FINAL ADMINISTRATIVE DECISION
ILLINOIS PROPERTY TAX APPEAL BOARD

APPELLANT: Aux Sable Liquid Products, LP
DOCKET NO.: 03-01919.001-I-3
PARCEL NO.: 03-22-100-008

The parties of record before the Property Tax Appeal Board are Aux Sable Liquid Products, LP, the appellant, by attorneys Thomas M. Atherton and David Suess of Bose McKinney & Evans LLP in Indianapolis, Indiana; the Grundy County Board of Review; and Minooka Community Consolidated School District No. 201 and Minooka Community School District No. 111, intervenors, by attorneys Frederic S. Lane and Scott Longstreet of Robbins Schwartz Nicholas Lifton & Taylor Ltd. in Chicago.

By letter dated May 2, 2007, the Grundy County Board of Review was defaulted in this proceeding for failure to timely file evidence.

A Request to Intervene dated April 12, 2005 was also filed in this matter by the Village of Channahon through attorney Justin M. Fredin of Mahoney, Silverman and Cross, Ltd. in Joliet. By letter dated June 15, 2005, the Property Tax Appeal Board advised this intervenor it had until July 15, 2005 to file its evidence in this proceeding or be found in default. By letter dated February 24, 2006, the intervenor Village of Channahon was advised it was in default in this matter.

Based on the facts and exhibits presented, the Property Tax Appeal Board hereby finds ***no change*** in the assessment of the property as established by the **Grundy** County Board of Review is warranted. The correct assessed valuation of the property is:

LAND:	$205,380
IMPR.:	$77,453,290
TOTAL:	$77,658,670

Subject only to the State multiplier as applicable.

ANALYSIS

Only parcel number 03-22-100-008 consisting of 119.06 acres has been appealed. The entire subject property consists of three-

parcels comprising 157.91 acres[1] which have been improved with a natural gas liquids (NGLs) extraction and fractionation plant. The plant was built on the site between March 1999 and December 2000. The Aux Sable plant is divided into a little over 80 different systems consisting of spheres, towers, and piping for purposes of extraction, fractionation and storage. Given input of 1.6 billion cubic feet of raw natural gas per day (bcf/day) from the Alliance Pipeline, the subject plant extracts 58,500 barrels of NGLs per day. The plant was constructed with a total production capacity of 78,000 barrels of NGLs per day based upon 2.1 bcf/day of natural gas being delivered for processing. The property is located in Channahon, Aux Sable Township, Grundy County.

Appellant's case

The appellant appeared before the Property Tax Appeal Board through counsel arguing that the 2003 assessment of all the assets at the subject plant (including all machinery and equipment), assuming all the assets can be legally assessed, is excessive as compared to its fair market value. In support of the overvaluation argument, the appellant presented a complete summary appraisal of the subject property.

Additionally, the appellant asserted the assessment illegally has included items of personal property. The appellant agreed that land, buildings, large storage tanks (spheres), and foundations are properly assessed as real property; however, appellant disputed that its machinery and equipment or its piping may be assessed as real property. In part, the piping was argued to be like-kind to other non-taxable gas mains and pipes and that the same do not perform a process other than transportation and distribution. Furthermore, the appellant has challenged the lawfulness of Grundy County's classification of machinery and equipment as real property. In 1972 such in-line process machinery and equipment was reclassified. Prior to this reclassification, the county had a policy and practice of assessing process machinery and equipment as personal property. Appellant contends the decision to reclassify and its effects were unlawful and, as a consequence, the subject's machinery and equipment cannot be taxed as realty. In support of these legal arguments concerning assessments of piping and the unlawfulness of the reclassification, the appellant submitted a brief (Appellant's Ex. H) and further argued these points in post-hearing briefing.

In addition to the testimony of an appraiser, the appellant called other witnesses. Throughout this decision and for ease of the reader in setting forth the facts before the Property Tax Appeal Board, evidence and witness testimony may not be discussed

[1] Parcel 03-22-100-009 consists of 7.3 acres and parcel 03-22-100-011 consists of 31.55 acres.

in the same order in which it was presented during the multi-day hearing.[2]

Jeff White

Appellant's employee Jeff White, an engineer with a degree in mechanical engineering, was called for testimony.[3] He began employment with Aux Sable in April 2000 when construction of the Aux Sable facility was about half complete. In terms of construction scheduling, White was involved in reviewing the daily scheduling and had input into the schedule.

Construction of the plant began in early 1999; the Alliance Pipeline from Canada was also under construction. The pipeline was scheduled to go into service on October 1, 2000. In order for the pipeline to begin to flow gas, Aux Sable had to be ready to process the gas to make it saleable. As a consequence, Aux Sable's construction was on a fast track where the engineering, procurement, bidding of construction work and actual construction were occurring simultaneously or overlapping as opposed to flowing from one project to the next. (TR. 545-47)

Due to this timing issue, foundation or earthwork began while design was going on for electrical, piping, and similar items. As an example of the problems this created, some plant foundations, involving 7' deep spread footings with enormous excavations and backfill, had to be modified and additional foundations had to be installed. Such change events required the presence of additional equipment and ultimately cost more to remove and replace foundations. The fast track process also required more staffing, a shorter construction schedule, and arrival of some modules[4] before they were actually complete. Overtime included electricians who had to work on the modules that arrived on site incomplete along with other necessary electrical work on the site. The fast-track process prohibited the use of more cost effective lump-sum bidding. The majority of the work was done on a time and material basis where craftsmen on site were paid on an hourly basis along with material and equipment costs. The other method to pay the craftsmen was a unit basis for a specific task or project, such as a 24" weld. (TR. 547-57)

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[2] References to pages of the Transcript of hearing will be by page number(s) such as: TR. 22-24.

[3] In August 2002, White was promoted to Technical Services Manager. Those duties involved oversight of all departments, except maintenance and operations; the oversight includes purchasing, warehouse, safety, environmental engineering, process engineering, process control, quality control, and inspection. As of the date of hearing, White still held that position. (TR. 529-30)

[4] Modules were in two forms, either piping modules, sections of 120' long pipe rack, or equipment modules, sections that include everything such as pumps, heat exchangers, instrumentation, and electrical. To install the modules on site, the foundations were built, the module was set in place, and then began the process of connecting them together. (TR. 550-51)

During construction, there were also change orders, such as, gas compressors instead of electric-driven motors as negotiations with Commonwealth Edison for an electrical contract failed. As part of this change, waste heat boilers were also installed to capture the waste heat from the turbines for use in the glycol system in the plant; this addition meant there were two heaters for the glycol system already installed that were not needed. (TR. 557-59)

According to White, in general the fast track activities imposed additional costs on plant construction. Costs were tracked by David Parks, the cost control engineer for Aux Sable who tracks, monitors and forecasts costs on a large construction project. (TR. 559-60)

White testified besides the plant and pipeline construction projects, there was also a pipeline built between Aux Sable and the Mobil Refinery and a truck-loading rack was built in Monee at the Teppco facility. (TR. 566-67)

Upon completion of construction, White was involved in the commissioning and checkout of the plant after installation of the machinery, equipment and piping.[5] During this process, the facility/owner reviews the system to ensure it meets all design standards and was installed as it was intended. At Aux Sable, there are about 140 different design specifications that must be maintained to meet codes, specifications and to safely operate. The checkout process involved actually physically going out and walking every single piece of pipe in the system, every piece of equipment, making sure all the testing was properly done, and reviewing inspection records. If additional work was to be done, White developed punch lists. Once the work was completed, White had to take the system over for operation as part of the checkout phase. The commissioning phase was to prepare it for operation including purging, drying, loading the catalyst, and then ultimately starting up the unit. (TR. 527-28, 530-31)

The Alliance Pipeline interfaces seamlessly with the plant which takes the natural gas and removes the NGLs. Natural gas is a naturally-occurring product that includes methane, ethane, propane, butane, C5+ (normal gasoline) along with some contaminants such as sulfur or water. The Aux Sable plant extracts the NGLs from the raw natural gas,[6] fractionates the

[5] Appellant, after asking a number of questions, tendered White as an engineering expert in the physical characteristics, design characteristics, and production characteristics of the Aux Sable facility including the piping. Upon objection, the witness was not accepted as an "expert witness," although White's engineering background and experience with the plant was acknowledged by the Hearing Officer. (TR. 533-36)

[6] Extraction begins with dehydration removing any water in the gas; next an expander drops the pressure from 1,300 PSI down to 500 PSI, the gas gets very cold to about -140° F, which allows removal of the ethane and heavier liquids in the gas (C2+); and the next step utilizes the demethanizer, a large tower where the actual separation takes place; and the final step is to recompress the remaining methane gas (residue gas) which is redelivered back to the Alliance Pipeline which is the only product produced solely by extraction.

NGLs,[7] treats them for sulfur, and sells the NGLs. The fractionation process produces ethane, propane, isobutene, normal butane and C5+ (normal gasoline). Products from the plant are moved to customers either via pipeline or rail. (TR. 537-44, 572)

In describing the process, White did not include the piping because the main equipment consists of the towers, pumps, compressors and other items. Storage tanks at the plant are pressurized spheres, the products must be stored under pressure or else they just evaporate; there are nine spheres on site that hold propane, isobutene, normal butane and C5. Major equipment includes the towers, heat exchangers, pumps, and compressors. The piping simply moves the products to and from different locations within the facility. The pipes at the plant perform no other functions beyond the distribution of gas and liquid from one point to another at the facility according to White. Given his engineering background, White testified that the pipes at the plant satisfy the same design conditions, operate at the same pressure and same temperatures as the Alliance Pipeline. (TR. 573-74, 585-86, 589, 591, 597, 608)

The plant's capacity is expressed in terms of barrels per day, namely, the amount of barrels per day that can be run through an operating unit based on its design or rating. As of January 1, 2003, the Aux Sable plant produced 58,500 barrels of NGLs per day. The plant was designed to handle 2.1 billion cubic feet of gas per day (bcf/day) delivered by the Alliance Pipeline, but the pipeline in its initial construction only delivered 1.6 bcf/day of gas. The Alliance Pipeline was designed with 14 compressor stations along with the ability to install an additional 14 compressor stations to increase the pipeline's capacity from 1.6 to 2.1 bcf/day. The Aux Sable plant was built to handle the 2.1 bcf/day capacity as it would be much harder for the plant to expand than for the pipeline to install additional compressors. At 2.1 bcf/day of natural gas, the Aux Sable plant could produce approximately 78,000 barrels of NGLs per day. (TR. 567-71)

White also testified that there is a pipeline from the Aux Sable plant to the Exxon Mobil Refinery whereby the plant delivers products to the refinery. The Aux Sable plant also has 6-inch and 8-inch diameter pipelines to take plant products away from the facility; through the One Oak facility product is delivered to the Citgo Refinery in Lemont and through the Teppco facility to any part of the eastern United States. These downstream pipelines have the same design conditions as the pipes they connect to. Delivery pipes range from 6 to 10-inches in diameter. (TR. 609-10, 612-13)

[7] The NGLs are fractionated into their individual liquid components. The first step is the de-ethanizer where ethane is removed for sale and the remaining NGLs mixture goes to the depropanizer which removes the propane and then the remaining butane and heavier liquids go to the debutanizer which removes the natural gasoline and butane, and the final step is to take the remaining butane liquids to the butane splitter which separates it between isobutene and normal butane.

During cross-examination of White, intervenors established that rich natural gas coming down the Alliance Pipeline is above an optimum BTU value which requires processing before it can be sold. The witness reiterated that Aux Sable does not sell the residue gas (natural gas remaining after extraction of the NGLs) which is now a saleable product.

White further testified that the Alliance Pipeline was designed with compressor stations every 120 miles along with tie-ins in between at 60-mile markers to put additional compressors in. White knows of no plans to bring in more than 1.6 bcf/day of natural gas. Compressor stations could be added to the Alliance Pipeline without shutting down the Aux Sable plant. (TR. 652, 655, 662-63)

To produce all the products, the entire extraction and fractionation process, including the piping, is integral and necessary to flow from one spot to another in the process. The piping at the plant is not laid in roads, streets or alleys. (TR. 623-26) The heat exchanger, which is necessary for the processing of the natural gas, must have water to perform its function; the water flows through pipes. (TR. 628-32)

The witness reiterated the extraction and fractionation processes within the plant with the residue or dry gas being recompressed in a compressor and sent back to the Alliance Pipeline. Further details of the individual aspects of the plant process were developed including acknowledgement that the components had both inlet and outlet pipes, flare blow-downs, pressure safety valves, and instrumentation piping, among other components; without the piping that was described, it would be impossible to perform the given processes. The piping is a necessary and integral part of the various processes being performed. (TR. 666-69, 680-83, 686-90, 726-40, 753, 767-70, 776-80, 785-97, 821-26, 828-34, 836-37, 858-67, 875-88, 890-91, 918-23, 925-26, 928-31)

The witness explained that the entire plant from the entry of the Alliance Pipeline to the end point of the five end products and the return of the dry gas to the Alliance Pipeline requires all of the piping and equipment that is at the plant all of which is essential and integral to the creation of the five products and the return of the dry gas to the Alliance Pipeline. (TR. 892-94, 915-16)

White also testified that the Aux Sable plant has the ability to reject ethane by either lowering the recovery of the demethanizer so the plant does not recover as much ethane or by producing the ethane and, rather than sending it through Enterprise, the plant could send it back to Alliance. The typical reason to reject ethane is because it is uneconomical to produce. (TR. 932-33)

The witness testified the plant purchases its electricity needs on the open market, although it has two emergency generators for use to bring the plant down safely. The plant's gas-fired

turbines are used to recompress the gas that's sent back to Alliance. The exhaust heat from the turbines goes to the waste heat boilers which heats the glycol system[8] in the plant. When on a two-train operation, around January 1, 2003, the exhaust heat from the turbines was sufficient to heat all of the glycol necessary for plant operations. (TR. 933-34, 937-43)

White described the subject's construction via about 60 modules, either equipment or piping, which were constructed in Louisiana and barged in part to the facility. Once established on site, the piping, electrical and other connections were made to make it an operational piece of the plant. (TR. 964-65, 983-86)

The witness acknowledged that the Aux Sable plant has pollution control facilities, but he could not identify which specific systems qualified as such devices. (TR. 917-18)

White was asked about the recordkeeping of the plant related to the costs of equipment. White testified costs of the entire extraction train area exist and are maintained by accounting and White has a copy in the final construction report. The construction reports of indirect costs include owner's costs (which includes commissioning costs), engineering, insurance, and legal fees. The final construction report was prepared by the plant construction manager, Hans Zinkmantel.[9] (TR. 671-73, 675-76) The witness testified to his duties in developing capital project costs including depreciation and breaking down costs by percentages as requested by accounting from time to time. (TR. 678-79) White relies on the final construction report of Zinkmantel, but White does not know the source of the data in the Zinkmantel report. (TR. 839, 845, 869)

White has not seen a detailed cost analysis prepared by David Parks. The witness described Parks as the cost control engineer for the plant on the construction project. (TR. 785, 842, 845)

White was aware there were costs over budget in the construction of the plant due to overtime. The major reason was trying to meet the schedule with an example being that additional electricians were brought in. (TR. 997, 1000)

The witness recapped the commissioning and checkout process he engaged in to ready to the plant for operation. He noted that with 80 systems, some systems were fully operational while others were still in process. All systems were commissioned as of December 1, 2000 after which the plant went into operation. (TR. 1011-13, 1015, 1017-21, 1024)

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[8] The glycol system is the heat transfer fluid used throughout the plant; for instance, the reboilers in the towers exchanges heat with the product in the towers.

