

MEMORANDUM

TO: State Tax Commission

FROM: Jim Porter, Attorney for Wakeshma Township

Date: December 17, 2007

Re: Response to Memorandum of T.J. Schnelle dated December 11, 2007 and Meeting of the State Tax Commission held on December 12, 2007

SUMMARY AND INTRODUCTION.

On December 11, 2007, T.J. Schnelle provided the State Tax Commission with a memorandum regarding Table K and Enbridge (Lakehead) pipelines. Pursuant to the Executive Summary and Introduction, the memorandum was drafted by the Assessment and Certification Division (“ACD”) of the Michigan Department of Treasury, at the request of the State Tax Commission (the “Commission”), for the purpose of providing the Commission with the ACD’s opinion regarding the validity of the personal property valuation multiplier Table K. At the request of the Commission at the December 12, 2007 hearing in this matter, Wakeshma Township provides this response to the memorandum.

I. MASS APPRAISAL TOOL VERSUS THE APPRAISAL METHODOLOGY UTILIZED IN THE SETTLEMENT OF *ENBRIDGE ENERGY LIMITED PARTNERSHIP v TOWNSHIP OF WAKESHMA*, MTT DOCKET No. 031679.

The matter of *Enbridge Energy Limited Partnership v Township of Wakeshma*, MTT Docket No. 031679 (“Enbridge Energy Litigation”) pitted Table K, which had been used to develop the Township’s assessments, against appraisal experts in an attempt to arrive at true cash values for the particular piece of property in issue, *i.e.*, a portion of a pipeline. As the Commission is well aware, Table K is a mass appraisal tool. A mass appraisal is “the process of valuing a universe of properties as of a given date using standard methodology, employing

common data, and allowing for statistical testing.” See, USPAP and Regulatory Affairs Committee White Paper, 07/26/2006. Therefore, Table K yields generalized property values that are not specific to any one parcel of property.

In the context of the Enbridge Energy Litigation, the parties to the case hired appraisal experts to apply the traditional approaches to the derivation of market value to the specific property in issue. In applying these traditional methods, the appraisal experts used very specific financial and economic data for the property in issue over a particular tax period. *Note that, as concerns this litigation, both parties (and Respondent on more than one occasion) requested assistance from the Commission, and invited the Commission to participate as an intervening party – a setting in which the Commission could have attempted to justify values calculated under Table K. At all times, the Commission declined to participate in the litigation, and to Respondent’s knowledge took no active, continuing interest in the progress of the Wakeshma case before the Michigan Tax Tribunal.* Indeed, Tim Schell informed Wakeshma’s counsel in a telephone conversation that occurred on January 18, 2007 that, once appraisals have been commissioned in a property tax case, Table K becomes irrelevant because it is a mass appraisal tool. The Commission therefore *should not be surprised* that the values reached when applying Table K can, and in many, if not most, instances will be, different from the values achieved through litigation based upon the testimony of seasoned appraisal witnesses who have prepared and submitted appraisals resting on traditional appraisal methods. Nor should the Commission have been “surprised” that the parties to the Wakeshma litigation reached a consent agreement, given that the vast majority of cases filed in the Tax Tribunal are resolved through pre-trial stipulation, and given that the Commission had no defined interest in the progress of the proceeding, as it was not a party.

A. WORK UNDERTAKEN BY WAKESHMA IN CONJUNCTION WITH THE ENBRIDGE ENERGY LITIGATION.

The settlement reached by the parties to the Enbridge Energy Litigation was the product of exhaustive discovery undertaken that, in part, allowed for an examination and analysis of the taxpayer's financial and economic circumstances, including analysis of Enbridge Energy's independently-audited financial statements and statements made to the Federal Energy Regulatory Commission. Both sides employed qualified appraisal experts, each with decades of experience in valuing pipeline property. Waukesma reviewed and analyzed literally thousands of pages of financial documents, interrogatory responses, depositions, and motions to compel to determine an accurate picture of the subject property's circumstances as of the relevant tax days. Both parties' appraisers considered all three traditional appraisal methods, *i.e.*, the market, income, and cost approaches. Both appraisers determined that the market approach was inappropriate in this case, and both achieved a final determination of value for the Waukesma property using a unitary valuation technique.

