BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

PACIFICORP,	)	STAB No. CT-2005-3
Appellant,	)	
v.	)	***FINDINGS OF FACT, AND PRINCIPLES OF LAW, CONCLUSIONS OF LAW AND BOARD DISCUSSION, ORDER AND OPPORTUNITY FOR JUDICIAL REVIEW***
DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,	)	
Respondent.	)	

This matter came before the Montana State Tax Appeal Board (the "Board") for formal hearing on October 25, 2006, and October 30 through November 3, 2006. David J. Crapo and Daniel J. Whyte represented PacifiCorp. Peter Crossett, Charlena Toro and Derek Bell represented the Department of Revenue ("DOR" or "Department").

Testimony was presented, exhibits were received, and proposed findings and conclusions were submitted. The Board having fully considered the testimony, exhibits, and submissions, hereby finds and concludes as follows.

ISSUES

The main issue presented in this matter is whether the DOR properly determined the market value of PacifiCorp's operating property for ad valorem tax purposes for tax year 2005. In order to decide this matter, the Board considered four separate issues.

1. Should the DOR's cost approach have recognized any economic obsolescence?

2. May the DOR use stock prices and stock earnings from other electric companies as a proper methodology to estimate a direct capitalization rate?

3. Did the error in the DOR's calculation of yield capitalization materially affect the Department's final valuation of PacifiCorp?

4. Does the post-lien date sale price for PacifiCorp's equity have any relevance in validating the market value set by the Department?

FINDINGS OF FACT AND PRINCIPLES OF LAW

1. The issue involved in this matter is the valuation of the operating property owned by PacifiCorp, an electric utility corporation, for purposes of ad valorem taxation in the state of Montana.

2. The DOR is required to assess all taxable property at 100% of its market value and may not adopt a lower or different standard of value from market value except as otherwise provided. Section 15-8-111, MCA.

3. 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." Section 15-8-111 (2) (a), MCA.

4. PacifiCorp is subject to central assessment by the Department of Revenue on January 1 of each year pursuant to §15-23-101, MCA.

5. The valuation lien date at issue is January 1, 2005. Exh. 4.

6. PacifiCorp, an Oregon corporation established in 1984, is a regulated electric utility serving customers in portions of the states of Utah, Oregon, Wyoming, Washington, Idaho and California. Exh. 2, p. 1.

7. On January 1, 2005, PacifiCorp was a wholly owned subsidiary of PacifiCorp Holdings, Inc., a Delaware corporation. In turn, PacifiCorp Holdings, Inc. was a subsidiary of Scottish Power, a Scotland corporation. As a wholly owned subsidiary, PacifiCorp itself had no publicly traded stock. Exh. 3, PAC09101.

8. PacifiCorp has no customers in Montana. It does own an interest in certain electric generation properties in Montana. Specifically, PacifiCorp owns (1) a 10% interest in Colstrip Units 3 and 4 located in Colstrip, Montana, (2) the Big Fork Hydro-electric project located in Flathead County, Montana, (3) limited transmission facilities and certain transmission rights, and (4) miscellaneous supplies, tools, vehicles, etc. Exh. 3.

9. PacifiCorp is subject to regulation by the Securities and Exchange Commission ("SEC"), the Federal Energy Regulatory Commission ("FERC"), state rate regulation commissions, and other federal, state and local regulatory agencies. These agencies regulate many aspects of PacifiCorp's business, including customer rates, service territories, sales of securities, asset acquisitions and sales, accounting policies and practices, wholesale purchases of electricity, and the operation of its electric generation and transmission facilities. Exh. 1; Exh. 2, p. 1.

10. The Department centrally assessed the operating properties of PacifiCorp for the 2005 tax year through the use and application of the unit method of valuation. Exh. 4, p. 3. The unit method of valuation involves appraising, as a going concern and as a single entity, the entire unit of the company, wherever located. Rule 42.22.101(30), ARM. The valuation thus determined is intended to capture all the operating assets of the company, both tangible and intangible.

11. PacifiCorp, like all centrally assessed taxpayers in Montana, is required to file a return with the Department by March 31st of each year to provide the Department with the financial information needed to prepare the assessment. Sections 15-23-103, 301 and 303, MCA.

12. PacifiCorp filed its return on March 30, 2005, but did not include all requested information such as the company's projected cash flows, Montana Form E-47, finalized FERC Form 1, Statement of Cost and Situs "turn-around" document, Mileage Re-Cap Form, and Situs and Mileage Totals by County Form. Much of this financial information had not been finalized at the time of required filing with the Department. Exh. 3.

13. On April 29, 2005, the Department issued a preliminary appraisal establishing an overall system unit value of $7,199,314,000 for PacifiCorp. Exh. 31.

14. PacifiCorp's property tax representative, Mr. Norman Ross, contested the Department's preliminary appraisal and was provided an informal hearing on May 19, 2005. Exh. 33, P-DOR 001138. Following the informal hearing and

consideration of PacifiCorp's oral and written submissions, the Department issued its final revised appraisal on May 26, 2005. Exh. 4.

15. The Department's revised final appraisal, released on May 26, 2005, arrived at an overall correlated system unit market value of $7,837,244,000. After deducting for the intangible personal property exemption, the value equaled $7,053,520,000. Exh. 4.

16. This value was allocated to Montana at a factor of 1.5757%. PacifiCorp is not contesting the allocation factor in this matter. Haller, 94-95, Exh. 4, p. 5.

17. The Montana allocated market value of $111,143,218 was then adjusted for certain deductions and additions to arrive at the total Montana market value of $117,286,836 to be distributed to counties for the 2005 tax year[1]. Exh. 4, p. 5.

18. On September 16, 2005, PacifiCorp timely filed its Complaint with this Board relating to the valuation of its assets and a hearing was held in this matter.

Sale of PacifiCorp to MidAmerican

19. On May 24, 2005, Scottish Power announced that it would sell its equity in PacifiCorp to MidAmerican Energy Holdings Company (MidAmerican) with the expectation that the transaction could be closed sometime within the next 12 to 18 months. Exh. 34, p. 00292.

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[1] The deductions are for such items as town sites, tools, vehicles and equipment and the additions are for contributions in aid of construction (CIAC's) and Bonneville Power Administration (BPA) transmission lines. The calculations of these deductions and additions are not contested in this proceeding. PacifiCorp Proposed FOF 35.

20. The purchase price for the equity of PacifiCorp was set at $5.1 billion, which would be payable at the future closing date. *Id*., p. 00292.

21. The sales agreement also required MidAmerican to assume approximately $4.3 billion of PacifiCorp debt, including preferred stock. *Id*.

