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Ohio | Department of Taxation

Office of the Tax Commissioner
30 E. Broad St., 22nd Floor • Columbus, OH 43215

FINAL DETERMINATION

Date: JUL 1 0 2020

Rover Pipeline, LLC
c/o Energy Transfer Partners, L.P.
ATTN: Megan McKavanagh, Senior Manager, Property Tax
800 E. Sonterra Blvd.
San Antonio, TX 78258

Re: Assessment No. 1901142
Public Utility Personal Property Tax
Various Counties
Tax Year: 2019

This is the final determination of the Tax Commissioner with regard to a petition for reassessment filed pursuant to R.C. 5727.47 concerning a public utility personal property tax assessment.

PROCEDURAL BACKGROUND

Rover Pipeline, LLC (hereinafter "petitioner" or "Rover Pipeline") originally filed its 2019 Annual Report with the Department on May 30, 2019 claiming an exemption for "cost overruns". Subsequently, the Department issued its public utility personal property preliminary assessment certificates. The petitioner then asserted additional claims for reductions in value for both "rights of way" and "drawing" exemptions in September 2019. On October 10, 2019, the petitioner submitted an amended 2019 Annual Report with the Department claiming a reduction in its valuation based on its capitalized interest. Upon audit, the Department disallowed the cost overrun claim in addition to the "rights of way" and "drawing" claims. The Department then issued its amended public utility personal property assessment certificates. In response, the petitioner filed the petition for reassessment on November 27, 2019. An in-person hearing was held on this matter at the Department's offices in Columbus, Ohio.

In its petition for reassessment, the petitioner seeks a reduction in the taxable value of its personal property from the Department's assessed taxable value amount on the amended assessment of $3,505,062,880 to a taxable value of $1,846,705,014. The overall reduction in taxable value sought by the petitioner is $1,658,357,866. The petitioner bases this reduction on valuation computations prepared and submitted by its tax representative, KE Andrews of Rowlett, Texas.

FACTUAL BACKGROUND

The petitioner operates a 713-mile pipeline designed to transport up to 3.25 billion cubic feet per day (Bcf/day) of domestically-produced natural gas to markets in the Midwest, Northeast, East Coast, Gulf Coast, and Canada. The petitioner has three owners: Blackstone Group, Energy Transfer Partners, L.P., and Traverse Midstream Partners.

Rover Pipeline transports gas from processing plants in West Virginia, Eastern Ohio and Western Pennsylvania as well as various dry gas-gathering systems for delivery to the Midwest Hub near Defiance, Ohio, where about 68 percent of the gas is delivered via interconnects with existing pipelines in Ohio and West Virginia for distribution to markets across the U.S. The remaining 32 percent of the natural gas is delivered to markets in Michigan through an interconnect in Livingston County, Michigan, with the existing Vector Pipeline.

The completed line has direct deliveries to Ohio, West Virginia, Michigan, and into the Dawn Hub located in Ontario, Canada.[1] The petitioner currently has two pipelines in service: one that began service in 2017, and another that began service in 2018.

THE PETITIONER'S CONTENTIONS

The petitioner seeks a large reduction in taxable value based upon its representative's "cost-approach" and "income-approach" computations of valuation. In particular, the petitioner bases its reduction in true value on the following circumstances: (1) costs associated with the acquisition of rights of way; (2) drawing costs; and (3) cost overruns and economic obsolescence. At the hearing, the petitioner's representative stated that the actual cost of the pipeline was $6.2 billion, while the pipeline had been budgeted to cost $4.2 billion. It seeks approximately a $2 billion cost reduction in valuation for its 2019 Ohio public utility property tax valuation report.

For the reasons explained below, the petitioner's contentions are not well taken.

DETERMINING THE TRUE VALUE OF PROPERTY

STATUTORY COST VALUATION

Pursuant to R.C. Chapter 5727, public utilities must pay property tax on their personal property. *Ohio Bell Tel. Co. v. Levin*, 124 Ohio St.3d 211, 2009-Ohio-6189, 921 N.E.2d 212, ¶ 2 (2009). The property tax is an ad valorem tax and the Tax Commissioner must determine the value of the utility's property. R.C. 5727.10 provides the process under which the Tax Commissioner assesses the value of public utility property stating, in pertinent part, that:

> Annually, the tax commissioner shall determine, in accordance with section 5727.11 of the Revised Code, the true value in money of all taxable property * * * to be assessed by the commissioner. * * * The commissioner shall be guided by the information contained in the report filed by the public utility and such other evidence and rules as will enable him to make these determinations.

The Tax Commissioner's valuation forms the base for the ultimate determination of the amount of the tax. R.C. 319.30, 319.301, 5705.02 –.05, 5705.19.

The Ohio Supreme Court has recognized that it is "impractical for the commissioner to personally value all personal property in Ohio" and, therefore, the commissioner "may resort to a predetermined formula

[1] The Dawn Hub in Ontario, Canada has a broad network of distribution points back into the United States, including distribution points located in the Northeast.

to ascertain value." *Snider v. Limbach*, 44 Ohio St.3d 200, 201, 542 N.E.2d 647 (1989). The Ohio General Assembly provided the Tax Commissioner with a predetermined formula for valuing personal property in R.C. 5727.11(A), which states, in pertinent part, that:

> [T]he true value of all taxable property . . . required by section 5727.06 of the Revised Code to be assessed by the tax commissioner *shall* be determined by a method of valuation using cost as capitalized on the public utility's books and records less composite annual allowances as prescribed by the commissioner. If the commissioner finds that the application of this method will not result in the determination of true value of the public utility's taxable property, the commissioner *may* use another method of valuation. (Emphasis added.)

The Ohio Supreme Court long has held that use of the word "shall" in a statute followed by a permissive exception using the word "may" such as in the wording of R.C. 5727.11(A) indicates the General Assembly's grant of discretionary authority. "Ordinarily, the word 'shall' is a mandatory one, whereas 'may' denotes the granting of discretion." *Dennison v. Dennison*, 165 Ohio St. 146, 149 (1956). "[T]he word 'may' shall be construed as permissive and the word 'shall' shall be construed as mandatory unless there appears a clear and unequivocal legislative intent that they receive a construction other than their ordinary usage." *Dorrian v. Scioto Conservancy Dist.*, 27 Ohio St.2d 102 (1971), accord, *Dept. of Liquor Control v. Sons of Italy Lodge 0917*, 65 Ohio St.3d 532, 534 (1992), and *State ex rel. Adams v. Aluchem, Inc.*, 104 Ohio St.3d 640 (2004). The Ohio Supreme Court has also recognized that "'[m]ay' is generally construed to render optional, permissive, or discretionary the provision in which it is embodied." *J.M. Smucker, L.L.C. v. Levin*, 113 Ohio St.3d, 337 at ¶14, 2007 Ohio 2073 (quoting *State ex rel. Niles v. Bernard* (1978), 53 Ohio St.2d, 31, 34). Also see, *Interstate Motor Freight System v. Bowers*, 170 Ohio St. 483 (1960); and *General Motors Corp. v. Tracy*, 73 Ohio St.3d 29 (1995).

