

BEFORE THE STATE ASSESSMENT REVIEW BOARD
STATE OF ALASKA

IN THE MATTER OF)	Appeal of Revenue Decision
THE TRANS-ALASKA PIPELINE SYSTEM)	No. 07-56-06 & 07-56-07
)	
)	OAH No. 07-SARB-TAX
OIL & GAS PROPERTY TAX (AS 43.56))	
<u>2007 ASSESSMENT YEAR</u>)	

CERTIFICATE OF DETERMINATION

The State Assessment Review Board (Board) convened from May 15, 2007 through May 24, 2007 to hear and deliberate on the AS 43.56 appeals of the 2007 assessment of the Trans-Alaska Pipeline System (TAPS). Chair Steven L. Van Sant and members Don Martin McGee, and Mickey Keller, were present, constituting a quorum as required by AS 43.56.130(b).¹

The Board Chair, Steven L. Van Sant, conducted the hearing. Mark T. Handley, Administrative Law Judge from the Office of Administrative Hearings, assisted the Chair.²

The owners of the TAPS (Owners) were represented by attorneys Steven Mahoney and Marie Evans for ConocoPhillips Transportation Alaska, Inc., and Carl Bauman, C. Stephen Davis and Cris K. O'Neill for the other Owners, BP Pipelines (Alaska) Inc., Exxon/Mobil Pipeline Company, Koch Alaska Pipeline Company, and Unocal Pipeline Company. Attorney Robert M. Johnson, Assistant Attorney General Ken Diemer and Jim Greeley represented the Taxation Division (Division). The municipalities appealing the Division's 2007 TAPS assessment (Municipalities) were represented by attorneys, Robin O. Brena, William M. Walker, Craig Richards, and Clifford J. Groh for the City of Valdez, Joseph Miller and Rene Broker for

¹ Board member Mike Salazar participated in the first five days of the hearing, but did not participate in the deliberations because he had to leave before the sixth day of the hearing.

² Under Alaska Statute 44.64.030(b), the Office of Administrative Hearings provided an administrative law judge to advise the Board at the request of the Department of Revenue.

the Fairbanks North Star Borough, and Mauri Long for the North Slope Borough.

A court reporter was present to swear in witnesses and create a transcript of the hearing.

I. Introduction

The subject of this appeal is the Division's \$4.578 billion updated assessed valuation of the TAPS. The Division used Replacement Cost New Less Depreciation (RCNLD) methodology to arrive at its assessed valuation.

The Owners argued that the 2007 TAPS value was \$0.8 billion. The Municipalities argued the TAPS assessed valuation should be set at \$7.404285 billion.

Under AS 43.56.130(f), the Board cannot adjust the Division's assessed valuation unless the evidence in the record shows that this valuation is unequal, excessive, improper or otherwise contrary to the standards set out in AS 43.56.

The Board determined that the Division improperly added its adjustment to the TAPS Right-of-Way value to its RCN estimate, which resulted in the Right-of-Way costs receiving a depreciation reduction that should not have been applied. The Board concluded that the Division's Right-of-Way valuation should be removed from the Division's Replacement Cost New (RCN) estimate, and then added to the Division's RCN less Physical Depreciation, Functional & Economic Obsolescence estimate. The Board recalculated the Division's updated RCNLD of the TAPS value making this change. The Board concluded that the resulting value of \$4.588895312 billion should be the 2007 assessed value of the TAPS.³ The Board concluded the Municipalities and the Owners did not meet their burdens of proof to show that the Division's assessed valuation was otherwise unequal, excessive, improper or otherwise contrary to the standards set out in AS 43.56.

³ See Graphic showing the Board's adjustment at page 12.

A. Description of the Property

The TAPS is an 800-mile long, 48-inch diameter, crude-oil transportation pipeline stretching from the oil fields of the North Slope of Alaska to the port terminal in Valdez, Alaska. The TAPS includes its oil-associated pump stations, buildings, materials, supplies, machinery, tanks, terminal facilities and other related property.

Portions of the TAPS are located in the municipalities of the City of Valdez, the Fairbanks North Star Borough, the North Slope Borough and the Unorganized Borough of Alaska. Portions of the TAPS may be located in other taxing jurisdictions within the state of Alaska.

B. Names and Addresses of Each Owner of the TAPS

1. BP Pipelines (Alaska) Inc., PO Box 190848, Anchorage, AK 99519-0848
2. ConocoPhillips Transportation Alaska, Inc., PO Box 110360 Anchorage, AK 99510-0360
3. Exxon/Mobil Pipeline Company, PO Box 2220, Houston, TX 77252-2220
4. Koch Alaska Pipeline Company, LLC, PO Box 2913, Wichita, KS 67201-2913
5. Unocal Pipeline Company, 14141 Southwest Freeway, Sugar Land, TX 77478

C. Parties Appealing

The Owners of the TAPS appealed Alaska Department of Revenue Decision No. 07-56-07. This decision ruled on the Owners' claims against the Division's March 1, 2007 Notice of Assessment of the TAPS.