22. As part of the proposed transaction, Scottish Power agreed to make annual capital investments in PacifiCorp of at least $500,000,000 a year until the closing was completed. A portion of that payment would be reimbursed to Scottish Power at closing. *Id.*

23. The sale of PacifiCorp to MidAmerican was completed on March 21, 2006. Exh. 52, p. 32.

24. The announced sale was not referenced in the DOR appraisal. Haller, 17.

The Department's Assessment

25. As noted before, the Department assessed PacifiCorp's property utilizing a unit approach to valuation. Unit method of valuation is a method for determining the market value of a centrally assessed company that may have property in more than one jurisdiction. This involves appraising the entity as a single entity going concern, and then deducting the intangible personal property value and ascertaining the proper allocation for the Montana portion of the property. The resulting value is referred to as the state allocated value. Rule 42.22.111, ARM.

26. The Department assesses approximately 130 companies through the central assessment process each year. Currently, three Department staff

members perform all of these assessments. The Department uses a template for valuing centrally assessed property. Haller, 14.

27. On May 26, 2005, the Department issued its Revised Final Appraisal Report for the January 1, 2005, lien date in which it asserted the following assessment against PacifiCorp's operating property:

Correlated Unit Value Before 10% Intangible Adjustment	Correlated Unit Value After 10% Intangible Adjustment	Allocation Factor	Montana Allocated Value
$7,837,244,000	$7,053,520,000	1.5757%	$111,143,218

Angie Haller, a utility appraiser with the Department of Revenue, performed this appraisal. Exh. 4; Haller, 5.

28. The cash flow and income information used to derive the Revised Final Appraisal Report was provided by PacifiCorp to Ms. Haller through required filings and the informal review process. Ms. Haller accepted the figures provided by PacifiCorp in the informal review process for use in the Revised Final Appraisal. Haller, 526.

29. The Department utilized four indicators of value to determine an overall correlated unit value: (1) Original Cost Less Depreciation ("OCLD") model, (2) Direct Capitalization of Net Operating Income ("NOI") model, (3) Direct Capitalization of Gross Cash Flow model, and (4) Yield Capitalization model. Exh. 4.

30. Mr. Gene Walborn, Administrator of the Business and Income Taxes Division of the Department, testified that he began work with the Department in 1990 as a utility appraiser. At that time, the Department used three approaches

to valuing centrally assessed property: original cost less depreciation, direct capitalization, and market or stock and debt approach. Walborn, 468.

31. Mr. Kory Hofland, the Department's Unit Manager of the Business Tax and Valuation Bureau's Centrally Assessed and Industrial Properties Unit, first worked as a utility appraiser in the Department in 1998. He performed the Department's appraisals of PacifiCorp from 1999 through 2003. He used four indications of value: original cost less depreciation, direct capitalization of net operating income, direct capitalization of gross cash flow, and stock and debt. In addition, after the 2006 sale of PacifiCorp to Scottish Power, he used the sales price of that transaction. The original cost less depreciation method and the direct capitalization rate study had been used as long as Mr. Hofland could remember. Hofland, 547-549.

32. Tax year 2005 was the first year that the Department used the yield capitalization approach. Haller, 84; Hofland, 549.

33. The Department did not use a market based valuation. Haller, 17.

34. The DOR derived their system value of $7,053,520,000 for PacifiCorp through the following values and weightings:

	Department's Assessment Exhibit 4	After 10% Intangible Adjustment	Approximate Correlation Weight
OCLD	$8,581,317,664	$7,723,185,898	50%
Direct Cap NOI	$7,359,184,623	$6,623,266,161	40%
Direct Cap Gross Cash Flow	$7,216,315,212	$6,494,683,691	5%
Yield Cap NOI	$4,841,917,648	$4,357,725,883	5%
Correlated Unit Value	$7,837,244,000	$7,053,520,000	100%

Exh. 4, p. 5.

35. The DOR applied an allocation factor of 1.5757% to the system value of $7,053,520,000 to derive a Montana allocated value of $111,143,218. Exh. 4. p. 5.

36. The DOR then made several adjustments for deductions and exemptions that totaled $643,369. The DOR also made an addition of $6,788,339 that was primarily to account for the use of certain Bonneville Power Administration ("BPA") Transmission Lines. The final Montana value set by the DOR was $117,286,836 ($111,143,218 - $643,369 + $6,788,339). Exh. 4, p. 5.

37. Intangible personal property is exempt from taxation in Montana. Section 15-6-218, MCA. An electric utility taxpayer is entitled to a "default" deduction of 10% of the value from each indicator of value (i.e., cost, income and market). If the electric utility taxpayer believes that the value of its intangible personal property exceeds the default 10%, the taxpayer may present such information to the Department during the appraisal process. Rule 42.22.110 (1) (a) (2), ARM. The Department did not have evidence of intangible personal property greater than 10%. Haller, 544. PacifiCorp did not challenge the use of the default 10% in this matter. PacifiCorp Proposed FOF, 34.

DOR's Cost Approach

38. The Department's cost approach utilized original cost less depreciation (OCLD). This method analyzed the cost of the electric plant in service and deducted book depreciation to derive a net plant value of approximately $8.6 billion. Exh. 4, p. 6; Rule 42.22.112, ARM.

39. As a rate regulated entity, PacifiCorp is required to comply with the Federal Energy Regulatory Commission (FERC) accounting guidelines in keeping a set of audited financial statements. These financial statements are reported to FERC annually in a form referred to as FERC Form 1. Exh. 1. The FERC forms are also provided to the Department by PacifiCorp for use in calculating assessed value of property. Exh. 3.

40. PacifiCorp calculates its depreciation for FERC Form 1 based on a straight line depreciation model. Ross, 108.

41. Ms. Haller identified the historic cost of PacifiCorp's assets as listed on the FERC Form 1 at approximately $13.6 billion. Exh. 4, p. 6; Haller, 111.

42. Ms. Haller then subtracted book depreciation of approximately $5.81 billion as cited in the FERC Form 1. Exh. 4, p. 6; Haller, 24.

43. The cost approach valuation determined by Ms. Haller was significantly higher than the other indicators of value in her appraisal. Exh. 4, p. 5.

44. The Department gave 50% weight to the value derived in the cost approach. Haller, 22.

45. Mr. Brent Eyre, Accredited Senior Appraiser (ASA) with significant professional appraisal experience, and expert for the Department, argued that the cost approach, in his expert opinion, was the most reliable method for calculating value for rate regulated entities. Eyre, 602. His argument was based on the fact that the historic cost less depreciation (HCLD[2]) for a utility property is subject to very stringent oversight and the book value then has a greater

[2] HCLD and OCLD were used synonymously in this hearing. *See* Haller, 24.

relevance as an indicator of value than the projections used in income approaches to value. 614.