[9] The final construction report cost records authored by Zinkmantel were broken down by area of the plant; the breakdown was by major equipment, piping, instrumentation, insulation for an area of the plant and as part of the overall extraction process lumped into the category of major equipment. (TR. 780-84)

After commissioning the plant did not run completely problem-free. The witness acknowledged that with any start-up you have normal issues that must be dealt with, such as equipment problems. Most of those issues were worked through in the month of December. White asserted that plant operation problems in 2001 were normal operation and maintenance of the facility. (TR. 1025, 1030-31, 1039-40)

White testified the natural gas that comes into the plant is a vapor; it would evaporate if not contained within pipes or equipment. (TR. 1079) He also reported that all piping on the facility is above ground, except the cooling water and fire water. (TR. 1082)

During redirect examination, White testified in order to operate the plant, it is necessary for Aux Sable to receive natural gas and therefore the pipelines that deliver natural gas are necessary for the operation of the plant. That would also be true of the Alliance Pipeline and the pipelines to Mobil and Enterprise that take the NGLs away from the plant. (TR. 1091)

Peter Fasullo

In support of the appellant's overvaluation argument, a complete summary appraisal of the subject property prepared by Real Estate Analysis Corporation (REAC) with a valuation date of January 1, 2003 was submitted. In part, the appellant's appraiser relied on data gathered by Peter Fasullo, an individual not employed within REAC.

Fasullo, a chemical engineer, who has operated his own consulting company, EnVantage,[10] since 1999, was called as a witness. The witness was tendered as an expert in the economics of the NGLs industry.

Counsel for intervenors made inquiry on *voir dire* regarding the type of consultations done by Fasullo involving market analysis, positioning in the market and related matters. It was confirmed that he does not perform valuations of any type regarding real property, machinery or equipment. Fasullo testified that his firm does economic type evaluations on what a given asset may generate in terms of margins and therefore an opinion if an asset is properly or improperly priced or positioned in the marketplace given market conditions. The witness was qualified as an expert in the economics of the NGLs industry; over objection on relevancy grounds, the witness was allowed to testify further.

[10] The company consults on strategic planning, project development and project evaluation for energy companies and others regarding natural gas, gas processing, NGLs, refining, and petro-chemical products. Clients also include hedge funds, private equity groups, and investment banks which are gathering data on market trends for investments and/or projects. (TR. 22-28)

NGLs consist of five products extracted from rich natural gas and consist of: ethane, propane, iso-butane, normal butane, and normal or natural gasoline. The amount of each of these products varies depending upon the richness or liquid content of the natural gas; the most predominant product tends to be ethane. Each of these five products obtained from NGLs is a commodity that is marketed and traded in the marketplace. The ethane market is limited to the production of ethylene (plastics for bags, etc.); propane is primarily used in the space heating market; normal butane and iso-butane are used in the production of motor gasoline with some limited uses of normal butane in the petrochemical industry; and natural gasoline has the widest uses in motor gasoline production, in heavy crude oil production, and to denature ethanol, among others. (TR. 37-38, 40-41)

Fasullo testified that NGL prices are set by the competition or by other petroleum feedstocks since the markets that utilize these products have flexibility in selecting from several suitable feedstocks other than NGLs. Additionally, there are many impacts upon the prices of natural gas including economic conditions and very cold weather since natural gas is used in residential heating. If natural gas prices rise faster than NGL prices, Fasullo testified there is a compression in the margin.[11] (TR. 42, 45-46, 59)

Fasullo briefly addressed some historical natural gas prices in January 2000, average prices in 2001, changes that occurred in prices over the course of 2002, and how the price was again high by March of 2003. He also discussed the natural gas futures market which was also high by March 2003. He further opined that looking back at natural gas prices for a prior twelve month period as a predictor of future prices is ill-advised as it is an extremely volatile market, due to variables such as weather or other circumstances, although past prices are used as a reference point.

He stated that data on both the NGLs prices and the price of natural gas are necessary to consider the profitability of the NGLs industry. If margins were low, or narrow, in the NGLs industry, a buyer would not be willing to pay as much for that asset as during a high margin environment thus, Fasullo opined that margins have a direct link to the valuation of a particular asset in the gas processing business. Margins are the primary mechanism by which earnings are set in the NGLs industry. The asset is evaluated based on its earnings stream according to Fasullo.

The witness testified that margins were very distressed in the NGLs industry as of January 1, 2003 where processors were not able to make money because natural gas prices were high relative to the market price available for NGLs. His opinion was based

[11] The gross profit or margin in the NGLs market is the difference between what NGLs sell for and the cost of the natural gas; this difference is a gross way to calculate gross profits. (TR. 51-52)

upon reports of, for instance, publically traded gas processing operators which reported first quarter 2003 profits suffered due to narrow margins in the NGLs business. (TR. 56-57)

He also opined that the NGLs market is cyclical and volatile which is known to knowledgeable buyers. Because of the volatility in the market and the margins, Fasullo opined there is a great deal of risk in the earnings stream due to the lack of predictability from one period to the next which thus impacts the value of the assets used to make NGLs in that there would be an effort to discount the risk in the price of the asset.

EBITDA is an acronym for "earnings before interest, taxes, depreciation, and amortization." The price paid for an asset is measured by many in the industry by an EBITDA multiple to ascertain whether there is a high multiple or a low multiple against the asset's earning stream. Fasullo testified that EBITDA is another measure of cash flow before interest, taxes, depreciation, and amortization.

Fasullo provided data in his role as a consultant which was given to appellant's appraiser Michael Kelly and appears in the REAC appraisal report on page 141. Fasullo gathered the sales data and EBITDA multiples from analyst reports, industry publications, and/or discussions with industry participants. (TR. 63-65)

As of January 1, 2003, industries which process NGLs were purely based upon margins (proceeds from sales of NGLs versus what was paid for natural gas) although there was a movement occurring to shift to a fee-based contract with natural gas producers for processing the natural gas. The appellant's appraiser requested Fasullo's assistance in estimating fees for services. The information Fasullo gathered reflected a fee of about $0.09/million cubic feet to process a producer's natural gas for extraction. The fractionation fee was about $0.02/gallon. (TR. 66-67)

According to Fasullo, the appellant's appraiser also worked with Paul York of EnVantage regarding understanding sales of partial interests in the subject facility. (TR. 67-68)

Upon cross-examination by intervenors' counsel, Fasullo acknowledged his firm has done a number of projects in the past and subsequent to the instant consultation project with Aux Sable to evaluate markets, perform market reviews, provide an outlook on ethane supply and demand, and to evaluate the natural gas and NGLs markets; in fact, EnVantage was on a monthly retainer fee when the Aux Sable plant was starting up and just recently the firm was hired by Aux Sable to provide updated data on ethane supply and demand. (TR. 71-74, 76-77)

Fasullo never discussed Aux Sable's margins with its representatives; his work with Aux Sable at that time involved analysis of trending for the supply and demand for a given NGL product and/or natural gas including storage, pricing

implications and what was driving the NGLs market at that time; Fasullo does not recall having provided a forecast[12] for Aux Sable at that time; they may have discussed short-term price direction in weekly updates that were provided with an outlook of up to one month. (TR. 78-79, 287, 289-91)

Appellant's appraiser did not seek any forecasts from Fasullo; he may have sought data on what margins were prior to January 1, 2003; however, such a backward look would not be used in making a forecast. (TR. 292)

The witness testified that processors working on margin must either pay for or physically replace the equivalent volume of gas or BTUs that were removed by taking out the NGLs. There is no set percentage of each of the five products in a gallon of NGLs because the breakdown is dependent on the liquid content of the gas that is being processed. The quality of the gas can also vary from day to day; it is not a constant; it may depend upon the producers feeding into the pipeline. (TR. 436) In the course of processing, volume is removed from the natural gas which must be replaced (some ethane may be used, but it is unusual); this make-up dry gas is usually purchased on the open market to make up by actual physical volume or it can be made-up by money; there is no industry standard; the method is dependent upon the contracts.[13] The cost of make-up gas is the largest part of the cost of goods sold for an extraction plant. The margins are determined by calculating the difference between the price obtained for the NGLs and the price the processor must pay for "make-up"/dry gas to replenish the volume of rich gas removed in the fractionation process. As compensation for making the wet or rich natural gas a saleable product through processing (i.e., performing a service) for the producer, the processor receives the NGLs that are extracted. (TR. 107-08, 230-32, 256-58, 277-80, 379-83, 410, 434, 441)

Impacts on the price of natural gas include extreme temperatures, the price of crude oil which tends to rise or fall with natural gas, inventory levels, and there can be regional differences based on the network of storage and/or pipelines. (TR. 334-38) An oversupply of natural gas can be caused by reduced demand such as a mild winter with plenty of gas in storage and plenty of production. (TR. 359) With an oversupply, the price of natural gas would tend to decrease. (TR. 359-60, 365) Such a price decrease would tend to decrease the cost of goods sold for Aux Sable and possibly increase its profit margins. (TR. 365)

Many factors impact the selling price for each of the five NGLs products which can be different for each product. Many factors also impact the costs associated with processing rich gas to

[12] A forecast service may involve a five-year forecast in NGLs prices and/or natural gas prices. (TR. 291)

[13] The processor can compensate the producer of the natural gas for the value of the shrinkage or the processor can compensate the producer physically for the shrinkage. (TR. 257-58)

extract the NGLs, the primary component is the cost of the natural gas; other components can be costs of plant operation, capital charges, variable costs (could be fuel, electricity, etc.), fixed costs (labor). Costs of fractionation are basically the fuel cost to operate the fractionators along with operating costs like labor, capital costs, and variable costs. These factors do not affect the selling price of the NGL products, but the factors can affect profit margins for the NGLs. (TR. 328-32) The various factors impacting the gas industry and the NGLs industry can create a lot of variability in the profitability of these industries which have been historically volatile and continue to be so; the profit margins were volatile in 2002. The volatility can be cyclical as it revolves around the economy that is cyclical. (TR. 375-77)

In general, Fasullo would characterize the subject plant as a mid-stream company[14] in that it serves an upstream natural gas exploration/production company and in that it links downstream products (NGLs) for a petro-chemical plant or a refinery. (TR. 80) As a mid-stream company, the appellant obtains income from fees it may charge or on the margins received on the product(s) extracted from the rich natural gas. (TR. 81) The price of the NGLs is dependent upon the market for the products into which the NGLs can be made. (TR. 260-61) The unit of sale of NGLs is in barrels per day and the price of the commodity is quoted in cents per gallon. (TR. 261) Fasullo agreed that the Alliance Pipeline was dedicated to the subject plant. (TR. 85)

Natural gas can be rich or it can be lean. According to Fasullo, the natural gas shipped to the subject plant was fairly or relatively rich gas; it had enough liquids to be extracted. The witness explained the distinction is that natural gas for residential use has about 1,040 BTUs per standard cubic foot[15]; gas entering the subject plant would have about 1,090 BTUs per standard cubic foot whereas other gas streams may have 1,100 or 1,200 BTUs per standard cubic foot which would be considered to be very rich streams. (TR. 88-89, 228)

Upon the gas stream entering the plant, Fasullo understood that the producer still owned the natural gas. (TR. 91) After the extraction process, the natural gas is called dry or lean because the liquids have been extracted. (TR. 93) After extraction, the ownership of the dry gas depends upon the contractual relationships of the processor and producer. (TR. 95)

According to Fasullo, it was Aux Sable's in-house counsel Katherine Dodds who advised Fasullo and his firm to expect contact from appellant's appraiser to assist on this particular project; it was understood EnVantage would be compensated for

[14] Plants in the midstream industry include those which transport either oil or gas to an end-use market, whether that be petrochemicals or refining; the plant is between what is being produced and what is being consumed. (TR. 367)
[15] Saleable natural gas generally has a BTU content of from 1,040 to 1,060 BTUs per standard cubic foot. (TR. 225-27)

assisting the appraiser in gathering market data, market analysis and/or gathering information on transactions and the like. (TR. 159-60) He has been paid on an hourly basis for this project related to providing data to appellant's appraiser at about $300 per hour with the total fee to EnVantage for this work from $5,000 to $20,000 thus far. (TR. 161) His testimony is compensated similarly at $300 per hour and he has put in at least fifteen hours thus far. (TR. 191, 198)