The Municipalities appealed Alaska Department of Revenue Decision No. 07-56-06. This decision ruled on the Municipalities' claims against the Division's March 1, 2007 Notice of Assessment of the TAPS.

D. Consolidation and Coordination of Appeals

For the appeal before the Board of the Division's 2007 assessment of the TAPS, the appeals of Revenue Decision No. 07-56-06 and Revenue Decision No. 07-56-07 were consolidated and the different owners and the different municipalities coordinated the presentation of their cases.⁴

II. Historical Context of the Board's Review of the 2007 TAPS Assessed Valuation Under AS 43.56.

A. Before 2001

Prior to 2001, no appeals the TAPS valuation were heard by the Board because the TAPS assessed valuation was set in negotiated settlements between the Division and owners of the TAPS with little, if any, participation by the Municipalities.

B. 2001 TAPS Assessment

In 2001, both the Owners and the Municipalities appealed the Division's \$2.75 billion assessed valuation of the TAPS. Each party commissioned appraisals of the property. Neither of these appraisals included an updated replacement cost study of the TAPS. Both relied most heavily on projected TAPS tariff income data in setting their valuation estimates. The Owners argued that the Division's assessed valuation was too high, while the Municipalities argued that the valuation was too low.

In its 2001 assessment, the Division had considered its own income approach, which it called its TAPS Tariff Settlement Agreement Income Model (TSM). An income approach projects the future income of an income producing property and then discounts that income stream to its present worth. The Division's TSM estimate was based on the assumption that

⁴ See Pre-Hearing Order issued May 3, 2007.

future TAPS tariffs would be set in accordance with the TAPS Tariff Settlement Agreement between the Owners and the State of Alaska. The TSM estimate used the Division's future TAPS throughput projections, which are the Division's estimates of the number of barrels of oil that will be sent through the TAPS each year that the TAPS will be in production. The TSM estimate resulted in a valuation of the TAPS at \$3.017 billion.

The Division also considered the appraisal prepared for the Municipalities by Tegarden & Associates, Inc. and the appraisal prepared for the Owners by Shank & Kinnard (Shank). The Division explained that it had reconciled these two appraisals with its TSM estimate to arrive at its \$2.75 assessed valuation of the TAPS.

In 2001, the Owners asserted that the "full and true value" of the TAPS under AS 43.56.060(e) was no more than \$2.1 billion, the valuation advocated by the Owners' expert, Shank. The Owners appeal focused on lack of weight given to Shank's cost approach and comparable sales approach valuations. A cost approach estimates what it would cost to build or replace a property new and then adjusts for factors such as depreciation, obsolescence, and inflation. A comparable sales approach uses recent sales of similar properties or partial sales of the same property to estimate value.

The Owners also challenged the future TAPS throughput projections in the Division's TSM valuation. The Owners argued that the Division should have reduced its best estimate of future TAPS throughput so that these estimates would only include oil that currently met requirements of the definition "proven reserves" suggested by the Owners.

In 2001, the Municipalities argued that the state improperly lowered its valuation of the TAPS from \$3.017 billion to \$2.75 billion, and that an alternate assessment of \$5.9 billion was appropriate under the second part of AS 43.56.060(e)(2) based on a cost approach using straight-line depreciation of the TAPS.

In 2001, the Board concluded that an income approach was the most reliable methodology for calculating the 2001 TAPS assessed value based on the evidence that had been

presented to the Board. Problems in both the cost and comparable sales value estimates of the parties' 2001 experts made those value estimates so much less reliable than the Division's TSM valuation using the tariff income approach that the Board concluded that the TSM valuation was proper for setting the 2001 assessed value of the TAPS.

The 2001 comparable sales value estimates were not reliable because they were based on sales that were not arms-length transactions. Furthermore, the relatively small percentage of total ownership those minority interest sales represented, combined with the inability to assign an accurate control premium, made the attempts to gross-up these partial sales a very unreliable measure of the full value of the TAPS. The control premium was the increased value to a minority interest that would result from owning a controlling interest in the TAPS.

The 2001 cost value estimates had to be calculated based on the original cost of the TAPS. Having to adjust these original costs forward so many years made the valuations based on the original costs a very poor indicator of the 2001 value of the TAPS.

The evidence presented to the Board in 2001 showed that the Division's projections of future through-put for the TAPS, which it used in its TSM model valuation, were clearly the most reliable estimates available to the Division and the Board at that time. In reaching this conclusion, the Board gave weight to the consideration that these estimates were prepared by the state for purposes other than property tax assessments, including revenue forecasts and statewide budgeting. It was apparent that the Division had made every effort to ensure that these projections were as accurate as possible.