46. Pursuant to Montana law, if the Department uses construction cost as one approximation of market value, the Department must fully consider reduction in value caused by depreciation, whether through physical depreciation, functional obsolescence, or economic obsolescence. Section 15-8-111(2)(b), MCA.

47. PacifiCorp argued that the Department failed to calculate external obsolescence in its valuation utilizing the cost method. Had the Department done so, the DOR valuation would have been lower. Tegarden, 201, 203; Exh. 6, p. 23-26.

48. Ms. Haller testified that she believed that the depreciation deduction made in her cost approach accounted for all forms of depreciation. Haller, 101.

49. Ms. Haller did not have any evidence of additional functional depreciation. Haller, 30. Further, Ms. Haller did not do any additional study or analysis to determine if there was additional depreciation. Haller, 34.

50. Mr. Hofland testified that the federal definition for depreciation used by PacifiCorp for their FERC Form 1 reporting includes both functional and external obsolescence. Mr. Hofland noted that, if an appraiser removed both depreciation as calculated under the Federal definition and obsolescence as calculated by PacifiCorp, obsolescence would have been deducted twice. Hofland, 550, 564.

51. Thomas K. Tegarden, certified CAE and MAI, disputed the Department's assertion that the depreciation deducted in its cost approach

accounted for all forms of depreciation. He testified that the book depreciation allowed by FERC would not capture external obsolescence. Tegarden, 220.

DOR's Income Approaches to Valuation

52. The Department utilized three income approaches to calculate value for PacifiCorp: direct capitalization of net operating income, direct capitalization of gross cash flow, and yield capitalization of cash flows. Exh. 4, p. 5.

53. For both the direct and yield capitalization approaches, the Department utilized standard capitalization rates for the electric utility industry which were developed through the Department's annual capitalization rate study. The Department then applied those rates to each of the centrally assessed companies in the electric utility industry, including PacifiCorp. For the capitalization rate study, DOR drew companies from the electric utility industry group in the Value Line Investment Survey to use as comparables. Exh. 5, Walborn, 477.

DOR's Direct Capitalization of Net Operating Income

54. Direct capitalization is a standard method used in the income capitalization approach; it capitalizes a single year's income into a valuation of a subject property. In some cases, the incomes for several years may be averaged to obtain a representative income to capitalize. *See* Appraisal Institute, *Appraisal of Real Estate*, 11th Ed, 513, 456.

55. A capitalization rate used in the direct capitalization approach is typically derived from comparable sales of similar properties. The Department

did not have comparable sales so it utilized an earnings to price ratio from similar companies. *See* Eyre, p. 514.

56. The Department used the band of investment method to calculate the capitalization rates for its direct capitalization approaches as set forth in Rule 42.22.114(2), ARM. In this method, the typical industry rate for each source of capital, *i.e.*, common equity, preferred stock, and debt, was weighted according to its proportion in the typical capital structure for an industry. The result is a weighted average direct capitalization rate. Exh. 5.

57. The equity rate used by DOR in the direct capitalization approach was the Earnings to Price (E/P) ratio for comparable electric utility companies which, as noted before, are selected from the Value Line Investment Survey. Exh. 5, page following the transmittal letter. The use of E/P ratios to derive an equity rate is described in the Standards of the National Conference of Unit Value States ("NCUVS"). Exh. 23, p. 4.

58. The Department's capitalization rate study describes DOR's calculations to derive rates for common equity using E/P ratios, for preferred stock using dividend yield, and for debt using current yield. Exh. 5, page following the transmittal letter and 6-2.

59. For the direct capitalization of net operating income (NOI) approach, the 2005 capitalization rate derived by the Department for the electric utility industry was 6.5%. Exh. 5, p. 6-4.

60. The Department used $462 million, a simple average of PacifiCorp's net operating income for 2003 and 2004, as the income figure in its direct

capitalization of NOI approach. Exh. 4, p. 8. These income figures were extracted from the FERC Form 1. Haller, 111.

61. To calculate an indication of value using the direct capitalization of NOI model, the Department divided the income figure of $462 million by the capitalization rate of 6.5% to derive an estimated value of $7.1 billion. A subsequent adjustment for construction work in progress produced an overall estimate of $7.3 billion for the direct capitalization of net operating income approach. After deducting the 10% default allowance for intangible personal property, the final estimate of value for the direct capitalization of NOI was $6.6 billion. Exh. 4, p. 8; Haller, 44.

62. The Department gave the direct capitalization of NOI a weight of 40% in its final correlated value. Haller, 22.

63. PacifiCorp asserted that the Department's direct capitalization approach was the equivalent of a stock and debt approach. PacifiCorp's experts questioned the use of E/P ratios by the Department to determine the equity component of the direct capitalization rate. Heaton, 228, 259; Tegarden, 239.

64. PacifiCorp also challenged the comparability of the companies the Department used in developing a direct capitalization rate. Tegarden, 239; Heaton, 276. PacifiCorp argued that many of the DOR's "comparable" companies are not comparable because they operate in different parts of the United States than PacifiCorp, have non-regulated lines of business, include subsidiaries that are not electric utilities or that they operate internationally. Ross, 115-123. Mr. Tegarden asserted that these flaws in the Department's

methodology made the Department's direct capitalization rate terribly invalid and not useful. Tegarden, 239.

65. PacifiCorp also argued that the Department's methodology sets up a mismatch between the equity part of the direct capitalization rate and the income to which the final rate is applied. The equity rate is based on earnings reported on 10K filings with the Securities and Exchange Commission (SEC) while the net operating income used comes from the FERC Form 1. Haller, 80-81.

DOR's Direct Capitalization of Gross Cash Flow

66. The Department also calculated an indication of value through a direct capitalization of gross cash flow approach. Exh. 4, p. 9. In this approach, the Department used the same methodology for deriving a capitalization rate as they used in the direct capitalization of NOI approach, except that gross cash flow of the comparison companies was used in place of the earnings of those companies. Haller, 82.

67. Gross cash flow, as used by the Department in this approach, is comprised of net operating income plus depreciation and amortization expense minus preferred stock dividends. Exh. 5, p. 6-2. The gross cash flow figures used by the Department came from each company's FERC Form 1. Haller, 83.

68. For the direct capitalization of gross cash flow approach, the Department's 2005 capitalization rate for the electric utility industry was 13.00%. Exh. 5, p 6-4.

69. The Department adjusted the gross cash flow figures it used for PacifiCorp based on information provided by the Taxpayer in response to the

Department's preliminary appraisal. Haller 111, 526; Exh. 33, p. P-DOR 001135.

