BEFORE THE STATE ASSESSMENT REVIEW BOARD
STATE OF ALASKA

IN THE MATTER OF THE TRANS-ALASKA PIPELINE SYSTEM OIL & GAS PROPERTY TAX (AS 43.56) 2008 ASSESSMENT YEAR	))))))	Appeal of Revenue Decision No. 08-56-09 & 08-56-10 OAH No. 08-SARB-TAX (TAPS)

CORRECTED CERTIFICATE OF DETERMINATION

The State Assessment Review Board (Board) convened from May 20, 2008 through May 23, 2007, to hear and deliberate on the AS 43.56 appeals of the 2008 assessment of the Trans-Alaska Pipeline System (TAPS). Chair Steven L. Van Sant and members Mary (Mickey) E. Keller, Don (Marty) M. McGee, Michael B. Salazar and Richard Stovarsky were present, constituting a quorum as required by AS 43.56.130(b).

The Board Chair, Steven L. Van Sant, conducted the hearing. Mark T. Handley and Terry L. Thurbon, administrative law judges from the Office of Administrative Hearings, assisted the Chair.[1]

The owners of the TAPS, ConocoPhillips Transportation Alaska, Inc., BP Pipelines (Alaska) Inc., Exxon/Mobil Pipeline Company, Koch Alaska Pipeline Company, and Unocal Pipeline Company (collectively, Owners) were represented by attorneys Steven Mahoney, James M. Seedorf, James D. Decker, C. Stephen Davis, Cris K. O'Neall and Marie P. Evans. Assistant Attorneys General Ken Diemer and Steven D. DeVries, attorney Robert M. Johnson and State Petroleum Assessor James H. Greeley represented the Taxation Division (Division). The municipalities appealing the Division's 2008 TAPS assessment (Municipalities) were represented by attorneys Mark Cotham, William M. Walker and Craig Richards for the City of

[1] Under Alaska Statute 44.64.030(b), the Office of Administrative Hearings provided administrative law judges to advise the Board at the request of the Commissioner of Revenue.

Valdez, Robin O. Brena and Joseph Miller for the Fairbanks North Star Borough, and Mauri Long for the North Slope Borough.

A court reporter was present to administer an oath to witnesses and create a transcript of the hearing.

I. Introduction

The subject of this appeal is the Division's $7.16589746 billion 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 2008 TAPS value was $0.8 billion. The Municipalities argued the TAPS assessed valuation should be set no lower than $12 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's $7.16589746 billion valuation was improper and excessive and should be adjusted with respect to (1) the contingency factor; (2) access roads; (3) remaining life; and (4) camp salvage. The Board concluded that its adjusted value of $6.15447972 billion should be the 2008 assessed value of the TAPS.[2] 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.

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

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[2] *See* Graphic showing the Board's 2008 adjustment at page 18.

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. 08-56-09. This decision ruled on the Owners' challenged to the Division's February 27, 2008 Notice of Assessment of the TAPS.

The Municipalities appealed Alaska Department of Revenue Decision No. 08-56-010. This decision ruled on the Municipalities' challenges to the Division's February 27, 2008 Notice of Assessment of the TAPS.

Incorporated within the Owners' and Municipalities' appeals are their appeals of the Division's April 8, 2008 Revised Notices for Informal Conference Decisions Number 08-56-09 & 08-56-10. These revised notices informed the parties that the corrected 2008 assessed value for the TAPS was $7.16589746 billion.

D. Consolidation and Coordination of Appeals

For the appeal before the Board of the Division's 2008 assessment of the TAPS, the appeals of Revenue Decision No. 08-56-09 and Revenue Decision No. 08-56-010 were consolidated and the different owners and the different municipalities coordinated the presentation of their cases.[3]

II. <u>Historical Context of the Board's Review of the 2008 TAPS Assessed Valuation Under AS 43.56.</u>

A. Before 2001

Prior to 2001, no appeals of the TAPS valuation were heard by the Board because the

[3] *See* Pre-Hearing Order issued May 3, 2007.

