fair market value.

(5) Appraisal Methodologies.

(a) Cost Approach . Cost is relevant to value under the principle of substitution, which states that no prudent investor would pay more for a property than the cost to construct a substitute property of equal desirability and utility without undue delay. A cost indicator may be developed under one or more of the following methods: replacement cost new less depreciation (RCNLD), reproduction cost less depreciation (reproduction cost), and historic cost less depreciation (HCLD).

(i) "Depreciation" is the loss in value from any cause. Different professions recognize two distinct definitions or types of depreciation.

(A) Accounting. Depreciation, often called "book" or "accumulated" depreciation, is calculated according to generally accepted accounting principles or regulatory guidelines. It is the amount of capital investment written off on a firm's accounting records in order to allocate the original or historic cost of an asset over its life. Book depreciation is typically applied to historic cost to derive HCLD.

(B) Appraisal. Depreciation , sometimes referred to as "accrued" depreciation, is the difference between the market value of an improvement and its cost new. Depreciation is typically applied to replacement or reproduction cost, but should be applied to historic cost if market conditions so indicate. There are three types of depreciation:

(I) Physical deterioration results from regular use and normal aging, which includes wear and tear, decay, and the impact of the elements.

(II) Functional obsolescence is caused by internal property characteristics or flaws in the structure, design, or materials that diminish the utility of an improvement.

(III) External, or economic, obsolescence is an impairment of an improvement due to negative influences from outside the boundaries of the property, and is generally incurable. These influences usually cannot be controlled by the property owner or user.

(ii) Replacement cost is the estimated cost to construct, at current prices, a property with utility equivalent to that being appraised, using modern materials, current technology and current standards, design, and layout. The use of replacement cost instead of reproduction cost eliminates the need to estimate some forms of functional obsolescence.

(iii) Reproduction cost is the estimated cost to construct, at current prices, an exact duplicate or replica of the property being assessed, using the same materials, construction standards, design, layout and quality of workmanship, and embodying any functional obsolescence,

(iv) Historic cost is the original construction or acquisition cost as recorded on a firm's accounting records. Depending upon the industry, it may be appropriate to trend HCLD to current costs. Only trending indexes commonly recognized by the specific industry may be used to adjust HCLD.

(v) RCNLD may be impractical to implement; therefore the preferred cost indicator of value in a mass appraisal environment for unitary property is HCLD. A party may challenge the use of HCLD by proposing a different cost indicator that establishes a more accurate cost estimate of value.

(b) Income Capitalization Approach. Under the principle of anticipation, benefits from income in the future may be capitalized into an estimate of present value.

(i) Yield Capitalization. The yield capitalization formula is $CF/(k-g)$, where "CF" is a single year's normalized cash flow, "k" is the nominal, risk adjusted discount or yield rate, and "g" is the expected growth rate of the cash flow.

(A) Cash flow is restricted to the operating property in existence on the lien date, together with any replacements intended to maintain, but not expand or modify, existing capacity or function. Cash flow is calculated as net operating income (NOI) plus non-cash charges (e.g., depreciation and deferred income taxes), less capital expenditures and additions to working capital necessary to achieve the expected growth "g". Information necessary for the Division to calculate the cash flow shall be summarized and submitted to the Division by March 1 on a form provided by the Division.

(I) NOI is defined as net income plus interest.

(II) Capital expenditures should include only those necessary to replace or maintain existing plant and should not include any expenditure intended primarily for expansion or productivity and capacity enhancements.

(III) Cash flow is to be projected for the year immediately following the lien date, and may be estimated by reviewing historic cash flows, forecasting future cash flows, or a combination of both.

(Aa) If cash flows for a subsidiary company are not available or are not allocated on the parent company's cash flow statements, a method of allocating total cash flows must be developed based on sales, fixed assets, or other reasonable criteria. The subsidiary's total is divided by the parent's total to derive the allocation percentage to estimate the subsidiary's cash flow.

- (Bb) If the subject company does not provide the Commission with its most recent cash flow statements by March 1 of the assessment year, the Division may estimate cash flow using the best information available.
- (B) The discount rate (k) shall be based upon a weighted average cost of capital (WACC) considering current market debt rates and equity yields. WACC should reflect a typical capital structure for comparable companies within the industry.
- (I) The cost of debt should reflect the current market rate (yield to maturity) of debt with the same credit rating as the subject company.
- (II) The cost of equity is estimated using standard methods such as the capital asset pricing model (CAPM), the Risk Premium and Dividend Growth models, or other recognized models.
- (Aa) The CAPM is the preferred method to estimate the cost of equity. More than one method may be used to correlate a cost of equity, but only if the CAPM method is weighted at least 50% in the correlation.
- (Bb) The CAPM formula is $k(e) = R(f) + (\text{Beta} \times \text{Risk Premium})$, where $k(e)$ is the cost of equity and $R(f)$ is the risk free rate.
- (Cc) The risk free rate shall be the current market rate on 20-year Treasury bonds.
- (Dd) The beta should reflect an average or value-weighted average of comparable companies and should be drawn consistently from Value Line or an equivalent source. The beta of the specific assessed property should also be considered.
- (Ee) The risk premium shall be the arithmetic average of the spread between the return on stocks and the income return on long term bonds for the entire historical period contained in the Ibbotson Yearbook published immediately following the lien date.
- (C) The growth rate "g" is the expected future growth of the cash flow attributable to assets in place on the lien date, and any future replacement assets.
- (I) If insufficient information is available to the Division, either from public sources or from the taxpayer, to determine a rate, "g" will be the expected inflationary rate in the Gross Domestic Product Price Deflator obtained in Value Line. The growth rate and the methodology used to produce it shall be disclosed in a capitalization rate study published by the Commission by February 15 of the assessment year.
- (ii) A discounted cash flow (DCF) method may be impractical to implement in a mass appraisal environment, but may be used when reliable cash flow estimates can be established.
- (A) A DCF model should incorporate for the terminal year, and to the extent possible for the holding period, growth and discount rate assumptions that would be used in the yield capitalization method defined under Subsection (5)(b)(i).
- (B) Forecasted growth may be used where unusual income patterns are attributed to
- (I) unused capacity;
- (II) economic conditions; or
- (III) similar circumstances.
- (C) Growth may not be attributed to assets, not in place as of the lien date.