Fasullo never read the appraisal report. Fasullo recognizes the numbers in the report as the numbers that had been given to the appraiser by EnVantage although he did not check the data in the appraisal line by line. (TR. 95-97) He also testified that he educated appellant's appraiser as to the markets and, in response to the appraiser's request, gave him data with regard to sales of midstream assets (gas processing plant or fractionation) prior to and in 2003; in addition, the appraiser requested that EnVantage dissect the partial sale of Aux Sable's interest which was a project worked on by York, another employee of EnVantage. (TR. 98) Data in the report regarding the sale of a partial interest in the Aux Sable plant as shown on page 128 was provided by York. (TR. 151-59) Fasullo did not review York's data (TR. 182) Fasullo and York did not cross-check each other's data submission(s). (TR. 185-86)

Fasullo has assisted in buyer or seller transactions of natural gas processing plants by engaging in due diligence on the plant in terms of its commercial operations, any risk associated with the plant, and based on a market analysis; Fasullo tried to determine an income stream and cost analysis for the plant. (TR. 128)

During the course of cross-examination, Fasullo also revealed that his company has provided a weekly report to El Paso Company starting when El Paso became an owner of Aux Sable, but he has no working relationship with Williams, Enbridge or Fort Chicago. (TR. 196-98)

Fasullo testified that to his knowledge the four sales presented on page 141 of Kelly's appraisal report were the only sales about which EnVantage provided information to Kelly. (TR. 102-03) The reported sale price was derived either from a participant in the transaction or a press release; EBITDA data may have been reported by a participant, an investment bank, or it may have been published. The asset description was usually obtained from press report(s). (TR. 122-23)

As shown on page 141 of the REAC appraisal, Sale #1 involved buyer Enbridge Energy Partners; the transaction was verified after appearing in the press that the property sold on a certain date with certain capacities, liquid capability and specified sale price; this was an extraction operation.[16] Fasullo believed

[16] The assets described by Fasullo in Sale #1 include "1880 miles of gathering" which refers to piping from well heads to a central point that gathers the

that the sale involved a 100% interest in the business including the entire going concern and all of the assets. (TR. 103-06) Fasullo was unaware whether this was a stock sale. (TR. 125)

As to the EBITDA multiplier for Sale #1, Fasullo's firm reviewed analysts that follow the companies; in some cases, the analysts reported what EBITDA multiple was paid for the assets and in some cases an analyst of the company may reveal what EBITDA multiple was paid for the asset(s); alternatively, other industry participants may have reported the type of EBITDA paid. (TR. 114) Fasullo does not believe he spoke to any of the participants in this sale transaction, but testified the data was probably documented fairly well. (TR. 144)

Fasullo viewed Sale #1 as having similar components to the subject property, being a midstream sector asset, with a sale of the entire interest in the company of the going concern and all the assets. Fasullo was not aware how this particular plant charged for its processing.

As to Sale #2 on page 141 between seller El Paso Corps and buyer El Paso Energy Partners, LP, Fasullo testified these could possibly be affiliated companies. The witness was not familiar with the term minority discount. One of the El Paso companies was a part owner of the appellant company based on press releases and on site it states who owns Aux Sable. (Tr. 126-30) This sale involved a 42.3% interest in an Indian Base, New Mexico processing (extraction) and treating[17] plant; the plant did not include fractionation. Fasullo also reported to Kelly that the assets included "10,677 miles of gas transport assets (major component of sale)" because Fasullo thinks it constituted the bulk of the assets which were sold in the transaction. (TR. 130-31) The sale principally involved the pipeline sale. Fasullo believes he spoke with participants in Sale #2 although the sale and EBITDA was very well documented. (TR. 144)

Sale #3 involved the sale of Trans Canada's midstream operations, but Fasullo did not know specifically what type of interest was sold, i.e., stock, etc. The entire business was sold according to press reports which he trusted as accurate.[18] In the sale price column for Sale #3, Fasullo believes this may reflect $540 million in U.S. dollars followed by $81 million Canadian dollars, but he was not sure without reviewing his own notes. Fasullo could not explain the "8 mm plus Ft. McMurray plant costs"

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gas; "treating" means removal of impurities from the natural gas before processing and made marketable; and "Gas Processing Capacity" notations refer to the three processing plants that were part of the sale of the going concern. (TR. 132-33)

[17] On occasion, natural gas contains impurities like sulfur or carbon dioxide which requires treatment before the gas can be marketable. (TR. 130)

[18] The sale included Cochrane, a processor (extraction), as were Empress II and Empress V; "field plants" which are located adjacent to where the gas production is occurring (drilled up); the Redwater fractionator, an NGL fractionators; an NGL pipeline system and 5 mm barrels of NGL storage capacity. (TR. 134-36, 139)

notation on Sale #3's price. The witness believes he provided Kelly with all of the data shown on page 141 of the appraisal report, including the EBITDA multiplier. Fasullo testified he obtained the Sale #3 EBITDA figure from a published report known as Gas Processors Report; Fasullo did not recall specifically if he further confirmed the EBITDA data. (TR. 141-44)

Data on Sale #4 was published by the participants and in their press releases; Fasullo also verified the terms through conversations with the participants. This sale involved both an extraction and fractionation facility with storage facilities. (TR. 144-46)

EnVantage also provided appellant's appraiser Kelly with the "Fractionation Spread" graphic on page 142 of the appraiser's report which is another aspect of what the market was doing at the time. The graphic was not specially prepared for Kelly, but was regularly maintained by Fasullo in the course of his work on the industry. (TR. 148-49, 160)

Fasullo characterized the NGLs industries' economic conditions on or before January 1, 2003 as being in distress in the fourth quarter of 2002 for those companies operating on other than a fee basis and prior to that it was marginal. The futures market was predicting a price rise in 2003 in natural gas prices; the NGLs industry has a major cost component in natural gas. After asserting fee-based processors were not in distress, Fasullo noted that he cannot actually specify if there was distress for fee-based NGLs processing companies since he did not know the negotiated fee and/or what other services the plant may have had with the producers. (TR. 199-200, 204)

The witness stated a processing plant does not have a choice to charge a fee, but must accept what is acceptable to the natural gas producer.[19] In terms of business strategies for an extraction plant, shifting to a fee-based structure from a margin-based structure may be dependent upon the terms of the existing contract (i.e., length of contract, etc.). (TR. 200-01, 301-03) In 2003 when margins were very, very poor in the gas processing industry, processors were able to convince producers to shift to a fee-based relationship as producers need the processor. (TR. 305-07)

In response to Kelly's request, Fasullo provided data he thought was representative of the market value of fees during 2003; there were not many fee-based companies and the data is deemed confidential so Fasullo presented what may be a typical negotiated fee. He surveyed three to four processors, reflecting about 30% to 40% of the industry, to ascertain typical negotiated fees charged for natural gas processing and found a range of 8

[19] Margin-based extractors began to contest contracts in about 2003 since margins were so low that processing was not economical and the processors tried to switch to a fee basis; prior to that time, very few contracts were fee-based.

cents to 10 cents per gallon. Fasullo also gave representative fee data to Kelly that was published in Gas Processors Report which reflected 0.09 cents per 1,000 cubic feet of natural gas. Prior to January 1, 2003, fee-based arrangements were not widely used or very common. (TR. 205-10, 216, 467-76)

As to the sales chart on page 139 of the REAC appraisal, Fasullo noted it included Sales #1, #2, #3, and #4 that was data provided by EnVantage, except the price per barrel of daily capacity which was not provided by EnVantage.[20] (TR. 163-66, 173-74, 178-79) Fasullo could not explain the discrepancy in sale dates for Sale #3 on page 141 and what was shown as Sale #2 on page 139. (TR. 166, 176)

In this industry to compare one sale to another sale, Fasullo testified that several different metrics can be used such as a multiple of EBITDA, price per barrel of capacity, or price per barrel of the inlet capacity of the plant in terms of millions of cubic feet per day, as examples. (TR. 175-76) If Fasullo was going to compare the profitability of two extraction plants, he would have to know the percentage of NGLs that are taken into each plant; each gas stream could have a different composition of liquids. (TR. 255-56) Prior to the instant project, Fasullo had never been hired to provide data to an appraiser. (TR. 180)

The latest project from the appellant, for a thorough overview of the ethane markets and the impact on appellant, was agreed to in early April 2008 through a call from Bill McAdam initially and later an arrangement was made with the Canadian office with a different compensation arrangement for a fixed price of $30,000 for the work. (TR. 187, 192-95) At the time the project was contracted, Fasullo was not aware of his impending testimony in this matter; he did not learn of his need to testify during the week of June 2, 2008 until about three weeks prior. (TR. 189)

On re-direct examination, Fasullo testified that the potential cost saving techniques that extractor/fractionator plants can use do not provide a guarantee of cost savings. Likewise, the risk reducing techniques Fasullo described do not guarantee that risks will be reduced. Profit enhancing techniques that were described also do not guarantee profit enhancement. However, each of these techniques is known throughout the industry. (TR. 478-79)

To his knowledge, Aux Sable is a knowledgeable and competent operator in the industry. (TR. 479)

Fasullo opined that natural gas processing plants are bought as investments. (TR. 479) In a purchase decision of an operating plant, the knowledgeable buyer would look at the cash flow stream generated by the margins of the plant to determine how much the buyer is willing to pay for it and what kind of return the buyer

[20] To calculate barrels of production per day from the data EnVantage provided as shown on page 141 of the appraisal, the sales price would be divided by the liquid processing capacity.

wants based on price. (TR. 480-82) Also for the tangible assets of the natural gas plant, land/buildings/equipment and excluding goodwill or working capital, would be the same answer. (TR. 482-83)

The general status of income streams generated at natural gas processing plants as of January 1, 2003 was very marginal during that time. (TR. 483-84) Any knowledgeable buyer of such a processing plant would take that fact into account when determining the amount to be paid. (TR. 484)

As to the sales listed on page 141 of Kelly's appraisal report, none of the four mid-stream sales listed have exactly the same physical characteristics as the Aux Sable plant; each sale includes some assets not found at the Aux Sable plant; the sales also differ one to another in terms of assets and locations. (TR. 484-85) Fasullo did report to Kelly the EBITDA multiplier shown in the far right-hand column of the data on page 141. (TR. 485) The industry uses EBITDA multipliers to reconcile differences between different mid-stream facilities, for instance, as an indicator of the quality of the earning stream in that in very good times there may be high multiples paid and in bad times or marginal times the multiples may be lower in nature. It could indicate the risk profile of particular assets in the business; if an asset has a lot of margin volatility, then it sometimes will be paid a much lower multiple than if it has more of a reliable earning stream and you may pay a higher multiple to it. (TR. 486-88) The EBITDA multiples always measure the assets on their income streams. (TR. 488-89)

In making a purchase decision, Fasullo opined that buyers are primarily concerned with the future income stream, which is a projection, and to Fasullo's knowledge no knowledgeable participant would buy an operating natural gas processing plant without considering the income stream produced by that plant. (TR. 489-90) Looking to the REAC appraisal, Fasullo stated that a Redwater fractionator, a mid-stream asset, was part of a sale in October 2000 from Trans Canada to Williams Company as shown on page 141 in the EBITDA analysis. This property was then sold again in September 2003 as Sale #2 on page 139 of the report from Williams to Provident Energy. (TR. 492-95)

Fasullo's understanding was also that the Aux Sable plant was built to service the Alliance Pipeline. (TR. 497-98)

A knowledgeable operator would seek to maximize profits for the whole extraction/fractionation plant because it is an integrated system with common utilities to where the plant would operate almost like one unit, especially if the fractionator's sole feedstock came directly from the processing plant. (TR. 498)

The witness opined that processors in difficult financial straits might have some strength in negotiating a fee contract with the owner of the natural gas stream since the processor can approach the producer and indicate that it cannot continue to process;

since the producer needs a certain amount of liquids extracted to make the pipeline gas marketable quality, the processor which is in economic distress now has leverage to negotiate terms. (TR. 499-01)

Upon further cross-examination, Fasullo acknowledged that he was not personally familiar with the operations of Aux Sable. (TR. 503) Furthermore, he assumes Aux Sable is a knowledgeable or competent operator since it is still in operation; the plant has been viable since 2001 from an operational standpoint. (TR. 503-04) However, Fasullo does not know about Aux Sable's level of competence. (TR. 504)

Fasullo asserted that a knowledgeable buyer of a processing plant would factor in one quarter's poor margins into setting the price. (TR. 505-06)

As to the question about buying the tangible assets, Fasullo was looking at the plant as one that generated a margin; the witness does not know what is meant by "going business concern." (TR. 506-09)

For additional re-direct examination, the witness noted the he has no reason to think Aux Sable management is incompetent; they seem very knowledgeable about what they are doing from his contacts with them. (TR. 512)

As a final cross-examination inquiry, Fasullo noted he has no knowledge about the operational side of the Aux Sable plant; Fasullo's contact with the company has been mostly on the business side. (TR. 512-14)

Michael J. Kelly

One of the appraisers who prepared the REAC appraisal report (Appellant's Ex. A), Michael J. Kelly, appeared at the hearing and was subject to extensive cross-examination. Prior to the hearing, the parties stipulated that Kelly was qualified as an expert in the field of real estate appraisal.

Kelly, who is a licensed appraiser in Illinois, Iowa, Indiana and Michigan, also holds the Member of the Appraisal Institute (MAI) designation and the SRPA designation from the Society of Real Property Appraisers in addition to having published articles on the valuation of landfills, business value at regional malls, analysis of rates of return on stocks, and a chapter on appraisals for the Illinois Institute of Continuing Legal Education. For fifteen years, he has taught courses throughout Illinois for assessors. For about the past twenty years, Kelly has been employed as president of REAC which is an appraisal firm concentrating in industrial and commercial properties located primarily in the Midwest.

Kelly has been qualified as an expert witness in proceedings in various states and stated that he has testified before the

Property Tax Appeal Board more than fifty times. He has prepared appraisals for governmental entities and has experience appraising complex industrial properties such as paper mills, liner board mills, cement plants, fertilizer, and lime plants; in those instances, Kelly appraised the properties as an economic unit with machinery and equipment included in the valuation. Kelly has also appraised "more typical" industrial properties with an appraisal of the land and buildings.