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 then-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 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.

Because there had never been a replacement cost study for 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.[4]

The evidence presented to the Board in 2001 showed that the Division's projections of future throughput 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

[4] At the 2008 TAPS hearing, the Owners' Appraiser Kathy G. Spletter, ASA, testified that it is not appropriate to trend a cost study more than five years, because after five years trending becomes too inaccurate for any particular property, and a new cost study is needed to establish an accurate value using a cost approach.

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 thoughput 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.

[5] A copy of Board's 2001 TAPS Certificate of Determination was not included in any of the parties' exhibits.

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) had 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.

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 Replacement Cost New Less Depreciation (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]

E. 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

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[6] A copy of the Board's 2005 TAPS Certificate of Determination is found at the Division & Owners' Reference Exhibit II-5.

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.

In 2006, both the Owners and the Municipalities appealed the Division's $3.641 billion assessed valuation of the TAPS to the Board. The Owners argued that the 2006 TAPS value was approximately $1.5 billion. The Municipalities argued the TAPS assessed valuation should be set at no less than $6 billion.

In 2006, the Board concluded that capitalized interest and ad valorem tax cost deductions, and a reasonable program manager profit amount, should be added back into the Division's Replacement Cost New (RCN) estimate. The Board concluded that the Division's assumption that it was legally required to divert from standard appraisal methodology to deduct capitalized interest and ad valorem tax costs from its calculation of the TAPS 2006 Replacement Cost New Less Depreciation (RCNLD) was incorrect. The Board concluded that these deductions were not jurisdictional exceptions to the standard appraisal methodology required for valuation of the TAPS as pipeline property in operation. The Board also concluded that the Division should have included program manager profit costs in its TAPS Replacement Cost New (RCN) estimate.

SARB Recap of TAPS 2006 Valuation

	$	8,329,183,058	0.03	$	249,875,492	Program Fees
					1.059	
					264,618,145.75	Program Fees Profit @ 3% escalated by 1.059

	DOR -TAPS-2005		.			
				DOR's Original Asset Adj.		
RCN	$	8,329,183,058		**NOT Deducted**		
Roads & Bridges	$	(209,393,000)	deducted	**$**	**702,500,000.00**	**Capitalized Interest**
Valdez Terminal Office	$	(3,500,000)	deducted	**$**	**235,000,000**	**Property Tax**
Salvage of Camps	$	(54,230,000)	deducted			
Supplemental Legal & PR	$	(20,000,000)	deducted			
					RECAP	
Program Fees	$	249,875,492	**added**			
	$	8,291,935,550	1.059	$	8,781,159,747	**2006 TAPS RCN**
			-0.4419	$	(3,880,394,492)	Physical Depr.
				$	(367,384,329)	Strategic Reconfig.
				$	**4,533,380,926**	**RCNLD**
Escalator= 1.0590			0.0512	$	232,109,103	Thruput Adj
Through-Put Adj. = .0512				**$**	**4,301,271,823**	**RCNLD(w/Thrput Adj)**
				$	5,000,000	Land
				$	**4,306,271,823**	**2006 SARB Value**
				$	**4,306,271,800**	**Rounded**

The Board recalculated the Division's RCNLD of the TAPS value to add the two deductions back into the RCN costs and added program manager profit costs. The Board 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]

F. 2007 TAPS Assessment

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.

[7] A copy of the Board's 2006 TAPS Certificate of Determination is found at the Division & Owners' Reference Exhibit II-4.

In 2007, the Division 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. The Board approved of this correction.

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.

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.[8] 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.

In 2007, the Board alerted 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.

In 2007, the Board also expressed its concerned about the Division's frequent use of the term conservative in reference to some of its assumptions and estimates in its TAPS valuation.

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[8] *See* Graphic showing the Board's 2007 adjustment at page 14.

The Board reminded 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.