- (iii) Direct Capitalization is an income technique that converts an estimate of a single year's income expectancy into an indication of value in one direct step, either by dividing the normalized income estimate by a capitalization rate or by multiplying the normalized income estimate by an income factor.
- (c) Market or Sales Comparison Approach. The market value of property is directly related to the prices of comparable, competitive properties. The market approach is estimated by comparing the subject property to similar properties that have recently sold.
- (I) Sales of comparable property must, to the extent possible, be adjusted for elements of comparison, including market conditions, financing, location, physical characteristics, and economic characteristics. When considering the sales of stock, business enterprises, or other properties that include intangible assets, adjustments must be made for those intangibles.
- (II) Because sales of unitary properties are infrequent, a stock and debt indicator may be viewed as a surrogate for the market approach. The stock and debt method is based on the accounting principle which holds that the market value of assets equal the market value of liabilities plus shareholder's equity.
- (d) Reconciliation. When reconciling value indicators into a final estimate of value, the appraiser shall take into consideration the availability, quantity, and quality of data, as well as the strength and weaknesses of each value indicator. Weighting percentages used to correlate the value approaches will generally vary by industry, and may vary by company if evidence exists to support a different weighting. The Division must disclose in writing the weighting percentages used in the reconciliation for the final assessment. Any departure from the prior year's weighting must be explained in writing.
- (6) Property Specific Considerations. Because of unique characteristics of properties and industries, modifications or alternatives to the general value indicators may be required for specific industries.
- (a) Cost Regulated Utilities.
- (i) HCLD is the preferred cost indicator of value for cost regulated utilities because it represents an approximation of the basis upon which the investor can earn a return. HCLD is calculated by taking the historic cost less depreciation as reflected in the utility's net plant accounts, and then:
- (A) subtracting intangible property;
- (B) subtracting any items not included in the utility's rate base (e.g., deferred income taxes and, if appropriate, acquisition adjustments); and
- (C) adding any taxable items not included in the utility's net plant account or rate base.
- (ii) Deferred Income Taxes, also referred to as DFIT, is an accounting entry that reflects the difference between the use of accelerated depreciation for income tax purposes and the use of straight-line depreciation for financial statements. For traditional rate base regulated companies, regulators generally exclude deferred income taxes from rate base, recognizing it as ratepayer contributed capital. Where rate base is reduced by deferred income taxes for rate base regulated companies, they shall be removed from HCLD.
- (iii) Items excluded from rate base under Subsections (6)(a)(i)(A) or (B) should not be subtracted from HCLD to the extent it can be shown that regulators would likely permit the rate base of a potential purchaser to include a premium over existing rate base.

6. For a party who is requesting a value that is different from that determined by the County BOE to prevail, that party must: 1) demonstrate that the value established by the County BOE contains error; and 2) provide the Commission with a sound evidentiary basis for reducing or increasing the valuation to the amount proposed by the party. *Nelson v. Bd. of Equalization of Salt Lake County*, 943 P.2d 1354 (Utah 1997); *Utah Power & Light Co. v. Utah State Tax Comm'n*, 590 P.2d 332, (Utah 1979); *Beaver County v. Utah State Tax Comm'n*, 916 P.2d 344 (Utah 1996); and *Utah Railway Co. v. Utah State Tax Comm'n*, 5 P.3d 652 (Utah 2000).

CONCLUSIONS OF LAW

1. The Division's original YEAR assessed value of \$\$\$\$\$ for PIPELINE-3 does not have the presumption of correctness. First, no party now relies on this value. PETITIONER asks the Commission to reduce the pipeline's value to \$\$\$\$\$, while the other parties ask the Commission to increase its value, the Counties to \$\$\$\$\$ and the Division to \$\$\$\$\$. Second, the original assessed value of \$\$\$\$\$ was derived with an income approach value of \$\$\$\$\$ that received %%% weight in the reconciliation process. This income approach value is incorrect. All three appraisers have derived income approach values of at least \$\$\$\$\$ in their appraisals. Accordingly, the Commission will apply the preponderance of the evidence standard when determining PETITIONER's value.

2. Article XIII, Section 2(1) of the Utah Constitution provides that "[s]o that each person and corporation pays a tax in proportion to the fair market value of his, her, or its tangible property, all tangible property in the state that is not exempt under the laws of the United States or under this Constitution shall be: (a) assessed at a uniform and equal rate in proportion to its fair market value, to be ascertained as provided by law; and (b) taxed at a uniform and equal rate." In line with this constitutional provision, Section 59-2-103(1) provides that "all tangible taxable property shall be assessed and taxed at a uniform and equal rate on the basis of its fair market value, as valued on January 1, unless otherwise provided by law."