In 2001, the Board rejected the Owners' arguments that lower estimates of future production based on "proven reserves" should be used. The Board concluded that if TAPS throughput estimates were limited to oil that would come from "proven reserves," a large portion of the oil that any reliable projection would include in the future through-put of TAPS would be excluded. The Board noted that AS 43.56.060(e) requires that assessed valuations of the TAPS use its full and true value with "due regard" to its economic value "based on the estimated life of the proven reserves." The Board determined that this statute does not require that a valuation of

TAPS ignore future income generated by the transportation of oil, which no one could reasonably dispute would be produced, simply because that oil did not meet the strict definition of “proven reserves” on the assessment date. The Board concluded that such a reading of the statute would give undue regard to “proven reserves” because it would result in an assessed value that is lower than the “full and true value” of the TAPS.

The Board concluded that the Division’s reduction of the 2001 TSM valuation to \$2.75 billion through its reconciliation process resulted in an assessed value that was improper. The Board found that the Division had improperly used what it characterized as reconciliation to reduce its best estimate TSM valuation to bring that valuation closer to a projected graph line of historical negotiated TAPS assessments, and closer to valuations that were based on data and methodologies that both the Division and the Board considered much less reliable. The Board ordered that the 2001 TAPS assessed value be adjusted to \$3.017 billion.⁵

C. 2002, 2003 and 2004 TAPS Assessments

From 2001 through 2004, the assessed valuation of the TAPS remained at \$3.017 billion as the result of negotiated agreements between the Division, the Owners, and the Municipalities.

D. 2005 TAPS Assessment

The Division’s estimated value of the future tariff income stream of the TAPS in 2005 was significantly less than its future tariff income stream estimate in 2001. This was primarily because a recent decision by the Regulatory Commission of Alaska (RCA) lowered the amount of tariff that the Owners could charge to intrastate shippers of Alaska North Slope oil. This amount is far below the amount previously charged under the TAPS Tariff Settlement Agreement, which still controlled the tariffs for interstate Alaska North Slope oil shipped through the pipeline.

⁵ The Board’s 2001 TAPS Certificate of Determination is found in the Division’s Ex. m-7.

Although most Alaska North Slope oil is shipped out of state and was thus still subject to the TAPS Tariff Settlement Agreement tariff rate, the RCA decision was generally accepted as an indication that Tariff Settlement Agreement tariff rate might be subject to a significant reduction when it would be reviewed by the Federal Energy Regulatory Commission (FERC). This uncertainty about future tariff rates in 2005 led the Division to question whether the income approach using a capitalized estimated future tariff income stream still provided the most complete and reliable estimate of the value of the TAPS. Left with no useful comparable sales data, and no longer willing to rely on an income approach valuation, the Division decided to look at a RCNLD (replacement cost new less depreciation) cost approach.

As part of the 2005 TAPS assessment process, in response to a request from the Division, the Owners contracted with Mustang Engineering, L.P. (Mustang) to conduct a replacement cost study of the TAPS. The Owners also had an appraisal of the TAPS done by Stancil & Co. (Stancil). Kathy G. Spletter, ASA, was Stancil's Appraiser. The Stancil appraisal was based on Mustang's replacement cost study and a TAPS tariff income stream valuation.

The Municipalities contracted with R.W. Beck, Inc. (Beck) to review the Mustang replacement cost study. Beck reviewed Mustang's draft report and consulted with Mustang and the Owners' attorneys regarding some issues that Beck had identified in the Mustang report. Beck produced its own replacement cost report based on the Mustang report and on some of its own investigations. Beck also produced a TAPS valuation estimate based on its review of the information in its own replacement cost study and other information.

The Division's 2005 Assessment set a \$3 billion assessed valuation for the TAPS. The Division's valuation used RCNLD cost approach methodology to value the TAPS. The Division relied on both the Mustang and Beck reports in determining the TAPS 2005 value. The Division explained that it had considered other approaches to valuation, including income, sales comparison, stock & debt, and integrated economic value.

The Board concluded in 2005, as it had in 2001, that it would be improper for the Division to adjust its best estimate of the TAPS value by giving significant weight to approaches

of valuation or other indicators of value that were not reliable. The Board agreed with the Division that the 2005 value of the TAPS could no longer be accurately measured by the tariff income approach. The Board found that the regulated tariff income stream did not reflect the total economic value of the TAPS, but only a portion of it. The Board concluded that it would have been improper for the Division to reduce its 2005 assessed valuation of the TAPS to bring it closer to tariff income approach valuations because the uncertainty of future tariff rates and other factors caused the value of future tariff income streams to understate the full and true value of the TAPS.