In short in 2007, the Board found for the third year in a row that the Division's assessed valuation was at the low end of an acceptable range of value for the TAPS. However, except for one minor adjustment, the Board concluded that based on the evidence in the record, Division's value was not is unequal, excessive, improper or otherwise contrary to the standards set out in AS 43.56.[9]

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[9] A copy of the Board's 2007 TAPS Certificate of Determination is found at the Division & Owners' Reference Exhibit II-3.

Board's 2007	Adjustment to Division's Original Recap	TAPS SARB Change	Assessed Value
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 $100,182,640	$4,578,497,614	$4,588,895,312	

III. 2008 TAPS Assessment Process

For the TAPS assessment process for 2008, the Division explained that it had originally intended to obtain a new a replacement cost study of the TAPS. The Division decided that the 2005 Mustang estimates were too old to use to extrapolate the TAPS 2008 assessed value. The Division also hoped that through a new cost study the Division would be able to investigate some of the troubling issues that had been identified by the Division and the Municipalities regarding the Mustang study since that study was first produced in 2005.

Before the Division had contracted a new study, however, the Municipalities informed the Owners and the Division that they would contract with Pro Plus to obtain an independent re-costing of the 2005 Mustang study. The Division decided to work with the Municipalities and Pro Plus and invite the Owner's input. The Division later characterized the result of the Pro Plus study as a fresh re-design of the TAPS even though it is based on the 2005 Mustang study. The Division used the results of the Pro Plus study as its primary basis for its 2008 assessed valuation of the TAPS.

On February 27, 2008 the Division issued a Notice of Assessment of Oil and Gas Related Property for the TAPS which set the assessed valuation at $7.75785182 billion. Both the Owners and the Municipalities appealed. After it reviewed the issues raised by the Owners and the Municipalities, the Division lowered the assessed value the TAPS to $6.90541821 billion in Informal Conference Decision Nos. 08-56-09 and 08-56-10, which were issued on April 4, 2008.

On April 8, 2008, the Division issued Revised Notices for Informal Conference Decisions Number 08-56-09 & 08-56-10. These revised notices informed the parties that due to a missing cell reference in the TAPS valuation excel spreadsheet, Informal Conference Decisions Number 08-56-09 & 08-56-10 were incorrect. These revised notices informed the parties that the correct 2008 assessed value for the TAPS was $7.16589746 billion.

The Owners and the Municipalities timely appealed the corrected informal conference decisions to the Board.

At the time the 2008 TAPS appeal was heard by the Board, the Board's decisions in both the 2006 and 2007 TAPS assessments were on appeal in Superior Court. Many of the Owner's points on appeal before the Board in the 2008 TAPS were issues that the Board had ruled on in 2006 and 2007. As a result, while the parties continued to contest many of the issues which the

2008 assessed valuation shared with the assessments still on appeal, due to the time limitations at the hearing, the parties focused on issues that were discrete to the 2008 assessment.

After a three-day public hearing, the Board took the matter under advisement and deliberated in executive session.

IV. Board's 2008 Findings of Improper Valuation

In contrast to its decisions on the TAPS valuations for the prior three years, the Board did not find that the Division's 2008 assessed valuation was at the low end of an acceptable range of value for the TAPS. 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 $7.6589746 billion 2008 valuation was excessive and improper and should be adjusted.

The Board found that the Division's decision to generally rely on the Pro Plus cost study was reasonable, but that the Division did not adequately correct for the excessive contingency in the RCN of the Pro Plus study. The Board found that the evidence in the record showed that the Division's decision to reduce the contingency by just 5%, from 25% in Pro Plus study to 20%, was improper. For the reasons discussed under "Contingency" below, the Board concluded that a 5% contingency factor is appropriate.

The Board also found that in 2008, the Division improperly extended the economic end life of the TAPS from 2042 to 2045. The three-year extension used by the Division led it to incorrectly depreciate of the Right of Way and other TAPS property.

The Board found that the Division had improperly excluded $171,653,367 from its RCN for access roads. The Board also found that the Division had improperly excluded $65,000,000 from its RCN for salvage value of construction camps.