70. The Department used $906 million, a simple average of PacifiCorp's gross cash flow for 2003 and 2004, as the income figure in its direct capitalization of gross cash flow. Exh. 4, p. 9.

71. To calculate an estimate of value using the direct capitalization of gross cash flow model, the Department divided the income figure of $906 million by the capitalization rate of 13.0% to derive an estimated value of $6.97 billion. An adjustment for expansion construction work produced an overall estimate of $7.2 billion for the direct capitalization of gross cash flow. Deducting the 10% default allowance for intangible personal property reduced the estimate to $6.49 billion. Exh. 4, p. 9.

72. The direct capitalization of gross cash flow approach to valuation is only used by the Department in limited circumstances. This approach has particular use for companies with net operating losses or where book depreciation does not reflect economic depreciation. The Department determined that these conditions are not relevant to PacifiCorp and therefore gave this indicator a 5% weight in its final correlation. Exh. 5, p. 6-2; Haller, 22.

DOR's Yield Capitalization

73. Yield capitalization is a method used to convert future benefits to a present value by discounting each future benefit at an appropriate yield rate or by applying an appropriate overall rate that reflects the investment's income pattern, yield rate, anticipated changes and other factors. It requires explicit forecasts of

income, expenses, expenditures, and a net sales price. Appraisal Institute, *The Appraisal of Real Estate*, 11th Ed, 462, 463.

74. A yield capitalization approach requires selecting an appropriate holding period, estimating the income stream and potential selling price of the subject property, choosing a discount rate and converting future benefits to derive an estimate of value. *Id*,, 529. Yield capitalization differs from direct capitalization by utilizing a long-term income stream instead of a single year's income and a yield rate instead of an overall rate. *Id*., 462-468; *see* Tegarden, 235.

75. As noted before, the Department developed a yield capitalization rate for the electric utility industry as part of their 2005 Capitalization Rate Study. Exh. 5. This was the first year that the Department actually applied a yield capitalization approach. Haller, 84; Hofland, 549.

76. In deriving a yield capitalization rate for the equity component, the Department utilized two methods: the discounted cash flow (DCF) model and the capital asset pricing model (CAPM). The equity yield capitalization rate derived by the Department through these methods was 8.52%. Exh. 5, p. 6-21.

77. The debt yield rate used by the Department was 7.23%, derived from the fourth quarter average yield for B rated electric utility bonds in the Standard and Poor's Bond Guide. Exh. 5, p.11, 6-21.

78. By applying the equity and debt yield rates in a band of investment approach to a capital structure of 52% equity and 48% debt, the Department arrived at a weighted average cost of capital ("WACC") of 8%. Exh. 5, p. 6-21.

79. The Department requested projected cash flows from PacifiCorp for use in its yield capitalization approach but did not receive any projected income information from the company. Hofland, 557-558.

80. The Department used a five year simple average of free cash flow, $387,353,412, as the income stream to be capitalized. Exh. 4, p. 10. This figure was based on revised income and cash flow information provided to the Department by PacifiCorp. Exh. 33, P-DOR 001135.

81. To calculate an estimate of value using the yield capitalization approach, the Department divided the income figure of $387 million by the WACC of 8.00% to derive an estimated value of $4.8 billion. After deducting the 10% default allowance for intangible personal property, the Department's final estimate of value for the yield capitalization of free cash flow was $4.3 billion. Exh. 4, p. 10.

82. Ms. Haller acknowledged that there is an error in the Department's yield capitalization approach. The Department failed to subtract growth in calculating its estimate of value through this approach. If growth had been subtracted, Ms. Haller believed that the Department valuation would have been about $6.9 billion. Haller, 84. Because of the error, the Department only placed 5% weight on the yield capitalization approach in correlating the unit's value. Haller, 22.

Sales Comparison Approach

83. Neither the Department nor PacifiCorp conducted a sales comparison approach to valuation in this matter because both appraisers believed there to be a lack of comparable sales data. Haller, 17; Tegarden, 256.

PacifiCorp's Appraisal

84. PacifiCorp provided the Board with an appraisal of the subject property by Thomas K. Tegarden, certified CAE and MAI. Mr. Tegarden has extensive appraisal experience including utility appraisal, expert testimony, teaching appraisal courses and authoring articles on relevant subject matter and is an expert in his field. Exh. 6, p. 75 through 82.

85. Mr. Tegarden's appraisal estimated the market value of the fee simple interest in the operating properties of PacifiCorp as of January 1, 2005. Exh. 6, transmittal letter.

86. Mr. Tegarden's appraisal valued the subject property at $5.6 billion. *Id*.

87. Mr. Tegarden utilized two indicators of value to determine a unit value of PacifiCorp's operating property: (1) Historic Cost Less Depreciation ("HCLD") model and (2) Yield Capitalization Income model. Exh. 6, pp. 70, 72; PacifiCorp Proposed FOF 33. The values from this assessment were as follows:

	Mr. Tegarden's Valuation	Approximate Reconciliation Weights
HCLD	$5,975,000,000	least
Yield Capitalization	$5,556,000,000	most
Correlated Unit Value	$5,600,000,000	

88. PacifiCorp argued that Mr. Tegarden's correlated unit value of $5,600,000,000 should receive the same 10% intangible personal property adjustment made by the DOR in its appraisal of PacifiCorp. By making this adjustment, the correlated unit value after intangibles was $5,040,000,000 ($5,600,000,000 less 10%). PacifiCorp did not challenge the DOR's allocation factor of 1.5757%. By applying the allocation factor of 1.5757% to the $5,040,000,000 valuation, the Montana allocated value is $79,415,280. PacifiCorp Proposed FOF 34.

89. PacifiCorp did not challenge the DOR's deductions, exemptions, and addition for the BP Transmission Lines. As a result, PacifiCorp argued that the final Montana value for its property should be $85,558,897 ($79,415,280 - $643,369 + $6,786,986). PacifiCorp Proposed FOF 35.

PacifiCorp's Cost Approach

90. Through the cost approach, Mr. Tegarden calculated a value of $8,604,483,817 before reducing that amount by 30.56%, his estimate for external obsolescence. Mr. Tegarden's final estimate of value using the cost approach was $5,975,000,000. Exh. 6, p. 21.

91. Mr. Tegarden utilized an original cost less depreciation method to calculate his cost approach. Tegarden, 217. Using the FERC Form 1, his calculation of net book value was $8,604,483,817. He deducted book depreciation of $5.86 billion as allowed by FERC in arriving at the $8.6 billion valuation figure. Tegarden, 219-220.

92. Mr. Tegarden's calculation of net plant was only slightly different from the Department's calculation because they each used the FERC filing as their source document. Tegarden, 219; Haller, 25.