3. Section 59-2-201(1)(a)(i) provides that the Tax Commission shall assess, at 100% of its fair market value, "all property which operates as a unit across county lines, if the values must be

apportioned among more than one county or state[.]" PIPELINE-3 operates as a unit across county lines, and its value is apportioned among more than one county. Accordingly, the subject pipeline is a centrally-assessed property that is assessed by the Division. Furthermore, its assessed value is to be 100% of its fair market value.

4. Rule 62(2)(d) provides that a "unitary property" includes operating property that is assessed by the Tax Commission pursuant to Section 59-2-201(I)(a) through (c). Rule 62(d)(i)(A) also provides that "unitary property" includes "all property that operates as a unit across county lines, if the values must be apportioned among more than one county or state[.]" PIPELINE-3 is assessed by the Tax Commission pursuant to Section 59-2-201(1)(a)(i). In addition, it operates as a unit across county lines, and its value is apportioned among more than one county. Accordingly, the subject pipeline is a "unitary property" for purposes of Rule 62.

5. Rule 62(4) provides that "[u]nitary properties shall be assessed at fair market value based on generally accepted appraisal theory as provided under this rule." For unitary properties like the subject pipeline, Rule 62(4)(b) provides that "[t]he preferred methods to determine fair market value are the cost approach and a yield capitalization income indicator as set forth in Subsection (5)." However, Rule 62(4)(b)(i) also provides that "[o]ther generally accepted appraisal methods may also be used when it can be demonstrated that such methods are necessary to more accurately estimate fair market value." Accordingly, PIPELINE-3's value can be determined with methods other than the preferred methods if these other methods are necessary to more accurately estimate its value.

6. Furthermore, Rule 62(4)(b)(iii) provides that the "[p]referred valuation methods as set forth in this rule are, unless otherwise stated, rebuttable presmptions, established for purposes of consistency in mass appraisal. Any party challenging a preferred valuation method must demonstrate, by a preponderance of evidence, that the proposed alternative establishes a more accurate estimate of fair market value."

7. Rule 62(4)(b) provides that one of the preferred methods to determine the value of a unitary property is the yield capitalization income indicated, which is set forth in Subsection (S)(b)(i) of

the rule. Rule 62(5)(a)(v) provides that the other preferred method in a mass appraisal environment for unitary property is the HCLD cost approach. However, this subsection also provides that "[a] party may challenge the use of HCLD by proposing a different cost indicator that establishes a more accurate cost estimate of value." Accordingly, PIPELINE-3's will be determined with the yield capitalization income approach and the HCLD cost approach, unless a party shows that a different indicator of value establishes a more accurate estimate of PIPELINE-3's fair market value.

Yield Capitalization Income Approach

8. In the appraisals relied upon by the three parties, their appraisers each derived a yield capitalization income approach to value, which is one of the Rule 62's preferred methods. All three parties have relied on this preferred method when reconciling a final value for PIPELINE-3.

9. Rule 62(5)(b)(i) provides that "[t]he yield capitalization formula is $CF/(k-g)$, where 'CF' is a single year's normalized cash flow, 'k' is the nominal, risk adjusted discount or yield rate, and 'g' is the expected growth rate of the cash flow." With this formula, the parties determined a wide range of values for PIPELINE-3. PETITIONER determined a value of \$\$\$\$\$, the Counties determined a value of \$\$\$\$\$, and the Division determined a value of \$\$\$\$\$. Although the parties' appraisers used the same general yield capitalization formula, they determined different values because for the most part, they used different cash flows, discount rates, and growth rates in the formula.

Cash Flow.

10. Rule 62(5)(b)(i)(A) provides that cash flow is "calculated as net operating income (NOI) plus non-cash charges (e.g., depreciation and deferred income taxes), less capital expenditures and additions to working capital necessary to achieve the expected growth 'g.'" It also provides that "[c]ash flow is to be projected for the year immediately following the lien date, and may be estimated by reviewing historic cash flows, forecasting future cash flows, or a combination of both."¹⁶³

11. For a number of reasons, the cash flow that PETITIONER calculated is a better projection for the year immediately following the lien date than the cash flows calculated by the Counties

¹⁶³ Rule 62(5)(b)(i)(A)(III).

and the Division. First, the Commission finds that APPRAISER-I 's (and ultimately the Division's) decision not to deduct a historical property tax expense from cash flow, but to increase the capitalization rate to reflect 'this expense, results in a more accurate value for PETITIONER. Second, the Commission finds that the operating revenues and expenses that APPRAISER-I used in his cash flow are more convincing than the amounts used by APPRAISER-3 and APPRAISER-4, who relied upon budgeted numbers only.

12. Third, the Commission prefers APPRAISER-I 's iterative methodology to estimate depreciation because it produces a depreciation number that better reflects the price that a hypothetical purchaser would pay for the subject property. In comparison, the Counties' and the Division's depreciation amounts are based on the depreciation of the seller, which in this case, reflects construction costs for the relatively new pipeline that are higher than its fair market value.

