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**DECISION OF THE KENAI PENINSULA BOROUGH
BOARD OF EQUALIZATION**

Appellant:	Tesoro Alaska Petroleum Company
Hearing Date:	June 12, 2003
Parcel No:	014-150-02
Appeal No.	2003-501
Tax Year:	2003
Assessed Value Appealed:	Real Property Total: \$128,924,300 Land: \$924,300 Improvements: \$128,000,000
Value Established by BOE:	Real Property Total: \$93,924,300 Land: \$924,300 Improvements: \$93,000,000

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The Board of Equalization of the Kenai Peninsula Borough was convened on June 12, 2003 to hear an appeal filed by Appellant Tesoro Alaska Petroleum Company regarding the valuation of Assessor's Parcel No. 014-150-02 (Tesoro Refinery in Nikiski, Alaska).

A quorum was established of the members of the Board of Equalization. Members present were: Chairman Pete Sprague and Board Members John Davis, Paul Fischer, Betty Glick, Ron Long, Milli Martin, Grace Merkes and Gary Superman.

Prior to taking testimony or argument from either party, Chairman Sprague noted that each party had been granted a total of 3-1/2 hours to present the party's case and to provide any rebuttal testimony. Mr. Sprague also ruled on several issues raised by the Appellants as follows:

- The burden of proof lay with the taxpayer to provide sufficient evidence to prove an excessive, unequal, improper or under valuation of the property. The taxpayer does not have to offer the correct amount, range, or method of valuation. Once the burden of proof is met, the burden shifts to the taxing

authority to introduce credible evidence which substantiates the assessment.
(AS 29.45.210 and KPB 5.12.060)

- The borough code does not require the submission of a written outline or summary of testimony to be provided by witnesses. Therefore, Mr. Goodwin would be allowed to testify.
- The earlier decision with respect to Tesoro's motion to compel stands. (The original motion to compel release of documents by the Assessor was denied.)
- Clarification was offered with respect to the order of business. The presentation of assessment data was provided by the Chairman of the Board of Equalization.
- Tesoro's request to have the last word was approved, so that the order would be: 1) Presentation by the Appellant; 2) Presentation by the Assessor; 3) Rebuttal by the Appellant; 4) Rebuttal by the Assessor; 5) Final argument by the Appellant.
- At the request of the Assessor, Assessor's Exhibits 2 through 6 were withdrawn. These exhibits addressed the appeal of the Tesoro pipeline, and that appeal was settled by the parties prior to the hearing.

Appellant's attorney Robin Brena presented Tesoro's case. Testimony was provided by Rodney S. Cason, President of Tesoro Alaska Company; Thomas R. Dunagan, Licensed M.A.I. Appraiser; Jim Wentworth, Tesoro Manager of Manufacturing Projects and Support Services; and Michael Clarkson, Machinery and Equipment Appraiser.

KPB Assessor Shane Horan and the Assessor's Attorney John Messenger appeared on behalf of the Kenai Peninsula Borough. Testimony was provided by Dave Walters, Principal of Walters and Associates Consulting, and Michael Goodwin, President of Michael W. Goodwin & Associates.

After hearing testimony from the witnesses specified above, and having reviewed the evidence submitted by the parties pursuant to the rules of the Board of Equalization, the Board found that the Assessing Department's valuation of \$128,000,000

for the improvements was excessive and reduced this amount to \$93,000,000. The land value of the Assessor of \$924,300 was found to be correct. More specifically, the Board of Equalization found:

The Assessor contracted with D. A. Platt and Associates (hereinafter DAPA) to prepare the calculation of the value for the property in this appeal. DAPA adopted a cost approach to calculate the full and true value of the property. However, in doing so, DAPA clearly adopted a fundamentally wrong principle of valuation which resulted in a value which this Board has found to be in excess of the full and true value of the property.

Specifically, DAPA, in calculating the cost of the improvements to the property of the Appellant, wrongly utilized and applied the Nelson-Farrar Refinery (Inflation) Index to the historical acquisition cost for the improvements to come up with a present value/cost of the improvements if constructed now. The refinery in question was constructed during or shortly after 1969. The creators of the Nelson-Farrar Refinery Index appear to have limited the index to a three to four year period of usefulness. Other experts contend that it should not be used for longer periods as well. Michael W. Goodwin, the Assessor's own expert witness, testified that the Nelson-Farrar Refinery Index should only be used for perhaps five or six years. DAPA, on the other hand, applied the index over a much more lengthy period of time. David Walters of Walters and Associates, contracted with DAPA to work on this project and testified to the effect that at the time of preparing the DAPA report, he was unaware of the limited duration for which the Nelson-Farrar Refinery Index should be utilized. As a result of wrongly applying the Nelson-Farrar Refinery Index, the present value/cost of the improvements if constructed now, or on January 1, 2003, is erroneously inflated. This inflated figure was then multiplied by a "percent good" which was used to determine the present value of the property.

Therefore, the Appellant has met its burden of proof in that it showed that DAPA and the Assessor placed an excessive valuation on the Appellant's property as a result of the clear adoption of a fundamentally wrong principle of valuation.

Having found the approach relied on by DAPA to have utilized a fundamentally wrong principle of valuation, the Board considered the Income approach which was discussed at length and the subject of significant evidence. While the authorities' articles

seem to advocate that the Discounted Cash Flow seems to be the method that is most representative of the fair market value, neither party has been found to have completed that calculation with sufficient and adequate information to produce a reliable figure for the full and true market value in this case. Accordingly, the income approach cannot be utilized to set the value on this property.

