BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

PPL MONTANA, LLC,	)	
	)	**Docket Nos. SPT-2002-4**
Appellant,	)	**SPT-2002-6**
	)	**NUNC PRO TUNC**
v.	)	**FACTUAL BACKGROUND,**
	)	**CONCLUSIONS OF LAW,**
THE DEPARTMENT OF REVENUE	)	**ORDER, and OPPORTUNITY**
OF THE STATE OF MONTANA,	)	**FOR JUDICIAL REVIEW**
	)	
Respondent.	)	

The above-captioned appeals were heard from April 26 through April 29, and June 3 through June 10, 2004, in accordance with the order of the State Tax Appeal Board of the State of Montana (Board). The notice of the hearing was duly given as required by law. Robert Sterup and Kyle Gray represented PPL Montana (PPLM). C.A. Daw, Brendan Beatty, and Charlena Toro represented the Department of Revenue (DOR).

Testimony was presented, exhibits were received, and post-hearing briefs and proposed findings and conclusions were submitted. The final submission was received on October 5, 2004. The Board having fully considered the testimony, exhibits, and post-hearing submissions, hereby finds and concludes as follows.

STATEMENT OF THE ISSUES

The evidence presented at the hearing and the briefs and arguments of the parties establish that the following issues are submitted for the Board's consideration:

1. Whether PPLM's property is subject to central assessment pursuant to section 15-23-101, MCA.

2. Whether DOR properly determined the market value of PPLM's property for tax assessment purposes.

3. Whether DOR exempted from taxation the proper amount of intangible personal property owned by PPLM, pursuant to section 15-6-218, MCA.

4. Whether DOR allocated the proper value to PPLM's pollution control property.

5. a) Whether DOR properly equalized the value of PPLM's interest in Colstrip Units 1 and 2 with the co-owner of the property, Puget Sound Energy.

b) Whether DOR properly equalized the value of PPLM's Montana hydroelectric properties with the hydroelectric properties owned by Avista Corporation.

FACTUAL BACKGROUND

1. Due, proper, and sufficient notice was given of this matter, the hearing hereon, and of the time and place of the hearing. All parties were afforded opportunity to present evidence, oral and documentary.

2. PPLM appeals tax years 2000, 2001, and 2002.

3. Tax years 2000 and 2001 were appealed as one action under Docket No. SPT-2002-4. The issues before the Board are:

a. Whether the Department has properly valued PPLM's property.

b. Whether the Department has properly equalized the valuation of PPLM's interest in Colstrip Units 1 and 2 with its co-owner of the property, Puget Sound Energy.

c. Whether PPLM's property is property centrally assessed.

d. Whether the Department exempted from taxation the proper amount of intangible personal property owned by PPLM; and

e. Whether the Department property valued PPLM's pollution control equipment.

4. Tax year 2002 was appealed as a separate action under Docket No. SPT-2002-6. The issues before the Board are:

a. Whether the Department has properly valued PPLM's property.

b. Whether the Department has properly equalized the valuation of PPLM's interest in Colstrip Units 1 and 2 with its co-owner of the property, Puget Sound Energy.

c. Whether the Department has properly equalized the valuation of PPLM's hydroelectric facilities with a facility owned by Avista Corporation.

d. Whether PPLM's property is property centrally assessed.

e. Whether the Department exempted from taxation the proper amount of intangible personal property owned by PPLM: and

f. Whether the Department properly valued PPLM's pollution control equipment.

5. The Board consolidated both actions in this proceeding.

The Purchase of MPC's Electric Generation Assets

6. In 1998 PP&L Global was a subsidiary company of PP&L Resources. In October, 1998 PP&L Global entered into a written agreement to purchase the electric generation assets at issue in this cause from the former Montana Power Company (MPC). The transaction was formalized pursuant to a contract identified as the "Asset Purchase Agreement" between PP&L Global and MPC (Purchase Agreement). The eventual closing date for the purchase was December 17, 1999. (Day 1 Tr. at 62-64; Exh. 114).

7. In the early 2000's, PP&L Resources began trading as PPL Corporation following a corporate realignment. In 1999 PP&L Global

assigned its interest in the Purchase Agreement to PPLM, which is a wholly owned subsidiary of PPL Corporation. PP&L Global later became known as PPL Global.1 (Day 1 Tr. at 63; Exh. 141 at 06; Exh. F).

8. The original "base purchase price" for the MPC assets, as stated in the Purchase Agreement, was $780,000,000. (Exh. 114).

9. Pursuant to other provisions in the Purchase Agreement, the base purchase price was adjusted down to $740,000,000, because MPC did not transfer its interest in Colstrip Unit 4 to PPLM. (Day 1 Tr. at 64).

10. The amount paid by PPLM at closing was $757,608,136.09. This amount included, in addition to the adjusted base purchase price of $740,000,000, amounts for inventory, property taxes, and certain prepayments. (Day 1 Tr. at 64; Exh. 10 at 013929).

11. With the addition of related acquisition costs, the total amount paid by PPLM was $767,101,000. (Day 2 Tr. at 76-77; Exh. 118 at 01273).

12. According to a report prepared by Deloitte & Touche, a New York company hired by PPL Global, the total purchase price was $769,746,000. This is also the amount that PPL Global reported to the Internal Revenue Service as the value of the tangible, long-lived assets purchased from MPC pursuant to the Purchase Agreement. (Exh. 115 at 00852; Exh. EEEE).

13. The purchase included 11 hydroelectric generation plants, one reservoir, partial interests in the coal-fired power plants known as Colstrip Units 1, 2, and 3, and the J.E. Corette Electric

1 Based on the assignment described in Fact 4, in subsequent findings, conclusions, and discussions herein the names "PPLM" and "PPL Global" may be used interchangeably.

Generating Plant. As noted in Fact 6, MPC did not transfer its interest in Colstrip Unit 4 pursuant to the Purchase Agreement. PPL Global also did not purchase the transmission or distribution assets of MPC. (Exh. 115).

14. Pursuant to the Purchase Agreement PPLM obtained a 50% undivided interest in Colstrip Units 1 and 2, and a 30% interest in Colstrip Unit 3. Puget Sound Energy, Inc. (Puget) owns the other 50% undivided interest in Colstrip Units 1 and 2. (Exh. 115).

15. As part of the transaction PPLM assumed liabilities associated with certain contracts entered into by MPC, as described in the following paragraphs. (Day 1 Tr. at 125-26; Tr. Day 2 at 39-41).

16. One of the liabilities assumed by PPLM involved sales obligations to the Flathead Irrigation Project, which required PPLM to provide power to the Flathead Irrigation Project that was below the market rate. (Day 1 Tr. at 125-27; Tr. Day 2 at 39-41).

17. PPLM also assumed a liability consisting of an agreement to purchase electricity from Basin Electric for a period of time, at a price that was, at the time of the transaction, above market rates. (Day 1 Tr. at 125-27; Day 2 Tr. at 39-41).

18. PPLM also assumed liabilities associated with Wholesale Transition Service Agreements (WTSA), which required PPLM to sell power back to MPC or its successors at a price that was, at the time of the transaction, below market rate. PPLM was obligated under two contracts, the “Colstrip Unit 3 WTSA” and the “NonColstrip Unit 3 WTSA.” (Day 1 Tr. at 67-70, 127; Day 2 Tr. at 39-41).

19. The assumption of the liabilities described in Facts 12

through 15 had the effect of increasing the amount of consideration paid by PPLM to purchase the assets of MPC. However, the precise value of the liabilities assumed by PPLM was not established during the hearing before the Board. (Day 2 Tr. at 39-43).