By its terms, R.C. 5727.11(A) expressly requires use of the capitalized cost of taxable property, as shown on the taxpayer's books, as the basis of the property's true value calculation, except as otherwise provided. In providing for the use of booked cost less annual allowances to determine the true value of public utility property, the General Assembly has statutorily prescribed the same approach to value public utility property as had been applied for years in determining true value for purposes of R.C. 5711.18 for the former general personal property tax. Applied simply, the true value of a pipeline is the cost of the pipeline as included on the taxpayer's books and records, less annual allowances. In particular, new pipelines, such as the one in the present case, are straightforward to value, as the cost to build the pipeline is known and is recent.

In the present case, the Department applied the statutory valuation methodology to establish the value of the petitioner's pipeline.

REBUTTABLE PRESUMPTION OF VALIDITY OF THE STATUTORY METHOD

In order to deviate from the statutory methodology, the petitioner must prove that the cost-based method does not reflect the true value of the property.

The Supreme Court of Ohio interpreted R.C. 5727.11 in *Texas E. Transm. Corp. v. Tracy*, 78 Ohio St.3d 83 (1997):

> R.C. 5727.11 does not preclude the use of a unit-appraisal method and, where true value is being contested, there need not be a finding of special or unusual circumstances . . . [T]he words 'special and unusual circumstances' do not appear in R.C. 5727.11 and are not a prerequisite for using an alternate valuation method where appellees are contesting true value rather than depreciation rates. If the statutory method does not yield true value, then another method of valuation may be used, whether or not there are special or unusual circumstances. Although a statute may provide a prima facie estimate or presumption of value, where rigid application of the statute would be inappropriate, the presumption of value must yield to other competent evidence reflecting true value. *Monsanto Co. v. Lindley*, 56 Ohio St.2d 59, 61, 10 Ohio Op.3d 113, 381 N.E.2d 939 (1978); *W.L. Harper Co. v. Peck*, 161 Ohio St. 300, 53 Ohio Op. 178, 118 N.E.2d 643 (1954). *Id.* at 85-86

Three justices dissented in *Texas E. Transm. Corp. v. Tracy* and would have ruled the BTA's deviation from the statutory valuation method to be unnecessary, unlawful, and unreasonable. Even so, both the majority and dissenting opinions acknowledged that it remains the taxpayer's burden to demonstrate that application of the statutory cost-based formula does not result in true value. *Texas E. Transm. Corp. v. Tracy*, *Id.* at p. 87 (Cook, J., dissenting) citing *Snider v. Limbach*, 44 Ohio St.3d 200, 542 N.E.2d 647 (1989). Furthermore, both the statute and the majority in *Texas E. Transm. Corp. v. Tracy*, *supra* are silent as to when the Commissioner needs to apply an alternate methodology for determining valuation, except in circumstances where the application of the cost of the property will not result in true value. A review of how the Court has decided other cases where a taxpayer seeks a deviation from a statutorily-prescribed method of valuation may be helpful in this regard.

In the context of the former tangible personal property tax, Ohio courts have looked at how the property or equipment was used when compared to its intended use or how other taxpayers used similar or identical property.[2] For example, in *Sun Chem. Corp. v. Limbach,* BTA No. 86-A-157, 1989 WL 82611 (Apr. 21, 1989), the Ohio Board of Tax Appeals ("BTA") found that a taxpayer requesting an alternative valuation must establish either that: (1) the personal property under valuation be subject to external factors negatively impacting its value; or (2) the taxpayer used the equipment in an abnormal manner as compared to the industry, causing the taxpayer's equipment to diminish in value more rapidly.

In *Terraza 8, L.L.C. v. Franklin Cty. Bd. of Revision*, 150 Ohio St.3d 527, 2017-Ohio-4415, 83 N.E.3d 916, the Ohio Supreme Court held that "a party challenging the presumptive value of real property for ad valorem tax purposes has the burden to submit rebuttal evidence showing that the presumptive value

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[2] *See also Phoenix Dye Works v. Limbach*, BTA No. 83-E-299, 1985 WL 23004 (July 16, 1985) (equipment used under conditions not intended by its original purchase); *Spang & Co., Ferroslag Div. v. Limbach*, BTA No. 86-D-71, 1989 WL 107396 (Aug. 25, 1989) (equipment used under conditions not intended by the original specifications); *The Reynolds & Reynolds Co. v. Limbach*, BTA No. 85-C-219, 1988 WL 162060 (Mar. 25, 1988) (technological and functional obsolescence requires alternate valuation; *Dayton Walther Corp. v. Limbach*, BTA No. 88-J-190, 1992 WL 141599 (Aug. 25, 1990) (foundry equipment was run 24-hours per day, for six or seven day per weeks, and was exposed to corrosive wet sand, extreme weight due to the products, excessive vibrations, high operating speeds, and extreme heat); *Philips Electronics N. Am. Corp., v. Tracy*, BTA No. 93-K-825, 1996 WL 368488 (June 28, 1996) (equipment was used in a manner not intended by its original purchase); *Defiance Precision Products Inc. v. Tracy*, BTA No. 95-T-564, 1998 WL 156482 (Apr. 3, 1998) (equipment was operated at twice the normal speed for three, eight hours shifts per day, for up to six or seven days per week).

did not reflect the property's true value." In addition, in *Columbus City Schools Bd. of Edn. v. Franklin Cty. Bd. of Revision*, 146 Ohio St.3d 470, 2016-Ohio-757, 58 N.E.3d 1126, the Court held "the mere fact that an expert has opined a different value should not be deemed sufficient to undermine the validity of the sale price as the property value." Most recently, in *Columbus City Schools Bd. of Edn. v. Franklin Cty. Bd. of Revision*, Slip Opinion No. 2020-Ohio-353, the Court reaffirmed that an appraisal could not be used to rebut the presumed value of property (sale price) when the appraiser failed to state why the presumed value was not indicative of value but merely offered an alternative opinion of value. Therein, the Court held:

> Because Weiler did not account for the fact that the entity transfer involved a transfer of the real estate for consideration, he failed to explain why that datum should be accorded no weight in valuing the property. This permitted the BTA to regard Weiler's appraisal as failing to refute the $35,250,000 sale price as the value of the property. See *Columbus City Schs. Bd. of Educ. v. Franklin Cnty. Bd. of Revision*, 146 Ohio St. 3d 470, 2016-Ohio-757, 58 N.E.3d 1126, ¶ 29-30 (reliance on appraisal affirmed when appraiser explained why he did not rely on the sale price), superseded by statute on other grounds, as stated in *Westerville City Schs. Bd. of Educ. v. Franklin Cty. Bd. of Revision*, 154 Ohio St. 3d 308, 2018-Ohio-3855, 114 N.E.3d 162, ¶ 13.

Accordingly, appraisal evidence must be evaluated, but the appraisal must show something specific about the property or the sale that proves that the sale price does not reflect true value. Merely offering an alternative opinion of value is not sufficient.

This same analysis applies to the valuation of public utility property. In order to deviate from the presumed value determined by the statutory methodology, the property owner must prove that the cost-based method does not reflect the true value of the property. This requires more than simply providing an alternative opinion of value. Rather, in order to rebut the presumptive value, the property owner must show something specific about this property that renders the statutory methodology unreliable.