After making adjustments to correct for these problems, the Board concluded that $6.15447972 billion should be the 2008 assessed value of the TAPS. The following table shows the Board's adjusted valuation in comparison to the Division's.

	Board's 2008 Adjustment to	TAPS Assessed	Value	
		Department	SARB	
I.	Environmental & Environmental Permitting 2	79,960,000	79,960,000	
II.	Survey	40,905,200	40,905,200	
V.	Pipeline Materials	2,923,552,800	2,923,552,800	
	VMT Materials	512,733,600	512,733,600	
VI.	Pipeline Equipment & Assemblies	6,337,900	6,337,900	
VII.	Pipeline Installation	4,704,607,100	4,704,607,100	
	VMT Installation	512,733,600	512,733,600	
VIII.	Pump Facilities	553,047,300	553,047,300	
IX.	Meter Stations	15,728,400	15,728,400	
	Direct Costs	9,349,605,900	9,349,605,900	
X.	Project/Construction Management, Engineering, Inspection	701,220,400	701,220,443	
XI.	Owners' Costs	467,480,300	467,480,295	
	Direct Costs plus X., & XI.	10,518,306,600	10,518,306,638	
XII.	Contingency	2,103,661,300	**525,915,332**	**5%**
	Direct Costs plus X., XI., & XII	12,621,967,900	11,044,221,969	
XIII.	Land and ROW	-	-	
	Direct Costs plus X., XI., XII & Land and ROW	12,621,967,900	11,044,221,969	**2042**
XIV.	Ad Valorem Tax	298,719,900	298,719,906	
XV.	Interest During Construction	1,372,563,300	1,200,992,874	
	Total RCN	14,293,251,100	12,543,934,749	
	Less Land and ROW	-	-	
	RCN Less ROW	14,293,251,100	12,543,934,749	
	Valdez Terminal Office Building	(3,000,000)	(3,000,000)	
	Salvage of Camps (10%)	(65,000,000)	-	
	Access Roads	(171,653,367)	-	
	Taxable RCN	14,053,597,733	12,540,934,749	
	Depr., Physical	(6,141,942,713)	**(5,735,776,358)**	
	Taxable RCN Less Physical Obsolescence	7,911,655,020	6,805,158,391	
	Depr., Functional - Utilization & Scaling (Super Adequacy)	(692,669,362)	(595,795,031)	
	Depr., Functional - Strategic Reconf.(Excess Operating Costs)	(228,384,344)	(228,384,344)	
	Depr., Economic	-	-	
	Taxable RCN Less All Forms of Obsolescence	6,990,601,314	5,980,979,016	
	Land and ROW	175,296,200	**173,500,700**	
	Total RCN as of January 1, 2008	7,165,897,514	6,154,479,716	
	Total RCN as of January 1, 2008 - ROUNDED	**7,165,897,510**	**6,154,479,720**	

Contingency

The Division reduced the 25% contingency in the Pro Plus study to from 25% to 20% reasoning that 25% overestimated the contingency based on the level of planning in the Pro Plus study.

The Municipalities argued that the 25% estimate was accurate and that 25% might even understate the contingency given the recent history of cost over-runs in mega-projects like the TAPS.

The Owners argued that the contingency in the Pro Plus study was excessive, given the way the risk that the contingency factor was intended to provide for had already been accounted for in other parts of the Pro Plus estimate. The Owners also argued that it was improper to use the level of planning in the cost study to derive the contingency percentage for a replacement cost new estimate for a property like the TAPS. The Owners pointed out that most of the unknown costs for building the original TAPS that would justify a high contingency were now a matter of public record, and could be directly and accurately accounted for in the replacement cost study. The Owners also pointed out that some of the factors that went into the contingency for new construction, such as the risk of inflationary costs during an extended period of construction, did not apply to a Replacement Cost New estimate because the estimate should value the replacement cost on the assessment date, not over a theoretical construction period during which costs grow higher than they were on the assessment date.