B. UNITARY METHODOLOGY.

Despite the contention of the ACD, the unitary approach *is* an appropriate methodology for deriving the true cash value of property akin to that in issue in the Enbridge Energy Litigation. The unitary approach, which is a specific form of the income approach, is commonly used to value separate articles of tangible property that are joined together by unity of ownership, as well as use. This method is widely accepted in the United States as well as in Michigan, and has been a tool for various property tax appeals involving regulated industry property. *See, Michigan Bell Telephone Co v Dep't of Treasury*, 445 Mich 470 (1994); *see also* Admur, *Property Taxation of Regulated Industries*, 40 Tax Lawyer 339, 347 (1987); *Detroit's Citizen's Street-Railway Co v Detroit Common Council*, 125 Mich 673 (1901). The propriety of the unit

method of valuing utility-type property has been recognized in the United States for well over 100 years, and specifically in Michigan since 1901. *See, Adams Express Co v Ohio State Auditor (After Rehearing)*, 166 US 185 (1897); *Detroit's Citizen's, supra*. As described by the Michigan Supreme Court in *Michigan Bell, supra* at 482,

[t]he unitary valuation approach allows a determination of the true cash value of a particular segment of an interstate business by valuation of the entire system with subsequent value allocation to the taxing jurisdiction by a percentage factor representative of the value of the portion of the total system attributable to the taxing jurisdiction.

Additionally, it is important to note that the “use of unit concept in valuing property does not always or necessarily result in an increase in the assessment. The effect of appraising the property as a unit – including intangibles – can either enhance or diminish the value of the tangible property.” *Id* at 482; *see also, Bertane, The Assessment of Public Utility Properties in California*, 20 UCLA L R 419 (1973).

While it is true that the Enbridge pipeline property is not subject to the same regulations as public utility properties – like telephone companies – in Michigan that are subject to the unitary method, Wakesma submits that it is not the regulatory aspect that is the critical feature here – what makes the unitary method both plausible and apropos is the simple fact that a single company owns property that works as a unit and traverses multiple taxing jurisdictions.

As concerns its discussion of the unitary method, the ACD’s attempt to analogize use of the unitary method of valuation for an oil pipeline to the use of the same methodology for an apartment complex is absurd at best. *See*, pp 8-9 of the ACD’s Memorandum. First and foremost, the use of the unitary method to derive the true cash value of personal property of an industry such as a telephone company or an oil pipeline company arises in a fundamentally different context from that of an apartment complex, so much so that the two cannot be

reasonably equated for illustrative purposes. Certainly, the apartment complexes cited by the ACD in its memorandum do not extend beyond township, city, county, and state lines, do not service various communities, and each is not dependent upon the function of the preceding complex for its own function. How the ACD possibly considered this example as reasonable is beyond comprehension – indeed, it should be disregarded completely, as it does not permit an understanding of the ultimate settlement figures reached by the parties to the Enbridge Energy Litigation.

C. SETTLEMENT VALUE

The value range for the entire pipeline using the unitary valuation technique was between \$796 million (Enbridge Energy) and \$1.095 billion (Wakeshma). The techniques used to achieve these values involved specific and measurable factors specific to the subject property, as well as to the tax years at issue. As is common in litigation, each appraisal had its strengths and weaknesses. Ultimately, given that the hired appraisal experts were in agreement as to the appropriate valuation methodology, the parties concurred that the income approach (utilizing the unitary methodology) was the most accurate technique to apply in these circumstances. The parties worked through many hours of negotiations and data analysis to determine an appropriate net operating income and capitalization rate for the Enbridge property. Over the course of the litigation, the parties engaged in contentious debate concerning the method to be used to allocate value to Michigan and to individual parcels, and ultimately settled on use of an allocation method based upon the historical cost of each parcel.