The Board concluded that AS 43.56 charges the Division, not the Board, with the responsibility to initially weigh the evidence and choose between conflicting data, indicators, and methodologies to arrive at its best estimate of value. Based on the evidence presented, the Board concluded that the Division's 2005 assessed valuation of the TAPS at \$3 billion was at the low end of an acceptable value range, but it was not unequal, excessive, improper or otherwise contrary to the standards set out in AS 43.56. The Board found that neither the Owners nor the Municipalities carried their burden of proof. The Board determined that the Division's valuation should not be adjusted.⁶

D. 2006 TAPS Assessment

In making its 2006 assessment, the Division had decided that it should assume that the data and methodology used to calculate the TAPS \$3.0 billion assessed value for 2005 had been correct. The Division made adjustments to the 2005 TAPS data to account for value changes that had occurred over the following twelve months. The Division's initial adjustments and recalculations to update its \$3.0 billion 2005 assessed value for TAPS resulted in a 2006 TAPS assessed valuation of \$3.344 billion. The Owners and the Municipalities requested an informal conference to review this valuation. After reviewing the Municipalities' and the Owners' concerns about its 2006 assessment, the Division issued an informal conference decision which adjusted its 2006 assessed valuation of the TAPS to \$3.641 billion.

⁶ The Board's 2005 TAPS Certificate of Determination is found in the Division's Ex. a-12.

concluded that the resulting value of \$4.3062718 billion should be the 2006 assessed value of the TAPS. The Board concluded the Municipalities and the Owners did not meet their burdens of proof to show that the Division's assessed valuation was otherwise unequal, excessive, improper or otherwise contrary to the standards set out in AS 43.56.⁷

III. 2007 TAPS Assessment Process

For the TAPS assessment process for 2007, the Division again decided that it should look to the final assessed valuation of the previous year as the starting point for the valuation from the current year. The Division reviewed the data and methodology used to calculate the Board's TAPS \$4.3062718 billion assessed value for 2006. The Division made adjustments to the data used in the 2006 valuation and followed the methodology approved by the Board in 2006 to account for value changes that had occurred in 2007. The Division also revisited the issue of the value of the TAPS Right-of-Way as suggested by the Board in its 2006 determination.

The Division's adjustments and recalculation resulted in a 2007 assessed valuation of the TAPS at \$4.469 billion. The Owners and the Municipalities requested an informal conference to review this valuation. After reviewing the Municipalities' and the Owners' concerns about its 2007 assessment, the Division issued informal conference decisions which adjusted its 2007 assessed valuation of the TAPS to \$4.478 billion. The Division later raised this valuation to \$4.578 billion based on some information that was filed late. Both the Owners and the Municipalities appealed to the Board. After six days of public hearings, the Board took the matter under advisement and deliberated in executive session.

IV. Board's Finding of Improper Valuation

The Owners and the Municipalities both presented evidence that resulted in different values than the Division. After reviewing evidence in the record and the arguments of the parties, the Board found that the Municipalities had met their burden of proof only in showing that the Division's Right-of-Way adjustment should be moved to its proper place in the RCNLD

⁷ The Board's 2006 TAPS Certificate of Determination is found in the Division's Ex. a-13.

calculation. The Board removed the Division's Right-of-Way valuation from the Division's RCN estimate, because placing this value in the RCN means that the Right-of-Way (ROW) would have resulted in the Right-of-Way receiving an improper reduction for depreciation. The Board added the Division's the Right-of-Way to the Division's RCN less Physical Depreciation, Functional & Economic Obsolescence estimate. The Board recalculated the Division's updated RCNLD estimate of the TAPS value after making these changes. The Board concluded that the resulting value of \$4.588895312 billion should be the 2007 assessed value of the TAPS.

Board's 2007 Adjustment to TAPS Assessed Value

	Division's Original Recap	SARB Change	
RCN	\$8,304,935,550	\$8,276,423,150	Removed ROW from RCN before Depreciation
Inflation Adjusted RCN 15.04%	\$9,553,838,514	\$9,521,197,192	
Depreciation - Physical Deterioration	\$(4,302,873,835)	\$(4,288,347,215)	
RCN less Physical Depreciation	\$5,250,964,679	\$5,232,849,977	
Functional Obsolescence (Utilization & Scaling)	\$(549,811,217)	\$(549,811,217)	
RCN less Physical Depreciation & Functional Obsolescence	\$4,701,153,462	\$4,683,038,760	
Functional Obsolescence Strategic Reconfiguration	\$(242,639,688)	\$(242,639,688)	
RCN less Physical Depreciation & Functional Obsolescence	\$4,458,513,774	\$4,440,399,072	
Economic Obsolescence	\$ -	\$ -	
RCN less Physical Depreciation, Functional & Economic Obsolescence	\$4,458,513,774	\$4,440,399,072	
ROW	\$19,801,200	\$48,313,600	Add undepreciated ROW Value
RCNLD plus DOR adjustment of \$100,132,640	\$4,578,497,614	\$4,538,895,312	

VI. Parties' Failure to Show Valuation Should be Further Adjusted

The Municipalities agreed with the Division that the Division could use the RCNLD approach to value the TAPS. The Owners argued that the value of the TAPS could not exceed the value of its regulated tariff income stream. The Owners and the Municipalities presented cases for different 2007 TAPS values, but neither showed that the Division's assessed valuation was unequal, excessive or improper. One of the Owners' appraiser witnesses, Stephen Stewart, admitted that while he did not agree with Division's assessor's conclusions, that the Division's assessor had not violated any appraisal rules or assessment statutes in his valuation of the TAPS.