This appraisal utilized the three traditional approaches to value in concluding an estimated market value in fee simple estate of the subject property, including personal property, after deduction for the contributory value of the Pollution Control Equipment, as of January 1, 2003 of $150,000,000. For valuation purposes, Appellant's Exhibit A, included the land, buildings, and what the appraiser termed as 'personal property' of machinery and equipment and less than $1 million for portable equipment such as furniture, hand tools and office equipment. The appraisal included a value estimate for all 157.91-acres consisting of three separate parcels. The appraiser determined the highest and best use of the subject land as vacant would be industrial use and its highest and best use as improved is its current use. (Appraisal, p. 45-48)

Kelly testified that with the inclusion of machinery and equipment as a component of real property and valuation of tangible assets of the business, in a sense the nature of the appraisal assignment is changed; the appraiser is valuing the property as an economic unit including the machinery and equipment which means it is an appraisal of the property as an operating unit taking into consideration what takes place in the industry that the property competes in. (TR. 1316)

Kelly testified the typical procedure in these industries is to look at the property in terms of what it can produce, the products made on the machinery and equipment, and analyze it in the context of that market in terms of profitability, including what the plant can produce and the state of the industry is as of the date of valuation. When valuing an economic unit, the industry trends affect all of the producers in that industry to some extent, whether the trends are good or bad at that point in time; the plant has to operate within the context of whatever industry it is in. When valuing the economic unit, the appraiser is valuing the economics of the plant as a participant in that industry. Kelly was not sure that the inclusion of all the tangible business assets by itself in the appraisal would have an impact on the volatility of valuations from year-to-year; the given industry may be volatile and needs to be looked at in the context of what is going on in the industry. (TR. 1316-18)

The witness also asserted that inclusion of machinery and equipment narrows the potential range of buyers compared to valuation of only industrial buildings because it is a valuation of the property as an economic unit which means it is a plant competing in an industry; offering it for sale, the most likely

buyers are persons within that industry as compared to an empty industrial building that can be used for a variety of different purposes which expands the potential pool of buyers. (TR. 1318-19)

In the report, Kelly was said to have inspected the subject property on June 28, 2001 and August 20, 2003. Kelly testified that the subject plant is connected to the end of a rich natural gas pipeline that comes down from Canada; the plant pulls out roughly 2% of the natural gas to make NGL products and then returns the gas in a slightly lower BTU content to the pipeline for use in commercial applications. The plant then takes the NGLs which were pulled from the rich natural gas stream and first makes ethane which is shipped out of the plant through a pipeline; then propane is pulled out and shipped out of the plant; then they make two types of butane that are shipped out of the plant; and the final product is C5+ that is shipped out of the plant. (TR. 1333-34; Appraisal, p. 26-28)

According to Kelly, the prime driver of the subject's revenues essentially is the margin or what can be made on the difference between what it costs the plant for the natural gas versus what they can sell the NGLs for after they have been pulled out; the margin creates the profits for Aux Sable. (Appraisal, p. 34) Kelly also asserted the price of crude oil impacts the subject because if purchasers of the plant's products can substitute cheaper feedstocks, they tend to do so. For the plant, the primary cost of goods sold is the cost of the make-up gas, i.e., the replacement of the shrinkage which occurs due to the removal of the NGLs. In addition, the subject has fixed expenses for labor and fuel to operate the machinery. (TR. 1335, 1338-39)

Research data utilized by Kelly included information from Petral Consulting,[21] EnVantage, and other published sources. The appraisal report discusses the natural gas market from page 17 through page 25. Page 19 in Appellant's Exhibit A reflects the trend in natural gas prices from January 1998 to mid-2001 with prices around $2 per million BTU in 1998/1999 and then climbing to a peak in late 2000/early 2001 of $8 or $9 with a downward trend during 2001. Kelly testified that natural gas prices for the period from June 2001 to the date of valuation were generally between $3.50 and $4, but began to increase again to about $4.50 by December 2002. (TR. 1336-38)

Kelly testified that the income approach to value was an important part of the valuation process for the subject property because it is an income-producing plant and its value is driven by whatever net income it can produce in its industry. Kelly opined that a buyer's purchase price for the subject property would be what the buyer thinks the net income would be for the plant. (TR. 1339)

[21] Petral Consulting is a company in Houston which publishes national newsletters on prices and projected prices at certain points in time. (TR. 1376, 1803)

"A specific procedure is followed [under the income approach] to estimate the value of a natural gas extraction and fractionation plant as a going concern." (Appraisal, p. 87) For the income approach Kelly used two methods to project net income.

First, he projected market price for NGLs and deducted the cost of goods sold which was the cost of the natural gas. The plant currently assumes all the market risk for the price and margin of the processed NGLs under the 15-year contract with the owners of the Alliance Pipeline to process the gas for a group of 37 gas producers. (Appraisal, p. 106) To make this projection, Kelly looked at revenues of the plant that had been up and running for only 2001 and 2002 (Appraisal, p. 96); Kelly stated the plant had been operating at a loss. He looked at what the margins have been for those two years by product line and projected a margin for each product (Appraisal, p. 100-01). Kelly noted that in general Aux Sable's margins have been less on a per-gallon basis than the nationwide margins, therefore, he thought using what Aux Sable was getting for the last two years was more representative than what the average had been nationally. (TR. 1384-86) Kelly then looked at what the projected price of natural gas was for 2003 and used that as his cost if it sold and deducted fixed expenses, and then capitalized that at a rate of return from the industry and added the effective property tax rate. (TR. 1341-42) From this analysis, he determined stabilized revenue of $300,000,000[22] (Appraisal, p. 101) less cost of goods sold of $245,434,000 (Appraisal, p. 102-103) and less fixed expenses (excluding real estate taxes) of $38,000,000 (Appraisal, p. 104).[23] This resulted in a stabilized net income before taxes for the subject under this analysis of $16,566,000. (Appraisal, p. 104)

As a second method, Kelly considered income via 'fixed fee' or a market indicated fixed processing and fractionation fee where the risk of market price and margins remained with the gas producer (Appraisal, p. 105). In this scenario, a gas producer/gatherer, pays a fixed processing fee to a plant like the subject. Such an arrangement reduces the risk for the processing plant, but also removes the potential for profits if the NGL margin rises. Kelly's research[24] resulted in use of a processing fee of $0.09 per 1,000 cubic feet of natural gas at the plant's intake of 1.5 bcf/day and 365 days resulted in a revenue projection of $49,275,000 for gas processing. In addition, fractionation fees

[22] The plant was getting approximately 1.6 bcf/day of gas which converts to approximately 58,500 barrels of NGL products that can be extracted from that. Kelly did not utilize the "potential" 2.1 bcf/day of natural gas figure because the plant does not have that input now and did not have it on January 1, 2003. (TR. 1345-46)

[23] While the first year's expenses were $46 million, Kelly testified that in the first year of operation you would probably expect expenses to be slightly above typical; given the 2002 decrease in expenses, Kelly used the lower amount of $38 million. (TR. 1390-91)

[24] This method was aided by Fasullo in terms of what the plant might be able to generate if it was operated on a fixed fee basis. (TR. 1391-92)

would be an additional $0.02 per gallon of NGLs produced at an estimated operating rate of 97.5% on a yearly basis for income of $17,488,000. Thus, using this fixed fee method, Kelly opined total income of $66,763,000 less the operating expenses (excluding taxes) of $38,000,000 for a net income before provision for taxes of $28,763,000 under the fixed fee analysis.

Given the two alternate estimates of income from the two methods he used, Kelly reconciled the data by considering all of the income streams at the property, the actual as well as the two stabilized income streams. He concluded a stabilized net income before taxes of $22,000,000. (TR. 1395-97; Appraisal, p. 106) Kelly also noted this figure is significantly higher than the actual income and losses that Aux Sable had experienced for the previous two years. (TR. 1397)[25]

To convert the net annual income stream into an indication of value for the entire going concern, first Kelly chose direct capitalization of an overall rate. By doing so, Kelly opined this provided an estimate of value for the going concern including the tangible assets (land, buildings, machinery and equipment) and the intangible assets to the extent they are making a contribution to the going concern value. (TR. 1342-43; Appraisal, p. 108) Utilizing the band of investment technique, Kelly looked at what the market indicators were for debt rates as well as market indicators for what the rates of return were on equity; those were multiplied by the various weighted positions to get an overall rate. (TR. 1401-02)

First Kelly looked at the bond ratings of four diversified companies with NGLs business; three of these companies have 14%, 14% and 21%, respectively, ownership interest in the Aux Sable plant. Kelly abstracted a stabilized bond interest rate of 7.8% for debt. (Appraisal, p. 109; TR. 1402) To establish a proportion of debt to equity, the appraiser analyzed publicly traded companies that hold similar assets like the subject. Based on his analysis, the appraiser stabilized the subject's debt portion at 30%. The equity portion would represent the balance or 70% of the total capital structure. (Appraisal, p. 110; TR. 1403) To determine return on equity and to do so on a before-tax basis, Kelly analyzed four companies with operations in natural gas transportation, gas gathering and processing, gas and oil production and other energy services. (Appraisal, p. 111) Each of these companies holds interests of 14.4%, 21.4%, 23.6%, and 14.4%, respectively, in the subject plant. These companies indicated rates of return of between 13% and 19.7% over the years 2001 and 2002.[26] The appraiser derived an equity rate of return on a before-tax basis for use in the band of investment method of 15%. (Appraisal, p. 111-12; TR. 1403) Based on these

[25] As shown in the report, for 2001 the plant had a loss before taxes of $7.5 million and for 2002 the plant had a positive net income before taxes of $8.7 million. (TR. 1397)

[26] On page 112 of the appraisal, the asterisks (*) reflect companies that in 2002 had severe financial losses so that Kelly was not able to abstract any kind of meaningful rate of return. (TR. 1404-05)

foregoing figures, page 113 of the appraisal depicts the calculations for an overall capitalization rate of 13.2%.

Next, Kelly added the effective property tax rate for the subject also known as the property tax load. The property tax load was calculated by starting with the effective tax rate for the subject reduced by the amount of property taxes that are returned to Aux Sable under their TIF agreement; the effective tax rate was 1.75% which resulted in an overall capitalization rate of 14.95%. (TR. 1405-07; Appraisal, p. 115) Applying the overall capitalization rate to the stabilized net income resulted in an indicated "value of subject as a going concern; real estate, personal property, working capital, and business value" of $147,000,000, rounded.

The witness asserted that by starting with an income stream for the going concern, the appraiser looks at the rates of return and the income amounts to satisfy the return on the underlying tangible assets first; after that deduction and a deduction for working capital, any amount left would be attributable to the business value. (TR. 1343-44) Kelly stabilized the working capital deduction at $3 million based on the subject's two-years' of records (balance sheet) as reported. (Appraisal, p. 116) Kelly did not find any amount allocable to business value or goodwill at that point in time "due to the low net income of the plant and industry." (TR. 1407-09; Appraisal, p. 117-18)

The final value in the income approach, after deducting for working capital, was $144 million as the value of the real estate and personal property. (Appraisal, p. 119) Next, an adjustment was made on page 120 of the appraisal for the depreciated value of the pollution control items of $17,583,539 which was set forth at the end of the cost approach to value analysis of the report. (TR. 1409-12; see also Appraisal, p. 8) As a result of this deduction, Kelly opined an estimated value by the income approach for real estate and personal property (excluding pollution control) of $126,500,000, rounded.

Kelly acknowledged that the market or sales comparison approach to value presented several challenges for this type of property. One is that rarely, if ever, is a stand-alone plant like the subject sold as the industry has gone to more consolidation; as a result, the sales also include other off-site assets like pipelines. Other challenges include the differences between the sold properties and the subject such as an examination of price per barrel; for this reason, Kelly also examined the data in terms of an EBITDA multiplier because it allowed him to take the earnings from the subject and then apply them to whatever multiplier the market sales approach indicated at that point in time. (TR. 1419-20)

In this report, the appraiser used sales of six properties set forth on pages 125 through 138. One was property located in Louisiana, one property was located in Canada, and four (Sales #3 through #6) were partial interest sales of the subject property.

In the four partial interest transactions, about 36% or 37% of the Aux Sable plant sold. (TR. 1436-37)

Sale #1 occurred in June 2002 and was the sale of the Toca processing plant and fractionator along with related storage and loading facilities. Kelly first received information on this sale from Fasullo. (TR. 1437-38) As described on pages 125 and 126, Kelly adjusted this sale to arrive at an adjusted sale price of $73,200,000 or $5,154 per barrel of daily capacity. Kelly found it necessary to make adjustments to the sale with assistance from Fasullo by adding the value for additional processing capacity for the fractionation side of the plant raising the sale price from $32 million to $73 million. Kelly also testified the plant did not have enough gas processing capacity for all of the liquids, therefore with Fasullo's assistance, on a theoretical basis the capitalized cost of additional processing capacity was applied so when the price is divided by the fractionation capacity, there is enough processing capacity to fulfill the needs for liquids on the fractionation side. (TR. 1439-40)

Sale #2 located in Red Water, Alberta, Canada, occurred in September 2003 and consisted of a sale by Williams of a fractionation plant, an extraction plant, 350 miles of pipeline and gathering system, and storage tank facilities. Fasullo was the source of data for this sale. This transaction included extensive off-site assets for pipeline and storage which Kelly was not able to quantify and allocate in order to deduct from the sale price. (TR. 1440-41) As described on page 127, Kelly reported the sale price was $196,000,000 or $3,161 per barrel of daily fractionation capacity.

Sale #3 in the appraisal, which occurred in November 2002, involved a 9.55% partial interest sale of the subject property from El Paso Corporation to Enbridge Inc., both of whom were existing owners of the subject plant.[27] Also included in this transaction were a sale of a 6.15% interest in the Alliance Pipeline and an assumption of related liabilities for contractual agreements and support obligations for Alliance Canada Marketing (ACM). (Appraisal, p. 128-29) According to Kelly, one part of the transaction involved a transportation obligation which was recognized as a liability with a present value of $11.9 million; however, there was also a payment in the sales contract to offset that liability. (TR. 1424-26; Appraisal, p. 128-30) Another part of the transaction was a cash payment for a 9.5% interest of approximately $10.9 million.[28] Kelly made several adjustments to the net cash payment of $10.9 million for a 9.55% equity interest in the subject property including a 5% positive adjustment for minority discount which resulted in an adjusted price of

[27] On page 128, the appraiser reports that Aux Sable was 'originally' owned by five companies: Fort Chicago (26%); Duke Energy (23.6%); Enbridge Inc. (21.4%); Williams Companies (14.6%) and El Paso Corp. (14.4%).