13. Fourth, the Commission is not convinced that the Division's use of MACRS depreciation is appropriate when estimating a "single-year's normalized cash flow." Because MACRS depreciation is so much greater in the early years of a property than in the later years, using MACRS depreciation associated with a new property suggests that this level of depreciation will exist throughout the property's life, which is not the case and which may overstate normalized cash flow. The use of MACRS depreciation might be appropriate to determine value if used in a DCF analysis, where revenues and expenses are accounted for over a number of years. But, no party performed a DCF analysis of all revenues and expenses.

14. Fifth, the Commission is not convinced by the Counties' and the Division's determination that a single-year's normalized cash flow for PETITIONER should reflect a depreciation amount that is many times greater than the capital expenditures amount. In the Counties' cash flow calculation, the depreciation number is more than ##### times greater than capital expenditures. In the Division's, it is more than##### times greater. Usually, the Commission would expect the depreciation number and the capital expenditures number in a normalized cash flow to be close to one another, if not the same, because the totals should theoretically be the same or similar over the life of the property. The

Commission recognizes that the Counties and the Division are attempting to reconcile the fact that capital expenditures expended during the beginning of a new property's life are generally lower than depreciation for these years, with most capital expenditures occurring closer to the end of the property's life. The Commission finds this theory about the timing and present value of capital expenditures to be sound, especially for a new property like PIPELINE-3. However, the evidence is insufficient to show that the capital expenditure number that the Counties and the Division used in their cash flow calculations adequately captures the present values of PETITIONER's expected capital expenditures over its year-life. Again, a DCF model where all of PETITIONER's revenues and expenses were discounted to the present could have been used to capture the timing effect for this new property's capital expenditures and depreciation. However, no party produced such a model.

15. That being said, the timing and present value of capital expenditures, unlike depreciation, are generally much lower at the beginning of the economic life for a new property like PIPELINE-3 than later on. As a result, APPRAISER-I's determination that depreciation and capital expenditures should be the same in his cash flow calculation may underestimate PETITIONER's normalized cash flows and, thus, undervalue the subject pipeline. Nevertheless, APPRAISER-I's cash flow methodology is more convincing than either the Counties' or the Division's and should be used to determine a yield capitalization income approach value for the subject property. The fact that APPRAISER-I's yield capitalization income approach may underestimate the subject's value to some extent can be addressed in the reconciliation process.

Discount Rate - "k".

16. Rule 62(5)(b)(i) provides that the capitalization rate, "k-g," is based on "k," the nominal, risk adjusted discount or yield rate, and "g," the expected growth rate of the cash flow. It also provides that the discount rate, "k," is "based upon a weighted average cost of capital (WACC) considering current

market debt rates and equity yields."¹⁶⁴ All three parties developed a WACC with which to calculate their discount rates.

17. If interest expense is included in computing cash flow, the WACC formula is $(EN \cdot k(e)) + (DN \cdot k(d))$, where "k(e)" is the cost of equity, "k(d)" is the cost of debt, "EN" is the percentage of industry capital structure that is equity, and "*DIY*" is the percentage of industry capital structure that is debt. If interest expense is not included in computing cash flow, the WACC formula is the same, except that the cost of debt ($DN \cdot k(d)$) is multiplied by $(1-T)$, where "*T*" is the marginal income tax rate. All parties treated the interest expense appropriately, either including it in computing cash flow and not accounting for its in cost of debt, or accounting for it in cost of debt and not including it in cash flow.

18. *Cost of Equity and Size Premium.* Rule 62(5)(b)(i)(B)(II) provides that "[t]he cost of equity is estimated using standard methods such as the capital asset pricing model (CAPM), the Risk Premium and Dividend Growth models, or other recognized models." It also provides that "[t]he CAPM is the preferred method to estimate the cost of equity" and that if more than one method is used, "the CAPM method is weighted at least 50% in the correlation." The CAPM formula is $k(e) = R(f) + (\text{Beta} \times \text{Risk Premium})$, where k(e) is the cost of equity and R(f) is the risk free rate.¹⁶⁵

19. All parties developed a CAPM method and weighted it at least %%% in their cost of equity correlations. There are two primary differences between the costs of equity that the three parties developed, which concern: 1) the "beta" that each appraiser used in the CAPM approach and 2) APPRAISER-I's decision to add a size premium to his calculation of CAPM, whereas APPRAISER-3 and APPRAISER-4 did not add a size premium.

20. Rule 62(5)(b)(i)(B)(II)(Dd) provides that "[t]he beta should reflect an average or value weighted average of comparable companies and should be drawn consistently from Value Line or an equivalent source." APPRAISER-I derived a beta of ##### from #4#1## comparables, whereas APPRAISER-3 and APPRAISER-4 each derived a beta of ##### from ##### comparables.

¹⁶⁴ Rule 62(5)(b)(i)(B).

¹⁶⁵ Rule 62(5)(b)(i)(B)(II)(Aa) and (Bb).

APPRAISER-I's comparables are more convincing than the comparables relied upon by APPRAISER-3 and APPRAISER-4. APPRAISER-I used some smaller and medium sized guideline companies that reflect the risks associated with the asset (i.e., the subject pipeline). In addition, the comparables used by the Counties and the Division are, on the whole, less similar to a crude oil property or company than APPRAISER-I's comparables. Accordingly, the Commission prefers APPRAISER-I's cost of equity calculation, with the exception of the size premium.