In the instant case, the petitioner's valuation computations are simply an opinion of true value; not evidence of any fundamental or inherent deficiency in the statutory valuation method that prevents it from determining true value. Specifically, the petitioner has failed to meet its burden of proof because, as described in detail below, it has not submitted sufficient evidence establishing how the statutory valuation method as applied to the petitioner resulted in an error that rendered the method's determination of true value inaccurate. Instead of identifying any specific objections or substantive evidence refuting the accuracy or appropriateness of the statutory cost-based valuation, the petitioner simply provides its alternative valuations. The petitioner has not provided evidence that would allow the Tax Commissioner to find that the statutory valuation method does not reflect true value. Moreover, the Commissioner has found no other basis or need to deviate from the statutory valuation method because it accurately and appropriately reflects the true value of the petitioner's property as required by R.C. 5727.11.

The Court recognized in *Texas E. Transm. Corp. v. Tracy, supra,* that the statutory valuation method, itself, is prima facie evidence of true value. Absent evidence that shows otherwise, the Tax Commissioner has no basis for applying a different valuation method. The burden is not on the Tax

Commissioner to establish the accuracy of the statutory valuation method; that method is the one chosen by the General Assembly to establish true value. Unless the Commissioner has information showing that the statutory method does not reflect true value, the statutory method applies. In this case, the Commissioner did not have any such evidence or information that would warrant his deviation from the statutory method, and the petitioner did not provide evidence as to why the statutory method should not be used.

Here, the petitioner asserted that the additional $1,349,776,777 in excess costs should be deducted from its valuation. The excess cost was related to: (1) significant changes in legal factors that affected the value of its asset; (2) the adverse action or assessment by a regulator; and (3) the accumulation of costs significantly in excess of the amount originally expected to acquire or construct the pipeline. The petitioner claims that these costs should be deducted as not reflective of true value, but it has not taken actions that are consistent in this contention. For example, the petitioner, for financial reporting purposes, has not prepared an impairment study or recorded an impairment on its books for the long-lived asset that it claims will have no ability to generate a return on investment. As such, the petitioner is asking the Commissioner to ignore the value its property holds on its own financial records and make an adjustment to the value of its property based on a value that it has not "booked". The fact that the petitioner did not record these values in its financial statements tends to show that the petitioner, itself, when reviewing for impairment as required by the Financial Accounting Standards Board ("FASB"), did not find any impairment to exist. This is of particular importance as such recording of impairment by U.S.-based companies is required by the FASB, as explained herein. It is also well settled that a company is bound by its books and records. *Rickenbacker Holding Corp. v. Tracy*, BTA No. 91-Z-709, 1993 WL 122514 (Apr. 12, 1993).

In addition, the valuation computations submitted by the petitioner are a rough estimate, at best, since the petitioner has provided the Department with minimal information supporting the values found in its valuation computations. Such estimates of value are not sufficient to make a reduction in the property's true value that is below the value carried on the petitioner's books. An approximation of these values is not probative evidence for a deduction in taxable personal property. *See United Tel. Co. of Ohio v. Tracy*, 84 Ohio St.3d 509, 1999-Ohio-366, 705 N.E.2d 679 (1999). In *Anheuser-Busch Companies, Inc. v. Zaino*, BTA No. 2003-K-699, 2004 WL 2258152 (Sept. 24, 2004), the BTA reaffirmed established case law when it held that estimates of value are not sufficient to carry the burden of proof needed for such a reduction. In challenging the assessed value, the petitioner has the burden of establishing the value of its taxable property. The evidence submitted by the petitioner does not meet this burden.

The Tax Commissioner is legislatively mandated to apply the statutory valuation method found in R.C. 5727.11 unless he finds that it will not result in the true value of the property. In order to make such a finding, the Tax Commissioner must have probative evidence that the statutory method did not result in true value. Without such evidence, the Tax Commissioner does not have any basis for a finding to the contrary. The petitioner did not submit evidence that established that it values its property at a reduced amount due to the asserted cost overruns; likewise, the Commissioner will not reduce the valuation of this property. Moreover, applying the statutory cost-based valuation method in this case results in an accurate and appropriate valuation of the petitioner's property. The Commissioner therefore finds that the statutory method for determining the true value of the property reflects the true value of that property.

REQUESTS FOR EXEMPTION

Although the Tax Commissioner finds that the statutory cost methodology is appropriately applied to value the petitioner's personal property, the Commissioner will analyze each of the petitioner's contentions regarding decreasing the valuation as filed the petitioner's public utility tax return and subsequent valuation calculations. Again, R.C. 5727.11 provides that the Tax Commissioner may apply an alternate methodology to value a taxpayer's personal property only in cases where the Commissioner finds that the statutory methodology will not result in the true value of that property. Since the petitioner has asked the Commissioner to review various intervening factors, the Commissioner shall analyze each one separately.

In its 2019 Annual Report, the petitioner claimed a reduction in the cost of its personal property for the following amounts on its Schedule E – Other Exempt Property ("Schedule E"):

Exempt Property Reported on Petitioner's Schedule E	Cost Amount Claimed
Weather Delays	$267,176,671.00
Tuscarawas Incident & Horizontal Directional Drilling ("HDD") Re-Plan Delays	$228,879,137.00
Increased Regulatory [Costs] Post-Tuscarawas	$93,732,411.00
Slips	$319,748,301.00
G&A Inc. Increase (Net of Contingency Adjustment)	($5,038,562.00)
Contractor Costs Associated with Delays	$322,198,358.00
Budget Adjustment for Reduction in Measurement Budget	($5,929,672.00)
Acceleration Costs [related to] Seneca [County]	$60,000,000.00
Subcontractor Fall-Through Costs	$60,407,435.00
Construction Work-in-Progress ("CWIP")	$8,602,689.00
TOTAL AMOUNT OF EXEMPTIONS CLAIMED	**$1,349,776,768.00**

Originally, the petitioner challenged four specific exemptions: rights of way costs, drawing costs, construction work-in-progress (CWIP), and cost overruns. During the appeal period, the petitioner withdrew its claim for exemption for rights of way costs and drawing costs and raised claims relating to economic obsolescence. Therefore, the Tax Commissioner will only address the claims for exemption for construction work-in-progress ("CWIP"), cost overruns, and economic obsolescence.

CONSTRUCTION WORK-IN-PROGRESS (CWIP)

One of the petitioner's claims to exemption stems from CWIP. The petitioner submitted evidence to the Department during the audit period and prior to the Commissioner issuing the assessment certificate relating to its claim for exemption based upon CWIP. During the audit, the Department agreed with the petitioner's claim as it related to CWIP and did not include those amounts in the underlying assessment. Therefore, there is nothing further to consider on petition as it relates to CWIP, and this contention is denied.

"COST OVERRUNS" REPORTED AS EXEMPT PROPERTY

The petitioner contends that it encountered a "significant amount of additional, unanticipated spending associated with the construction of the . . . pipeline." Specifically, the petitioner asserts that the initial projected cost forecast for the Net Utility Plant was expected to be around $4.2 billion. The petitioner further contends that, due to unforeseen circumstances beyond the control of the petitioner, the entire plant reached a total cost of $6,301,485,440 as of December 31, 2018. In particular, the petitioner argues that "circumstances consist[ing] of weather-related delays due to record rain[fall] in the region" and additional regulatory delays caused "construction to be shut down during various stages" of development.