The Board agreed with the Owners' witness KC Yost that there is not a lot about the TAPS replacement project that we do not now know compared with what was known by the original builders. The Board agreed with the Division's conclusion that the Pro Plus cost study was generally more detailed and more reliable than the current and previous Mustang cost study. However, the Board concluded that the increased reliability of the underlying cost study should result in the contingency percentage going down, not up. The Board also identified other places in the Pro Plus study where some risks that Pro Plus had accounted for through increased contingency had already been accounted for, such as high contractor profits. The Board found that while the Division had correctly determined that the Pro Plus contingency percentage of 25% should be lowered, the Division's failure to lower the percentage to 5% was improper.

Economic End Life

In its 2006 decision on the TAPS appeal, the Board found that the Division's conclusion that the TAPS would be able to maintain a minimum throughput of 200,000 barrels per day was adequately supported by the evidence in the record. In 2006, the Board also concluded that the Division properly adjusted its valuation to reflect its current best estimate of the TAPS economic life as running to 2042.

In its 2007 decision on the TAPS appeal, the Board approved of the Division's attempt to correct its historic slight trend of overestimates of future TAPS throughput. The Division made this correction by removing oil that would come from projects "under evaluation" from its future throughput projections. In 2007 the Board found that this adjustment was reasonable. With this adjustment to its future throughput estimates, the Division estimated that the economic end-life of the TAPS remained at 2042.

In 2008, the Division decided to move its estimate of the economic end-life forward to 2045. This change apparently was based primarily on the Division's decision to add oil that would come from projects "under evaluation" back into its future throughput projections.

The Board recognizes that it likely will be proper to extend the estimated economic end life of the TAPS past 2042 in future assessments as additional oil reserves on the North Slope become economically extractable or the estimated minimum mechanical throughput of the TAPS is reduced below 200,000 barrels per day. However, in 2008, the evidence submitted by the parties did not persuade the Board that an increase or decrease in economic end life over that used in 2006 and 2007 was appropriate as of the January 1, 2008 date of valuation. The Board found that putting the "under evaluation" oil back into the projections was not justified as of that date, and it was unclear to the Board what extent the Division had relied on the competing evidence regarding the feasibility of reducing the minimum mechanical throughput and on the likelihood of high oil prices driving additional exploration and development.

Roads and Bridges

In its 2007 decision on the TAPS appeal, the Board encouraged the Division to provide more detail in future TAPS valuations showing which roads and bridges the Division included as being dedicated to ongoing pipeline operations. The Board also recommended that the Division

determine which pipeline access roads were gated and locked, and are open only to members of the public who have a permit or who are on all terrain vehicles which allow them to move around gates. The Board encouraged the Division to make a determination about whether gated roads should be characterized as dedicated to ongoing pipeline operations.

For the 2008 assessment, the Division investigated the TAPS access roads and determined that these roads were gated for security purposes, but that members of the public who could get around the gates were not prohibited from using these roads. The Division concluded that the estimated value of these access roads and bridges, $171,653,367, should be deducted from the RCN Less ROW.

The Board agreed with the Municipalities that this deduction was improper. The Division appears to have made this deduction based on the incorrect assumption that the deduction for roads and bridges was required under 15 AAC 56.110(b)(2)(B). This regulation requires a deduction from the value of certain pipeline properties for "roads . . . that are used during the construction period . . . and are subsequently dedicated to and accepted by the state." Section 110 as a whole prescribes rules for valuing pipeline properties, but subsection (b)—where this deduction appears—applies only to pipeline properties that are "under construction." That is plain for the first sentence of 15 AAC 56.110(b), which begins as follows: "The full and true value of pipeline property under construction will be all the actual costs incurred …." The second sentence of subsection (b) reinforces the fact that the subsection governs valuation of "[p]ipelines under construction[,]" not those under operation. Even pipeline properties under construction receive the deduction only if the roads are dedicated to and accepted by the state. The subsection (b)(2)(B) provision addressing salvage value reductions for roads used during construction simply does not apply to access roads remaining after construction for continued use by the pipeline operator to access the pipeline for inspections and maintenance.