21. Rule 62 does not specifically address whether a size premium should be added when determining cost of equity. However, the Commission has had a long-standing practice not to incorporate a size premium when determining values for property tax purposes. The evidence is insufficient to show that the Commission should disregard this long-standing practice and apply the size premium to PETITIONER in this appeal.

22. APPRAISER-I obtained the size premium he added to his cost of equity from the YEAR Ibbotson Yearbook, which provides that the size premium is ###% for a micro-cap company (i.e., companies with market capitalizations from roughly \$\$\$\$\$ to \$\$\$\$\$). APPRAISER-3's arguments against the addition of an Ibbotson size premium to the cost of equity are convincing. APPRAISER-3 explained that the size premium has been criticized for a variety of reasons. These arguments are persuasive to show that it is not clear that a size premium based on the "fuH" Ibbotson period (i.e., from 1926 to the present), as proposed by PETITIONER, accurately reflects the investment risk that exists for an investor in YEAR.

23. In addition, the Commission disagrees with PETITIONER's position that a size premium, even if appropriate, should be based on PETITIONER's value or market capitalization instead of the value or market capitalization of OWNER-1 or an investor likely to purchase PETITIONER. The Commission does not believe that OWNER-I or a likely investor of PETITIONER would sell PETITIONER for a price that included a %%% size premium. Accordingly, even if a size premium were appropriate, it should be based on OWNER-I's value or market capitalization. There would be no size premium for a company the size of OWNER-I.

24. Lastly, the Commission does not believe that the long-standing practice concerning the size premium should be addressed in the appeals process. If a party desires for the long-standing practice to be overturned, we recommend it be done through rulemaking or by statute so that the full effects of the practice can be considered *for all taxpayers*. APPRAISER-I 's evidence suggests that companies with less than \$\$\$\$ of market capitalization should be valued with a size premium of%% or higher. It would not be surprising if a significant percentage of taxpayers whose values would be determined with a WACC would have values of\$\$\$\$ or less. If so, changing the Commission's practice on the size premium could result in their costs of equity being determined with significant size premiums that would substantially reduce values. If the size premium primarily affected centrally-assessed taxpayers, the potential reduction in centrally-assessed values raises substantial concerns about statewide uniformity. Because of these potential effects, the Commission sustains the long-standing practice concerning the size premium for all taxpayers, including PETITIONER, until it is changed by rulemaking or by statute.

25. *Cost of Debt.* Rule 62(5)(b)(i)(B)(I) provides that "[t]he cost of debt should reflect the current market rate (yield to maturity) of debt with the same credit rating as the subject company." To determine their costs of debt, APPRAISER -1 used the same ##### guideline companies be used to determine his beta for the cost of equity, whereas APPRAISER-3 and APPRAISER-4 each used the same ##### guideline companies with which they determined their beta for the cost of equity. Again, the Commission considers APPRAISER-I 's guideline companies to be more convincing because he considered some smaller and medium sized companies in addition to larger companies and because some of the comparables used by the other two parties were more dissimilar to PETITIONER. Accordingly, APPRAISER-I 's cost of debt of %%% is more convincing than the cost of debt of %%% that APPRAISER -3 and APPRAISER-4 used.

26. *Capital Structure.* Rule 62(5)(b)(i)(B) provides that the "WACC should reflect a typical capital structure for comparable companies within the industry." The parties used almost identical capital structures. APPRAISER-I and the Division each derived their WACC by weighting cost of equity at %%% and cost of debt at %%%, whereas APPRAISER-3 used a capital structure of%% equity and

%%% debt. Again, the guideline companies that the parties used to develop their capital structures are the same ones that they used to develop their betas and costs of debt. As before, APPRAISER-I's comparables are more convincing because he uses some smaller and medium sized companies and because the companies are more similar to PETITIONER. Accordingly, the Commission finds that PETITIONER's capital structure is %%% equity-%%% debt.

GrowthRate – "g".

27. Rule 62(5)(b)(i)(C) provides that "[t]he growth rate 'g' is the expected future growth of the cash flow attributable to assets in place on the lien date, and any future replacement assets." The rule further provides that "[i]f insufficient information is available ...to determine a rate, 'g' will be the expected inflationary rate in the Gross Domestic Product Price Deflator obtained in Value Line."¹⁶⁶

28. To calculate his capitalization rate, APPRAISER-I used a growth rate of%%%, which is the expected inflationary rate in the Gross Domestic Product Price Deflator obtained in Value Line. APPRAISER-3 and APPRAISER-4, however, determined that there was sufficient information available to determine a growth rate that was higher than this "default" rate. They determined a growth rate of %%% for PETITIONER. APPRAISER-I's %%% growth rate will only be used if the Commission finds that there is insufficient information available to determine a growth rate, or if there is sufficient information available to determine a growth rate and that evidence shows that the rate is %%%. The Commission finds that there is sufficient information available to determine a growth rate for PETITIONER. However, the Commission finds that the growth rate is %%%, as proposed by the Counties and the Division.

29. Specifically, the evidence does not show that PETITIONER's volume throughput will either decrease in the future, as the taxpayer suggests, or that it will increase, as the Counties suggest. The most convincing evidence shows that it will remain relatively stable in the near future. On the other hand, the Division has provided convincing evidence to show that prices are expected to increase by

¹⁶⁶ Rule 62(5)(b)(i)(C)(n).

%% in the future. For these reasons, the Commission finds that growth rate is %% and that this rate should be used in the yield capitalization income approach to estimate PETITIONER's value.