20. The Purchase Agreement provided that the sale was contingent on PPLM's attainment of certification by the Federal Energy Regulatory Commission (FERC) as an Exempt Wholesale Generator (EWG). An EWG is regulated by the FERC, but is not regulated by a state public utility regulatory agency. Thus, the Purchase Agreement contemplated that PPLM would not be subject to regulation by Montana's Public Service Commission (PSC). (Day 1 Tr. at 64-65, 71; Day 3 Tr. at 16-17; Exh. 114 at 0275-0276).

21. The sale of MPC's assets would not have been finalized if the FERC had not granted EWG status to PPLM. The FERC did, in fact, grant EWG status to PPLM in June, 1999. (Day 1 Tr. at 64-65; Exh. 140).

22. An EWG sells energy on wholesale markets, and is not permitted to sell energy in retail markets. Because an EWG is not subject to regulation by a state's public utility regulatory agency, the price that PPLM can charge for electricity is not regulated by the PSC. (Day 1 Tr. at 64-65, 71).

23. Pursuant to the terms of the WTSA's, PPLM was required to fulfill the obligations of those contracts first, and then it could enter other contracts and sell the balance of the energy into the spot market on an hourly basis. According to Paul Farr, former PPLM official, this arrangement resulted in PPLM, in effect, operating the power plants the same way that MPC had operated them, and serving the same loads that MPC had been obligated to serve.

(Day 1 Tr. at 67-68, 93-94).

24. PPL Energy Plus, an energy trading and marketing subsidiary of PPL, has a contract with PPLM to act as an agent for purchase and sale of energy at wholesale. In addition, PPL Energy Plus is a wholesale customer of PPLM. Since PPLM, as an EWG, is prohibited from selling energy in the retail market, PPL Energy Plus engages in that activity and sometimes purchases power from PPLM to fulfill its contracts to service retail customers. (Day 1 Tr. at 92-94; Day 2 Tr. at 65).

25. In July, 2000 PPLM entered into a "sale-leaseback" transaction, whereby PPLM sold its interest in Colstrip Units 1, 2, and 3 to institutional investors who did not intend to operate the power plants. PPLM then leased those interests back from the institutional investors on a long-term basis. The purpose of this transaction was to secure necessary financing for PPLM. (Day 1 Tr. at 110-113).

Central Assessment of the Properties by DOR

26. For tax years 2000, 2001, and 2002, DOR assessed PPLM as a centrally assessed electric utility. (Exh. 114, T, U, and V).

27. Although the Purchase Agreement did not include the purchase of the transmission or distribution assets of MPC, it included a "generation interconnection agreement," which allowed PPLM to interconnect to and transmit power through the electric transmission system that was owned at the time by MPC. The agreement provided for the physical interconnection of all the facilities purchased by PPLM so that they could be operated as an integrated unit. According to the agreement, PPLM and MPC intended to "establish a regimen that will allow the continued operation of

generation, transmission, and distribution facilities in an efficient manner regardless of ownership." PPLM has the right to use the transmission facilities as if it owns them. (Day 7 Tr. at 19-20; Day 8 Tr. at 53-56, 62-63; Exh. 114; Exh. SS at Exhibit M, "Separation Principles"; Exh. TT).

28. FERC Order No. 888 provides, in effect, that transmission owners must give nontransmission owners that are dependent on a transmission system access to the system as if the nontransmission owner owned it. Thus, PPLM has the right to use the transmission facilities that are owned by Northwestern (which purchased them from MPC) as if PPLM owns the facilities. The express purpose of Order No. 888 was to remove barriers to competition in the wholesale bulk power marketplace, in an effort to bring more efficient and lower cost power to the country's electricity users. (Day 8 Tr. at 55-63; Exh. UU at 9).

29. PPLM's electric generation facilities are operated as a fleet of plants in an economic manner. They are not operated as independent, individual enterprises. Rather, they are operated in the same manner as when the facilities were owned by MPC. (Day 8 Tr. at 52).

30. Even though PPLM entered into a sale-leaseback transaction with respect to Colstrip Units 1, 2, and 3, as described in Fact 22, PPLM controls and operates those power plants under the lease arrangement, as if it owns them. (Day 8 Tr. at 63).

<u>DOR's Valuations of PPLM's Assets</u>

31. PPLM entered into a contract with Deloitte & Touche (D&T) to perform a purchase price allocation and appraisal of the fair

market value of the properties PPLM purchased from MPC. For purposes of the appraisal, D&T defined “fair market value” as the price at which property would change hands “between a willing buyer and a willing seller with equity to both, neither under any compulsion to buy or to sell and both fully aware of all relevant facts.” (Day 3 Tr. at 14-16; Day 5 Tr. at 18-19; Exh. HH; Exh. 115 at 00849).

32. Based on its appraisal, which was issued on August 29, 2000, D&T determined that the fair market value of the properties exceeded the purchase price. Therefore, it did not assign any value to the intangible assets in arriving at a fair market value amount. (Day 5 Tr. at 19-20; Exh. 115 at 00848).

33. D&T considered three approaches in its appraisal: the market approach, the cost approach, and the income approach. D&T’s report states that PPLM had advised it that the purchase price of the assets was $769,746,000. Due to limited information regarding market transactions involving electric generating facilities, D&T made only partial use of the market approach, and did not assign a fair market value using that approach. Utilizing the cost approach, D&T determined that as of December 17, 1999 (the valuation date) the assets had a fair market value of $784,795,523. Using the discounted cash flow method to apply the income approach, D&T determined that as of December 17, 1999 the assets had a fair market value of $800,000,000. In choosing a valuation using the two approaches, the D&T report concludes:

> Considering the difficulty in estimating inflation adjustments under the cost approach and the structure of the marketplace, it is our opinion that the discounted cash flow method of the income approach provides the strongest indication of the current [fair market value]

of the acquired tangible assets at the Facilities.

> Thus, we conclude that the [fair market value] of the acquired tangible assets at the Facilities as of the Valuation Date [December 17, 1999] is $800,000,000.

(Day 5 Tr. at 12; Exh. 115).

34. A June 20, 2001 memorandum to DOR from Craig Bartholomew, PPLM's Controller, addresses the fair value of the assets acquired from MPC by PPLM. Although the memo focuses on the valuation of the company's pollution control equipment, it describes the appraisal produced by D&T as "a credible valuation" of PPLM's assets, and "the most recent and best indicator of the value of the assets." Day 2 Tr. at 17-20; Exh. 16).

35. DOR issued appraisals of the PPLM properties for the years 2000, 2001, and 2002 as illustrated in the following table: (Exh. 144, T, U, and V).