Instead, 15 AAC 56.110(c) prescribes the rules for valuing a pipeline property in operation. Section 110(c) requires that a pipeline property in operation, such as the TAPS in 2008, must be valued based on its economic value determined by the use of standard appraisal methods. Standard appraisal methods do not permit an appraiser to exclude the value added by access roads available to the pipeline owner when no jurisdictional exception applies. Since the jurisdictional exception for roads dedicated to and accepted by the state applies only when valuing pipeline properties under

construction, it does not justify excluding the access roads and bridges from the 2008 assessed valuation of the operating TAPS.

The Board recognizes that after a road built for the construction of a private pipeline becomes a public road no longer primarily dedicated to ongoing pipeline operations, that road becomes so independent of the taxable pipeline property that the cost of constructing the road can no longer be properly included in a valuation of the taxable pipeline using standard appraisal methods, including an RCNLD valuation of that pipeline. An example of such a road would be the Dalton Highway.

The TAPS access roads, however, are gated and locked; they have not been removed and the land reclaimed for its natural use; they have not been altered through ditching or berming to prevent the TAPS operator from using the roads to access the pipeline. The photographic and other evidence in the record, therefore, supports a finding that the Owners control access to these roads, at least insofar as access requires unlocking the gates. These roads and bridges remain primarily dedicated to ongoing pipeline operations of the TAPS. The costs of these roads and bridges should not be deducted from the 2008 RCNLD valuation of the TAPS.

Salvage Value of Camps

The Board concluded that the portion of 15 AAC 56.110(b) that requires a deduction for the salvage value of construction camps from the taxable value of pipelines in construction does not apply to pipelines in operation such as the TAPS. The reasoning behind this regulation, that the salvage value of these camps is in a sense not an "actual cost" of construction, is relevant to whether the salvage value of construction camps should be included when valuing a pipeline in operation.

Using standard appraisal methodology, the value of any salvage recovered from construction camps would not be included in the value of a pipeline in operation. Once sold, the salvaged camps would no longer be part of the taxable property. When valuing a pipeline using RCNLD, the estimated salvage value of any property that was purchased rather than leased for the construction of the pipeline would not be a cost of replacing the pipeline.

If, for example, for economic reasons it would be less expensive to purchase new heavy equipment, rather than to lease the heavy equipment, and then sell that equipment for its salvage

value at the end of the project, the salvage value would not properly be included as a cost of construction.

In the case of the cost of construction camps, however, the Pro Plus estimate for these costs that was used by the Division was based on the lease cost rather than the purchase cost of these camps. The Division's deduction of salvage value for these camps was therefore improper.

V. Parties' Failure to Show that Valuation Should be Further Adjusted

The Board concluded that only the adjustments discussed above should be made to the Division's updated 2008 assessed value of the TAPS. 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 2008 assessed value of the TAPS.

The 2006 and 2007 appeals of the Division's RCNLD TAPS assessed valuations are still on appeal in Superior Court. This was the fifth time that valuation of the TAPS has come before the Board. Some of the issues that the Owners and Municipalities raised in their 2008 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, 2006 and 2007 appeals of the Division's RCNLD TAPS assessed valuations.

The Board was favorably impressed by the Division's 2008 TAPS assessment process. The Board approved of the Division's decision to rely primarily on the Pro Plus cost study for 2008. The Board again recognized that in setting an assessed valuation for a property as difficult to accurately value as the TAPS, the assessing authority, the Division, must exercise its independent judgment in weighing the evidence and choosing between conflicting data, value indicators and valuation methodologies to arrive at its best estimate of value. AS 43.56 charges the Division, not the Board, with the initial responsibility to take these steps to arrive at its best estimate of value. This task is especially challenging, when, as in 2005 and 2008, the Division must review a new or almost new cost study for the replacement of the TAPS. The Board understands the work involved in the review of a cost study for a mega construction project like the TAPS, which must be undertaken before other valuation issues such as depreciation must be dealt with. The Board also appreciates the work that the Division did on the TAPS Right-of-Way

valuation for 2008, which the Board found to be a significant improvement over the Division's prior efforts.