The petitioner specifically asserts that "[w]eather conditions made it extremely difficult for [construction] crews to get to and from work site locations" and that there "were many instances where [construction] crews . . . could not access the location due to [the] wet conditions." Furthermore, the petitioner contends that "adverse weather conditions had both a direct and indirect impact on construction and severely impacted the timing of the project by creating significant duplicative work." For example, the petitioner explained that "excessive water in the soil meant the soil needed to be dry before construction could begin. Contractors [would have to] blade and turn [the] dirt continually over in an attempt to dry it out due to the [continued] rains."

The petitioner also asserts that it "experienced regulatory delays [when] state regulators were concerned about contamination at road bore locations [which required] a shut down while [state regulators] investigated." The petitioner further contends that "additional delays [were] initiated by [the] FERC [which] included a complete halt to [horizontal directional drilling] for a period of time as [the FERC] investigated other options for crossing the Tuscarawas River."

Regulatory Delays

Construction of the pipeline began in February 2017 with the construction route traveling through 207 "sensitive" water crossings.[3] As the petitioner continued with construction, it resulted in numerous spills of drilling fluid, which contaminated some of the surrounding area.[4] The EPA also ordered the petitioner to pay at least $431,000 in fines for multiple water and air pollution violations that had occurred across the state. Specifically, the Ohio Environmental Protection Agency ("OEPA") recorded 18 pipeline-related incidents that had affected 11 counties between March 2017 to May 2017 ranging from open burning violations, bentonite mud spills, and water pollution. Additionally, the Federal Energy Regulatory Commission ("FERC") ordered all horizontal directional drilling ("HDD") to stop along the Rover Pipeline due to the two April incidents.[5]

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[3] The Washington Post, *The company behind the Dakota Access pipeline is in another controversy*, https://www.washingtonpost.com/news/energy-environment/wp/2017/04/27/the-company-behind-the-dakota-access-pipeline-is-in-another-controversy/ (last accessed June 3, 2020).

[4] *See* Richland Source, *Rover Pipeline work dumps 50,000 gallons of drilling fluid in Mifflin Twp. wetlands*, https://www.richlandsource.com/ashland_source/rover-pipeline-work-dumps-gallons-of-drilling-fluid-in-mifflin/article_afb6065c-25bf-11e7-96f1-bb1a41e0619b.html (last accessed June 3, 2020); PBS, *The Rover Pipeline leaked millions of gallons of drilling fluid into Ohio wetlands*, https://www.pbs.org/newshour/nation/two-weeks-rover-pipeline-leaked-drilling-fluid-ohio-wetlands (last accessed June 3, 2020).

[5] Reuters, *Energy Transfer to sell stake in Rover pipeline entity to Blackstone*, https://www.reuters.com/article/us-energy-transf-divestiture/energy-transfer-to-sell-stake-in-rover-pipeline-entity-to-blackstone-idUSKBN1AG2H3 (last accessed June 3, 2020).

Many of the costs incurred and claimed as exempt by the petitioner are directly and indirectly related to its numerous federal and state regulatory violations. The petitioner's compliance history and its continued spilling of contaminated drilling fluid resulted in the suspension of HDD work along the Tuscarawas River and various timing setbacks related to the FERC's hesitancy to issue subsequent permits to the petitioner. Additionally, the petitioner repeatedly took nominal steps to mitigate any damage caused by the construction of the Rover pipeline. These occurrences are not simply functional or economic obsolescence that were "out of the petitioner's control" and affected the industry. In fact, these "cost overruns" were squarely within the control of the petitioner.

Budgeted Costs

The petitioner's data shows that what it considers to be "cost overruns" are actual costs to construct the pipeline that exceeded its budgeted costs to construct the pipeline. The petitioner is contending that its budgeted costs to construct the pipeline are the best determinant of true value, and any cost above budgeted cost is a "cost overrun" that should not be included in determining the true value of the pipeline. Such a stance mistakenly makes budgeted costs a controlling factor for determining true value. The reality is that a budget is just an estimate of the cost of construction, and costs above budget are not necessarily a sign of overspending on construction, but may be an indicator of an overly ambitious budget in which all phases of construction occur under perfect planning and perfect conditions. R.C. 5727.11(A) sets the starting point for determining the true value of taxable property as the cost of that property on the company's books and records, less composite annual allowances. The petitioner is ignoring R.C. 5727.11(A) in attempting to set the value starting with its budgeted costs.

Much of the cost overruns were due to rainy weather, various delays, construction problems, and other issues. In a colossal project such as constructing a major pipeline, one should budget for the inevitable rainy weather, flooding, wet soil, delays and problems. The petitioner has not demonstrated that its budgeted costs were a realistic measure of what the total construction cost should have been or that it appropriately factored in predictable costs. For instance, Ohio has very rainy, seasonal weather, and the budget did not adequately plan for weather issues. However, many of the problems encountered in the construction of this pipeline are very ordinary issues and are not special or unusual circumstances: rainy weather, saturated soil, ponding of water, weather delays, various construction issues. All construction projects undertaken by companies within Ohio, including those of other pipeline companies, have to deal with Ohio's frequent rainy weather and unpredictable temperatures.

Costs Recorded on Books and Records

Further, it must be noted that the petitioner recorded on its books as assets what it contends are "cost overruns". The petitioner could have chosen to expense much of its "cost overruns", or it could have later written off these "cost overruns" if it believed these costs were not valid assets on its books. Instead, however, the petitioner determined that the costs were assets to be recorded on its books. Thus, the petitioner is arguing that, in effect, its books are incorrect in recording the costs at issue as assets, and that the Department should ignore its books in determining how to treat these costs.

As explained herein, pursuant to R.C. 5727.11, the true value of the taxable property of a public utility taxpayer is to be determined by using the capitalized cost of the assets on the taxpayer's books, less composite annual allowances as permitted by the Tax Commissioner. In *Ohio Bell Tel. Co, supra,* the

BTA held that the fact that a taxpayer does not book an impairment write-down used to reduce the value of its property is due some consideration but that fact, alone, is not enough for the Board to completely disregard the appraisal. Thus, the BTA still considered Ohio Bell's appraisal but also considered the fact that Ohio Bell did not book any impairment write-downs based upon the appraised values. The petitioner is asking the Department to ignore its books and to ignore R.C. 5727.11, which requires public utility taxpayers to determine taxable value based upon capitalized cost on the taxpayer's books.

In this case, the petitioner did not complete an impairment study of its long-lived assets to be held and used and it did not "book" the 32.55% reduction in property value for what the petitioner labels "cost overruns" and for which it seeks a reduction herein. Pursuant to FASB, an entity shall review its long-lived assets held and used for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The FASB has indicated that the following is a non-exhaustive list of circumstances which would require an entity to prepare an impairment study: (1) a significant decrease in the market value of an asset; (2) an accumulation of costs significantly in excess of the amount originally expected to acquire or construct an asset; or (3) a significant adverse change in legal factors or in the business climate that could affect the value of an asset or an adverse action or assessment by a regulator. If the petitioner truly believes that its pipeline is overvalued, it can engage its financial accounting experts to conduct an impairment study and adjust its books and records accordingly, assuming that is the outcome of the analysis. That would provide the Tax Commissioner a factual, professionally-verified basis upon which a reduction in value could be considered. The Commissioner will not reduce the valuation based on the mere allegations of the petitioner.