Montana Department of Revenue	**Lien Date: January 1, 2000** Exhibit T	**Lien Date: January 1, 2001** Exhibit U	**Lien Date: January 1, 2002** Exhibit V	**Lien Date: January 1, 2002** Exhibit V
Correlated Unit Value				
Value Indicators			Before I.P.P. (intangible personal property)	After I.P.P. (intangible personal property)
Original Cost Less Depreciation	788,683,768	840,386,189	836,725,536	753,052,982
Direct Capitalization of Net Operating Income	675,461,007	1,479,736,377	1,628,751,049	1,465,875,944
Direct Capitalization of Gross Cash Flow	750,816,717	1,164,868,793	1,449,906,863	1,304,916,177
Market (Stock & Debt) 1	792,303,027	735,222,595	1,241,038,180	1,116,934,362
Market (Stock & Debt) 2	717,176,974	985,204,670	1,441,153,112	1,297,037,801
Correlation of Indicators	788,683,768	900,000,000	915,928,000	824,335,000
Expansion CWIP(construction work in progress)	2,232,900	0		
Total System Value	*790,916,668*	*900,000,000*	*915,928,000*	*824,335,000*
Intangible Personal Property Deduction (10%)	(79,091,167)	(90,000,000)	Calculated Above	Calculated Above
Phase-in	10% (7,909,167)	66.67% (60,000,000)		
Montana Market Value	*783,007,501*	*840,000,000*		*824,335,000*
Less Rail Cars	(808,347)	(684,932)		(679,804)
Less Hand Held Tools (exempt)	(15,000)	(15,000)		(15,000)
Less Licensed Vehicles	(818,055)	(824,561)		(776,662)
Market Value Apportioned to Counties	**781,366,099**	**838,475,507**		**822,863,574**
Pollution Control Equipment (Class 5)	(74,629,373)	(69,240,822)		(93,401,040)
Electric Generation Property (Class 13)	706,736,726	769,234,685		729,462,534

36. Based on legislation passed by the 1999 Montana Legislature, electric generation facilities of a centrally assessed electric power company in Montana are taxed as Class 13 property, at 6% of market value. (Day 6 Tr. at 104-106; Mont. Code Ann. § 15-6-156).

37. Air and water pollution control equipment is taxed as Class 5 property in Montana, at 3% of market value. (Mont. Code Ann. § 15-6-135).

38. DOR prepared appraisal reports on PPLM's assets for tax years 2000, 2001, and 2002, the three years appealed herein. Vern Fogle, who at the time was a utility appraiser in DOR, performed the appraisals. (Day 3 Tr. at 58-59; Day 7 Tr. at 96, 102-03, 127, 140; Exh. T; Exh. U; Exh. V).

39. Mr. Fogle testified that on behalf of DOR he utilized the "unit assessment methodology" in conducting the appraisals. He described the methodology as "the appraisal of a set of related assets, a business unit as one thing, a going concern, an organic whole." Gene Walborn, DOR's Business Tax and Valuation bureau chief, described unit valuation as an appraisal method that values a business's entire system. (Day 6 Tr. at 109-110; Day 7 Tr. at 100-102).

40. Pursuant to the unit assessment methodology, in performing the appraisals of PPLM's property Mr. Fogle used the cost approach, the income approach, and the market approach, coming up with various value indicators using each approach. He then arrived at a total system valuation by applying a correlation of the various indicators. In each of the three years Mr. Fogle placed the greatest weight on the cost indicator in assessing

PPLM's properties. (Day 3 Tr. at 61-62; Day 7 Tr. at 136-37).

41. For the year 2000, DOR's final appraisal assessed PPLM's property at $706,736,726 for its Class 13 electric generation assets, and $74,629,373 for its Class 5 pollution control equipment (PCE). When the 2000 appraisal was completed DOR had not yet been provided with the "trued up" financials that D&T had provided to PPLM. (Day 3 Tr. at 73, 76; Day 7 Tr. at 103-05; Exh. T).

42. For the year 2001, DOR appraised PPLM's property at $769,234,685 for its Class 13 electric generation assets, and initially valued PPLM's Class 5 PCE at $69,240,822. Later, following informal settlement discussions between PPLM and DOR, the value of the PCE was increased to $93,401,040. The increase in value attributed to the class 13 property from 2000 to 2001 was based on the fact that DOR had not been provided with the final "true ups" when it completed its 2000 appraisal and assessment. The revised financial statements reflecting the true ups resulted in an increase in the assessed value of the property. (Day 7 Tr. at 156-57; Exh. U).

43. For the year 2002, DOR's final appraisal assessed PPLM's property at $729,462,534 for its Class 13 electric generation assets, and $93,401,040 for its Class 5 PCE. Mr. Fogle testified that when the 2002 assessment was completed DOR had the benefit of two years' history of income for PPLM's property. (Day 7 Tr. at 140; Exh. U).

44. PPLM contends that the proper assessments of its properties for the three tax years at issue are as follows:

2000

Class 13 (electric generation) assets: $561,468,598

Class 5 (PCE) assets: $102,890,000

2001

Class 13 (electric generation) assets: $581,030,507

Class 5 (PCE) assets: $102,890,000

2002

Class 13 (electric generation) assets: $565,433,574

Class 5 (PCE) assets: $102,890,000

(PPLM's proposed Conclusion of Law 3).

PPLM's Intangible Personal Property

45. Intangible personal property is exempt from taxation in Montana. Pursuant to an administrative rule adopted by DOR, there is a 10% "default" exemption for electric utilities. According to the Montana statute, for centrally assessed property, the 10% exemption was required to be phased in over a three-year period, beginning in tax year 2000. Applying the phase-in requirement, 10% of the value of the intangible personal property was exempt in tax year 2000, two-thirds of the value of the intangible personal property was exempt in tax year 2001, and the full value of the intangible personal property was exempt in tax years 2002 and thereafter. (Day 6 Tr. at 136-140; Day 7 Tr. at 48-51; Mont. Code Ann. § 15-6-218; ARM 42.22.110).

46. A company has the right to submit additional evidence of the value of intangible personal property if it believes the 10% default allowance is insufficient. DOR is then required to consider the additional information submitted and make a determination whether the default allowance or an additional

allowance is appropriate. (Day 6 Tr. at 138-140; ARM 42.22.110).

47. Applying the statutory and regulatory requirements, including the phase-in provision discussed above, for tax year 2000 DOR calculated the standard 10% default allowance for intangible personal property to PPLM's property, then deducted 10% of the value of that amount from the unit value of PPLM's assets (since it was the first year of the phase-in). In tax year 2001, DOR allowed two-thirds of the 10% default value of PPLM's intangible personal property as an exemption. In tax year 2002 DOR allowed the full 10% default amount as an exemption. (Day 7 Tr. at 122-123, 129-130).

48. In determining that the 10% default value was appropriate for PPLM's intangible personal property exemption, Mr. Fogle reviewed PPLM's financial records and noted that one item, goodwill, qualified as intangible personal property under the law. Mr. Fogle calculated the 10% default value, compared it to the value of the company's goodwill, and determined that the 10% default value was higher. Therefore, that was the value that was allowed. (Day 7 Tr. at 122-123, 129-130).

49. PPLM contends that its exempt intangible personal property had the following values for the three tax years at issue:

2000: $74,000,000

2001: $76,160,000

2002: $74,421,000

(PPLM's proposed Conclusion of Law 3).

50. PPLM's public reports to shareholders and its filings with the Securities and Exchange Commission (SEC) reflect no separately identified goodwill in the purchase of MPC's assets.

(Day 2 Tr. at 57-59).

51. Internal Revenue Service (IRS) form 8594 is an "Asset Acquisition Statement" that must be completed and filed with the IRS following a transaction involving the purchase and sale of assets, attached to an income tax return. The purpose of the form is to identify how the purchase price was allocated to different classes of assets. The form lists various classes of assets -- Classes I through V. Class I assets are cash, Class II assets are cash equivalents, and Class III assets are fixed assets. Class IV assets are intangible assets other than goodwill. Class V assets are goodwill. (Day 8 Tr. at 192-195; Exh. DDDD).

52. PPLM completed and filed a form 8594 with the IRS, reporting the entire purchase price of the assets purchased from MPC as Class III, or fixed assets, and representing the "aggregate fair market value" as $769,746,000. No portion of the purchase price was allocated to Classes IV and V, intangible assets and goodwill. (Day 7 Tr. at 5-8; Exh. EEEE).