The Board concluded that only its one adjustment to the Division's updated 2007 assessed value of the TAPS should be made. The Board concluded that neither the Municipalities nor the Owners had met their burdens of proof to show that, applying the standard of review set out in AS 43.56.130(f), the Board should make any additional adjustments to the Division's updated 2007 assessed value of the TAPS.

This was the fourth time that valuation of the TAPS has come before the Board. Many of the issues that the Owners and Municipalities raised in their 2007 appeals were issues that had been raised against the Division's earlier RCNLD valuations of the TAPS. The Board has ruled on these issues previously in its Certificates of Determination on the 2005 and 2006 appeals of the Division's RCNLD TAPS assessed valuations. The Board was not persuaded by any of the Owners' and Municipalities' arguments that the Board should change its prior rulings. The Board hopes that the parties will refer to those Certificates of Determination and the analysis contained within them for the Board's rulings on issues that the Board chose not to address once again, with more specificity, this year. However, in addition to having concluded that the Owners and the Municipalities did not meet their burden of proof to show that the Division's assessed valuation should be further adjusted, the Board chose make some additional comments on the issues raised in their appeals, in the hope that the parties will find them helpful in future assessments.

A. Economic Value

The Board again concluded that the term “economic value” in Alaska Statute 43.56.060(e)(2), does not have the same meaning as the market value that is given to the term the “true and full value” in Alaska Statute 29.45.110(a). Had the Alaska Legislature intended “economic value” to have the same meaning as the market value given to the term the “true and full value” in Alaska Statute 29.45.110(a), with its focus on the price paid to a willing seller by a willing buyer, the statute would have used the same “open market,” “prevailing market conditions” and “sale between a willing seller and a willing buyer” language used in Alaska Statute 29.45.110(a), or otherwise indicated its intent that “economic value” has the same meaning. Instead, the language of Alaska Statute 43.56.060(e)(2), indicates that the term “economic value” means more than the value obtained using a simple willing buyer, willing seller, open market model. Often there is no open market for oil and gas transportation pipelines in production as stand alone properties. Often there is no willing buyer or a willing seller for an Alaska pipeline at price that would reflect the pipeline’s value. Attempts to create a model based on a willing buyer and willing seller may overstate or understate the value of such a pipeline because its value is often more closely tied to the economic life of oil field it serves than its value in a theoretical open market without reference to the oil fields it serves. Hence Alaska Statute 43.56.060(e)(2), requires an assessed valuation based on the pipeline’s economic value with due consideration given to the reserves the pipeline serves in estimating that economic value.

B. Proven Reserves and Throughput

The Board also concluded again that that the reference to “proven reserves” in Alaska Statute 43.56.060(e)(2) is not intended to give the owners of pipeline property in Alaska a tax break by requiring an assessed valuation that is less than the full and true economic value. The Owners argued that if they could show that not all the oil that is expected to be transported by the TAPS will come from “proven reserves” that the assessor must ignore the fact that this oil from unproven reserves will probably be produced in determining the economic end life of the TAPS. The Board rejected this argument. The Board rejected a similar argument from the Owners in 2001, when the Owners asked the Board to artificially limit future TAPS throughput projections

for an income approach valuation to the throughput of oil that would then meet the Owners' definition of proven reserves. The "due regard to proven reserves" language in Alaska Statute 43.56.060(e)(2), is intended to force the Division to value oil pipeline property in production as part of an economic unit that includes, but is not limited to, the current proven reserves in the fields it serves. The Board concluded the Division correctly applied that language when estimated future TAPS throughput in order to determine the TAPS economic end-life in its RCNLD valuation.

The Board also found that the Owners failed to take advantage of the opportunity to provide the Division with persuasive data to challenge the reserves estimates or throughput projections used by the Division if the Owners have such data. The Board found that the Owners chose not to share information that the Owners and their parent companies possess regarding throughput and proven reserves with the Division or the Board and instead chose to present evidence and testimony from outside experts who did not have access to the information the Owners possess that was not already in the public record, and who lacked adequate direct experience with, or expertise about, the TAPS or the Alaska North Slope reserves. The Board found that when compared to the evidence presented by Owners' experts, the Division's future throughput projections were based on much more complete data from the individual Alaska North Slope oil fields, used more sophisticated methodology, and were therefore more reliable than the throughput projections offered by the Owners.