[28] Kelly had assistance in analyzing Sale #3 from Peter York and Peter Fasullo of EnVantage and also from persons at El Paso and Enbridge in terms of interpreting the sale. (TR. 1431)

$11,510,895. This figure was divided by the percentage of equity in Aux Sable that was purchased for an indicated value for a 100% equity interest in Aux Sable of $120,532,932. To this figure, Kelly added the long term lease obligation of $12,176,000 and the new current liabilities as of December 31, 2002 of $39,396,000 for an indicated sale price for a 100% interest in fee simple in Aux Sable of $172,100,000, rounded. (See page 130 of the Appraisal; TR. 1426-28)

Sale #4 reflects the exercise by Fort Chicago of its right of first refusal when El Paso announced the sale of its entire 14.4% interest in Aux Sable. Fort Chicago elected to purchase 4.9% leaving the remainder of 9.55% to be sold in Sale #3. Kelly reported Sale #4 on page 132 of the report as follows: $5,624,000 less payment for the present value of ACM support obligation liability of $6,108,000 plus the present value of future ACM support obligation assumed by purchaser of $6,108,000, for a net cash payment of $5,624,000 for a 4.9% equity interest in Aux Sable. Kelly applied an upward minority discount of 5% for a total of $5,905,200 divided by the 4.9% equity in Aux Sable resulting in an indicated value of $120,514,285 for a 100% equity interest in Aux Sable. To this figure, Kelly added the long term lease obligation of $12,176,080 and the net current liabilities as of December 31, 2002 of $39,396,000 for an indicated sale price of $172,100,000, rounded, for a 100% interest in fee simple. (Appraisal, p. 132)

Sale #5 was another partial interest transaction that occurred in April 2003 with Duke Energy as the seller and Enbridge as the buyer; both parties were already partners in Aux Sable. In this transaction, an 11.78325% interest in Aux Sable was sold with an assumption of the same type of transportation obligation shown in Sales #3 and #4. Kelly performed the same type of proration calculation to arrive at an indicated sale price of $71,500,000, rounded, for a 100% interest in fee simple in Aux Sable. (TR. 1434; Appraisal, p. 133-35) Ultimately, Kelly put very little weight on this sale because it did not fall in line with the EBITDA multipliers. (TR. 1435)

Sale #6 occurred in April 2003 and was a sale of Duke's 11.78325% interest to Fort Chicago under the same terms as Sale #5; Kelly made similar adjustments upward to result in a total sale price of $71.5 million. (TR. 1436; Appraisal, p. 136-38)

Kelly summarized the six sales on a chart on page 139 of the report; based on his adjustments, the price per barrel of daily capacity ranges from $1,222 to $5,154 per barrel with daily capacities ranging from 14,200 to 58,500 barrels. Kelly testified that on page 139 it should actually say that El Paso and Duke had a minimal return on their investment; they got back a portion of the investment when they sold, but they lost most of their investment. (TR. 1442) In testimony, Kelly also stated that he put very little weight on Sales #5 and #6. In the appraisal report, Kelly wrote, "The sale prices for the Aux Sable partial interests (Sale Nos. 3, 4, 5, and 6) are indicative of

how the shrinking margins in the gas liquids market have negatively affected the value of the plant." (Appraisal, p. 139)

From the data, Kelly concluded the subject had a unit price of $3,000 per barrel per day of capacity multiplied by its total capacity of 58,500 barrels per day for an indicated value by price per barrel per day of the real estate and personal property, goodwill, and working capital of $175,500,000.[29]

Commencing on page 140 of the report as a second methodology in the sales comparison approach, Kelly performed an EBITDA (Earnings Before Interest Taxes Depreciation and Amortization) Multiplier Analysis. The appraiser reported these multipliers are used in this industry as a method of analyzing sales data based on the relationship between "Sales Price and Net Income or EBITDA" where the sales price divided by EBITDA equals the EBITDA multiplier. It examines what multiples of earnings midstream assets are selling at. Since sales rarely involve only a plant, this method establishes the relationship between the sale price and EBITDA for several transactions in the gas industry. The appraiser acknowledged that multipliers abstracted in this manner are reflective of assets in addition to processing plants, such as pipelines, "but still reflect the relationship between net income and sale price for gas processing related assets." (Appraisal, p. 140)

To perform the analysis, Kelly utilized data gathered by Fasullo as shown on page 141 of the report where Kelly presented a summary chart of the EBITDA abstraction analysis for four sales (#3 and #4 in this chart were Sales #2 and #1, respectively, in the market analysis). Kelly contended the EBITDA multiplier is significant in this report where Sales #3 and #4 were adjusted upward to about $172 million and made sense with the EBITDA multiplier. In contrast, Sales #5 and #6, the other partial interest sales, did not make sense because when they were calculated given the EBITDA multiple, in that they were less than what was typical so Kelly put very little weight on them. According to Kelly, the subject's total price of $172 million and stabilized income of $22 million indicated an EBITDA multiplier of around 8 or 8 ½ which was in line with EBITDA multipliers in the industry at that point in time and in line with the multipliers that Kelly has in the appraisal report. (TR. 1429, 1443-44)

Kelly acknowledged that the data on page 141 depicts a variety of assets, plants, pipelines and gathering facilities, which differ from the subject. Kelly contends the analysis, however, provides a multiplier which is indicative of the general state of the industry at that point in time which is still representative of what is taking place in that industry. The appraiser analogized

[29] To arrive at a value conclusion for the subject under this first methodology in the sales comparison approach, Kelly multiplied the $3,000 per barrel calculation by the NGL capacity of 58,500 barrels per day to arrive at a value for the whole going concern of $175 million. (TR. 1443)

this method to a price-earnings-ratio in the stock market where the higher the multiplier, the more desirable the market considers the investment and vice versa. (TR. 1444)

Kelly noted the transactions on page 141 cannot provide a price per barrel figure due to too many other off-site assets, but based on the earnings when the group of assets sold the EBITDA multiplier can be abstracted and applied to the stabilized earnings for the subject. (TR. 1445) The chart depicts the four transactions as having EBITDA multipliers ranging from 6 to 8.5 times EBITDA.

The graph on page 142 of the report was prepared by EnVantage and depicts the general pattern of processing margins over time (the 'frac spread') providing an indication that there is volatility in the market, but that overall the processing margins have slightly decreased over the last few years. (TR. 1445-46)

As a result of this analysis, Kelly selected an EBITDA multiplier of 8.5 and multiplied that by the subject's stabilized EBITDA of $19,786,000. On page 143, the appraiser noted the subject's stabilized EBITDA was based upon applying the effective tax rate of 1.75% to the income approach to value of $126,500,000 and deducting the indicated tax of $2,214,000 from stabilized net income before taxes of $22,000,000. While Kelly had found stabilized earnings of $22 million from the income approach which was before property taxes, the EBITDA is after property taxes resulting in an adjustment to the stabilized earnings figure to $19.7 million. The EBITDA multiplier analysis indicated a value of $168,181,000 which includes machinery and equipment, goodwill, working capital and pollution control equipment. (TR. 1446-47)

On page 144, Kelly outlined his reconciliation of the two methods considered in the sales comparison approach to conclude a reconciled value of $173,000,000. To this calculation, Kelly made final adjustments for working capital of $3 million and the depreciated value of the pollution control items of $17,583,539 for a final indicated value by the sales comparison approach rounded to $153 million. (TR. 1447-48)

Kelly also testified that he had prepared an appraisal of the subject property as of January 1, 2001. While Kelly performed a sales comparison approach in that appraisal, he did not utilize the EBITDA multiple analysis in that appraisal and all of his sales data was of plants with significant off-site assets, so as a result in that 2001 appraisal Kelly placed minimal weight on the sales comparison approach. Kelly testified that he had more data in the sales comparison approach for the 2003 appraisal than he had in the 2001 appraisal. Kelly also had additional assistance from Fasullo in this 2003 appraisal. (TR. 1448-50)

Under the cost approach, the appraiser first estimated the subject's land value at $2,700,000. To arrive at this estimate, Kelly utilized seven vacant land sales from both industrial and agricultural zoning classifications and three offerings of

relatively small parcels with a manufacturing zoning classification. (Appraisal, p. 74) Since Kelly found only two industrial sales as large as the subject, he testified that he included larger agricultural sales and adjusted them upward for differences in zoning. The offerings were included primarily for informational purposes due to their proximity of 2 or 3 miles to the subject. (TR. 1452-53) These ten properties were located in Grundy or Will County and ranged in size from 1.33 to 152.09-acres of land area. The seven sales occurred from October 1998 to May 2002 for prices ranging from $3,200 to $28,571 per acre. The offerings were dated as of January 2003 and range in size from 1.33 to 2.35-acres of land with an asking price ranging from $67,953 to $71,003 per acre. (Appraisal, p. 58-72) These ten properties were adjusted with quantitative rather than qualitative adjustments for date of sale, location, size, and zoning to arrive at an overall similarity determination. (Appraisal, p. 55-57)

In addition to these ten properties summarized on page 74 of the report, Kelly also considered the original sale of the subject as set forth on page 75. (TR. 1453-54) Kelly reported the subject former Nicor site was purchased in September 1998 for $1,320,000 with additional demolition costs of approximately $835,000 for a total acquisition cost of $2,155,000 or $13,393 per acre based on 160.9-acres which were originally acquired.[30]

On page 75, Kelly summarized the seven land sales as either inferior or superior to the subject property and discussed the sale of the subject land which needed an upward adjustment for time; based on the data gathered, Kelly concluded $17,000 per acre for the subject or $2,700,000, rounded, for the subject property of 157.91-acres as of January 1, 2003. (TR. 1454)

Next for purposes of the cost approach to value, Kelly calculated the reproduction cost new for all of the improvements on the property. (TR. 1456-57) To do so, Kelly used the actual cost report for Aux Sable Liquid Products dated December 31, 2000 prepared by David Parks which reportedly included all items that went into the cost of the plant of $451,663,000.[31] Kelly opined that it was appropriate to deduct any off-site assets as outlined on page 77 of the report which totaled $14,234,000. (TR. 1461)

Having investigated the circumstances surrounding the construction of the plant between 1999 and 2000, Kelly was aware that the plant was being built at the same time as the Alliance Pipeline was being completed. "They wanted to have the plant

[30] A portion of parcel 3 of the Aux Sable property was sold between 2002 and 2003; after the donation of a portion for the Minooka fire district, the remainder was retained by Aux Sable and became parcel -011. (TR. 1456)

[31] The Parks report provided Kelly with the cost new numbers as well as his analysis of the cost for off-site assets, fast-track premiums, and some change orders during construction. REAC requested that Parks provide the total cost as well as an allocation of off-site costs, fast-track premiums, change orders, and any owners' cost. (TR. 1459-60; see also acknowledgment on p. 149 of the report)

finished and ready, so they could turn on the pipeline." As such, there was a time schedule at issue resulting in some significant fast-track premiums for overtime to complete the plant within the timeline for the pipeline. In addition, Kelly was aware that some changes in design during construction, such as changing from electric-operation to gas-fired, necessitated movement of certain foundations for equipment. (TR. 1457-59)

As shown in the report, Kelly deducted $42,894,000 for cost over budget which included overtime and fast-track premiums as those were business decisions rather than items that made a permanent contribution to the value of the tangible assets or increasing the plant's functional capacity; he deducted $38,282,000 for "approved changes that took place, but did not increase the potential productivity of the plant"; and he deducted $18,700,000 for direct owners cost which included commissioning, land, environment, information systems, and other (spare parts & operator training). (Appraisal, p. 78; TR. 1461-64) All these deductions resulted in a reproduction cost of $337,553,000 which included the cost of pollution control equipment.

Next Kelly trended the cost up from 2001 to 2003 by using a trending factor from the Means Cost Manual of 1.061. (Appraisal, p. 78) Another available source with a slightly lower factor would have been the Marshall equipment trend factor which, in hindsight, probably would have been more appropriate than Means which is based more on buildings and concrete. (TR. 1464-65) Means gave about a 3% per year trending factor, whereas Marshall gave about a 2% per year trending factor, which would have resulted in a minor difference in the calculation. (TR. 1467) The trended cost was determined to be $358,143,733.

The next step was to estimate depreciation of the improvements to which Kelly applied the breakdown method for each of the three types of depreciation. Physical depreciation was calculated using the age-life method wherein Kelly determined the effective age of the plant was 2 years divided by the total physical life of 30 years for 6.7% for physical depreciation. (Appraisal, p. 49-51 & 81) For total physical life, Kelly considered data from Marshall for natural gas processing plants which have a typical life of about 17 to 26 years along with consideration of a useful life of 30 years as used by the Aux Sable plant. From this data, Kelly opined a life of 30 years. (TR. 1467-68) Thus, physical depreciation of $23,995,630 was deducted resulting in a depreciated value of improvements of $334,148,103.