53. PPLM contends that when D&T performed its purchase allocation valuation of the assets acquired by PPLM from MPC, the valuation was performed under the premise of "value in continued use." Under that approach, according to PPLM, fair market value incorporates any value for intangible assets, but the value of any such intangible assets is not separately stated. Thus, PPLM contends that the purchase price that it paid for MPC's assets necessarily included an "intangible" component, even though the value of intangibles was not separately specified. (PPLM proposed Findings of Fact 160-162).

54. Edward C. Kerins testified as an expert for DOR. Mr.

Kerins is a certified public accountant. Mr. Kerins testified that when completing form 8594 it is not appropriate to include the value of intangible personal property (including goodwill) within the value of Class III fixed assets. He explained that if the buyer or seller feel that there is intangible personal property that has value and that is part of the transaction, the value of that property should be listed as a Class IV or Class V asset. (Day 8 Tr. at 186, 198).

55. On December 31, 1999, PPLM recorded $74,563,000 as the initial amount of goodwill associated with the purchase of MPC's assets. According to a memo from PPLM Controller Craig Bartholomew to DOR, following a true-up period, PPLM increased the estimate of the value of goodwill to $109,920,000, and also identified additional intangible assets. However, the value of goodwill was never separately identified in PPLM's records or accounts. (Day 2 Tr. at 52-57; Exh. 15).

56. DOR's final appraisal for tax year 2000 did not reflect the final "true-ups" and other revisions made by D&T because the information was not provided to DOR by the final appraisal date. (Day 3 Tr. at 73-77).

PPLM's Pollution Control Equipment

57. PPLM acquired the PCE previously owned by MPC as part of the assets it acquired pursuant to the Purchase Agreement. No significant changes to the PCE have occurred since the December, 1999 closing date of the asset purchase. (Day 2 Tr. at 16-17; Day 7 Tr. at 123-24).

58. As noted in Fact 38, in 2000 DOR valued PPLM's PCE at $74,629,000. DOR arrived at its year 2000 valuation of PPLM's PCE

by calculating the proportion of value that MPC had as certified PCE compared to the total value of MPC's electric generation property, and computing a similar proportion of value for the PCE after PPLM purchased the assets. DOR appraiser Vern Fogle determined that the market value of the PCE when it was owned by MPC in 1999 was $43,784,548. (Day 7 Tr. at 123-26; Exh. T; Exh. JJJJ).

59. In 2001 DOR initially valued PPLM's PCE at $69,240,822. As noted in Fact 39, following informal hearing requests by PPLM and settlement discussions, DOR increased the value of PPLM's PCE for tax year 2001 to $93,401,040, subject to verification by PPLM. (Day 7 Tr. at 156-57; Exh. U).

60. In 2002 DOR again valued PPLM's PCE at $93,401,040, subject to verification by PPLM. This amount was, again, based on informal settlement discussions between DOR and PPLM. (Day 7 Tr. at 156-57; Exh. V).

61. Citing Montana Code Annotated § 15-6-135(2), DOR takes the position that to qualify as Class 5 PCE the equipment must be "certified" by the Montana Department of Environmental Quality. DOR contends that PPLM failed to prove that all of its PCE was "certified." (Day 7 Tr. at 123-25; DOR proposed Conclusion of Law 23).

62. PPLM contends that its PCE should have been valued at $102,890,000 for each of the three tax years at issue. <u>See</u> Fact 41). PPLM bases its contention on the testimony and calculations of former PPLM controller Craig Bartholomew. Mr. Bartholomew reviewed the original cost of MPC's PCE, as calculated by DOR (approximately $94,000,000) and "stepped up" that figure to

$102,890,000, based on the step-up allocations applied by D&T. (Day 2 Tr. at 13-23; Exh. 16, Appendix C, at 00512).

63. D&T's valuation of PPLM's PCE, according to the same document prepared by Mr. Bartholomew, was $92,346,554. (Exh. 16, Appendix C, at 00512).

64. PPLM's witnesses did not testify that the PCE that was assigned a value by PPLM constitutes equipment that was certified by the Montana Department of Environmental Quality. However, to arrive at the $102,890,000 figure referenced in Fact 59, Mr. Bartholomew relied on the values initially assigned to MPC's PCE by DOR appraiser Vern Fogle. As noted in Fact 55, Mr. Fogle considered only MPC PCE that had been certified by the Montana Department of Environmental Quality. (Day 2 Tr. at 22-27; Day 5 Tr. at 49-52).

Equalization of Valuation Allocated to Properties

65. As noted in Fact 11, Puget owns the other 50% undivided interest in Colstrip Units 1 and 2. During tax years 2000, 2001, and 2002, Puget's Montana assets were regulated, rate-based utility assets, subject to regulation by the Washington Public Utility Commission. During those years Puget's Montana assets were used to generate power to be used for the benefit of rate-regulated customers. Puget does not own any generating assets in Montana that are operated as an EWG. (Day 1 Tr. at 132-33; Day 8 Tr. at 69-70).

66. During the same three tax years, PPLM's assets were not operated as rate-based utility assets subject to regulation by a state public utility regulatory agency, but were owned and operated by PPLM as an EWG, selling energy on wholesale markets. (Day 1 Tr.

at 64-65, 71).

67. Electric generation assets owned and operated by an EWG, such as PPLM, operate in different economic and regulatory environments. (Day 1 Tr. at 71-74; Day 8 Tr. at 15-39).

68. Puget's 50% interest in Colstrip Units 1 and 2 must be utilized for the production of power that is provided for rate-regulated customers. If there is any excess generation, the proceeds from the excess do not enlarge Puget's net income, but are credited to the benefit of the regulated customers. (Day 8 Tr. at 69-71).

69. Output from Puget's Colstrip generation facilities is not sold at wholesale, and Puget does not use electricity generated by its Montana facilities to compete "in any meaningful respect" in wholesale markets. The generation output from Puget's Colstrip facilities is fully committed to satisfying the retail regulated requirements of its rate-based customers. While Puget may sell excess energy in wholesale markets, the net revenues from such "off system" sales attributable to the Colstrip properties are credited by Puget's regulators against the cost of service revenue requirements collected from regulated utility customers, thereby reducing utility rates for those customers. (Day 8 Tr. at 33, 69-71, 73-76, 80; Exh. UU at 15-16).

70. Puget does not have sufficient generation output to satisfy all of its retail obligations. To meet those obligations Puget is required to purchase power from other providers. During tax years 2000, 2001, and 2002, Puget purchased power from PPLM for resale. (Day 8 Tr. at 74-76; Exh. VVVV).

71. Avista Corporation (Avista) is an energy company involved

in the production, transmission, and distribution of energy. Noxon Rapids, located on the Clark Fork River in Northwestern Montana, is Avista's largest generating hydroelectric project, with a generating capacity of 554 megawatts. The Noxon Rapids project generates 70% of the total capacity of Avista's Clark Fork Projects. (Exh. UU at 14, note 4; Exh. 146 at Exhibit 1).

72. PPLM owns hydroelectric generating property in Montana with a peak capacity to produce 577 megawatts of energy. Avista owns hydroelectric generating property in Montana (Noxon Rapids) with a peak capacity to produce 554 megawatts of energy. PPLM's Montana hydroelectric generating capacity is based on eleven geographically dispersed dams, while Avista's Montana hydroelectric generating capacity is based on the single dam at Noxon Rapids. PPLM's Montana hydroelectric property produces an annual average of 6,489 megawatt-hours of electricity per megawatt of capacity, while Avista's Montana hydroelectric property produces an annual average of 3,371 megawatt-hours of electricity per megawatt of capacity. (Day 8 Tr. at 70-71; Exh. UU at 15 and Tables 1 and 2).