93. The major difference between the cost approach valuation derived by the Department and that derived by Mr. Tegarden is Mr. Tegarden's additional calculation and deduction for economic obsolescence of 30.56% ($2.6 billion). Exh. 6, p. 21.

94. Mr. Tegarden testified that the depreciation allowed under the FERC guidelines does not capture external obsolescence. Tegarden, 220.

95. Mr. Tegarden tested for additional obsolescence by calculating how much return on net plant (*i.e.*, investment) the company was able to earn over a five year period. He divided the annual average net plant for each year into the net operating income for that year and determined that, over the five year period, the achieved rate of return was about 6.25%. According to Mr. Tegarden, this return is intended by the regulators to cover the company's cost of capital. He then compared this return to the 9% weighted average cost of capital he calculated for his income approach. The 9% is his estimate of the rate of return required by investors. Exh. 6, p. 23. Using this "income shortfall" methodology, Mr. Tegarden decided that PacifiCorp was under-earning and reduced his cost estimate by 30.56% for external obsolescence. Tegarden, 220, 221. He attributed this income shortfall to decisions by the company's regulators. Exh. 6, p. 24.

96. In Mr. Tegarden's experience, an appraiser must actively measure all forms of depreciation in the cost approach because there is no other way to identify all forms of depreciation than for the appraiser to do something to measure it. Tegarden, 222.

97. PacifiCorp supported the income shortfall approach as a valid approach to calculate external obsolescence by citing several texts, including *The Valuation of Real Estate*, authored by Dr. Al Ring and Dr. James Boykin, *Appraisal of Real Estate* by the Appraisal Institute, and a treatise by Arlo Woolery. Exh. 6, p. 24; Exh. 24.

98. Department of Revenue expert, Mr. Eyre, disagreed that *The Appraisal of Real Estate* by the Appraisal Institute supported the income shortfall method as Mr. Tegarden had applied it. Mr. Eyre pointed out that the classic methodology described in this text is appropriately applied to stand-alone properties. A utility company's property is different from a stand-alone property because it is located in a variety of states and is comprised of different types of properties with different types of income streams. Eyre, 614.

99. The Department criticized Mr. Tegarden's approach as circular because it relied on his asserted cost of capital to calculate a major determinant of his cost approach valuation. Eyre, 609-610.

100. Expert witness for the Department, John W. Wilson, Ph.D., is President of J.W. Wilson and Associates, Inc. and an expert on public utility company issues, especially relating to rate regulation. Exh. 13. Dr. Wilson asserted that Mr. Tegarden's cost approach merely reduces PacifiCorp's net plant value by his

estimated income deficiency ratio. Dr. Wilson argued that this is not “obsolescence” but merely a mathematical difference between Tegarden’s projected earnings and his asserted cost of capital. Exh. 7, p. 4; Exh. 13. Wilson’s report claims that economic obsolescence is not a factor at issue. Exh. 7, p. 24.

101. Dr. Wilson also pointed out that Mr. Tegarden assumed that all of PacifiCorp’s plant is funded with debt and equity capital. In fact, according to Dr. Wilson, a significant portion is funded with deferred income taxes, a zero cost source of capital. Deferred income tax balances occur because accelerated depreciation is used for income taxes and straight line depreciation is used to determine book values. Accelerated depreciation enables a company to write off a larger portion of original plant costs in the first years after those costs are incurred, thereby reducing taxable income in those years. At the same time, regulators base a utility’s allowable rates on straight line depreciation which results in higher calculated taxes being included in the rates than the taxes actually paid. These deferred taxes are collected from the company’s customers, providing a no-cost source of capital which reduces the company’s overall cost of capital. Exh. 7, p. 8.

102. Mr. Tegarden acknowledged that the regulators specifically excluded some properties from the rate base because those properties were financed through the use of deferred income taxes. He cited this exclusion as one of the reasons for what he considers to be a lower-than-adequate rate of return. Exh. 6, p. 24.

103. Mr. Eyre noted that property acquired by deferred income taxes is not part of the regulated rate base. He pointed out that Mr. Tegarden is comparing a rate-based income stream to an OCLD property base which is larger than the property in the rate base, thus setting up a mismatch between the income stream and the plant used to generate that income. Eyre, 610-611.

104. Mr. Eyre also pointed out that obsolescence is typically deducted from reproduction or replacement cost, not original cost. Citing the Western States Association of Tax Administrators' (WSATA) *Appraisal Handbook – Valuation of Utility & Railroad Property*, he stated that the OCLD indicator of value should stand on its own, without additions or deductions. Eyre, 614; Exh. 10, p. 6.

PacifiCorp's Yield Capitalization Approach

105. Mr. Tegarden's income approach is a yield capitalization model. He testified that the yield capitalization model was a very reliable model in this case, when calculated correctly, and should receive a significant amount of weight. Tegarden, 318-319.

106. In his yield capitalization approach, Mr. Tegarden divided approximately $500 million of income by a 9% capitalization rate for an indication of value of approximately $5,556,000,000. Exh. 6, p 32.

107. To estimate the $500 million of income for this approach, Mr. Tegarden relied on PacifiCorp's income information for the last five years, applying various techniques to this information, and on income projections by company officials. Exh. 6, p. 33; Tegarden, 229.

108. These income projections were not supplied to the Department of Revenue prior to the final assessment. Exh. 3; Exh. 33; Hofland, 558.

109. In deriving a yield capitalization rate for the equity component, Mr. Tegarden utilized four methods: the discounted cash flow (DCF) model, two risk premium models, and the capital asset pricing model (CAPM). The equity yield capitalization rate that he derived through these methods was 11.00%. Exh. 6, p.p. 36, 60; Tegarden, 246. In addition, Mr. Tegarden explained and applied a flotation cost adjustment to the equity rate. Exh. 6, p. 36.

110. The debt yield rate was estimated using information from *Mergent Bond Record* and *Value Line* for A rated electric utilities, as well as PacifiCorp's own long term debt. Based on these data sources, Mr. Tegarden determined the cost of debt to be 6.00%. Exh. 6, 46; Tegarden, 244-245. He also applied a flotation cost adjustment to the cost of debt. Exh. 6, p.p. 36.

111. By applying these equity and debt yield rates in a band of investment method to a capital structure of 55% equity and 45% debt, then applying the flotation cost adjustment, Mr. Tegarden arrived at a weighted average cost of capital of 8.97%, which he rounded to 9%. Exh. 6, p. p. 36-37.

112. Flotation costs are associated with issuing debt and equity and include such things as legal expenses, underwriting fees, *etc.* Exh. 6, p. 64.