Property Tax Adjustment.

30. As discussed earlier, the Commission finds that the capitalization rate should be adjusted for the property tax rate instead of deducting this expense in the calculation of cash flow. Accordingly, the decision of APPRAISER-I and the Division to adjust for property taxes in their capitalization rates is more convincing than APPRAISER-3's treatment of this expense. The Commission also finds that the %% adjustment to the capitalization rate to account for property taxes, as derived by both APPRAISER-I and the Division, is correct.

Yield Capitalization Income Approach- Conclusion.

31. With two exceptions concerning the size premium and the growth rate, the Commission finds PETITIONER's yield capitalization income approach to be more convincing than either the Counties' or the Division's yield capitalization income approach. The income approach to be used to determine PETITIONER's YEAR value is APPRAISER-I 's income approach, except that the size premium is to be removed from the calculation and the growth rate is to be increased to%%.

32. The Commission recognizes that due to the timing of capital expenditure in relation to depreciation for a new property like PIPELINE-3, APPRAISER -I 's use of a normalized capital expenditure amount that is equal to depreciation may undervalue PETITIONER to some extent. This will be considered later when the Commission determines the reconciliation percentages to be applied to each valuation method that is used to determine PETITIONER's YEAR value.

Cost Approach

33. Rule 62(5)(a) provides that "[c]ost is relevant to value under the principle of substitution, which states that no prudent investor would pay more for a property than the cost to construct a substitute property of equal desirability and utility without undue delay." The rule also provides that "[a] cost indicator may be developed under one or more of the following methods: replacement cost new less

depreciation (RCNLD), reproduction cost less depreciation (reproduction cost), and historic cost less depreciation (HCLD)."

34. APPRAISER-3 and APPRAISER-4 each derived an HCLD cost approach value of \$\$\$\$\$ for PETITIONER, while APPRAISER-1 derived an RCNLD cost approach value of \$\$\$\$\$. Rule 62(5)(a)(v) provides that "RCNLD may be impractical to implement; therefore the preferred cost indicator of value in a mass appraisal environment for unitary property is HCLD. A party may challenge the use of HCLD by proposing a different cost indicator that establishes a more accurate cost estimate of value." Accordingly, APPRAISER-1's RCNLD cost approach may be used if PETITIONER shows that it establishes a more accurate cost estimate of its pipeline than the HCLD approach.

35. For purposes of HCLD, Rule 62(5)(a)(iv) provides that "[h]istoric cost is the original construction or acquisition cost as recorded on a firm's accounting records." In addition, the rule provides that "[b]ook depreciation is typically applied to historic cost to derive HCLD." However, it also provides that physical deterioration, functional obsolescence, and external (or economic) obsolescence are forms of depreciation that are "typically applied to replacement or reproduction cost, but should be applied to historic cost if market conditions so indicate."¹⁶⁷ APPRAISER-3 and APPRAISER-4 applied book depreciation to historic cost to derive their HCLD value of \$\$\$\$\$, but did not apply any other depreciation or obsolescence.

36. The HCLD value derived by APPRAISER-3 and APPRAISER-4 is generally a reliable indicator of value for a property as new as PIPELINE-3. In this case, however, concern exists as to whether it produces a reasonable estimate of PETITIONER's value. Without applying any depreciation or obsolescence other than book depreciation, the HCLD approach results in a value that is very close to the actual cost to construct the pipeline, which unexpectedly increased to more than \$\$\$\$\$ by its completion. No party has proposed a value or submitted another valuation approach that produces a value as high as the \$\$\$\$\$ value that APPRAISER-3 and APPRAISER-4 calculated as the HCLD value. As a

¹⁶⁷ Rule 62(5)(a)(i)(A) and (B).

result, it seems evident that the Counties' and the Division's HCLD cost approach contains obsolescence associated with the cost overruns and, thus, overestimates PETITIONER's value.

37. For purposes of RCNLD, Rule 62(5)(a)(ii) provides that "[r]eplacement cost is the estimated cost to construct, at current prices, a property with utility equivalent to that being appraised, using modern materials, current technology and current standards, design, and layout. The use of replacement cost instead of reproduction cost eliminates the need to estimate some forms of functional obsolescence." APPRAISER-I derived an RCNLD value of\$\$\$\$\$ for PIPELINE-3 by first calculating a replacement cost of\$\$\$\$\$. To this replacement cost, APPRAISER-I then applied physical depreciation of%%(%%% per year) and obsolescence of%%% to derive his\$\$\$\$\$ RCNLD value.

38. APPRAISER-I 's RCNLD value is not convincing and does not establish a more accurate estimate of PETITIONER's value than the HCLD approach. First, APPRAISER-I 's replacement cost of\$\$\$\$\$ that he used in deriving his RCNLD value is not convincing. Although the actual construction costs of\$\$\$\$\$ to build PIPELINE-3 may have contained some expenses that would not be expended to replace the pipeline, the Commission is not convinced that PIPELINE-3 could be replaced for\$\$\$\$\$. The evidence does not show that PIPELINE-3 could be built over the same route or over a different route that would eliminate a majority of the costs that PETITIONER actually expended, as APPRAISER-I contends. In addition, APPRAISER-I 's reliance on the *estimated* construction costs of other pipeline projects and construction rules-of-thumb are not convincing. Accordingly, APPRAISER-I 's replacement cost of\$\$\$\$\$ underestimates the costs that would be incurred to replace PIPELINE-3 and, thus, underestimates PETITIONER's value.