73. During the years 2000, 2001, and 2002, Avista's Noxon Rapids hydroelectric facility was a regulated, rate-based utility asset subject to regulation by the Washington Public Utility Commission. Avista's Montana assets were used to generate power to be used for the benefit of rate-regulated customers. Avista does not own any generating assets in Montana that are operated as an EWG. (Day 1 Tr. at 132-33; Day 8 Tr. at 69-70).

74. Avista's Montana hydroelectric generation properties must be utilized for the production of power that is provided for rate-regulated customers. If there is any excess generation, the

proceeds from the excess do not enlarge Avista's net income, but are credited to the benefit of the regulated customers. (Day 8 Tr. at 69-71).

75. Output from Avista's Montana hydroelectric generation facilities is not sold at wholesale, and Avista does not use electricity generated by its Montana facilities to compete "in any meaningful respect" in wholesale markets. The generation output from Avista's Montana facilities is fully committed to satisfying the retail regulated requirements of its rate-based customers. (Day 8 Tr. at 33, 69-71, 73-76, 80; Exh. UU at 15-16).

76. Avista does not have sufficient generation output to satisfy all of its retail obligations. To meet those obligations Avista is required to purchase power from other providers. (Day 8 Tr. at 74-76; Exh. UU; Exh. OOOO).

77. During the years 2000, 2001, and 2002, PPLM was considerably more profitable than both Puget and Avista. (Day 8 Tr. at 77-79; Exh. UU at 17-18).

78. DOR utilized the same methodology and approach in appraising the Montana taxable properties owned by PPLM, Puget, and Avista. (Day 8 Tr. at 44).

TAXPAYER'S CONTENTIONS

1. Central Assessment

PPLM contends DOR improperly determined that it is subject to central assessment. PPLM argues that, although it owns a number of hydroelectric and coal-fired electric generation facilities, each generating facility is a separate, discrete, stand-alone facility. PPLM emphasizes that its purchase of MPC's assets did not include the transmission lines. Since PPLM's discrete assets do not constitute a unitary system, it is not subject to central assessment because it is not "operating a single and continuous property operated in more than one county." Montana Code Annotated § 15-23-101. PPLM argues that if DOR's position is correct, then multi-state businesses such as Wal-Mart or Best Western must also be centrally assessed, since their stand alone units are connected by the Interstate highway system.

2. Valuation

PPLM contends that DOR improperly used asset acquisition methodology when valuing PPLM's assets. According to PPLM, the acquisition methodology of assessment is forbidden because this "welcome stranger" method of assessment results in disproportionate tax burdens for the new purchaser of property. Citing Roosevelt v. Montana Dept. of Revenue, 1999 MT 30, ¶ 43, 293 Mont. 240, 975 P.2d 295, PPLM contends that Montana does not have an acquisition value system of taxation. Citing Allegheny Pittsburgh Coal Co. v. County Comm'n, 488 U.S. 336 (1989), PPLM argues that the acquisition methodology of assessment violates Equal Protection guarantees.

3. Intangible Personal Property

PPLM claims that DOR failed to properly value PPLM's intangible personal property. PPLM contends that D&T's appraisal of the fair market value of its assets was performed under a value-in-use approach, which incorporates intangible value.

4. Pollution Control Equipment

PPLM argues that it acquired all its PCE from MPC, and that there has been no significant change in the equipment since it was purchased from MPC. PPLM states that all the equipment obtained from MPC had been deemed by DOR to be "certified" PCE, and in 1999 the equipment was valued at approximately $94,000,000 by DOR. PPLM contends that application of "step-up" methodology suggested by one of its officials results in a proper valuation of PPLM's PCE at approximately $102,890,000.

5. Equalization of Values

PPLM claims that its hydroelectric generation assets are not equalized with Avista's hydroelectric generation facility at Noxon Rapids, and that its partial interests in Colstrip Units 1 and 2 are not equalized with Puget's partial interests in the same facilities. Although PPLM concedes that this Board does not have the authority to determine that DOR acted in an unconstitutional manner, PPLM argues that the Board has authority to "pass judgment on appraisal methods" used by DOR, and to conclude that DOR used erroneous appraisal methods in its 2000, 2001, and 2002 assessments of PPLM. PPLM contends that while DOR's market valuations of PPLM-owned generation assets has increased substantially every year beginning in 2000, the valuations of comparable Class 13 property owners, specifically Avista and Puget, has not changed substantially over that same period of time.

DOR'S CONTENTIONS

1. Central Assessment

DOR contends that it properly determined PPLM is subject to central assessment. DOR first emphasizes that PPLM bears the burden of proving that DOR's classification of its property as subject to central assessment is incorrect. DOR argues that, even though PPLM's various generation facilities are not physically interconnected by transmission lines owned by PPLM, PPLM operates its generation facilities as an integrated unit, both functionally and economically. DOR points out that the Purchase Agreement included an interconnection agreement authorizing PPLM to use the transmission lines as if it owned them. DOR also argues that ARM 42.22.102(1) lists electric companies as a type of company that is subject to central assessment.

2. Valuation

DOR claims that its appraisals of PPLM's unit are a correct reflection of the market value of the various properties held by PPLM.

For tax year 2000, the DOR relied on the cost approach to arrive at the market value. The final figure was established from the D&T appraisal for the asset allocation. (Day 3 Tr. at 73).

For tax year 2001, the DOR relied on the cost approach to arrive at the market value. The increase in value is a result of the sale and lease back. (Day 3 Tr. at 85).

For tax year 2002, the DOR used a weighting method. 90% was applied to the cost approach, and 10% was applied to the income approach (direct capitalization of net operating income). (Day 3

Tr. at 88).

Vern Fogle testified that for tax years 2000, 2001, and 2002, the DOR placed greatest emphasis on the cost approach in arriving at the market value. Less emphasis was placed on the valuations arrived at by the income approach due to, (1) a very short operating income history for PPL Montana, and, (2) unusual circumstances created by the electricity price spikes that occurred in the west, particularly California in 2001 and 2002

DOR notes that none of PPLM's witnesses characterized their valuations of PPLM's property as "appraisals," thus they are entitled to little, if any, weight. DOR insists that it did not assess PPLM based on its acquisition value, noting that at the time of its initial assessment DOR had not been provided the entire purchase agreement, nor had it been provided with the final "true-ups" regarding the purchase. Moreover, DOR's assessors examined all indicators of value in arriving at a market value for PPLM's property.

3. Intangible Personal Property

DOR argues that it typically determines the value of a taxpayer's intangible personal property by examining the audited financial statements of the taxpayer. In PPLM's case, its restated financial statements submitted to the SEC indicated no value attributable to intangible personal property. In addition, PPLM submitted a form to the IRS indicating no identifiable intangible assets. Thus, since PPLM's financial statements submitted to government authorities did not reflect any value attributable to intangible personal property, DOR applied the default amount of 10%.

4. Pollution Control Equipment

DOR contends that to be eligible for classification as Class 5 PCE, the equipment must be "certified" by the Montana Department of Environmental Quality. DOR claims PPLM's witnesses were unable to testify that PPLM's PCE was certified. DOR properly "wrote up" the value of the PCE purchased from MPC by PPLM to reflect the market value of the certified property using the same ratio based on when the property was owned by MPC.