An impairment loss shall be recognized when and if the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. *See* Financial Accounting Standards Board, *Statement of Financial Accounting Standards No. 121*, Section 4-11, 6-7 (1995) (superseded); Financial Accounting Standards Board, *Statement of Financial Accounting Standards No. 144*, Section 7-26, 9-13 (2001). The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. *Id.* An impairment loss shall be measured as the amount by which the carrying amount of a long-lived asset exceeds its fair market value. The fair market value of an asset is the amount at which the asset could be bought or sold in a *current* transaction between willing parties. *Id.* (Emphasis added.) The FASB notes that quoted market prices in active markets are the best evidence of fair market value and shall be used as the basis for the measurement, if available. *Id.* It is also well settled in Ohio that the best method of determining value is the actual purchase or sale of property on the open market between a willing buyer and a willing seller. *See Grabler Mfg. Co. v. Kosydar*, 43 Ohio St.2d 75, 330 N.E.2d 924 (1975); *Tele-Media Co. of Addil v. Lindley*, 70 Ohio St.2d 284, 436 N.E.2d 1362 (1982); *Conalco, Inc. v. Monroe Cty. Bd. of Revision*, 50 Ohio St.2d 129, 363 N.E.2d 722 (1977).

Under these national accounting standards set by the FASB, an entity shall review its long-lived assets held and used for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In the instant case, the petitioner argues that Rover's pipeline assets are impaired and should be valued at a much lower amount. However, it appears that the petitioner does not see any impairment of the pipeline assets, as the petitioner has not computed an impairment amount and taken such a write-down on its books. The petitioner is arguing for an impairment and reduction that it did not find to exist when/if the assets were reviewed for impairment. It is disingenuous for the petitioner to ask for an impairment reduction that it does not believe in enough to record into its own books and records.

Although the petitioner's property cannot be valued by a recent sale, as found in *Grabler Mfg. Co.* to be one of the best ways of determining true value, the property can be valued under recent construction costs. Much like a recent sale of property, the recent construction cost of an asset such as a pipeline is the best indicator of its value. Moreover, when a company, such as the petitioner, records its cost of construction as an asset on its balance sheet, this is another affirmation of the accuracy of the construction costs as an indicator of value.

In *Trunkline Gas Co. v. Tracy*, BTA No. 93-P-593, 1995 WL 389812 (June 30, 1995), the BTA found that a pipeline was properly valued pursuant to its acquisition cost one year earlier, rather than valued by an appraisal submitted by the company. Similar to *Trunkline Gas*, the majority of the petitioner's property was recently constructed in 2017 and 2018, very near to tax year 2019's listing date of December 31, 2018. In *Trunkline*, the value of the property was set by a recent indicator of value: the sale of the pipeline. In this case, the value of the Rover Pipeline was also set by a recent indicator of value: the construction costs that the pipeline recorded on its books as the cost of the pipeline. The petitioner in this case, like Trunkline Gas Co., is seeking a large reduction of its assessed value and has failed to show that its recently-constructed property was not properly valued under the statutory formula.

Economic Obsolescence

Coupled with the petitioner's claims for cost overruns, the petitioner cites its economic obsolescence as a factor impacting the valuation of the pipeline at issue. Specifically, because the petitioner's actual construction costs exceeded the petitioner's projected construction costs, the profitability of the pipeline was less than anticipated.

In a February 2017 FERC order, FERC Docket No. CP15-93-000, et al., the FERC evaluated the merit of the Rover Pipeline being constructed, and wrote the following in its order:

> Here, Rover has demonstrated public benefits for the proposed project. Approximately 95 percent of the Rover Pipeline Project is subscribed under long-term firm transportation precedent agreements, indicating a strong need for the project.

This quoted language from this FERC Order shows that the Rover Pipeline has received great acceptance by natural gas producers and had 95% of its natural gas shipping capacity contracted out before the pipeline construction even began. This shows the great commercial success of Rover Pipeline.

Hart Energy, an energy news organization, reported on an Energy Transfer Partners press announcement on October 31, 2014 that Rover Pipeline was, as of that date, "fully subscribed", meaning Rover, as of that date, had sold 100% of its gas shipping capacity through 15-year and 20-year fee-based contracts. The Hart Energy article provided:

> Energy Transfer Partners LP (ETP) announced it secured additional long-term binding shipper agreements on its Rover Pipeline project. The pipeline will connect Marcellus

> and Utica shale gas supplies to markets in the Midwest, Great Lakes and Gulf Coast regions. The pipeline is now fully subscribed through 15- and 20-year fee-based contracts to transport 3.25 billion cubic feet per day (Bcf/d) of capacity.[6]

Again, the Hart Energy article cited above shows the tremendous financial success of the Rover Pipeline. Pipeline long-term shipping subscription rates are much higher than spot subscription rates and are guaranteed via contract for 15 or 20 years. The commercial success of Rover, running at full capacity under long-term subscription contracts, cuts against the petitioner's argument in support of the economic obsolescence of this pipeline.

The petitioner has failed to adequately substantiate its purported functional and economic obsolescence. In particular, the petitioner has not submitted evidence that adequately quantifies a reduction in true value for what it deems "cost overruns." Evidence provided by the petitioner is notably dated from June 2015 to February 2017, prior to when construction of the pipeline began. The petitioner also submitted piecemealed exhibits from its initial 2015 FERC filings listing the gross total cost of the Net Utility Plant at $4,215,895,275 purporting the document was *from* the FERC that indicated the Commission's acceptance of "true value" once construction was complete. In reality, it was a pro-forma return submitted *to* the FERC as an indicator of what the petitioner believed to be the gross total cost two years before construction on the Rover pipeline began. As such, the evidence submitted does not accurately capture or reflect the true value of the petitioner's personal property following completion of construction in 2018. Instead, the information supplied is merely a "snapshot" of the expected cost to build an interstate infrastructure project prior to "breaking ground".

Thus, the petitioner has failed to adequately substantiate its purported functional and economic obsolescence. In failing to meet its burden of proof, the petitioner has not substantiated its contentions regarding a reduction in its true value for "cost overruns." Accordingly, the cost overruns are not exempt from the statutory valuation method found in R.C. 5727.11.

THE APPLICATION OF AN ALTERNATIVE VALUATION METHODOLOGY

Assuming, *arguendo*, that the Tax Commissioner determined that the statutory cost methodology was not accurate and produced an unjust or inaccurate result, the next question for the Commissioner to consider is what alternative value should be attached to the personal property. The petitioner contends that the statutory cost methodology does not accurately reflect the true value of the pipeline and requests an alternative methodology. In support of its position for using an alternative method to value its personal property, the petitioner provides three values, two using a cost-based method and one based on an income approach. Under the following authorities, these valuation conclusions are not probative evidence of the value of the personal property at issue.

FIRST PROPOSED CALCULATION OF TRUE VALUE: A COST APPROACH

[6] Hart Energy. *ETP's Rover Pipeline Is Fully Subscribed* (October 31, 2014). https://www.hartenergy.com/news/etps-rover-pipeline-fully-subscribed-100817 (last accessed June 15, 2020).