The Board understands the Owners' dismay at the large increase in the Division's assessed valuation between 2007 and 2008. The Owners focused on the facts that would tend to lower the TAPS value over this time period: the TAPS got older in those twelve months; the oil that was transported last year is gone and can no longer contribute to the value of the TAPS; there was an increase in the prospect of a gas line from the North slope in the last year (and a gas line would tend to reduce the estimated future throughput of oil from some the larger North Slope fields); and, finally, in the past year the future of TAPS tariff rates has become somewhat more certain as the result of court and administrative adjudicatory decisions. (Those decisions indicate that future TAPS tariffs will be lower.) The Board acknowledges that these facts tend to indicate the value of the TAPS would have decreased rather than increased between 2007 and 2008.

However, the Board concluded that these facts are far outweighed by the facts focused on by the Municipalities, which indicate that the value of the TAPS is more in 2008 than it was in 2007. In those twelve months there were large increases in the costs of construction for projects like the TAPS, which drove up the RCN. In addition, in 2007, the cost of the commodity transported by the TAPS has increased so much that there is a likelihood of increased exploration, increased investment in recovery technology, and an increase in the amount of reserves that will be economically recoverable.

The Board is also cognizant of the consideration that because the data relied on to value a particular property may improve from one year to the next, valid increases in assessed valuation from one year to the next are not solely dependent on actual changes in the value of the assessed property. If the assessed value of a property was lower than its actual value the previous year due to the assessor's lack of more reliable data on the value of the property, the assessed value of that property could properly increase the following year based on better data, even if the actual value of the property did not change.

The Board has, for the last three years, found that the Division's assessed valuation was at the low end of an acceptable range of values. The Division has also had concerns about potential problems with the 2005 Mustang cost study which tended to lower the TAPS value.

The Division worked with the Municipalities and Pro Plus, and attempted to engage the Owners, in its effort to investigate these issues, while the Division updated its cost estimate for the 2008 assessment. The fact that these efforts resulted in a substantial increase to the RCN and the 2008 assessed valuation of the TAPS is not, in and of itself, an indicator of excessive or improper valuation.

Aside from the Board's adjustments to the Division's 2008 assessed valuation described above, the Board was not persuaded by any of the Owners' and Municipalities' arguments that the Board should change the valuation or its prior rulings. The Board was concerned about several of the issues raised by the Municipalities regarding the value that the Division placed on the Valdez Marine Terminal. The Board found that for the 2008 assessed valuation, however, the Municipalities had not met their burden to show that the value used by the Division was improper. The Board encourages the Division to investigate these issues for future assessments, when the Division, having gotten through the challenging task of vetting the new Pro Plus cost study for 2008, will have more time and resources to devote to the discrete components of the TAPS valuation.

VI. <u>Conclusion</u>

The Board concluded that the Division made a careful, good faith effort, based on reasonable assumptions and using accepted methodology, to obtain its 2008 estimate of the TAPS value. Based on the evidence presented, the Board concluded that the Division's failure to adequately reduce the Pro Plus contingency, its extension of the economic end-life past 2042, its exclusion of the value of access roads and bridges primarily dedicated to on-going pipeline operations, and its deduction of the salvage value of construction costs were improper. The Board found that with these exceptions, the evidence presented did not show that the Division's value was unequal, excessive, improper or otherwise contrary to the standards set out in AS 43.56. The Board concluded that Division's 2008 assessed valuation of the TAPS at $7.16589746 billion should therefore be adjusted. The resulting value, $6.15447972 billion, is now set as the 2008 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 30, 2008

*Signed*____________________
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[This document has been modified to conform to technical standards for publication.]