The Board found that the Municipalities did not show that the Division's throughput projections should be adjusted. The Board was impressed by the efforts that the Division undertook to obtain accurate data for its throughput projections and by its analysis of that data. The Board noted that for its 2007 TAPS valuation, the Division correctly made an attempt to correct the historic overestimates of future throughput. The Division made this correction by removing oil that would come from projects "under evaluation" from its future throughput projections. When an assessor discovers that the information relied on in the valuation process needs to be adjusted, it is appropriate to make an adjustment at the time of discovery. The Board found that this attempt to adjust the Division's throughput projections was reasonable.

C. Tariff income

The Board again was not influenced by the Owners' attempt to characterize the Division's RCNLD valuation as an unfair taxation on the TAPS shippers' fractional interest in the TAPS. The Division's fractional interest analysis simply demonstrated one of the limitations of a tariff income approach to valuation of the TAPS. This analysis simply provides one more reason why the Division chose not to use the tariff income approach to value the TAPS. The Division does not use an income approach when it values other properties that do not produce an independent income and other pipelines that have an income that does not have a clear relationship to the pipeline's economic value.

The Board agreed that a tariff income does not necessarily reflect the full and true value of a pipeline. The value of a pipeline's tariff income stream is generally only a portion of the value of the pipeline. That portion is the value of the original investment, plus capital expenditures and a reasonable return on these outlays of capital, which make up the tariff rate base. The tariff regulatory process attempts to ensure that shippers pay the pipeline owners only once for the capital costs through their tariff payments. Allowing the owners to increase the tariff rate base to reflect the pipeline's current value would effectively force the shippers to pay for the capital costs of the pipeline over and over again. A regulated tariff limits the owner's income to only a reasonable, not the maximum possible, return on the owner's investment. The owners of regulated pipelines are not allowed to step up, or increase, the pipeline's rate base to reflect the pipeline's current market value. The tariff is based on depreciated capital costs, not current market value as a stand alone property or the pipeline's current value as part of an economic unit. A regulated tariff does not produce an income that would capture the current economic value of the pipeline.

Most of the capital costs of the TAPS have already been effectively depreciated through the tariffs that have already been paid. Furthermore, uncertainty about future tariff rates makes any valuation based on the capitalization of future tariffs very unreliable. The difficulty of allocating value between tangible and intangible property when using an income approach adds additional challenges to income approach valuations.

The Board found that there was no comparable property or representative sales of partial interests to make a reliable comparable sales valuation of the TAPS. In contrast, the cost approach is the best way to currently value the TAPS because of the reliability of the available data to make an accurate valuation.

D. Right-of-Way

The Board found that the Division correctly determined that the Blacksmith and Richard's \$5 million appraisal, which only valued the sum of the values of all the rights-of-way that make up the TAPS Right-of-Way, woefully understated the value of the Right-of-Way as an 800-mile corridor. The Board also found that the Division's per mile approach was a more reliable methodology than the percent of RCN approach advocated by the Municipalities. The Board found that the Owners' estimate understated the Right-of-Way value, in part because it undervalued the cost of ROW through property owned by Alaska Native Corporations. Given the admitted problems with the Division's Right-of-Way value, the Board would have been willing to make an adjustment to the Division's Right-of-Way value if one of the other parties had provided an estimate of value of the Right-of-Way that was more reliable than the Division's. However, the Board found that neither party did. The Board found that the Division reasonably concluded that its estimate of the value of the Right-of-Way was the best estimate it could make in the time allowed, based on the information currently available. The Board encourages the Division to undertake a valuation project for the Right-of-Way, and to ensure that valuation takes into account the fee holder's reversionary interest in the Right-of-Way.

E. Roads and Bridges

The Board found that it should encourage the Division to provide more detail in future TAPS valuations showing which roads and bridges the Division is including as being dedicated to ongoing pipeline operations. The Board recommends that the Division also determine which pipeline access roads are gated and locked, and are only opened to members of the public who have a permit or who are on ATVs so that they can move around gates. The Division should then

make a determination about whether these gated roads should be characterized as dedicated to ongoing pipeline operations.

F. Costs of Capitalized Interest & Ad Valorem Taxes during Construction

The Board again concluded that the capitalized interest and ad valorem taxes during construction of the replacement pipeline should not be deducted when calculating the RCNLD of a pipeline in production for the purpose of estimating its true and full value. Rather than restate all of its reasoning, the Board chose to simply refer the parties to its analysis on pages 9 through 20 of its Certificate of Determination for the 2006 TAPS appeal.⁸ However, the Board also noted that all of the appraisers who were witnesses at the 2007 hearing, including those called by the Owners, who were asked, agreed that capitalized interest and ad valorem taxes during construction were costs that should be included in a RCNLD valuation applying standard appraisal methodology.