In its memorandum, the ACD offered several specific observations regarding the appraisals prepared by each expert, and criticizes various portions of each expert's written work. *See*, pp 10-12 of the ADC's December 14, 2007 Memorandum. Throughout the Enbridge

Energy Litigation, Wakeshma did the same, for it carefully considered the strengths and weaknesses of each appraisal, and well knew of difficulties with each expert's appraisal. What the ACD neither considers nor informs this Commission is the effect those itemized appraisal "weaknesses" have on the presiding Tribunal judge during contentious litigation.

D. THE HAZARDS OF LITIGATION.

The Enbridge Energy Litigation settlement figures reflect the parties' analysis of the market value of the property in the shadow of the hazards of litigation. The wild card in any property tax litigation is that neither party knows the ultimate value the Tribunal will conclude to. However pristine and informed a party believes its' expert's appraisal is, the fact remains that the Tribunal Judge may not have the same vision at the conclusion of trial proceedings. While it appears from its December 11, 2007 memorandum that the ACD is convinced that the Tribunal would have concluded to higher values than those achieved via stipulated settlement, the ACD fails to mention that there was an equally likely chance that the Tribunal would have concluded to a value much closer to Enbridge's proposed value of \$796,000,000.

Upon receipt of a settlement offer from Enbridge Energy, counsel for Wakeshma carefully considered the offer by asking two questions.

- Are the values identified in the settlement offer reasonable?
- Would the Tax Tribunal likely achieve values more favorable to the Township after trial?

In a thorough evaluation of the evidence to be offered at trial by each party, Wakeshma, through its counsel, determined that the proposed settlement figures reflected a reasonable system value. Counsel also determined that the Tribunal in all likelihood would have concluded similar values to those achieved by the parties. As there was no guarantee whatsoever that the Tribunal would

not adopt the values proposed by Enbridge Energy, and cognizant of the prudence of not wasting the money of Wakeshma taxpayers by engaging in further contentious litigation, Wakeshma determined to favorably settle the Enbridge Energy Litigation.

E. THE STATE TAX COMMISSION AND THE ROLE OF TABLE K.

The ACD concludes that “Table K values Enbridge Energy’s pipeline assets in Michigan in a reasonable manner . . .” *See*, p 1 of the Memorandum. As discussed above, the ACD maintains various reasons why the Enbridge Energy settlement is not appropriate. Wakeshma offers no comment as to whether Table K is or is not valid, given that the validity of Table K was not an issue in the Enbridge Energy Litigation (although it could have been, had the Commission been responsive to the parties’ requests that it participate in the proceeding as an intervening party). Furthermore, there is nothing to prevent the Commission from utilizing the same approaches in the formation of Table K, or any other mass appraisal recommendation, that the Enbridge Energy Litigation experts utilized. *See, Wayne County v Michigan State Tax Comm*, 261 Mich App 174 (2004). While the Commission is charged with the general administration of property tax matters in the state, it is *not* the entity responsible to decide which party’s appraisal witness has presented the most cogent evidence of true cash value – that is the role of the Michigan Tax Tribunal in litigation initiated before it.

CONCLUSION.

Wakeshma has not and does not advocate using the true cash values reached in this litigation to somehow calibrate or otherwise “fix” Table K. The settlement achieved in this case reflects factors other than those that are, or should be, considered in developing Table K, a mass appraisal tool (namely minimization of litigation costs, and risk of a lower ultimate value conclusion at the hands of the presiding Tribunal judge).

However, it is Wakeshma's position that Table K, if left unchanged, will periodically create a significant disparity between the values derived through application of the table and values obtained by valuing the specific property in the context of litigation and consideration of current financial and economic circumstances. This disparity will engender continued expensive litigation by taxpayers who must resort to the Tribunal for determination of their valuation issues.