First, the petitioner arrives at a valuation under a "cost-approach" methodology by taking the asset cost, less exempted property, less physical depreciation, less any functional or economic obsolescence.[7] Specifically, the petitioner's proposed calculation is as follows:

"Historical Cost/New Original Cost" for Utility Plant	$6,301,485,440
Less Statutory Exemptions	(763,273,444)
Less Physical Depreciation	(105,128,694)
Reproduction Cost New Less Physical Depreciation	$5,433,083,302
Less Estimated 50% Economic Obsolescence	(2,716,541,651)
Total "True Value" Before Allocation	**$2,716,541,651**

The 50% "economic obsolescence" rate used by the petitioner is computed by dividing Rover's FERC return on investment (ROI) of 5.51% by the FERC peer group ROI of 10.21%, which yields 54%. The petitioner then rounds that percentage down to 50%. The petitioner also computes two other obsolescence rates, one by taking Rover's ROI net of taxes of 2.18% and dividing it by the peer gas pipeline group ROI of 8.4% to yield a "percentage good" of 26%, or economic obsolescence of 74%. The second computation divides Rover's ROI net of taxes of 2.18% by the FERC NGA Gas Tariff Total Return of 9.75% to arrive at 22.4% good or conversely 77.6% economic obsolescence.

The petitioner computed three different economic obsolescence percentages of 54%, 74%, and 77.6%, but nevertheless ultimately arrived at a fourth, round number: 50% economic obsolescence. The petitioner then allocates this true value amount to Ohio under a 77.25% Utility Plant allocation rate and applies an 88% Ohio listing percentage rate to reach a final "true value" of $1,846,705,014. The widely varying economic obsolescence percentages computed by the petitioner show that the petitioner is, at best, making rough estimates of obsolescence.

It is important to note that both of the petitioner's "cost-approach" valuations seek a reduction in "true value" for economic obsolescence. These "cost-approach" valuations base their respective obsolescence adjustments on estimated income capabilities of the property because the petitioner's purported rate of return of 2.18% is less than its "peer gas pipeline" group rate of 8.40%. As such, the petitioner has practically turned its "cost-approach" valuation into an income-approach valuation by making these reductions based upon the income capabilities of its assets.

SECOND PROPOSED CALCULATION OF TRUE VALUE: A SECOND COST APPROACH

[7] There are three types or causes of appraisal depreciation traditionally recognized by appraisers: (1) physical deterioration; (2) functional obsolescence; and (3) economic obsolescence (sometimes called "external obsolescence"). Physical deterioration is when the loss in value or usefulness of a property is due to the using up or expiration of its useful life caused by wear and tear, deterioration, exposure to various elements, physical stresses, and other similar factors. Functional obsolescence is when the loss in value or usefulness of a property is caused by inefficiencies or inadequacies of the property, itself, when compared to a more efficient or less costly replacement property that new technology has developed. Economic obsolescence is caused by factors external to the property and may include such things as the economics of the industry, availability of financing, labor, increased competition, or other similar factors. *See* Machinery and Technical Specialties Committee of the American Society of Appraisers, *Valuing Machinery and Equipment: The Fundamentals of Appraising Machinery and Technical Assets*, (3rd Ed.2011).

Second, the petitioner estimates another valuation under a "cost-approach" method of valuation by performing the following calculation:

"Reproduction Cost New"	$6,301,485,440
Less Excess Assets (e.g., Cost Overruns)	(2,002,538,743)
Less Agreed-Upon Physical Depreciation	(105,128,694)
Less Statutory Exemptions	(763,273,444)
Less Estimated 10% Economic Obsolescence	(343,054,456)
Total "True Value" Before Allocation	**$3,087,490,103**

The petitioner does not explain how it reached a 10% economic obsolescence rate for this "cost-approach" valuation method compared with the 50% rate of obsolescence the petitioner used in its first methodology. The petitioner then allocates this true value amount to Ohio under a 77.25% Utility Plant Allocation rate and applies the 88% Ohio listing percentage to reach a "true value" of $2,098,875,772.

Thus, in its second cost approach computation, the petitioner is taking a reduction for "economic obsolescence". In summary, valuation computations submitted by the petitioner take large economic obsolescence reductions but fail to address or assuage the concerns many courts have had with such a reduction, as described herein.

Other States Have Rejected the Cost Approach Based on Income-Deficiency

Alaska, Louisiana, Montana and Oregon have rejected utilizing the income-deficiency method to value public utility property. Specifically, *BP Pipelines (Alaska) Inc., et al. v. State of Alaska Dept. of Revenue, State Assessment Review Bd., and N. Slope Borough*, Alaska No. 3AN-06-08446 CL, 2011 WL 10604082 (Dec. 30, 2011) also dealt with an appraisal in which the cost and value was based upon the "income-deficiency" method. In that matter, the Alaska Department of Revenue ("Alaska DOR") rejected the use of the "income-deficiency" approach for a matter involving the valuation of the Trans-Alaska Pipeline System ("TAPS") for ad valorem tax purposes. The Alaskan court wrote "[o]ther appraisers persuasively testified that the effect of applying an income shortfall method is to eliminate the independent value of the cost approach by altering it to an income approach." Further, the court stated, "[t]his Court finds, as it did in the 2006 matter, that such a method should not be applied to determine the economic obsolescence of TAPS." Furthermore, the court in *BP Pipelines, et al.*, *supra* explained that a number of western states have denied the use of the "income-deficiency" method, noting that the Western States Association of Tax Administrators ("WSATA") has rejected the "income-deficiency" method. Specifically, the Superior Court stated:

> The Western States Association of Tax Administrators ("WSATA") Appraisal Handbook rejects the income-deficiency method:
>
> A few appraisers attempt to measure obsolescence by comparing a company's actual earnings with the theoretical earnings that should have been achieved by the company with the assets on hand if they were earning a fair return on cost. This method is an improper variation of a method often used for individual properties, where it can be demonstrated that the subject property is not technologically capable of producing as

> much operating income (cash flow) as new replacement property. When used to compare earnings with theoretical company earnings, the method simply forces the cost approach to agree with the capitalized earnings approach.
>
> The WSATA Appraisal Handbook has wide acceptance by the approximately 35 states that do unit valuation and has undergone a comprehensive peer review process.

As such, the Superior Court of Alaska has rejected the "income-deficiency" approach methodology.

Likewise, in *In re Appeal of ANR Pipeline Co., Mona Kelly as Cameron Parish Tax Assessor v. ANR Pipeline Co., et al.*, 73 So.3d 398 (La.App.2011), the Court of Appeals of Louisiana denied the use of an appraisal using the "income-deficiency" approach and refused to allow a reduction from that appraisal for "economic obsolescence" of the pipeline's property. Also, in *Southwest Airlines Co. v. Arizona Dept. of Revenue*, Arz.App. No. 1 CA-TX 11-0007, 2012 WL 3041179 (July 26, 2012) (Memorandum Decision),[8] the Court of Appeals of Arizona found that the "income-deficiency" approach failed to accurately measure the obsolescence of assets.