39. The most convincing replacement cost evidence that APPRAISER-I provided was Marshall pipeline cost information. From this information, the Commission believes that the most likely replacement cost for the#####-mile PIPELINE-3 would be\$\$\$\$\$ (or\$\$\$\$\$ a mile), based primarily on the good quality costs at the upper end (i.e., at%%%) of the normal cost range. Because many, if not most, of the unexpected costs associated with PIPELINE-3 would likely be incurred again if the pipeline

were replaced, this \$\$\$\$ estimated replacement cost seems more reasonable than either the \$\$\$\$ of costs actually expended to build it or the\$\$\$ of replacement costs estimated by APPRAISER-I.

40. Second, APPRAISER-I 's RCNLD cost approach value is also not convincing because of the%% obsolescence deduction that he applied in his calculation. APPRAISER-I determined that an obsolescence deduction was necessary because the demand for crude oil carried over PIPELINE-3 is lower than anticipated and because the pipeline's designed capacity exceeds historical throughput volumes. The Commission is not convinced the obsolescence deduction is warranted. The pipeline has been in operations for less than ##### years as of the lien date, and the short amount of time it has been in operations has occurred during a great economic recession. In addition, the Commission is not convinced that APPRAISER-I has adequately considered peak usage in his underutilization analysis. As a result, APPRAISER-I has not shown that PIPELINE-3 will suffer from%% underutilization into the future or that a%% obsolescence adjustment is appropriate when determining its value.

41. Based on the foregoing, PETITIONER has not shown that its proposed alternative cost approach value of \$\$\$\$ establishes a more accurate estimate of fair market value than Rule 62's preferred HCLD cost approach value of\$\$\$\$. Nevertheless, the HCLD value of\$\$\$\$ appears to contain obsolescence associated with cost overruns and, thus, overestimates PETITIONER's value. Earlier, the Commission determined that APPRAISER-I 's income approach, once the size premium is removed and the growth rate is increased to%%, should be the income approach used in reconciling a value for PETITIONER, but that it most likely underestimates PETITIONER's value. Nevertheless, the HCLD approach is less reliable than this income approach. Accordingly, the HCLD cost approach, if used in the reconciliation process, should receive a weight of only%%.

42. The Commission is more confident that an RCNLD cost approach based on a replacement cost \$\$\$\$ (based on Marshall cost information) would better estimate the fair market value of PIPELINE-3 than the HCLD cost approach, which appears to contain obsolescence associated with some of the cost overruns. If APPRAISER-I 's physical depreciation adjustment of%% is applied to a replacement cost of \$\$\$\$\$, it produces an RCNLD approach value of \$\$\$\$\$. The Commission also

considers this RCNLD value of\$\$\$\$\$ less reliable than APPRAISER-I 's income approach (once it is revised to remove the size premium and increase the growth rate to%%%). However, it considers it to be more reliable than the Counties' and Division's HCLD cost approach. Accordingly, this RCNLD cost approach value of\$\$\$\$\$, if used in the reconciliation process, should receive a weight of%%%.

Sales Comparison Approach

43. The sales comparison approach is not one of "preferred" methods to determine fair market value under Rule 62. Rule 62(4)(b)(i), however, provides that "[o]ther generally accepted appraisal methods may also be used when it can be demonstrated that such methods are necessary to more accurately estimate fair market value."

44. In YEAR, ENTITY-3 entered into a transaction to acquire a %% interest in the subject pipeline for a price between \$\$\$\$\$ and\$\$\$\$\$, which APPRAISER-I equates to a price between\$\$\$\$\$ and \$\$\$\$\$ for the entire subject project. APPRAISER-I determined that this transaction, which was negotiated prior to the cost overruns that occurred while the pipeline was built, is a sale that provides a meaningful indication of PIPELINE-3 's value. The Commission disagrees. First, the Commission is not convinced that a single transaction produces a reliable sales comparison indicator of value where the parties to that transaction were also entering into a transportation or shipping agreement, where the buyer (ENTITY-3) was giving up its plans to build its own pipeline, and where the seller (OWNER-I) was eliminating possible competition from an ENTITY-3 pipeline.

45. Second, the transaction does not reflect the subsequent cost overruns that occurred or the pipeline's final cost. In Utah law, "fair market value" is defined to mean "the amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts (emphasis added). For the YEAR lien date, the relevant facts would include knowledge of the cost overruns and the pipeline's final cost, facts that were unknown when the transaction for a%%% interest was negotiated in YEAR.

46. Third, the Commission is not convinced that the tax and accounting principles argued by PETITIONER show that the price negotiated in YEAR is relevant to PETITIONER's YEAR fair market

value. The Commission is convinced that the final cost to build PIPELINE-3 would be a factor that would affect the value at which it would sell between a willing buyer and a willing seller on the YEAR lien date.

47. Fourth, the Commission finds that the sale of a minority interest in a property is not as good an indicator of market value for an entire property than a sale of a controlling or majority interest. No evidence was provided to convince the Commission otherwise.