Next Kelly identified no functional obsolescence as the plant was new and built with all new, modern equipment, however, he testified that there is a possibility that the difference between the subject's production of 58,500 barrels of NGLs per day now versus the 70,000 barrels of NGLs per day capacity (if the additional compressors were installed on the Alliance Pipeline) could be treated as functional super adequacy. He further asserted, however, that this same data could be viewed in terms of potentially being part of economic obsolescence, too, because

the plant does not have a market for the product at this point in time. (TR. 1468-69)

Kelly then identified economic obsolescence on pages 83 and 84 of the appraisal report. Using the physically depreciated value of the plant of $334,148,103, Kelly multiplied that figure by the capitalization rate of .1495 as determined in the income approach to indicate what the required earnings would be on that physically depreciated value. The required earnings were thus found to be $49,955,141 and Kelly then compared that figure to the stabilized earnings for the subject of $22 million found in the income approach. Comparing these two figures indicated deficient earnings as of January 1, 2003 of $27,955,141. Kelly further testified that the deficient earnings were an indicator of economic obsolescence because if the earnings are not sufficient enough to provide for a return on the physically depreciated value of a property, the deficiency then can be capitalized to indicate economic obsolescence at that time of January 1, 2003. This deficit earnings figure was then capitalized by the same rate of .1495 to indicate economic obsolescence of $186,990,912. (TR. 1469-70; Appraisal, p. 84)

The last step in the cost approach was to deduct the forms of depreciation from the cost new for a depreciated value and then add back the land value. As shown on page 85 of the report, performing these calculations Kelly arrived at a value indication under the cost approach of $150,000,000, rounded. (TR. 1472)

The subject property has approval from the Illinois Department of Revenue for pollution control assessments on certain plant equipment as outlined on page 8 of the appraisal report with a cost new of $40,421,000. Therefore, on page 85 in the cost approach, Kelly deducted for the pollution control items. He determined the deduction by applying a trending factor of 1.061 from Means to the cost new figure less depreciation for all causes of 59% resulting in a depreciated value of the pollution control items of $17,583,539. Thus, the appraiser's final value excluding the depreciated value of pollution control items under the cost approach was $133,000,000, rounded. (TR. 1472-73; Appraisal, p. 85)

Kelly next testified regarding other appraisal reports he has been involved in preparing for the subject Aux Sable plant.

In a 2001 appraisal (Intervenors' Ex. S), Kelly utilized the three traditional approaches to value in arriving at a final value conclusion for the subject property as of January 1, 2001 of $270,000,000. Kelly explained that for the 2001 appraisal he found no physical depreciation in his cost approach analysis since it was a new plant with an age of 0. Economic obsolescence was calculated in a similar manner to the 2003 report, however, the amount was significantly less at that point in time. Kelly also opined that the depreciated value of the pollution control equipment would have differed in 2001 from 2003. In the 2001

report, Kelly also removed the fast track and change order costs utilizing the same source of information. (TR. 1474-76)

For the 2001 appraisal report, Kelly looked at about six months of data for the subject which was very little meaningful information on margins; thus, Kelly had to rely on industry projected prices and the margins "that they basically included in their prices from projected revenue for the subject back in 2001." (TR. 1482; Intervenors' Ex. S, p. 83-86) While the actual revenues can be looked at, Kelly testified that for a plant like the subject what is more meaningful is what the margins are; prices for the product fluctuate so that revenue alone does not indicate if the plant is making money, but looking at the margin, the difference between the sale price of the products and the gas cost; Kelly opined that the subject data, particularly with respect to margins, is the most important. (TR. 1479-81)

In explaining the differences in his value conclusions from 2001 to 2003 and reliance on particular data, Kelly noted that he had two years of actual margin data for the subject for 2001 and 2002 which were relied upon heavily in the 2003 report along with industry prices. The appraiser also felt two years' of data for the subject was better and depicted that the subject was not getting the margins, particularly on ethane, that some of the average industry data showed. As a result, Kelly put primary weight on the margins that had been indicated at the subject for 2001 and 2002 in his 2003 appraisal. When Kelly prepared the 2003 appraisal, he was aware of no facts that would indicate that Aux Sable would be able to achieve average industry margins with regard to ethane and data indicated that margins had been stagnant for a couple of years and did not appear to be improving in the immediate future. (TR. 1482-86)

In his final reconciliation for the 2003 report, Kelly considered all three indicators of value (Appraisal, p. 145) and put weight on the cost approach, but put substantial emphasis on the sales approach and the income approach. Kelly arrived at a final estimate of market value for the subject of $150,000,000, rounded. (TR. 1487-88)

Upon cross-examination, Kelly acknowledged that he does not hold a machinery and technical specialties designation. Kelly also acknowledged that most of the cost of the subject property is in machinery and equipment and the revenue stream for the plant is directly related to the output of the machinery and equipment. (TR. 1493-96)

The witness acknowledged that his practice and the practice of REAC is not in valuing machinery and equipment as a stand-alone, but rather valuing machinery and equipment as an economic unit. The last stand-alone appraisal Kelly performed was probably 4 to 7 years ago with one project in Texas and one in Wisconsin. (TR. 2329-31)

REAC was first contacted to perform work for Aux Sable related to the proposed issuance of $7.5 million in tax increment financing (TIF) by the Village of Channahon in 1999 or 2000. One of REAC's appraisers, Robert Herman, did this report and made the arrangements to collect information necessary for the project. (Intervenors' Ex. P) Kelly assumes that the report on the TIF project would be based upon facts and circumstances available to REAC from Aux Sable as of April 2000. On page 9 of the 2003 appraisal, Kelly reported the existence of the TIF.

The witness identified Intervenors' Ex. P, as a copy of a consultant's report dated June 6, 2000 prepared by REAC to facilitate a TIF. On page 29, the report depicted that the initial improved assessment based on what was thought to be placed on the property will likely be in the range of $225,000,000 to $250,000,000.[32] This estimate did not include any value for business value. (TR. 1749-52, 1766-67, 2346-47) This report was predicated on a larger plant than what was actually built as shown on pages 1 and 2 of the report to process up to 2.1 bcf/day and the extraction was proposed to recover 80,000 barrels of NGLs per day. (TR. 2351-52) REAC had a separate file for the TIF report. Kelly first reviewed the TIF file after a hearing was held on the Equistar appeal, another industrial property located in Grundy County. When performing the 2001 appraisal, Kelly knew there was a TIF file in the office. (TR. 1804-05)

The witness also acknowledged that REAC has prepared an appraisal with an estimated market value of the subject property as of January 1, 2004 of about $70 million more than this 2003 appraisal. (TR. 1753-56) As to appraisal methodology, for the 2004 appraisal of the subject property, Kelly included the industry's projected 2004 price for each product line and stabilized the price for each product line based on the industry's projected 2004 prices plus or minus Aux Sable's agreement(s) with customers. (TR. 2061, 2063) In the 2004 appraisal, there was no deduction for change orders. (TR. 2134-35)

The witness also addressed the 2001 appraisal of the subject property (Intervenors' Ex. S) which included the land, buildings and processing machinery and equipment, although there is a slight variance in the land size for land subsequently donated to the fire protection district. No business value was included in this appraisal; in addition, a similar deduction for pollution control equipment was made. (TR. 1764, 1765-66, 1768) The witness testified that the differences in value between the REAC 2001 appraisal and the REAC 2003 appraisal were based primarily on the income approach based on what happened in the market. (TR. 1772-73)

[32] In this report market value of a property was defined as estimated by the Grundy County Supervisor of Assessments using standards and procedures set forth by that office; market value of the property may or may not be equal to the cost or sale price of the property.

In the 2001 appraisal on pages 97 and 98, Kelly provided Aux Sable's cost of goods sold for each product line along with the industry's historical and 2002 projected cost of goods sold for each product line. As shown in the report on page 98, Aux Sable's actual cost of goods sold in 2001 for three of the product lines[33] varied from $16.39 to $26.45 per barrel, whereas the industry's "actual" cost of goods sold ranged from $18.07 to $29.38 per barrel for the five product lines. Thus, in the 2001 appraisal, Kelly used the industry average for 2002 as the stabilized cost of goods sold for Aux Sable. Additionally, in the 2001 appraisal, Kelly did not have to reconcile two sources of income in the income approach to value. (TR. 2067-68, 2099; Intervenors' Ex. S, p. 98)

The witness was questioned about the methodology of capitalizing the income where goodwill and working capital were deducted first before applying the rate in the 2001 report. (TR. 2115-16; Intervenors' Ex. S, p. 111) In the 2003 report, Kelly applied the capitalization rate to working capital which resulted in a lower market value. The witness characterized this as a "minimal difference." (TR. 2116-17)

Kelly sought to find sales for the 2001 appraisal and found it difficult to find "standalone" plants which did not include a lot of off-site assets, pipelines and similar entities. For the 2001 appraisal, Kelly did not have the assistance of EnVantage or any third-party. (TR. 2172-73)

Upon commencing work for the 2003 appraisal, REAC already had a lot of information concerning the plant from the 2001 appraisal project such as the physical description of the plant and property. To commence the 2003 report, Kelly went to the 2001 file to obtain documents that could be used. (TR. 1802-03) In order to prepare the 2003 appraisal, REAC requested revenue/expense statements that had taken place in the interim, namely the 2002 revenue and expenses statement. Kelly was given cost data, but never requested nor obtained an asset list with identification numbers on it for the plant. Kelly has been to the plant three or four times with inspections occurring on June 28, 2001 and August 20, 2003. (TR. 1786-91; Appellant's Ex. A, p. 2) Kelly's best estimate is that he returned to the plant in 2005 for the 2004 appraisal report and was out to the plant about one month ago in preparation for testimony in this matter; Kelly did not inspect the premises on that latter occasion. (TR. 1793)

Besides sources previously mentioned and public records, Kelly also examined various reports of owners, including Fort Chicago including excerpts from the 2000-01 annual report, as background information. (TR. 1884-87, 1899; Appellant's Ex. A, p. 96-97) In its 2001 annual report, Fort Chicago noted a lack of profitability of the subject plant and extremely volatile

[33] The 2001 appraisal indicates that for two product lines there was only "three months of data available."

margins. (TR. 1955-56, 1962-63, 2020; Intervenors' Ex. Z, TR. 2049) The witness did not request plant journals or ledgers. (TR. 1889) Kelly did get the financial statement and a margin statement by product line which presumably was kept in the ordinary course of business.[34] (TR. 1889-90, 1892-94) Kelly did not know the percentage of sales made to related and to unrelated parties, although ethane accounts for about 45% of the 2002 sales and is sold to Williams, a related party. (TR. 1894-95) Kelly verified his historical income data for Aux Sable on page 96 of the appraisal report with the margin report and found the total figures to be within 1% of each other. (TR. 1898-99) Kelly also looked at the Williams Company's 10-K, Enbridge, Duke Energy and El Paso to get rate of return analyses for the capitalization rate. (TR. 1899-1900)

The witness acknowledged that there were initial start-up deficiencies in the plant which impacted recovery volumes, plant performance, and operating costs, most of which were corrected during the year 2001. These start-up deficiencies in 2001 caused margins at the plant to be depressed. In January and February 2002, margins continued to be depressed as a part of the market and not as part of the start-up operations of the plant. (TR. 1961)

The issue of functional obsolescence would have been addressed in the interview in discussing the plant in general and whether there were any operating deficiencies; none were discussed that Kelly can recall. The appraiser did not perform a functional obsolescence analysis. (TR. 1899) Kelly's best guess is the meeting took 2 or 3 hours, including the plant inspection and meeting in the plant office. (TR. 1795-96) Kelly also spoke with David Parks, a cost consultant or an employee of Aux Sable, for the cost approach data; it was not important for Kelly to know if Parks was an outside consultant or an employee of Aux Sable. (TR. 1810-12)

Kelly assumes the 37 producers that send natural gas from Canada in the Alliance Pipeline own the rich gas. Kelly believes that all of the owners of Alliance are also owners of Aux Sable. There is a 15-year heat content management contract between those 37 producers and the Aux Sable plant to remove the NGLs from the stream and return the commercial quality or dry gas to the pipeline within a certain BTU content range. Aux Sable's compensation for doing that is that the plant is allowed to pull out the NGLs and sell them for whatever profit can be made. (TR. 1496-99, 1662, 1664)

The plant returns approximately 98% of the gas to the pipeline as commercial quality gas for which the BTU content must be between 1,000 and 1,050 BTUs along with some minor treatment for sulfur or moisture. The plant also must pay for the 2% of gas that was used in the process of extracting the NGLs. The plant pays for

[34] Kelly believes that there are also adjustments made in the form of net backs when the transaction involves a related party. (TR. 1894)

this make-up gas at the Chicago City Gate price. (TR. 1501-04, 1517-20) The witness testified both that the cost of goods sold was a calculation that he made on page 103 of the report with data from Petral Consulting, but that the total dollar amount shown on page 96 was given to him by Aux Sable. (TR. 1507-12)

Kelly understands that the Alliance Pipeline is the only inlet for rich natural gas coming in to the plant. Kelly is unaware if there are other pipelines in Grundy County or nearby that carry rich gas into the area; Kelly did not make any study whether there were other sources of product in the area for the plant. If there were other sources in the area as of January 1, 2003 with the same technical characteristics, the plant had adequate capacity to process additional gas over and above the gas it was receiving from the Alliance Pipeline. (TR. 1676-79, 1681-82)

Kelly's analysis was dependent upon the stated capacity of the plant according to the plant manager of 58,500 barrels per day which is a limitation caused by the amount of gas which is supplied to the facility. For all three approaches to value, Kelly relied upon the 58,500 barrel capacity figure. (TR. 1986-87) The Aux Sable plant machinery and equipment has a rated capacity of 70,000 barrels of product per day. Kelly acknowledged that if the pipeline were expanded to 2.1 bcf/day of rich natural gas, then the Aux Sable plant machinery and equipment could produce over 70,000 barrels of product per day.[35] (TR. 1847-48, 1966-67, 1981-82) For the appraisal, Kelly chose to use the current production rate because it was not economically feasible to bring in the additional gas; it was physically feasible but due to the economics it has not been done. (TR. 1851-58, 2033-34)

On page 28 of the report, Kelly did not list the plant capacity for each of the five products only due to a request by the client for confidentiality; an asterisk indicates the breakdown of product is retained in the appraiser's files. Kelly utilized the increment approach in the appraisal to make a projection of revenues for the 58,000 barrel per day production with a projection of income by product line. Kelly would not have been able to prepare his appraisal in the manner that he did without the capacity information that was provided by Aux Sable. (TR. 1683-87)

Based on the EnVantage analysis, for 2001 and 2002, the industry's average historic profit margin for liquid products was between about 7¢ to 9¢ per gallon. Historical processing margin data on pages 33 and 34 was presented in part because the subject plant was new and had no real track record as far as average

[35] Kelly was informed by the plant manager Bill McAdam that the estimate to increase the capacity of the pipeline to use the additional processing capacity of the Aux Sable plant was $500 million; McAdam did not give Kelly the specifics from an engineering perspective of what would have to be done for the expansion, but only the cost. (TR. 2032-33)

profit margins were concerned and to provide a broad perspective on industry margins. (TR. 2083-86)