113. The Department criticized various aspects of Mr. Tegarden's yield capitalization approach. Mr. Eyre noted that the general risk premium indicators Mr. Tegarden used in his cost of equity calculations do not have any industry

specific data; they are estimates of the cost of equity for the market as a whole. Exh. 10, p. 25; Eyre, 630.

114. In the risk premium indicators by group, Mr. Eyre disagreed with Mr. Tegarden's use of electric utility corporate bond yields as a risk free rate. Mr. Eyre pointed out that the risk free rate must be truly risk free, including free of default risk. Securities from a private company are not free of default risk; only government securities qualify as truly risk free. Eyre, 631, Exh. 10, p. 25. Mr. Eyre also noted that the risk premium indicators by group were not specifically related to the company being valued. In his opinion, none of the estimates that Mr. Tegarden developed using the risk premium methods were valid. Exh. 10, p. 26.

115. Mr. Eyre further argued that Mr. Tegarden's capital asset pricing model ("CAPM") and his dividend growth model ("DGM") both suffered from the same error, the use of a short-term (five-year) growth rate in a perpetuity model. Mr. Eyre argued that a five-year growth rate is not sustainable in perpetuity. He advocated the use of a multi-stage growth model which would make the risk premium more meaningful. Exh. 10, p. 23; Eyre, 632-633. He indicated that use of a multi-stage growth rate didn't make a lot of difference in utilities in the DGM model, but it did make a difference in one of the CAPM models. Eyre, 626.

116. Mr. Eyre also criticized Mr. Tegarden's use of flotation cost adjustments, arguing that they are not a part of the opportunity cost of capital. Eyre, 634. He noted, however, that flotation costs are non-material, a minor amount thrown into a process that is full of "judgment and rounding". Eyre, 635.

117. Dr. Wilson argued that both Mr. Tegarden's income approach and his cost approach reflected the same income deficiency that was entirely dependent upon the accuracy of Mr. Tegarden's cost of capital and income projections. Dr. Wilson indicated that Mr. Tegarden's valuation is understated if PacifiCorp's cost of capital is less than the 9% claimed or if expected income is higher than projected. Exh. 7, p. 5.

MidAmerican Sale

118. As noted before, in May 2005, MidAmerican Energy Holding Company purchased PacifiCorp from Scottish Power for a purchase price of approximately $9.4 billion. Exh. 34, PAC 00292. This sales price was substantially above both the book equity value and the net plant value as set forth in regulatory filings. Exh. 7, p. 3.

119. Dr. Wilson noted that the appraised value of the company put forth by Mr. Tegarden is less than 60% of the value paid by MidAmerican and only 65% of the book value of the net utility plant. Exh. 7, p. 4.

<u>CONCLUSIONS OF LAW and BOARD DISCUSSION</u>

The Board has jurisdiction over this matter pursuant to § 15-2-301, MCA. As a general rule, the appraisal of the Department of Revenue is presumed to be correct and the Taxpayer must overcome this presumption. The Department of Revenue should, however, bear a certain burden of providing documented evidence to support its assessed values. *Farmers Union Cent. Exch. v. Department of Revenue*, 272 Mont. 471, 901 P.2d 561, 564 (1995); *Western Airlines, Inc., v. Michunovich* (1967), 149 Mont. 347, 353, 428, P.2d, 3, 7, *cert.*

denied 389 U.S. 952, 19 L. Ed. 2d 363, 88 S. Ct. 336 (1967).

In this case, PacifiCorp's electric operating property is subject to central assessment by the DOR as of January 1, 2005. Sections 15-6-156, MCA and 15-23-101, MCA. Whenever appropriate, the Department uses the unit method of valuation to appraise centrally assessed properties. Rule 42.22.111(1), ARM.

In this instance, the Department has the unenviable task of calculating a valuation for a multibillion dollar company without having available to it all relevant data from the company. This incomplete data will, without doubt, create some question in the specifics of the valuation. It is the Board's function and duty, however, to find the facts in this matter and arrive at a proper taxable value. Section 15-2-201(d), MCA; *DOR v. Paxson*, 205 Mont. 194; 666 P.2d 768 (1983); *DOR v. Grouse Mountain Dev*. 218 Mont. 353, 355-56; 707 P.2d 1113, 1114-5 (1985). In this case, the Board's authority to examine the facts and determine a proper valuation is critical because of a few significant errors in the Department's appraisal. We hold that, in spite of some errors in the Department's appraisal, the valuation is substantially correct and will stand as set forth by the Department.

In the Board's opinion, the Department has come to an appraisal within the reasonable range for valuation of this entity. An appraisal is an opinion of value and, as such, the final value tends to be most critical. PacifiCorp failed to bring forward sufficient evidence to show the Department's appraisal was unsupported.

Post Lien Date Sale of Subject Company

The goal of unit valuation is to come to an appropriate valuation of a business enterprise. The concept has been approved by the Montana Supreme Court for over 50 years. *See, e.g.*, *Yellowstone Pipeline v. State Board of Equalization*, 138 Mont. 603; 358 P.2d 55 (1960); *Western Airlines* 171 Mont. at 350-351; *DOR v. Pacific Power and Light Co.,* 171 Mont. 334, 338-9; 558 P.2d 454, 457 (1977). In this instance, the sale of the subject property, which occurred after the State's lien date, nonetheless validates as appropriate the unit valuation performed by the Department.

It is well recognized that an actual sale price should be considered an indicator of market value. In this instance, PacifiCorp questions the validity of reviewing a sale announced five months after the lien date and concluded more than a year after the lien date.

Because the announcement of the sale and the sale itself occurred after the lien date, neither the State's appraisal nor PacifiCorp's appraisal utilized the sale data. The evidence did not show that the pending sale was known or knowable at the time of the lien date.

PacifiCorp argues that the post-lien date information is not relevant to the issue of valuation in this matter. The Board does not agree and concludes that the sale information is relevant to determining whether the Department accurately assessed the subject company. In reaching an opinion of value, appraisers are limited to information that is known or knowable as of the appraisal date. *See, e.g.* Tegarden, 279. However, the Board is not performing an appraisal but deciding which opinion of value should prevail. As such, the Board may take notice of the sale to verify the essential reasonableness of the Department's final estimate of value for PacifiCorp.