5. Equalization of Values

DOR argues that PPLM failed to meet its burden of proof on the claim that the valuation of PPLM's properties is not equalized with the valuations of similar properties. Citing the test in Department of Revenue v. State Tax Appeal Board, 188 Mont. 244, 250, 613 P.2d 691, 694 (1980), DOR contends that PPLM failed to meet several parts of the six-part test outlined in the Montana Supreme Court's decision. Most notably, according to DOR, PPLM's generation assets are not similar and comparable to those of Avista and Puget. In essence, DOR argues that PPLM, operating as an EWG, and Puget and Avista, operating as regulated public utilities producing rate-based electricity, operate in very different economic environments.

BOARD'S DISCUSSION

1. Central Assessment of PPLM's Property

For the three tax years at issue, DOR centrally assessed PPLM's property. PPLM has the burden of proving that DOR's decision to centrally assess its property is incorrect. See Farmers Union Cent. Exch., Inc. v. Dep't of Revenue, 272 Mont. 471, 476, 901 P.2d 561, 564 (1995). Montana Code Annotated § 15-23-101(2) requires DOR to centrally assess each year:

> . . . property owned by a corporation or other person operating a single and continuous property operated in more than one county or more than one state, including but not limited to telegraph, telephone, microwave, and electric power or transmission lines; . . .

DOR has implemented the provisions of this statute through the adoption of ARM 42.22.102(3), which requires DOR to "determine centrally assessed property based on the property's operating characteristics such as but not limited to property use, integration of operations, management, and corporate structure." In addition, ARM 42.22.102(1)(g) states that DOR is required to centrally assess inter-county continuous properties of electric companies. PPLM contends that, because its generation facilities are not physically connected by transmission lines owned by PPLM, they are not operated as a "single and continuous property . . . ."

The evidence presented at the hearing establishes that PPLM operates its facilities as a single, integrated property. Prior to PPLM's purchase of the generating facilities, they were owned and operated by MPC, which also owned the transmission lines that tie the facilities together. Prior to PPLM's purchase of its generating facilities, MPC operated them as a single, integrated property. Although PPLM did not purchase and therefore does not own the transmission lines, the Purchase Agreement includes an Interconnection Agreement that permits the generating facilities to continue to operate as a single, integrated property or unit. Exhibit M of the Interconnection Agreement (Exh. SS) states, in relevant part:

> Over the years, [MPC] has built an integrated generation, transmission and distribution system designed to serve the electric energy requirements of its retail and wholesale customers in an efficient and reliable manner. In order to achieve maximum economic efficiency and reliability, there are many instances in which communications, metering, control, operations and other equipment have been integrated to serve a combination of generation, transmission and distribution functions. In addition, there are many instances in which equipment or facilities used for one function are physically located within structures that are primarily used for another function.
>
> Complete physical separation of generation facilities from transmission and distribution facilities would be prohibitively expensive and of little or no value to [MPC] or [PPLM]. Instead, [MPC] and [PPLM] intend, through the Interconnection Agreement and related documents, to establish a regime that will allow the continued operation of generation, transmission and distribution facilities in an efficient manner regardless of ownership.

The express terms of the Interconnection Agreement, and the other evidence and testimony presented at the hearing, establish that PPLM operates its generation facilities as a single, integrated unit, in an efficient and reliable manner, despite the fact that

PPLM does not own the transmission lines connecting the facilities. PPLM's operation of its generating facilities as an integrated unit is further facilitated by FERC Order No. 888, which gives PPLM the right to access the transmission system currently owned by Northwestern, as if PPLM owned the transmission system.

The Board also takes note that, pursuant to the terms of the WTSA's that were assumed under the Purchase Agreement, PPLM is required to fulfill the obligations of the agreements by, in effect, operating the power plants in the same way as MPC had operated them, and serving the same loads that MPC had been obligated to serve.

All of these factors support DOR's determination that PPLM's property should be centrally assessed as property owned by a corporation operating a single, continuous property operated in more than one county or more than one state, as required by Montana Code Annotated § 15-23-101. In making its determination, DOR followed the provisions of 42.22.102(3) by considering the property's operating characteristics, such as property use, integration of operations, management, and PPLM's corporate structure.

2. Valuation of PPLM's Property

Montana law requires DOR to assess all taxable property at 100% of its market value, except as otherwise provided. "Market value" is defined as:

> . . . the value at which property would change hands

> between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.

Montana Code Annotated § 15-8-111. DOR contends that it properly appraised PPLM's property and calculated values that reflect the market value of the properties. PPLM claims that DOR improperly used the "acquisition methodology" of appraisal, which penalizes a "welcome stranger" or new purchaser of property.

The evidence presented at the hearing does not support PPLM's contention that DOR utilized acquisition methodology in appraising the properties. Vern Fogle, the DOR appraiser who valued PPLM's property, utilized the "unit assessment methodology" in conducting the appraisals. Using this methodology, the DOR valued PPLM's assets as an entire business unit. The DOR recognized the cost approach, the income approach, and the market approach, and then arrived at a total system valuation by applying a correlation factor to the various approaches. Although the DOR placed the greatest weight on the cost indicator in assessing the value of the properties, it cannot fairly be said that the DOR relied on acquisition methodology in performing his appraisals. The following table in summary illustrates the appraisals for the years at issue:

COST APPROACH			
Exhibit/Bates Page	T/013785-86	U/013824-25	V/13750-51
Year	2000	2001	2002
Plant In Service	707,061,649	427,563,000	443,000,000
Material & Supplies	6,486,935	5,045,000	6,000,000
Plant Leased From Others	0	411,000,000	411,000,000
Replacement CWIP (construction work in progress)	6,774,737	13,251,000	12,358,610

Expansion CWIP						1,941,045
Goodwill		74,563,085		0		0
Plant Leased To Others		0		0		0
Total Original Cost		794,886,406		856,859,000		874,299,655
Non-operating Property		(6,202,638)		(7,110,499)		(7,110,499)
Accrued Depreciation - Non-operating Property		0		145,344		320,269
Less: Accrued Depreciation - Operating Property		0		(9,507,656)		(17,000,000)
Less: Accrued Depreciation - Operating Lease Property		0		0		(13,783,889)
Construction Work In Progress (CWIP)						
Replacement	6,774,737		13,251,000		12,358,610	
Expansion	2,232,900		0		1,941,045	
Total	9,007,637		13,251,000		14,299,655	
Original Cost Less Depreciation		**788,683,768**		**840,386,189**		**836,725,536**

Correlated Unit Value:						
Original Cost Less Depreciation		788,683,768		840,386,189		836,725,536
Direct Capitalization of Net Operating Income		675,461,007		1,479,736,377		1,628,751,049
Direct Capitalization of Gross Cash Flow		750,816,717		1,164,868,793		1,446,906,863
Market (Stock & Debt)(1)		792,303,027		735,222,595		1,241,038,180
Market (Stock & Debt)(2)		717,176,974		985,204,670		1,441,153,112
Correlation of Indicators		788,683,768		900,000,000		915,928,000
Expansion CWIP		2,232,900		0	Included Above	
Total System Value		790,916,668		900,000,000		915,928,000
Default Intangible Percent	10%	(79,091,667)	10%	(90,000,000)	10%	(91,592,800)
Phase-in	10%	(7,909,167)	67%	(60,000,000)	100%	(91,592,800)
Montana Market Value		**783,007,501**		**840,000,000**		**824,335,000**
Less Rail Cars		(808,347)		(684,932)		(679,804)