On page 100 of the report, Kelly stabilized the price for the five product lines of the plant by looking back at Aux Sable's 2001 and 2002 profit margins. To the stabilized price for each product line, Kelly added Aux Sable's price adjustments it has based on agreements with its customers. The adjustment sometimes makes the price less than what the Mt. Belvieu published price is and in some cases it is more than that published price depending upon the negotiated agreement. (TR. 2050-52, 2064) For the period between 2001 and 2002, the industry was experiencing decreasing profit margins. (TR. 2055) On page 101, Kelly stabilized production at 84.3% overall or 18 million barrels.[36] (TR. 2055-56) There are 42 gallons in a barrel which means the stabilized annual production was equivalent to 756 million gallons annually. (TR. 2078) Despite the data from EnVantage with a 13.2 cent average margin, Kelly chose to utilize the first two years of the startup of the subject plant as the basis for his income analysis in the appraisal. (TR. 2087-88) Kelly also acknowledged that the 2003 appraisal did not include industry projected average prices for 2003 for each product line so that the technique he followed in 2001 and in 2004 differed from the technique followed in the 2003 appraisal. (TR. 2063)

Kelly acknowledged that if the Aux Sable plant had a longer track record of production than from December 2000 to December 31, 2002, in performing the income analysis Kelly would have gone back further into the plant's history with more data that would make the income approach more reliable. In the absence of a longer history at the subject plant, while the appraiser can look to the marketplace for more data, Kelly opined that it may not be as reliable as data for the subject. In performing the analysis, an appraiser can choose to use marketplace data or data from the subject. In this appraisal, Kelly chose to use the subject data of two years which he contends was a function of the marketplace. (TR. 2283-84)

Kelly noted in the appraisal that the NGLs market is a volatile market because it is highly correlated to the cost of natural gas which has been very erratic and volatile in the last few years of 2000 to 2003; as the price of gas goes up, the price of the liquids follows pretty much in tandem. Kelly summarized that the gas price went from $2 up to $9 in a period of 12 to 18 months which he called very volatile; he further characterized such movement as much more volatile than the normal day-to-day or month-to-month movements of the 1990's. (TR. 1689-92) The graph on page 19 of the appraisal depicts the price of natural gas over time between January 1998 and June 2001 as prepared by REAC based on data either from Petral or the Energy Information Administration. The witness could not find where the graph

[36] The client requested that the product capacity in barrels by product line not be disclosed in the report on page 101, although Kelly has those figures. (TR. 2056-57)

displayed a $7 variance in price. Kelly testified that the margins were more volatile than gas prices from 1990 to 2000 and then as of 2000 to 2003 the gas prices became very volatile along with the margins. Furthermore the witness contends that for the period January 1, 2000 to December 31, 2002, the price for the feedstock for the fractionation process (combined NGLs) was volatile. (TR. 1699-1712)

Kelly acknowledged that there are challenges in doing an appraisal and using an income approach for an industry that has volatility in commodity prices and margins. Those difficulties or challenges have to be overcome by making various adjustments. Therefore, the reasonableness of Kelly's appraisal is dependent upon the reasonableness of his adjustments. (TR. 1720-21)

In 2002, Aux Sable's processing margins were lower than market margins for processing in that the subject had a margin of 6 cents per gallon whereas EnVantage presented market data on page 142 in the appraisal of average processing margins of 8 to 10 cents per gallon. (TR. 1724-35) Kelly testified that the cost of goods sold was at market since it was basically at the Chicago City Gate price for MMBTU's for gas, but the subject's revenues from the sale of NGLs, which are also from the marketplace, are less than the average from the rest of the market and this is why the subject's margin is slightly less. While Kelly acknowledged previously that some products are sold to related parties, Kelly assumes that those are sold at market prices. (TR. 1738-41)

In determining the cost of goods sold on page 103, Kelly did not use the cost of Aux Sable's 2001 and 2002 actual gas purchases, but the data was based on the industry's projected gas costs for 2003. The industry projected rate of $3.96 for 2003 was higher than Aux Sable's actual rate of $3.44 in 2002. Kelly further acknowledged that by increasing the cost of goods sold, he also decreased the profit margin. Additionally, Kelly's stabilized rate for cost of goods sold was higher than Aux Sable's actual 2002 cost of goods sold for each product line. (TR. 2065-66)

Kelly testified that his final stabilized net income conclusion of $22 million was essentially a blend of both sources of income. (TR. 2113-14)

For purposes of determining a capitalization rate, on page 109 in determining the interest rate on debt all the companies Kelly reviewed had less risk than the subject property although Kelly opined a bond rating at the riskier end of the scale of 7.8%. Also at page 110, Kelly put the subject's proportion of debt and equity at 30% because it was more risky than Enbridge, Williams Companies, El Paso Corporation, and Duke Energy which were diversified because they owned other lines of businesses besides processing and fractionation. Based upon these factors, Kelly estimated an overall capitalization rate of 13.2%. (TR. 2108-09; Appellant's Ex. A, p. 109)

To arrive at the effective tax rate, Kelly took the statutory level of 33.33% multiplied by the local tax rate adjusted down for the TIF. For the TIF consideration, Kelly took the amount of taxes that are returned to the taxpayer and took that out of the taxes that were paid for 2002 and then recalculated the tax rate so it was reduced. The witness acknowledged that he therefore used the 2001 tax rate although he was trying to use data that would have been available as of January 1, 2003. The appraiser thus determined a loaded capitalization rate of 14.95%. (TR. 2109-11; Appellant's Ex. A, p. 115)

As to Appellant's Exhibit B, Kelly did not see the federal tax returns in preparing the 2003 appraisal; Kelly had the unaudited financial statements. (TR. 1586) He acknowledged that notes to an audited financial statement regarding related parties are presented to divulge any transactions which may or may not be at market. (TR. 1622) In both 2001 and 2002, the plant purchased some portion of makeup gas and gas for fuel[37] and shrinkage from both El Paso and Alliance Canada Marketing. Kelly testified that the cost of gas used to operate the plant in his appraisal report is included on page 96 in a line identified as "other fuel" under the fixed expenses. Kelly did not do anything to verify or test to ascertain if the information was correct, but simply used the financial statements presented to him by the plant. (TR. 1609-11) The witness contends, however, that he did determine the cost of goods sold were at market based on the average cost per BTUs at the Chicago City Gate price and dividing the gas cost by the million BTUs that were used. (TR. 1634, 1635-36, 1644)

Kelly obtained the general and administrative expenses set forth in the income approach from the unaudited financial statements. When preparing the appraisal, Kelly was not aware specifically of administrative services provided to Aux Sable by related parties. Kelly would assume that charges for services were at market. Kelly did not review any agreements between the plant and related parties. (TR. 1641-45)

As an alternative analysis or second method to project revenue,[38] Kelly considered a fixed fee arrangement, although the subject plant did not operate and could not operate on a fixed fee basis. The Aux Sable plant was operating on the basis of having to process all the gas that was delivered to it, regardless of what the market prices were for the fractionated products. The witness acknowledged that the Aux Sable operation is more risky than other companies that operate on a fee basis as Aux Sable assumes all the market risks for the price and margin of the liquid products. Based on Kelly's request for the 2003 appraisal, Fasullo did the research to obtain the 8¢ to 10¢ fixed fee data and how the arrangement would be structured, but Kelly

[37] The fuel is used to run some of the process machinery; i.e., to power the equipment. (TR. 1609)
[38] Fasullo indicated the industry was discussing expanding this method. (TR. 2090, 2102-03)

does not know how those figures came about other than that Fasullo spoke to four companies. (TR. 2089-91, 2093-98, 2101-02)

The appraiser acknowledged that a potential purchaser of the subject plant, if not granted access to books and records, would possibly look at the audited financial statements. The potential purchaser would want to know if the company had been running on a profitable basis. A potential purchaser would want to know whether there were any related party transactions that affected the profitability of the company. (TR. 1646)

The witness testified that a typical buyer interested in purchasing the plant, depending on the economic feasibility of the additional gas being brought in and the probability of that happening, would be more interested in the rated capacity of the plant than the current amount being processed. If it were economically feasible for more gas to be brought in that would be something a buyer would consider in determining the purchase price. (TR. 1850-51, 1870-72) A primary indicator of value to a potential purchaser would be the amount of net income the plant can generate. (TR. 1874-75, 1881)

Prior to preparing the 2003 appraisal report, the appraiser was aware of discussions as a business plan for long-term growth potential to bring in additional gas over and above the 1.6 bcf/day by the Alliance Pipeline and that is why spare capacity was prebuilt. (TR. 1858-59) Depending on the economics, Kelly is sure that additional gas would be brought in whether from Alliance or another pipeline, but if the economics do not work they would wait as they have done. (TR. 1866-67) As of January 1, 2003, there was no plan to expand the capacity of the plant that Kelly knew of.[39] (TR. 2022-23)

Page 44 of the appraisal report diagrams the pipelines; the document was provided by the plant. The diagram depicts a future connection to another nearby plant to ship propane which Kelly opined was dependent upon the economic feasibility of making the connection. (TR. 1902, 1911, 1919-21)

Kelly did not mathematically take potential expansion of the plant into consideration in the income approach. (TR. 2023) The appraiser opined that consideration of a discounted cash flow analysis would also present the same problem as there is no definite plan for plant expansion, the additional capacity is not in place or being built so it should not be included in the future years of a discounted cash flow analysis. There is nothing in the 2003 appraisal mathematically that shows an incremental value for the possibility that the per day capacity of the plant will or may increase over the remaining 28 years of the life of the plant. (TR. 2017-20)

[39] The Fort Chicago report speaks of a possibility in the future, within 5 to 7 years, for expansion of the plant capacity. (TR. 2023)

For the income approach, the use of a lower capacity figure than rated capacity for the plant did not necessarily result in a lower value conclusion; Kelly testified that the appraiser is projecting revenue so a plant operating at 80% of capacity, if that is all the product that can be sold, may not make a difference. In such a circumstance, the form of obsolescence would be economic. While rated capacity could be the starting point, if the market is only showing enough demand for 80% of the rated capacity, the facility will operate at something less than 100% which is fairly common. (TR. 1873-74)

For purposes of this 2003 appraisal, Kelly placed substantial reliance upon both the sales and income approaches; income was also considered within the sales approach through the EBITDA multiplier. (TR. 1875, 1879-80; Appellant's Ex. A, p. 146)

Kelly placed substantial emphasis on the sales comparison approach in the appraisal. For purposes of the sales comparison approach, Kelly asked EnVantage to look for sales of gas processing and fractionation plants and also to look for sales of groups of midstream assets where a standalone transaction could not be determined, but EBITDA multipliers could be abstracted; in addition, Kelly requested data on the partial sales of the Aux Sable plant. The witness testified that he verified information for Sales #1 through #6 provided by EnVantage with sale documents as well as verbal verification; in addition, for Sales #1 and #2, he also had the 10K documents. (TR. 2171-73) The witness acknowledged that Sales #3 through #6 all include the sale of partial interests in the Aux Sable plant. (TR. 2184-85, 2263; Appellant's Ex. A, p. 128-38) All of the sales involved the sale of interest in multiple partnerships and corporations that owned different assets. (TR. 2286-87) In Sales #3 through #6, the larger portion of the transactions was the sale of the interest in the pipelines, not the sale of the interest in Aux Sable. (TR. 2303)

Each of the six comparable sales required adjustment with at least five different adjustments for each comparable that could make a considerable difference in the value of the property. Admittedly the more adjustments that an appraiser makes, the less reliable the comparable becomes. Kelly believes that the sales comparables should be given less weight than the EBITDA sales comparison approach. (TR. 2253-55, 2263-65)

Sales #1 and #2 involve processing and fractionation facilities, but no adjustments were made because of gas with different richness in the gas supply. (TR. 2257-58) The data presented on pages 125 through 127 of the report concerning Sales #1 and #2 were all prepared by Fasullo. Kelly did not take any action to verify the 8 EBITDA multiplier for Sale #1. Kelly was unaware if the capacity on Sale #1 was rated capacity or the operational rate. The calculations on page 126 for this property were adjustments by Fasullo that made the plant bigger than it actually was. (TR. 2255-60, 2262-63, 2319, 2320-21)

As to Sale #2, the witness was questioned about the difference in fractionation and extraction capacities which were 62,000 barrels and 38,500 barrels, respectively. Kelly conceded that the extracted NGLs were coming to the plant from another fractionation plant. The witness also acknowledged that the sale also included a pipeline and gathering system of 350 miles in length, but did not derive a price for its contributory value of these off-site assets. The appraiser had no data on the various product lines produced. The witness acknowledged that the stated price per barrel of daily fractionation capacity calculation did not provide a unit price for plant production capacity only. (TR. 2177-79; Appellant's Ex. A, p. 127) Kelly was not aware that Sale #2 was part of an overall $3 billion sale of assets as part of a complete restructuring of Williams; Kelly checked for this particular sale, but cannot remember what else was going on in terms of restructuring. (TR. 2182-83)

Sales #3 and #4 were sales of interests in partnerships and interests in both Canadian and U.S. corporations. (TR. 2265, 2268) Kelly prepared the data for Sales #3 through #6 in terms of cash paid and what was purchased; EnVantage had no part in these calculations other than explaining theoretically the Alliance Canada Marketing liability, which calculation was already in the sales contract in terms of what the liability was going to cost the buyers and the sellers. (TR. 2269-71, 2288-91)

For Sale #3, Kelly could not explain how it was determined that a 9.55% interest in Aux Sable was worth at least a cash payment of $10,262,757; Kelly understood it was what was negotiated. He was not familiar with the negotiations other than value. The witness asserted that the parties made a present value calculation that would have considered the balance of 12 or 13 years of the Alliance Canada Marketing support obligation at that time resulting in the payment of about $11.9 million. (TR. 2195-97; Appellant's Ex. A, p. 129-130)