The sale of PacifiCorp's assets to MidAmerican at an agreed upon purchase price of $9.4 billion supports the Department's assessment as reasonable and is close in time to the appraisal. Nothing suggests that the transaction between MidAmerican and Scottish Power, the parent company of PacifiCorp, does not meet the market value definition in § 15-8-111, MCA. In addition, there is no indication that this sale is not an arm's length transaction as defined in §15-8-111(2)(a), MCA. Evidence did not demonstrate that there was any material change in the value of the subject property during the five month period between the lien date and the date of the sale announcement, or, for that matter, in the fifteen month period between the lien date and the actual sale date. *See* Affidavit of James Ifflander, October 5, 2006, Exh. A, p. 117, 22-25; DOR Brief in Opposition to Appellant's Motion in Limine, dated October 9, 2006; Exh. C; Norm Ross Deposition Rough Transcript Vol. 2, Sept 28, 2006, p. 188,

Finally, the Montana definition of market value is the commonly accepted definition utilized in appraisal practice. The definition recognizes that market value is best evidenced by free market sales transactions, taking into consideration relevant facts, including the market and economic conditions prevailing at the time of the sale. *See, e.g.*, §15-8-111, MCA and *Devoe v. Department of Revenue*, 263 Mont. 100, 866 P.2d 228 (1993).

With those concepts in mind, using the post-lien date sales data to verify the validity of an assessment is proper in this instance. This Board has specific statutory authority to consider the actual selling price of property in property tax appeals, both prior to and after the lien date. *See* §15-7-102(6), MCA; *Ray v. DOR*, State Tax Appeal Board, PT-2003-68; PT-2003-69; 2005 Mont. Tax LEXIS 8 (2005). *Dougherty v. DOR*; State Tax Appeal Board, PT-2002-10; 2003 Mont. Tax LEXIS 14 (2002); *Fradet v. DOR*, State Tax Appeal Board, PT-1993-568, 1995 Mont. Tax LEXIS 120 (1995). The concept of using post-lien date market data has also been endorsed by the Montana District Court. *Crown Pacific Ltd. Partners v. DOR*, 1998 Mont. Dist. LEXIS 725 (1995). In determining the validity of the assessment conducted by the Department, the sale of this subject company soon after the lien date is directly relevant to the matter at hand and is properly considered by the Board. Rule 401, M.R.Evid.

Although PacifiCorp brought forth valid concerns relating to the Department's methodology, the company cannot avoid the fact that a sale of the subject property was announced within months of the assessment date and two days before the Department's final appraisal was issued. There was no evidence that a substantial change to the value of the property occurred between the lien date, the sale announcement, and the consummation of the sale.

PacifiCorp also argues that the sale price has not been properly adjusted to yield a meaningful valuation estimate. There is no evidence that, at the time of the sale, the value of the company's intangible property was so great as to inflate the sale price and invalidate the reasonableness of the Department's valuation.

There can be little question that the sale of PacifiCorp for $9.4 billion validates the Department's valuation of $7.1 billion.

The Board holds that the post-lien date sale price of PacifiCorp's equity and debt has relevance in validating the market value of PacifiCorp's taxable tangible property.

Cost Approach

Did the Department's failure to recognize any economic obsolescence in its cost approach cause its valuation estimate to exceed the market value of the subject property? This question is the heart of the difference in valuation between the Department's appraisal and PacifiCorp's appraisal using the cost approach.

The Department placed a great deal of weight on the cost approach to determine value. While generally this may be problematic in valuing a business entity, there is increased reliability in a cost approach valuation for a rate regulated utility when the figures used are derived from rate regulation filings. This is, in part, because investors who estimate value for income producing properties use rate regulatory filings to identify the income stream for a utility company and thus calculate value for investment purposes.

In this instance, the Department based their cost approach methodology on PacifiCorp's filings with the Federal Energy Regulatory Commission (FERC) and the Securities and Exchange Commission (SEC). This data is utilized by regulators in setting rates for the company and is also used by PacifiCorp to provide full disclosure of the company's financials to their stockholders and the public[3]. In the electric utility industry, FERC and SEC financial reports are not only subject to public scrutiny, but also subject the company to regulatory oversight and potential sanctions for misinformation.

Pursuant to § 15-8-111(2)(b), MCA, when using the cost approach, the DOR is required to "fully consider" a reduction in value for economic obsolescence. The Department's appraiser testified that she did not specifically analyze whether all forms of obsolescence, including economic obsolescence, existed in PacifiCorp's property. *See* FOF 46-49. This is in contravention of the statutory requirement set forth in §15-8-111, MCA. However, in this case the error did not affect the reasonableness of the DOR's valuation of PacifiCorp. The review of all evidence presented at hearing indicates that there is no economic obsolescence present in this matter.

PacifiCorp's claim of economic obsolescence rests on Mr. Tegarden's income shortfall approach. The income shortfall methodology, as applied by Mr. Tegarden in arriving at his cost indicator of value, is not an accurate indicator of economic obsolescence in this matter. Exh. 15B and 15C. This methodology has been discredited in a number of jurisdictions. *Puget Sound v. Revenue*, 232 Mont. 314, 761 P.2d 336 (1988)*; United Telephone v. OTC*, 307 Or. 428, 770 P.2d 43 (1989)*; Delta Airlines, Inc. v. Dept. of Revenue*, 328 Or. 546, 984 P.2d 836 (1999).

Mr. Tegarden has based the income shortfall on total plant in service. However, the income stream used in calculating the shortfall is the income generated by the plant in the rate base. Rate-based plant does not include plant

[3] FERC.gov; C.F.R., Title 18, Chp. 1; SEC.gov; Title 15, U.S.C.

purchased with deferred income taxes (DIT). The straight line depreciation used in calculating rate base, when matched with the accelerated depreciation used for income tax purposes, enables the utility to accumulate DIT, a no cost source of financing for additional plant. Eyre, 610-611. Mr. Tegarden acknowledges that properties purchased with DIT are not included in the rate base but makes no adjustment in his economic obsolescence calculations to reflect this fact. *See* FOF 102.

PacifiCorp then argues that the income shortfall is due to rate regulation which has negatively impacted PacifiCorp's earnings and created economic obsolescence. Exh. 28. The Board disagrees. For the five years prior to the valuation date, PacifiCorp states that it achieved an average return of 6.25% on its plant in service. Exh. 6, p 21. PacifiCorp asserts that the market rate of return is 9%. Exh. 6, p. 21. PacifiCorp is, however, a rate regulated utility. To the extent that rate regulation affects returns, it is a foreseeable and integral part of the company's chosen business. In fact, PacifiCorp has utilized rate regulation to its advantage in past activities. *See PacifiCorp v. WY PSC*, 2004 WY 164, 103 P.3d 862; 2004 Wyo. LEXIS 210. Further, PacifiCorp is no more affected than any other rate-regulated utility company nor did rate regulation prevent the sale of the company to a knowledgeable purchaser.