Less Hand Held Tools (exempt)		(15,000)		(15,000)		(15,000)
Less Licensed Vehicles		(818,055)		(824,561)		(776,622)
Market Value Apportioned to Counties		**781,366,099**		**838,475,507**		**822,863,574**
Pollution Control Equipment (Class 5)	9.6%	74,629,373	8.3%	69,240,822	11.4%	93,401,040
Electric Generation Property (Class 13)	90.4%	706,736,726	91.7%	769,234,685	88.6%	729,462,534

Non-operating property - "… A large part of that was housing for the operating crew at various dams. That property is of course, taxable and taxed, but it's taxed at the local level as residential housing, like other residential housing." (Fogle testimony, Day 7, p. 103-104)

DOR's 2000 assessment was based on book values of the assets, which PPLM subsequently revised upwards. DOR's 2000 assessment was finalized prior to PPLM providing DOR with its final, "trued up" financial statements. Once those revised financial statements were provided, the increased market value was reflected in DOR's 2001 assessment of the properties. DOR's 2000 combined assessment of PPLM's Class 13 and Class 5 property resulted in a value of $781,366,099. It is noteworthy that D&T conducted an appraisal of the assets for PPLM and determined that, as of the purchase date of December 17, 1999, the assets had a fair market value of $800,000,000. And, as set forth in Facts 48 and 49, PPLM filed IRS form 8594 following the asset sale, representing that the aggregate fair market value of the assets was $769,746,000, which was slightly more than the $767,101,000 that PPLM paid at closing (including acquisition costs).

As noted previously, DOR's 2001 assessment of the properties included the sale lease-back and PPLM's revised financial statements. It was testified that the sale lease-back was nothing more than a financing mechanism and added no additional value to the property. It is the opinion of the Board that there is insufficient support to suggest this transaction increased the value of the property.

For tax year 2002, the DOR valued the property at 90% of the cost approach and 10% from the income approach (Direct Capitalization of Net Operating Income). In general, the Board gives considerable weight to the income approach for income producing properties. In fact, it's difficult to imagine that the historical income along with potential future income did not carry significant weight in the agreed upon sale price when PPLM and MPC were negotiating the sale. In the case before us, however, it is the Board's opinion that the operating income history available to the DOR was too unstable.. The D&T appraisal utilized the income approach, discounted cash flow analysis, to arrive at a market value of $800,000,000 for the property. (Exh. 115 at beta 00923). This discounted cash flow income summary is limited to only the allocation of values to the individual properties as follows:

Description	Discounted Cash Flow Fair Market Value
Colstrip Units 1 & 2 (50% Interest)	208,000,000
Colstrip Unit 3 (30% Interest)	205,000,000
J.E. Corette	49,000,000

Hydroelectric Facilities	
Mystic	3,000,000
Black Eagle	12,000,000
Morony	39,000,000
Madison	6,000,000
Rainbow	18,000,000
Ryan	59,000,000
Holter	33,000,000
Hauser	5,000,000
Kerr	49,000,000
Cochrane	43,000,000
Thompson Falls	67,000,000
Hebgen Reservoir	4,000,000
Total Income Approach	800,000,000

It is the opinion of the Board that there is insufficient detail with this discounted cash flow analysis to construct an opinion for or against the $800,000,000. As previously noted, the DOR's income approach was developed on a very short history and anomalous events that occurred in the electricity markets. Based upon these two circumstances, the values generated from the income approach for the DOR's 2002 assessment are not considered to be reliable indications of value at this time. Once the DOR has a more normalized income history for PPLM, the value indication from the income approach may be better supported.

The taxpayer asserts Montana does not have a valuation system that is premised on acquisition value. The sale price can most definitely reflect market value. In the immediate case, there is nothing to suggest that the transaction between MPC and PPLM does not meet the market value definition in Montana Code Annotated § 15-8-111.

The Board has been presented with multiple indications of value for the PPL Montana property, two of which are: (1) the actual purchase price, and (2) the independent D&T appraisal. The

Administrative Rules of Montana provide for the adoption of value from each of these; ARM 42.20.454 CONSIDERATION OF SALES PRICE AS AN INDICATION OF MARKET VALUE and 42.20.455 CONSIDERATION OF INDEPENDENT APPRAISALS AS AN INDICATION OF MARKET VALUE. For a property type that is infrequently traded in the market place, the purchase price could be the best indicator of value. In addition, the purchase price for this property is clearly supported by the fee appraisal.

It is the opinion of the Board that the total value for all the individual classes of property for the years at issue is $769,746,000.

3. PPLM’s Exempt Intangible Personal Property

PPLM contends that DOR under-valued its intangible personal property. Pursuant to Montana Code Annotated § 15-6-218, intangible personal property is exempt from taxation in Montana. To implement this exemption, Montana Code Annotated § 15-6-218 required a three-year phase-in period, beginning in tax year 2000. Montana Code Annotated § 15-6-218 further required DOR to adopt administrative rules to specify the methodology that would be used to establish the value of centrally assessed intangible personal property. DOR administrative rule ARM 42.22.110 establishes a 10% “default” value for intangible personal property owned by electric utilities. DOR deducted the 10% default value from the total value of PPLM’s property, then applied the statutory phase-in for each of the three tax years at issue in this proceeding.

DOR’s tax appraiser, Mr. Fogle, reviewed PPLM’s financial records and noted that one item, goodwill, qualified for the exemption. He determined that the 10% default value exceeded the stated value of the goodwill, and therefore applied the default value.

PPLM's reports to shareholders, its SEC filings, and its IRS filings all show no goodwill associated with the purchase of MPC's assets.

Under the circumstances, DOR was correct in applying the 10% default value for PPLM's intangible personal property.

It should be noted that tax year 2000 was the first year of the phase-in for intangible property. As the value for the intangible property increased, the value for the PCE and Class 13 property decreased. For tax year 2002 and future years, the intangibles are fully recognized.

4. PPLM's Pollution Control Equipment

PPLM disagrees with the values assigned by DOR to its PCE. The accuracy of the valuation of such equipment can have significant tax consequences, since air and water pollution control equipment is taxed as Class 5 property, at 3% of market value (compared to Class 13 property, which is taxed at 6% of market value).

For the tax years 2000, 2001, and 2002, the DOR valued PPLM's PCE at $74,629,373, $69,240,822, and $93,401,040, respectively (Exh. T, U & V). For the tax years at issue, the PCE represents the following percentages of market value apportioned to the counties (Class 5 & Class 13):

Exhibit & Bates Page	Tax Year	PCE (Class 5)		Market Value		PCE % of Value
T/13785	2000	$74,629,373	/	$781,366,099	=	9.6%
U/13825	2001	$69,240,822	/	$838,475,507	=	8.3%
V/013750	2002	$93,401,040	/	$822,863,574	=	11.4%
				Average		9.7%

It is the Board's opinion that the total value of the PCE is approximately 10% of the total system value as illustrated in the above table, which is a summary of the DOR's appraisal report (Exh. T, U, & V).

We have reviewed the testimony and the documentary evidence and are convinced that DOR properly stepped-up the value of the PCE based upon when it was owned by MPC and acquired by PPLM.

5. Equalization of Values

A significant portion of the testimony in this case concerned the issue of equalization of assessment valuations between PPLM, on the one hand, and Puget Sound Energy ("PSE") and Avista Corporation ("Avista"), on the other. In its appeal for tax years 2000 and 2001, PPLM alleged disparate treatment of its one-half interest in Colstrip Units 1 and 2. In its appeal for tax year 2002, PPLM re-alleged the disparate treatment of Colstrip Units 1 and 2, and added a comparison between its hydroelectric properties and those owned by Avista (Noxon Rapids Dam). PPLM's allegation was that, in any direct comparison between its facilities and those of the others, it was assessed at a substantially higher rate.