The Montana Tax Appeals Board also reviewed the "income deficiency" approach in a matter involving the valuation of a large electric generation company, which relied on a private appraisal. *PacifiCorp v. State of Montana, Dept. of Revenue*, Docket Nos. CT-2006-05 and CT-2007-7. The appraisal used by *PacifiCorp* is very similar to the one at issue, and this case is instructive. The Montana Department of Revenue consulted a number of appraisal experts to review and evaluate the proposed appraisal. Montana's Tax Appeal Board ultimately rejected PacifiCorp's proposed use of the "income shortfall approach" used in that appraisal. The decision involved weighing evidence from multiple Ph.Ds. and appraisers for both sides regarding the accuracy, acceptability, and applicability of the income shortfall methodology used in the privately-prepared appraisal. In this opinion, Dr. James Ifflander, who has a Ph.D. in finance, is a Chartered Financial Analyst, and was "certified as an expert in the areas of corporate finance, valuation and valuation methodologies", reviewed the appraisal. The Tax Appeal Board noted:

> In Dr. Ifflander's opinion, Mr. Tegarden's income shortfall method is not a valid or accepted method of measuring obsolescence. In addition to the inherent circularity of this method, Dr. Ifflander noted that Mr. Tegarden improperly attempts to compare a rate of return on booked accounting assets when in actuality it is calculated on the rate base. This creates a mismatch. Moreover, Mr. Tegarden's comparison, Dr. Ifflander notes, is in no way a measure of obsolescence.
>
> Dr. Ifflander also stated that Houlihan Lokey Howard & Zukin (Houlihan & Lokey), the investment bankers hired by MEHC [parent company of PacifiCorp] for valuing the purchase of PacifiCorp, did not use the income shortfall approach, nor did they find any additional external obsolescence above normal depreciation.

* * *

[8] Pursuant to Ariz. Sup. Ct. R. 111(c), memorandum decisions of Arizona state courts are not precedential and, [as] such, a decision may be cited only: (1) for persuasive value; and (2) if the citation indicates [that the] decision is a memorandum decision.

> Based on Dr. Ifflander's independent analysis, he did not find evidence of additional economic obsolescence that was not already accounted for in the Department's OCLD [original cost less depreciation] approach.

The Montana Tax Appeal Board also weighed testimony of Brent Eyre, an Accredited Senior Appraiser with the American Society of Appraisers (ASA), who testified in support of the Montana Department of Revenue's valuation. The decision noted:

> Mr. Eyre criticized Mr. Tegarden's income shortfall calculations for a number of reasons. Mr. Eyre explained that Mr. Tegarden's income shortfall methodology is not found in the traditional appraisal texts and that it is not the same capitalization of income loss method as outlined in *The Appraisal of Real Estate*, and has been rejected in other jurisdictions.
>
> * * *
>
> Mr. Eyre also detailed the inherent circularity in Mr. Tegarden's income shortfall methodology which converts the cost approach to an income approach, rather than considering them as two diverse ways of valuing the company.
>
> * * *
>
> Mr. Eyre noted that the cost indicator of value should stand on its own in the valuation process, separate from income indicators, as one of many methods of calculating value. It is an important value indicator as it calculates the total investment in plant made by the company. Comparing a historical stream of income that is calculated as a return on rate base to the historical cost less depreciation is, in essence, a mismatch. EP 46. Dr. Ifflander also noted that the calculation "effectively converts his cost approach to an income approach leaving but one indicator of value." Ifflander, Stipulated Exh. 53, p. PC-Dor 003463.

Additionally, the Montana Tax Appeal Board considered expert testimony from Dr. John W. Wilson who criticized the privately-prepared appraisal's economic obsolescence deductions:

> Dr. John W. Wilson testified in favor of the Department. He received his Ph.D. in Economics and has testified in numerous regulatory proceedings across the United States during the course of his career. Stipulated Exh. 50. Dr. Wilson is an expert on public utility company issues, particularly as it relates to rate regulation. Stipulated Exh. 50. Dr. Wilson was certified as an expert in the field of economics and public utility regulatory issues. Tr. P. 732, ll. 9-24.
>
> Dr. Wilson criticized Mr. Tegarden's economic obsolescence deductions. Dr. Wilson explained that this is not a true measure of obsolescence, but rather, the mathematical difference between Mr. Tegarden's "understated" projected earnings and his overstated "required" earnings. Stipulated Exh. 51, pp. 4-5; Tr. P.737,l. 6, through p.172,l. 8.
>
> Dr. Wilson also stated that economic obsolescence, like physical and functional obsolescence, is "regularly reflected in depreciation accrual rates, which are approved by regulatory authorities, and they would be recoverable from ratepayers, they would be reflected in the company's rates. So the idea that there is unrecouped obsolescence is invalid." Tr. P.736. ll. 3-12.

* * *

> Finally, Dr. Wilson testified that if there really was economic obsolescence, PacifiCorp would include it in its rate base and recover it from the ratepayers, so there is no unrecovered loss. EP 50.

The Montana Tax Appeal Board concluded its review of the privately-prepared appraisal's obsolescence deductions by noting:

> Thus, we find no empirical evidence demonstrating that economic or external obsolescence impaired the value of PacifiCorp for tax year 2006 and 2007. We find that the company does not suffer from economic obsolescence. Thus, we cannot find Mr. Tegarden's value of PacifiCorp to be market value. Further, we find Mr. Tegarden's appraisal less credible than other evidence presented to this Board. Additionally, the Court of Appeals of Louisiana, in *In re Appeal of ANR Pipeline Co., Mona Kelly as Cameron Parish Tax Assessor v. ANR Pipeline Co., et al.*, 73 So.3d 398 (La.App.2011), denied the use of an appraisal submitted by a representative using the "income-deficiency" approach and refused to allow a reduction for "economic obsolescence" of the pipeline's property.

The Supreme Court of Montana reviewed and upheld the decision of Montana Tax Appeal Board, which rejected the use of the "income-deficiency" approach in an appraisal. *PacifiCorp v. State of Montana, Dept. of Revenue*, 360 Mont. 259 (Mont.2011). Like the Montana Tax Appeal Board, the Supreme Court of Montana found numerous inaccuracies in the use of the "income-deficiency" method of valuation.

United Tel. Co. v. Department of Revenue (1989), 307 Ore. 428; 770 P.2d 43 provides guidance from the Oregon Supreme Court on the income shortfall approach to preparing cost approach valuations. The Oregon Supreme Court weighed testimony of Dr. John R. Davis, III, and provided a clear explanation of why the income shortfall approach to cost is, in reality, an income approach:

> * * * the mathematical logic of Dr. Davis' approach essentially converts the cost approach to an income approach. Where the income and the rate are given, Dr. Davis' method will always result in a value exactly the same as the income approach because it shoves the cost out the back door. Algebraically, the method cancels all cost in excess of the value indicated by the income approach as obsolescence.
>
> In theory, each approach [to valuation] views the concept of value from a different perspective, with the intent of considering all facts and perspectives relevant in the result in the marketplace. Adjusting one approach to make it rely on the result in the same indication of value as another approach effectively eliminates a relevant perspective from consideration. *Pacific Power & Light Co. v. Dept. of Rev.*, 7 OTR 203, 217 (1977).

As explained herein, the petitioner's cost approaches to value, as prepared under the income-shortfall methodology, have converted the cost approaches into income approaches. In *United Tel. Co. v. Department of Revenue*, *supra*, the Oregon Supreme Court explained that the income-shortfall approach to cost valuation essentially converts the cost approach into an income approach. Thus, the petitioner has not submitted a real cost approach to valuation, as all three valuations submitted are based upon income or the income-shortfall approach. By relying on an income approach, the petitioner has no way to test the reasonableness of its estimate of value against other, independent valuation methods. Any errors in assumptions, methodology, data interpretation and gathering, or appraisal judgment that the petitioner makes under the income approach are magnified. By using a "back-door" income approach as its "cost approach", the petitioner's "cost approach valuation" is truly misnamed. In fact, it is simply an income valuation study masquerading as a cost approach.