Lack of economic obsolescence is also apparent after analysis of the sale price of the subject property, which is in excess of the book value of the company. FOF 20, 21. *See also* Exh. 10, p. 40. It is impossible for the Board to pretend that a sale announced less than six months after the lien date and only two days before DOR issued its final revised appraisal does not provide credible evidence that PacifiCorp's property was not subject to economic or external obsolescence affecting its valuation.

When the income shortfall method cannot be properly applied, a generally accepted method for calculating external obsolescence is to look at comparable sales*. See, e.g.,* Tegarden 272. Neither the Department nor PacifiCorp, in this instance, had comparable sales data and neither was able to perform an analysis of economic or external obsolescence based on comparable sales. The Board, however, has the authority to review and recognize that the sale price of the company is itself a good indication that economic obsolescence does not exist.

This determination by the Board does not imply approval in any way of the Department's admitted failure to consider economic obsolescence in its cost indicator as specifically required by statute. Section 15-8-111(2)(b), MCA. We reiterate what we said in *Wells Fargo*, "[T]he Board does not condone this failure on the part of the Department. There is a clear statutory duty for the Department to consider all forms of depreciation when valuing a property through the cost approach." *Wells Fargo Services Co. v. DOR*, PT 2003-126 (June 6, 2005). In the PacifiCorp matter, however, this willful failing on the part of the Department has no disqualifying impact on valuation because there is no economic obsolescence in this case. In other cases, the Department's failure to consider economic obsolescence in its cost approach could prove seriously detrimental to the Department's valuation.

The cost method valuations of the Department and of Mr. Tegarden are derived from known and accurate financial information, prior to the adjustment Mr. Tegarden makes for asserted economic obsolescence. Without the adjustment for economic obsolescence, the cost valuations indicate a range of value that is similar. *See* FOF 34; Exh. 4, p. 6; Exh. 6, p. 21. The Board concludes that the cost methodology in this matter is an accurate indicator of value for PacifiCorp.

Income Approach

In regard to the income approach in this matter, two questions are before the Board. First, may the DOR use the earnings to price ratios from other electric companies as a proper methodology to estimate a direct capitalization rate and valuation?

Use of a stock and debt approach based on a company's own stock and debt has been upheld as an appropriate valuation technique since the creation of the Board of Equalization[4]. *See, e.g., Yellowstone Pipeline*, 138 Mont. *at* 611. There is no question that the stock and debt approach to valuation has also been accepted across the nation since the late nineteenth century[5]. *See, e.g., Adams Express v. Ohio State Auditor,* 166 U.S. at 220 (1897); *Porter v. Rockford, R. I. &*

[4] The Board of Equalization was the predecessor to the State Tax Appeal Board. Chp. 405, L.1973 transferred the powers and duties of the State Bd. of Equalization to DOR and STAB. *See also, DOR v. Burlington N. Inc*., 169 Mont. 202, 545 P.2d 1083 (1976).

[5] *Adams Express v. Ohio State Auditor*, 166 U.S. at 220 (1897): "But what a mockery of substantial justice it would be for a corporation, whose property is worth to its stockholders for the purposes of income and sale $ 16,800,000, to be adjudged liable for taxation upon only one fourth of that amount. The value which property bears in the market, the amount for which its stock can be bought and sold, is the real value. Business men do not pay cash for property in moonshine or dreamland. They buy and pay for that which is of value in its power to produce income, or for purposes of sale."

St. L. R. Co., 76 Ill. 561 (1874); *State Railroad Tax Cases,* 92 U.S. 575 (1875). Thus, the specific question becomes whether the Department may use surrogate companies to derive a valuation.

Calculation of a direct capitalization rate through the use of an earnings to price (E/P) ratio for a certain industry is a standard methodology utilized over time by the Department for several industries. FOF 30, 31; (Walborn, 468, 475); *See e.g.,* Rules 42.22.111, 42.22.113, and 42.22.114, ARM. In addition, this practice conforms to the Standards of the National Conference for Unit Valuation States (NCUVS). Exh. 23, p. 4.

The Department is tasked with mass appraisal valuation. Annually, a small number of Department employees must centrally assess a large number of companies in a compressed time period. In addition, the financial information needed to set a value for a specific company is often not available to the Department in a timely fashion, if provided at all. While all of those factors do not relieve the Department of their obligation to conduct accurate, professional appraisals, those factors do make it necessary for the DOR to use mass appraisal methods that enable the Department to complete its assigned task in a timely fashion. Consequently, there is an appropriate role for industry-wide analysis in deriving capitalization rates.

Absent a demonstrated error in the calculation of the direct capitalization rates derived by the Department, those rates are appropriately used to calculate indicators of value for assessment purposes. In this instance, there is no error in the direct capitalization approach to valuation.

In addition, the evidence does not demonstrate that a material change in valuation results from the Department's application of an equity rate derived from earnings reported on SEC 10-K forms to the income reported by PacifiCorp on their FERC Form 1. PacifiCorp fails in its burden to demonstrate a material error by the Department in their direct capitalization approach to value.

The second question in regard to the income approach is whether the DOR's improper calculation of yield capitalization materially affects the Department's valuation of PacifiCorp?

The Department gave little weight to the indication of value derived through its yield capitalization method, largely because of the error they acknowledge. The Department also maintained that the yield capitalization model, when correctly calculated, resulted in a value that is similar to the valuations the Department derived through other approaches. Haller, 84.

In its value reconciliation, the Department gave the greatest weight to its cost indicator of value, and it was accurately calculated. The Department gave the next greatest weight to its direct capitalization of net operating income. As noted above, the Board has accepted the Department's direct capitalization methodology for mass appraisal. PacifiCorp has not demonstrated sufficient error to overcome the presumption of correctness accorded to the Department's valuation. Finally, the subsequent sale of PacifiCorp validates the final value assigned to the company by the Department. Consequently, we conclude that the Department's improper calculation of yield capitalization did not materially affect its unit valuation of PacifiCorp.

PacifiCorp has failed to meet its burden of proof to rebut the presumption that the Department's appraisal in this matter is correct. The Board upholds the Department's appraisal of $7.1 billion for the 2005 unitary value of PacifiCorp.

ORDER

IT IS THEREFORE ORDERED the Department's appraisal for the 2005 unitary value of PacifiCorp is upheld.

DATED this 31st day of July, 2007.

BY ORDER OF THE
STATE TAX APPEAL BOARD

/s/________________________
KAREN E. POWELL, Chairwoman

/s/___________________
SUE BARTLETT, Member

/s/___________________________
DOUGLAS A. KAERCHER, Member

Notice: You are entitled to judicial review of this Order in accordance with § 15-2- 303, 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

I certify that on this 31st day of July, 2007, a true and correct copy of the foregoing Order was served by placing same in the United States Mail, postage prepaid, and addressed as follows:

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