The lodestar case for PPLM's disproportionate tax burden argument is Allegheny Pittsburgh Coal Co. v. County Commission, 488

U.S. 336 (1989). In that case, which arose from the state of West Virginia, the United States Supreme Court held that a stepped-up tax assessment based upon a recent purchase price violated the Equal Protection Clause of the United States Constitution, when it was shown that the valuations of the other utilities in the class were substantially below fair market levels.

Based upon the testimony of Gene Walborn and Vern Fogle, it appears that in Montana Class 13 utility property has been primarily cost-based. While there is a discussion of a "correlation of value", the practical effect is that the original or historical cost of the utility property is depreciated, so that the value diminishes each year. There is no attempt to trend or index this amount to reflect price levels in the macro-economy. Without such a device or some other methodology, one would expect that the assessments have the potential to move away from actual market values. This may be one reason why the facilities owned by Montana Power in 1999 were assessed by DOR at 504 million; but when those exact same facilities were sold in the open market to PPLM they obtained a value of 769 million.

This discrepancy in valuation can be seen most vividly in Colstrip Units 1 and 2. As successor to Montana Power's interest in the properties, PPLM acquired an undivided one-half interest in the properties with PSE. For property taxes purposes in 2000 DOR assessed PPLM's one half interest at 186.4 million; PSE's identical one-half interest was assessed at 121.3 million. While DOR maintains that both properties are assessed using the "cost" approach to value, the fact is that one cost approach uses historical costs depreciated (PSE), and the other uses cost based upon purchase price (PPLM). It strains reason to argue that both properties are assessed by the same method, when the results are so dramatically different.

One of the ways DOR has sought to explain this difference in valuation is the fact that PSE and Avista are both subject to rate regulation in the jurisdictions in which they sell their final energy products. Whether Montana's statute defining fair market value allows for this "value-in-use" approach is an open question, which we will not decide today, but it is something, which the Montana Legislature may want to address. It is, at best, unclear if the "value in use" approach to utility valuation which is used by the DOR, is in fact encompassed within the definition of fair market value used in Title 15, chapter 8.

The only valuations properly before this Board in this proceeding are those of PPLM, and those valuations are the only ones that we are deciding today. We are also reluctant to address federal constitutional issues of first impression in Montana. As an administrative board we do not believe that the application of federal constitutional issues is within our normal purview.

CONCLUSIONS OF LAW

1. The Board has jurisdiction over this matter pursuant to

Montana Code Annotated § 15-2-301.

2. DOR is required to centrally assess property owned by a corporation "operating a single and continuous property operated in more than one county or more than one state." Montana Code Annotated § 15-23-101.

3. DOR has adopted ARM 42.22.102(3), which requires DOR to "determine centrally assessed property based on the property's operating characteristics such as but not limited to property use, integration of operations, management, and corporate structure."

4. DOR's administrative rules require it to centrally assess interstate or inter-county continuous properties of electric companies, such as PPLM. ARM 42.22.102(1)(g).

5. DOR properly centrally assessed PPLM's Montana properties pursuant to Montana Code Annotated § 15-23-101.

6. PPLM failed to meet its burden of proving that DOR improperly classified it as a centrally assessed property. See Farmers Union Cent. Exch., Inc. v. Dep't of Revenue, 272 Mont. 471, 476, 901 P.2d 561, 564 (1995).

7. DOR is required to assess all taxable property at 100% of its market value except as otherwise provided. Montana Code Annotated § 15-8-111(1). "Market value" is defined as "the value at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." Montana Code Annotated § 15-8-111(2)(a).

8. DOR did not properly assess PPLM’s property at 100% of its market value, as required by Montana Code Annotated § 15-8-111.

9. Intangible personal property is exempt from taxation. The phrase is defined in Montana law as personal property that is not tangible personal property and that:

> (a) has no intrinsic value but is the representative or evidence of value, including but not limited to certificates of stock, bonds, promissory notes, licenses, copyrights, patents, trademarks, contracts, software, and franchises; or
>
> (b) lacks physical existence, including but not limited to goodwill.

Montana Code Annotated § 15-6-218(2).

10. Recognizing that the valuation of intangible personal property is difficult, DOR has established by administrative rule a “default” quantification of 10% as the value of intangible personal property for electric utilities. ARM 42.22.110(1). If a taxpayer believes that the value of its intangible personal property is greater than the default valuation, the taxpayer “may propose alternative methodology or information at any time during the appraisal process,” and, if DOR is persuaded by the additional information, it may increase the valuation accordingly. However, in no event shall the value of intangible personal property be less than the default amount. ARM 42.22.110(2).

11. For centrally assessed property, the exemption for intangible personal property was phased in over a three-year period beginning in tax year 2000. Montana Code Annotated § 15-6-218(3).

12. DOR exempted from taxation the proper amount of intangible personal property owned by PPLM, pursuant to section 15-6-218, MCA and ARM 42.22.110.

13. Electric generation facilities of a centrally assessed electric power company and an exempt wholesale generator in Montana are taxed as Class 13 property, at 6% of market value. Montana Code Annotated § 15-6-156(1).

14. Air and water pollution control equipment in Montana is taxed as Class 5 property, at 3% of market value. Montana Code Annotated § 15-6-135(1)(b).

NUNC PRO TUNC ORDER

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the subject property was properly centrally assessed by DOR. The market value for the subject property is determined to be as follows for the various Classes of property:

Year		2000		2001		2002
Plant In Service				755,415,025		759,158,369
Less: Accrued Depreciation - Operating Property			1.3%	(9,507,656)	2.2%	(17,000,000)
Depreciated Value of Plant In Service				745,907,369		742,158,369
Add: Replacement CWIP				13,251,000		12,358,610
Add Expansion CWIP				0		1,941,045
Total Plant In Service		**755,415,025**		**759,158,369**		**756,458,024**
Intangible Personal Property	*10%*	*75,541,503*	*10%*	*75,915,837*	*10%*	*75,645,802*
Phase-in Amount	*10%*	*7,554,150*	*67%*	*50,610,558*	*100%*	*75,645,802*
Add: Materials & Supplies		6,486,935		5,045,000		6,000,000
Add: Rail Cars		808,347		684,932		679,804
Add: Licensed Vehicles		818,055		824,561		776,662
Add: Hand Held Tools		15,000		15,000		15,000
Add: Depreciated Non-Operating Property		6,202,638		6,965,155		6,790,230
Total (Year 2000 – Purchase Price)		769,746,000		772,693,017		770,719,720
Less: Phase-in Amount	10%	(7,554,150)	67%	(50,610,558)	100%	(75,645,802)
Market Value Apportioned to Counties		**762,191,850**		**722,082,459**		**695,073,918**
PCE (Class 5)		**76,219,185**		**72,208,246**		**69,507,392**
Class 13		**685,972,665**		**649,874,213**		**625,566,526**

The DOR's market value determinations for PPLM's property are therefore modified for tax years 2000, 2001, and 2002.

DATED this 15th day of February 2005.

BY ORDER OF THE
STATE TAX APPEAL BOARD

GREGORY A. THORNQUIST, Chairman

JERE ANN NELSON, Member

JOE R. ROBERTS, Member

NOTICE: You are entitled to judicial review of this Order in accordance with Section 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 15th day of February, 2005, the foregoing Nunc Pro Tunc Order of the Board was served on the parties hereto by depositing a copy thereof in the U.S. Mails, postage prepaid, addressed to the parties as follows:

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