The Appellant has submitted substantial information regarding the Comparable Sales method. The Appellant contends that comparable sales should be used to determine the value of this property because there are adequate comparable sales of similar properties. DAPA and the Assessor contend that comparable sales should not be used to determine the value of this property because there are not adequate comparable sales of similar properties. There have been only a limited number of comparable sales and of those many have been challenged as either distressed sales, takeovers, stock purchases, or mergers, each of which substantially takes away from the reliability of the transaction for comparable sales purposes. In addition, some of the sales were for refineries that were set up for refining fuel that meets California's more stringent requirements. The Appellant's facility is not set up to meet California's more stringent requirements and the difference in improvements is very extreme such that the sales price of those refineries meeting the California requirements cannot be compared with refineries such as the Appellant's facility which does not meet the California requirements.

In addition, the authoritative articles (including the authorities cited by the Appellant), indicate the comparable sales "approach has not, however, proved meaningful in the valuation of an on-going business or refinery operation because of the many differences between individual facilities and the fewer number of transactions available for comparison." In addition, "[v]irtually all refineries should be considered to be unique assets, in that very few are sufficiently similar in terms of location, capacity, complexity, markets, logistics, age, condition, etc., to provide meaningful comparisons." (T-245-246)

Therefore, the comparable sales approach is not a good means of determining the full and true value of a refinery such as the Appellant's and the approach will not be used by the Board.

From the evidence, the Cost approach (which was also selected by DAPA) is the best approach to use in this case. Based upon the evidence, it is the most accurate approach for determining the full and true value of the property. However, the abovementioned errors that were found to be made by DAPA need to be eliminated. The Board has found that the best indicator of full and true value is to use the Refinery Replacement Cost and Complexity as determined by Purvin and Gertz. By using this factor, the problem of bringing the original improvements cost up to present day values is eliminated. Bringing values up from a period of over 30 years to the present day is too speculative based upon the evidence presented. By taking the present day replacement cost for a refinery of the capacity this refinery was built to handle one ends up with the best starting point for determining the full and true value of this property. Purvin and Gertz find the "estimated replacement cost on a U.S. Gulf Coast 2003 basis, using Purvin and Gertz' most current replacement cost model, is \$377 million." (T-247) This is the current replacement cost for a refinery of this size.

The Board would also note that there was evidence that indicated there should be an additional expense in the amount of \$10 million dollars, perhaps somewhat more, due to this refinery being located in Alaska. However, in the Board's opinion, the evidence was not sufficient to merit this amount being added to the replacement cost. Accordingly, based upon the evidence presented, there should be no additional cost added to the replacement cost of this refinery by virtue of it being located in Alaska.

The Board would also note that there was a dispute whether comparing this refinery to the Gulf Coast or California Refineries would be a better comparison. While much of this dispute revolved around the issue of comparable sales, the Board would point out that this refinery is more like the Gulf Coast refineries than it is like the California refineries.

The Board would also note that being mindful of the fact that Tesoro had calculations prepared by Purvin and Gertz for a 52,000 barrel per day production at which the Appellant claims the refinery is operating, the fact that it was built as a 72,000 barrel per day refinery leads the Board to find that the 52,000 barrel per day calculations done by Purvin and Gertz should not be used in this analysis. To do otherwise would jeopardize

the calculations in the next step since the parties have presented their evidence primarily on a 72,000 barrel per day refinery.

The next step is to determine the current "percent good" of the refinery, based upon the various sources of depreciation and obsolescence. The "percent good" figure is one that is subject to some discretion. DAPA has contended that the refinery is thirty percent good based upon an opinion of the refinery's condition using twenty percent as the bottom level of a functioning plant. The Appellant has contended that a 19.4 percent good is the proper value. This value was based upon a summary of all U.S. Post September 11, 2001 Non-CARB Refinery Sales excluding the Farmland sale. (T-169) There were good arguments for and against both of these percent good recommendations. As stated above, the percent good figure is one that is subject to some discretion. Based upon the two different positions and the various good arguments for and against each of them, an average of the two percent good amounts (24.7%) is the appropriate percent good figure to use.

The proper full and true value for the refinery is obtained by multiplying the \$377 million replacement cost by the 24.7 percent good figure to obtain a rounded value of \$93 million.

The Board is mindful of some additional expenses that could be added to the \$377 million. However, the Board finds that there is insufficient information in the record to justify adding any of those additional expenses. Accordingly, the Board only adds the value of the land to the \$93 million. The value of the land, a non-depreciable asset, is found to be as determined by the Assessor. There was insufficient information presented by the Appellant to overcome the burden of proof with respect to the land.

The fact that the term "appraisal" was not contained in the DAPA report was not part of the basis for the Board's decision as a formal appraisal is not required to be conducted by the Assessor and in any event the report prepared by DAPA was generally in the nature of an appraisal.

Notice of Right to Appeal. In accordance with the Alaska Rules of Procedure and KPB 5.12.060(S), the Appellant has thirty (30) days from the date of this decision to file an appeal with the Superior Court of the State of Alaska at Kenai.

Dated: June 18, 2003

Pete Sprague
Pete Sprague, Chairman

Attest:

Linda Murphy
Linda Murphy, Borough Clerk