48. The Commission does not find that the transaction between OWNER-I and ENTITY-3 to be a reliable sale with which PIPELINE-3's fair market value can be estimated for YEAR. However, even had it been a reliable sale, the Commission is not convinced that APPRAISER-I 's %%% downward adjustment to the price range to account, in part, for external obsolescence not present and/or anticipated in YEAR is warranted. Earlier, the Commission found that APPRAISER-I 's %%% downward adjustment to his cost approach for obsolescence associated with underutilization was unwarranted. In addition, the transaction was negotiated in YEAR, and the Commission does not find the evidence sufficient to show whether prices increased, decreased, or remained the same between YEAR and YEAR.

49. Based on the foregoing, the Commission does not find APPRAISER-I 's sales comparison approach to be convincing or that it is necessary to more accurately estimate PETITIONER's fair market value. Accordingly, it should not be used to reconcile PETITIONER's final value.

Reconciliation of PIPELINE-3's Final Value

50. Rule 62(5)(d) provides that "[w]hen reconciling value indicators into a final estimate of value, the appraiser shall take into consideration the availability, quantity, and quality of data, as well as the strength and weaknesses of each value indicator." On the basis of these factors, the Commission finds that PETITIONER's final value should be determined upon consideration of APPRAISER-I 's income approach value (once it is revised to remove the size premium and to increase the growth rate to %%%) and a cost approach value.

51. The Commission finds the RCNLD cost approach value of \$\$\$\$ derived earlier from Marshall cost information to be a better reflection of PETITIONER' s fair market value than the HCLD

cost approach value proposed by the Counties and the Division. Accordingly, this RCNLD value of \$\$\$\$\$ should be used to reconcile PETITIONER's final value.

52. The Commission has determined that APPRAISER-I 's income approach value (once revised to remove the size premium and to increase the growth rate to%%%) most likely underestimates PETITIONER's fair market value due to the timing of capital expenditures in relation to depreciation for a new property like the subject pipeline. Nevertheless, the Commission finds APPRAISER-I 's income approach value (once revised to remove the size premium and to increase the growth rate to%%%) to be a more convincing indicator of value than the RCNLD value of\$\$\$\$\$. Accordingly, APPRAISER-I's income approach value (once revised to remove the size premium and to increase the growth rate to%%%) should receive more weight in the reconciliation process than the RCNLD value of\$\$\$\$\$.

53. Based on the foregoing, the PETITIONER's YEAR value should be determined by reconciling the values derived with APPRAISER-I 's income approach (once revised to remove the size premium and to change the growth rate to%%%), at a weighting of%%%, and an RCNLD cost approach value of\$\$\$\$\$, at a weighting of%%%.

Kerry R. Chapman
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission finds PETITIONER 's YEAR value is to be determined by reconciling the values derived with APPRAISER-I 's income approach (once it is revised to remove the size premium and to increase the growth rate to%%%), at a weighting of%%%, and an RCNLD cost approach value of\$\$\$\$\$, at a weighting of%%%. It is so ordered.

The Property Tax Division is ordered to adjust its records in accordance with this order. The Property Tax Division is also ordered to calculate the final adjustments to the values apportioned to tax districts as a result of this order and to deliver that information to the affected counties on behalf of the Commission. The auditors of the affected counties are ordered to use the information so provided to adjust their tax roles in accordance with this order.

DATED this _____ day of _____, 2014.

COMMISSIONER DIXON CONCURS

I concur on the final conclusion of value, but write separately to distance myself from what was expressed, and may be understood by those reading this order, as a general overall concern by the Commission regarding the use of the size premium.

It is my position that the Tax Commission's applicable administrative rules are silent on size premiums; the rules do not disallow consideration of the size premium. Further, a decision to use or not use a size premium should not be viewed as a policy decision, but an element of valuation, which can be considered from case to case based on the facts and the evidence given. And finally, when a taxpayer appeals a value, the Commission is seeking the best evidence of value; therefore all the information that may assist in determining the best evidence of market value should be considered and used if the preponderance of the evidence supports its use.

Conclusion of law number 24 refers to a "long-standing practice concerning the size premium". I believe the Commission can change its practice if the evidence in an appeal seems to indicate that the practice may be overvaluing a property. I believe prior commission rulings do not preclude the Commission from finding that a method, including use of a size premium, may be appropriate.

If a taxpayer appeals, and other similarly situated taxpayers do not, it is not clear why the one that appealed should be denied the use of the size premium if the preponderance of the evidence shows that use of the size premium may be appropriate. It is possible the evidence may show that if the size premium is not used it may result in over-valuation.

The limited argument the Commission has received on size premiums suggests that a size premium is just another method or tool to determine value; and for this reason perhaps it should not be so summarily discouraged. As in all elements of value, whether a size premium is warranted should be based on the preponderance of the evidence--the facts and the direct testimony and rebuttal by any witnesses.

In terms of the instant appeal before the Commission, the preponderance of the evidence did not support the use of the size premium. Of overall concern was that the requested size premium seemed a large percentile and had a significant impact on the income approach to value. This suggested that more information was needed to merit use of the size premium as it related to this taxpayer.

D'Arcy Dixon Pignanelli
Commissioner

Notice of Appeal Rights: You have twenty (20) days after the date of this order to file a Request for Reconsideration with the Tax Commission Appeals Unit pursuant to Utah Code Ann. §63G-4-302. A Request for Reconsideration must allege newly discovered evidence or a mistake of law or fact. If you do not file a Request for Reconsideration with the Commission, this order constitutes final agency action. You have thirty (30) days after the date of this order to pursue judicial review of this order in accordance with Utah Code Ann. §§59-1-60let seq. and 63G-4-401 et seq.