G. TAPS Construction Program Manager Profit

In 2006, the Board concluded that it was improper for the Division to fail to account for reasonable profit for the company that would fill the role of the general contractor for the reconstruction of the pipeline cost in its 2006 RCNLD valuation of the TAPS. In 2007, the Division included its estimate of these program manager costs in its 2007 TAPS RCN estimate. In 2007, the Owners argued that these program manager costs had already been accounted for in Mustang's RCN estimate. The Owners attempted to show through the testimony of K.C. Yost, who led the preparation of Mustang's 2005 RCN estimate, that this cost was imbedded in other costs. The Owners argued that the Division's inclusion of additional program manager costs was therefore duplicative, and should be removed from the Division's RCN.

The Board found that the Owners failed to meet their burden of proof to show that the Division had not properly accounted for program manager costs. The Board was not persuaded that Mustang's RCN estimate had adequately provided for the cost of reasonable profit for a program manager.

H. Scaling

The Board found that the Division's discriminate application of different scaling factors to different components of the TAPS, and no scaling factor to some components of the TAPS was reasonable, based on the available data. However, the Board shares the Municipalities' concerns about the whether it was appropriate for the Division to apply any scaling factors to account for excess throughput capacity.

The Board found that the agreement between the Owners to maintain 1.1 million barrels per day of maximum throughput capacity in the TAPS, and the fact that the recent strategic configuration was designed to maintain a throughput capacity range of 200,000 to 1.1 million barrels per day indicates that there may be some value to the Owners in maintaining excess throughput capacity. The Board encourages the Division to investigate this issue for future TAPS valuations in order to determine whether it is appropriate to apply any scaling factor to account for throughput below 1.1 million barrels per day.

I. Obsolescence

The Board found the Owners' arguments that the value of the TAPS should be further reduced to account for additional functional obsolescence was not persuasive. The Board noted an assessor should always keep in mind that the goal of an RCNLD valuation is to value the property that is actually there on the assessment date rather than a property that hypothetically might be there at some time in the future, after some change currently being considered by the property owners. The Board also found that some of the asserted additional obsolescence in the TAPS may have value to the Owners, and may be maintained in part due to the benefits of maintaining extra capacity throughout the system for the sake of safety and dealing with contingencies.

The Board concluded that, as of the assessment date, the timing and need for changes to

⁸ Ex. a-13.

the TAPS that form the basis for the Owners' claims for the need to account for additional obsolescence due to low flow conditions and other factors are too speculative to require an additional downward adjustment to the TAPS value. The further that possible impacts on value of the TAPS are pushed out into the future, the less these future contingencies, such as adding additional reserves to future throughput or incurring additional costs, are likely to impact current value. The Board agreed with the Municipalities and the Division that an assessor should generally wait at least until a property owner has definite plans to incur specific costs before the assessor gives those projected costs much weight in making an estimate of value.

The Board found that the Division had a reasonable basis for its valuation of the TAPS and assumptions upon which that valuation was based including its treatment of obsolescence. The assumptions that the Division relied upon were supported by the evidence in the record.

J. Depreciation

Although the Board concluded that the Division's approach to quantifying depreciation was reasonable, for future assessments, the Board encourages the Division to review the Municipalities' appraiser's approach to depreciation of the TAPS, using component depreciation or average weighted age analysis. The Division should determine whether her approach to depreciation would provide a more accurate value of the TAPS.

K. Division's Conservative Approach

The Board was concerned about the Division's frequent use of the term conservative in reference to some of its assumptions and estimates. The Board concluded that it should remind the Division that the object of an assessor valuing property under Alaska Statute 43.56.060(e)(2), is to make the best estimate of value, that is, to determine the pipeline's most likely value based on the available evidence, not to make a conservative estimate of value, or the lowest estimate of value within an acceptable range of possible values. Being "conservative" in the sense of accepting the lowest estimate of various components of value, or of picking the highest number in assessing the impact of a factor that would lower value, will simply result in an undervaluation

of the pipeline.

The Municipalities' appraisal indicates that the Division's estimate of value was not too high, but the Municipalities' evidence did not persuade the Board that the Division's valuation should be adjusted by the Board. The evidence provided by the Municipalities further persuaded the Board that the criticisms leveled at the Division's valuation by the Owners were not well founded, and persuaded the Board to alert the Division that it would be well advised to further investigate issues like the value of the Right-of-Way and the maintenance of throughput capacity, which indicate that the value of the TAPS may be higher than the Division's estimate.

L. Discovery in Appeals before the Board

The Board rejected the Municipalities' argument that the Board should seek the authority to issue subpoenas and allow discovery. The Division, at the investigative stage of the assessment process, can issue subpoenas and order production of documents. The court system can permit discovery if a determination by the Board is appealed. The Board is not the best forum to hear contested discovery proceedings, and it would be impossible to do so within time constraints imposed by AS 43.56 & 15 AAC 56, the statutes and regulations governing appeals to the Board.