Further, there is considerable case law holding that using an "income-deficiency" approach in a cost-based valuation is flawed because it converts the "cost-approach" into an "income-based" valuation. In *Delta Air Lines, Inc. v. Dept. of Revenue, State of Oregon*, 328 Or. 596 (Or.1999), the Oregon Supreme Court explained that the "income-deficiency" approach to cost would convert a "cost-approach" method into an "income-approach" valuation to such a great extent that the "income-deficiency" method would measure income rather than the cost of the assets. In *In re Appeal of ANR Pipeline Co., supra*, the Court of Appeals of Louisiana denied the use of an appraisal submitted by a representative using the "income-deficiency" approach and refused to allow a reduction for "economic obsolescence" of the pipeline's property.

In *Southwest Airlines Co. v. Arizona Dept. of Revenue*, supra, the Court of Appeals of Arizona rejected the use of the "income-deficiency" approach to determine property value. The Arizona court found that the "income-deficiency" approach failed to accurately measure the obsolescence of assets because the stock market value of its assets was listed above book value while the appraisal ignored market values in order to obtain a valuation far below book value for tax purposes.

Although the Commissioner has already determined that the statutory method of valuation is appropriate in this case, the Commissioner also rejects the petitioner's second alternative valuation methodology.

THIRD PROPOSED CALCULATION OF TRUE VALUE: THE INCOME APPROACH

Finally, the petitioner calculates another valuation under an "income approach" method of valuation by determining the "fair market value" of the pipeline by performing the following calculation:

Estimated Annual Net Operating Income (Prior to Tax)	$275,000,000
Divided by an Estimated Cost of Capital of 9.5%	÷ 9.50%
Valuation under Income Approach	$2,894,736,842
Less Estimated Statutory Exemptions at 12.11% Rate	(350,627,765)
Total Value under Income Approach Before Allocation	**$2,544,109,077**

The petitioner then allocates this amount to Ohio under a 77.25% Utility Plant Allocation rate and applies the prescribed 88% Ohio true value listing percentage to reach a final true value of $1,729,485,351.

It must be noted that this "income approach" valuation computed by KE Andrews is based entirely upon rough estimates. First, the pre-tax annual net operating income of $275 million is an unsupported estimate that KE Andrews used. KE Andrews has included a schedule of "estimated net income before taxes" from a schedule labeled "Long Term Plan - Fall 2018 Results of Operations" for years 2018, 2019, 2020 and 2021 of $365,007, $253,799, $262,007 and $262,947, respectively. From these four estimated income amounts, KE Andrews used an annual "net income before taxes" amount of $275 million in its income approach computations. As can be seen, this $275 million amount used is a rough estimate of "net income before taxes" that is not supported by significant amounts of data. As the valuation under KE Andrew's income approach is based entirely upon this estimated annual net income of $275 million, the income approach valuation here cannot be accepted as a reasonable estimate of value.

Further, in KE Andrews income valuation computations, it uses a rough estimate for "statutory exclusions". In its original annual report, the petitioner determined that its statutory exclusions were 12.11% of assets. In its income valuation comparison, the petitioner used 12.11% of its much lower valuation, which does not tie to an amount supported on any schedule.

In computing the 9.5% base capitalization rate, the petitioner uses a 13.00% rate for the equity component of the capitalization rate. A 13.00% required return on equity capital seems excessive based on the fact and circumstances. In the petitioner's own materials submitted regarding the capitalization rate, a table was submitted entitled "Rover Pipeline LLC Rate of Return Comparison". In this table, the average Adjusted NOI/FERC Utility Plant for the pipeline companies listed is 8.35%. Further, 8.35% is a mean or average rate of numerous pipeline companies. Using a high rate, such as this 13.00% equity capitalization rate, causes the overall capitalization rate to be much higher than it should be, leading to a much lower valuation under its income approach than would be produced using the 8.35% equity capitalization rate.

Additionally, the petitioner's income approach computations weights 50% to the equity component and 50% to the debt component. The petitioner does not submit any information or justification to support this weighting approach. Even so, based on the evidence available, this weighting appears to be too heavily weighted to equity, when the petitioner's principal owner's (Energy Transfer, LP's) balance sheet is reviewed. Although a balance sheet is not available for Rover Pipeline, itself, Energy Transfer's balance sheet shows "partners" capital of $22 billion and long-term debt of $45 billion. When this weighting ratio is applied to the petitioner, the weighting for Rover would be approximately 67% debt and 33% equity, which would lead to a much lower cost of capital, and this lower cost of capital would yield a much higher valuation under the income approach. In any event, choosing a 50-50 weighting rather than the exact actual weighting again represents another rough estimate that the petitioner used to compute valuation.

Further, the petitioner is using a very limited number of quarters of financial data for its income and cost approach valuation analysis. As parts of the Rover pipeline went into service in November 2017 (phase A) and May 2018 (phase B), only a few quarters of income data is available for tax year 2019, which uses for valuation the year ended December 31, 2018. Further, the petitioner is using its first few quarters of data in which it was in operation to prepare its valuation computations. Such a small sample of data is inadequate to set the value of such a major asset.

Additionally, *BP Pipelines (Alaska) Inc., supra*, explains that valuing a pipeline strictly on the value of the tariff income it generates is an incorrect method to value a pipeline because the producers of the oil and gas products and the owners of gas processing plants that have their product shipped in the pipeline would place a much higher value on the pipeline than merely the "tariff income" that the pipeline generates. The Alaska court in *BP Pipelines* found that pipelines are built to monetize the oil and gas reserves in the collection region of the pipeline and the value of being able to bring those oil and gas reserves to market for sale. Although the gas producers and natural gas processing plant owners using the Rover Pipeline do not own the pipeline, for these gas producers and processors relying on Rover to transport their natural gas to market for sale, the Rover pipeline has a value much greater than its tariff income generates, as the pipeline enables these producers and processors to have access to the energy end users to which they will sell their product. Valuing a pipeline merely on the tariff income it generates ignores the great economic value that the pipeline creates for the producers and processors by enabling oil and gas products to be transported to and sold in the marketplace. See *BP Pipelines (Alaska) Inc.*, pp. 197-208.

Thus, the Commissioner rejects the petitioner's third and final alternative valuation methodology, its income approach.

VI. Conclusion

For the reasons discussed above, the assessment is affirmed.

THIS IS THE TAX COMMISSIONER'S FINAL DETERMINATION WITH REGARD TO THIS MATTER. UPON EXPIRATION OF THE SIXTY-DAY APPEAL PERIOD PRESCRIBED BY R.C. 5717.02, THIS MATTER WILL BE CONCLUDED AND NOTICE WILL BE SENT PURSUANT TO R.C. 5727.47 TO THE APPROPRIATE COUNTY AUDITORS, WHO SHALL PROCEED IN ACCORDANCE WITH R.C. 5727.471.

I CERTIFY THAT THIS IS A TRUE AND ACCURATE COPY OF THE ENTRY RECORDED IN THE TAX COMMISSIONER'S JOURNAL

Jeffrey A. McClain

JEFFREY A. MCCLAIN
TAX COMMISSIONER

/s/ Jeffrey A. McClain

Jeffrey A. McClain
Tax Commissioner