The Board's lack of subpoena and discovery authority is consistent with the purpose of these statutes and regulations, which establish the procedures that allow the Board to fulfill its charge within the strict time limitations imposed by 15 AAC 56.030. It is also consistent with the nature of an appeal before a volunteer board, which does not lend itself to a protracted and complex pre-hearing motion practice involving requests to compel the contested disclosure of documents. Finally, it is consistent with the composition of the Board, which is designed to provide a balanced expert review of oil and gas production property valuation issues, not to serve as referees in such a contest.

Due process generally does not require that an administrative appellant be accorded

subpoena power.⁹ Furthermore, due process problems resulting from an administrative tribunal's lack of subpoena power can be cured by requesting a trial de novo in superior court and supplementing the record.¹⁰ Parties appealing a determination by the Board to superior court have a statutory right to a trial de novo.¹¹ This statutory provision for a trial de novo on appeal is further evidence that the omission of subpoena and discovery powers is both intentional and appropriate. AS 43.56 creates a limited special administrative appeals process. The regulations that set out the procedures for these appeal were drafted to ensure this process will be conducted in an orderly and timely fashion. The automatic trial de novo on appeal appears to be intended to cure any deficiencies in the record that this expedited process may create.

M. The Board's Jurisdiction over Allocation Issues

The statute governing appeals before the Board, AS 43.56.120, does not explicitly give the Board jurisdiction over issues of allocation, that is, allocation of the value of a taxable property that crosses the boundaries of different local taxing authorities between those local jurisdictions.

The regulations governing administrative appeals of assessments under AS 43.56, 15 AAC 56.005-900 divide the jurisdiction of appeals of valuation issues and taxability issues between the Board and the Department of Revenue in 15 AAC 56.015(a) &(b). Taxability issues are delegated to the jurisdiction of the Department of Revenue. Taxability appeals are conducted under the procedures set out set out 15 AAC 05.001-050.

After an informal conference held under 15 AAC 56.020, valuation appeals are delegated to the Board under 15 AAC 56.030. Valuation appeals before the Board are heard under the procedures set out in 15 AAC 56.040. An argument could be made that this regulatory allocation of jurisdiction for appeals of AS 43.56 property, that does not include any reference to allocation issues or grant jurisdiction for allocation issues to either the Board or the Department of

⁹ See *Copper River School District v. State* 702 P.2d 625, 628, fn. 2 (Alaska 1985).

¹⁰ See *Aloha Lumber Corporation v. University of Alaska* 994 P.2d 991, 998 (Alaska 1991).

¹¹ See AS 43.56.130(i).

Revenue, implies that allocation issues do not give rise to the right to an administrative appeal. This reading would mean that appeals of the Division's determinations regarding allocation must be filed directly with the courts.

The Board chose not to rule on whether it has jurisdiction over allocation issues generally, since it is clear that the Board did not have jurisdiction at this hearing over the allocation issues raised by the Municipalities. The real parties of interest in an allocation issue are the municipalities in which the property is alleged to be located. The owners of the property may have little or no interest in which municipality receives which portion of its AS 43.56 tax liability. Since the interests and issues and parties are so different than any underlying valuation issue, these issues should be heard in separate appeals. If the Board had jurisdiction over an allocation issue, that issue should first go before the Division for an informal conference after proper notice to the interested municipalities. Any appeal on allocation issues before the Board or the Department of Revenue should also be treated a separate appeal dealing exclusively with allocation issues after notice to the interested municipalities.

The Board recommends that the Department of Revenue clarify the appeals process for allocation issues in regulation. The Board also recommends that these appeals not be placed within the Board's jurisdiction. The Board also recommends that the Division make a detailed analysis of what, if any, property actually has situs in the taxing authorities that the Municipalities have raised questions about.

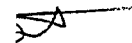
VI. Conclusion

The Board concluded that the Division had made a careful, good faith effort, reasonable assumptions and used accepted methodology to obtain its 2007 estimate of the TAPS value. The evidence presented by the Owners and the Municipalities indicated that there is a broad range of acceptable value estimates for the TAPS. The Board concluded that, while the evidence indicated that the Division's estimate may be at the low end of that range, with one exception, the evidence presented did not show that the Division's updated estimate was unequal, excessive, improper or otherwise contrary to the standards set out in AS 43.56.

Based on the evidence presented, the Board concluded that only the Division's failure to place its Right-of-Way adjustment in the proper place in its RCNLD calculation was improper. The Division's 2007 updated assessed valuation of the TAPS at \$4.578 billion should therefore be adjusted. The resulting value, \$4.588895312 billion, is now set as the 2007 assessed value of the TAPS.

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

DATED: May 31, 2007



Steven L. Van Sant, Chair
State Assessment Review Board

Certificate of Service: The Undersigned certifies that on May 31, 2007 a true and correct copy of this document was served on the following:

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