The appraiser also explained that the upward adjustment on page 130 of the report for a minority discount equity interest at 5% was done to arrive at a price for the whole enterprise.[40] For Sales #3 through #6, Kelly has the same minority discount of 5%, despite that the positions of the parties were different. Factors to be considered in determining a minority discount include lack of control, lack of marketability, and that must be correlated again to what partial interests sell for and what is the whole enterprise worth including, potentially, the relationship between the parties which then relates to control. The witness justified the application of a minority discount because in the end the appraiser looks at the whole transaction; after adjustments, the appraiser examines if the figure makes sense with the EBITDA multipliers in the industry. Kelly

[40] The theory of a minority discount reflects the lack of control related to only owning a portion of the company as compared to a purchase of the entire entity; thus, in theory some upward adjustment is made to reflect the buyer not having 100% control. (TR. 2212-13)

acknowledged that as an appraiser, he does not engage in advising clients on minority interest discounts to be taken. For Sales #5 and #6 which took place later in 2003, the EBITDA multipliers were lower so a minority adjustment of 10% or 15% could be used, but Kelly opined that these properties sold for less due more to the state of the market at that time as opposed to the minority discount. The appraiser opined that regardless of the minority discount, the final adjusted sale price must be related to an EBITDA multiplier and in this case the appraiser gave Sales #5 and #6 less weight in the final conclusion. (TR. 2198, 2201-08, 2219, 2222-23)

For Sale #3 on page 130, both the addition of a long-term lease obligation, which came from an unaudited balance sheet from Aux Sable, and the net current liabilities were added to get to a value for the 100% interest. The long-term lease obligation was for the future rental obligations on the Monee terminal (a truck rack facility and perhaps a pipeline) which the company was obligated to pay over the next 10 or 15 years. (TR. 2232-33)

In Sale #6, Kelly acknowledged that there were several companies listed in the sales contract meaning that adjustments with Canadian partnerships, Canadian corporations, U.S. partnerships and U.S. corporations were necessary. (TR. 2266-68, 2293-95) Kelly utilized the allocation(s) made by the parties in the sales contract; he does not know what the purpose of the allocations was, but assumes the parties did the allocations based on market value. (TR. 2295-98) Kelly also acknowledged that there were allocations made within the contracts that reflect Sales #3, #4 and #5. (TR. 2300)

Kelly prefers to use comparable sales of the entire fee simple rather than partial interests because it requires fewer adjustments. Hypothetically, in a partial land and building only sale, the appraiser would have to adjust the sale up to 100% interest. For a 50% interest, the price would be divided and then a minority discount, if any, would also be made.[41] (TR. 2246-51)

The witness acknowledged that every time the appraiser makes an adjustment of some sort, he or she was rendering the comparable less reliable. Kelly testified that the determination whether or not to use the sale as a comparable depends on how many other sales there are; if there are other sales without as many adjustments, the appraiser would want to put more weight on those. The appraiser uses the best data available, makes adjustments, and that is better than not using any sales data. (TR. 2251-53)

[41] Hypothetically, a 30% partial interest in an office building, adjustments would be made by first identifying that a 30% interest was purchased, prorate it up to 100%, and then look at the whole transaction to determine if the partial interest sold at a lower than normal cap rate or a higher than normal cap rate to see whether or not a minority discount is warranted. If a mortgage or other liability was assumed, that would also have to be added. (TR. 2248-49)

On page 141 of the report for the sales comparison approach, Kelly has four sales that were part of the EBITDA abstraction analysis as obtained from Fasullo for the total operation, whatever the nature of its assets are. The EBITDA figures were not derived from an extraction and fractionation plant alone. Fasullo performed the research using a variety of midstream assets which have both pipelines and processing plants. This was the best and really the only data that was available to pull out an EBITDA multiplier. Because Kelly asked Fasullo for sales that have meaningful numbers and meaningful EBITDA multipliers, Kelly essentially asked Fasullo for sales with profits. The "liquid processing capacity" figure set forth in the chart for each asset was presumably the rated capacity for each plant as presented to him by Fasullo who would have investigated the input and processing capacity relationship. Furthermore the witness contends that similar data for the subject plant would reflect 58,500 barrels per day as the capacity as the plant does not have sufficient gas input for production of 70,000 barrels per day. (TR. 1987-88, 1990-92, 2305-07, 2314-16, 2318-19, 2321-23)

Kelly acknowledged that he did not independently verify any of the sales on page 141 of his report. (TR. 2325)

On page 141, Sale #2 reflects a partial sale of a 10,677 mile pipeline (which is an upstream asset) plus a processing plant. For this sale, the Fasullo EBITDA calculation includes a business that is partially in a different sector of the industry. Sale #3 on page 141 is an NGL pipeline system which also is an upstream asset. Sale #1 also has upstream assets resulting in a composite EBITDA derived from different businesses in different sections of the industry. (TR. 2317-19) Kelly explained that his understanding was that the EBITDA analysis and the revenue generated for Sale #4 was based on the plant as it was without the gas processing capability. (TR. 2324)

In the witness' opinion the EBITDA multiplier analysis was relevant to doing a comparable sales analysis because of the difficulty of finding sales of stand-alone plants which did not have any off-site assets. Therefore, an additional indicator of value could be found from the sales approach by looking at sales of assets that are in the gas processing business and include not only gas processing assets, but also related assets such as pipelines, etc. which are in a similar industry and exhibit similar risk characteristics. As a similar industry, Kelly looked at the relationship between what the total sale price was for multiple assets that sold as one and what the earnings were at the time it sold. He opined that with this analysis the appraiser can calculate how many times earnings that particular asset sold for and then that multiplier, like the gross income multiplier supplied to the earnings that have been projected for the subject, gives an indication of value from the sales comparison approach. Kelly acknowledged he was describing getting an EBITDA multiplier for a business that operates midstream assets. (TR. 2303-05, 2307-10, 2314)

In the EBITDA analysis, Kelly deducted for working capital by relying upon the balance sheets for the Aux Sable plant, but there is no indication whether the amount was checked for reasonableness.[42] The witness admitted if there were less working capital deducted in the appraisal, the market value of the tangible assets would be increased. (TR. 2340-42)

In the cost approach, Kelly concluded the plant has over 50% economic obsolescence which was based essentially on Kelly's income approach analysis. The reproduction cost new estimate was based on the actual cost of the plant as reported by David Parks, the cost engineer, who was present through the project's construction. (TR. 1993-95, 2000-01, 2119; Appellant's Ex. A, p 77-78) The Parks cost report was 50 to 60 pages long and included each of the change orders for the project. (TR. 2002) Kelly's understanding was that Parks obtained all the information contained in his report from Aux Sable. (TR. 1998-99) The witness acknowledged that for the 2001 appraisal report, the Parks cost figure was $459,127,000 which reportedly was later revised by Parks to $451,663,000 for this 2003 appraisal report. (TR. 2122-23) Kelly verified the cost data by examining an unaudited financial statement which showed approximately what the recorded cost was of $400 or $425 million. (TR. 1812-13, 1999)

During further cross-examination, the witness acknowledged testimony in another proceeding describing an appraisal of a Caterpillar plant with machinery and equipment. If the assignment were to appraise the land, buildings, and the machinery and equipment it would have to be done in pieces beginning with identifying the machinery and equipment from an asset list, trend up the costs, and depreciating them. An asset list typically identifies the machinery and equipment, how long it has been in use, and the original cost which is then trended up to current costs as of the date of value from a cost manual for equipment and then apply some type of life depreciation factor to depreciate each of the assets based on an equipment depreciation schedule. The appraiser would probably discuss the asset list with someone at the plant about what is on the list and an explanation of what the categories mean. The appraiser would also discuss with someone at the plant the maintenance programs, tour the facility, and inspect the equipment to observe the physical condition. (TR. 2332-39)

Kelly acknowledged that he did not perform any of these foregoing steps for the purpose of the instant appraisal. Instead, it was Parks, a cost engineer, not an appraiser, who gathered the data. Kelly has no knowledge of Parks' knowledge, if any, of appraisal theory. Parks did not trend the values for the plant, Kelly did; when doing the trending, Kelly did not use a machinery and equipment trending table. (TR. 2339-40)

[42] Working capital is determined by subtracting current assets less current liabilities. Changes by management or management decisions regarding current assets would impact working capital. (TR. 2341)

In examination of the subject property, the appraiser did not find any functional obsolescence in the plant as it was a new plant, Kelly did not see any reason why there would be any functional operating penalties, staff at the plant did not know of any, and Kelly also determined this was a state of the art plant. Kelly also found that there were changes made to the plant design from time-to-time and Kelly found that none of those changes contributed to any functional obsolescence. (TR. 2354-56)

The appraiser reiterated his opinion that change orders as set forth in the Parks report which did not contribute additional capacity should be deducted from total cost. This opinion is based on his discussion with plant personnel, an article in Oil & Gas Journal about the construction of the plant,[43] and the testimony he heard from Jeff White during this proceeding. The witness believes the change order costs involved both hard costs (physical changes) and soft costs (engineering associated with the changes). As far as Kelly is aware, cost over budget deductions on page 78 of the report were only for overtime and fast-track premiums. (TR. 2131-35)

Kelly agreed there was a timing issue related to the completion of the subject plant and the pipeline which was one of the reasons there was overtime and fast-track premiums. Kelly asked Parks to quantify whatever fast-track premiums were incurred strictly to complete the plant on time. Thus, the witness asserted it was Parks who determined that these particular items did not add value to the tangible assets and did not increase the functional capacity of the plant.[44] The appraiser Kelly did not perform any spot checking of this data to ensure accuracy. (TR. 2135-39)

Part of the change orders occurred due to a change from electric-run to gas-fired compressors. Kelly understood through discussions with Parks that these changes did not impact capacity. (TR. 2140-41) The witness did not know if there were any other benefits gained from changing to gas-fired compressors. Kelly acknowledged that the gas-fired compressors add value to the facility and are in the cost, but the additional cost to change (the change order) involving placement of the foundations was not included. He also did not know if electric compressors had already been purchased. (TR. 2143-44)

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[43] An article on the subject plant including the planning of building, the Alliance Pipeline route, and the interaction between the plant and pipeline appeared in Gas & Oil Journal in July 2001 authored by Aux Sable employees. (Intervenors' Ex. AA; TR. 2150-55) Kelly considered the article particularly for the construction management section discussing building the plant. The article was not his source for information on the commercial operation of the plant. (TR. 2156-61)

[44] Kelly testified that Parks, as a cost engineer, had the qualification to understand whether overtime or a fast-track premium did or did not increase the functional capacity of the plant. (TR. 2139-40)

Kelly also acknowledged that the article in Gas & Oil Journal discussed that a side benefit of gas-fired compressors was to install a waste heat recovery system to provide all the heat necessary for the fractionation process; however, Kelly is not qualified to calculate what that was worth. (TR. 2162) He also learned some of the modules were shipped before they were finished resulting in additional expenses to finish the modules on-site. Kelly did not know if those were part of the change orders or over-budget cost(s). He learned both from the article and Parks that the workweek was increased to 60-hours to build up the electrical workforce. (TR. 2165-67)

On page 78 of the report, Kelly also deducted direct owners costs based on a list from Parks. Having made deductions from costs on page 78, Kelly took no specific action to determine whether the cost was reasonable. (TR. 2145-47)

Kelly then trended the cost figure provided by Parks using the Means Cost Manual. The witness acknowledged that most of the Aux Sable facility consists of machinery and equipment rather than buildings. He also acknowledged that the Means Cost Manual is not for equipment, but is for buildings. (TR. 2147-48)

Kelly testified that as shown on page 8 of the appraisal, Kelly gathered the pollution control assessment data from two sources: (1) pollution control returns from the State of Illinois with the cost new for each item and (2) the assessed valuation came from a separate government document. (TR. 2357-58)

Kelly also testified that the economic depreciation is due in part to the plant not producing 70,000 barrels per day, but mostly it is due to the lower profit margins experienced by the plant. (TR. 2362)

On redirect examination, Kelly further expounded on his methodology in the 2001 appraisal of the subject property where with only six months of operating data from the plant, he chose to also use six months of operating data after the date of value of January 1, 2001. In addition, he used the prices for the five product lines from the industry that were available. (TR. 2364-65)

For the 2003 appraisal, Kelly examined and relied upon the actual margins at the subject plant for 2001 and 2002 and he also looked back at 2001 in terms of using what the industry predictions were for prices and margins, none of which came true; Aux Sable did not get those margins, so Kelly relied upon what the plant actually achieved for 2001 and 2002 for purposes of the 2003 appraisal. (TR. 2368-69) Page 106 of the appraisal report depicted a net operating loss for 2001 of $7.5 million and a net operating income for 2002 of $8.793 million. (TR. 2374-75)

In 2004, the feeling in the industry was that margins were going to rise so for the 2004 appraisal, Kelly used the industry

projected prices which effectively incorporated the industry projected margins. (TR. 2369)

The witness did analyze whether the data was at market price in the course of performing the appraisal, such as analyzing the gas cost in comparison to the market price for gas for each of the years, which in his opinion "checked out." (TR. 2392)

On the date of valuation, Aux Sable had five owners, which he does not believe had ownership in each other, but he did assume that the owners competed in some respects in the natural gas industry. None of the five owners owned over 50% of Aux Sable individually. Kelly opined that given the corporate structure of the company he assumes the transactions of Aux Sable would be at market because each is looking out for their own interest and he cannot see why they would want to subsidize another company. (TR. 2403-04)

Kelly opined that the excess capacity between 70,000 gallons per day and 58,500 gallons per day could be taken out and calculated as excess capacity, however, the resulting net value would be the same. This would reflect economic obsolescence because right now it is not economically feasible to get the gas there. However, Kelly acknowledged another appraiser could classify it was a super-adequacy, which would not be incorrect in Kelly's opinion. (TR. 2413)

The witness acknowledged that the sales data that he looked at in this case was not ideal, but he felt it was better to use the sales comparison approach than to not use one. He further noted the EBITDA multiplier section provided another method to value the property. (TR. 2424)

If in an appraisal only a cost approach is used, Kelly opined it is more difficult to measure economic obsolescence because there is no income approach to draw an income stream from. Kelly further opined that conceptually sales prices of property indicate the amount of depreciation that is present once the appraiser goes through the analysis. (TR. 2425-26)

Upon further cross-examination, the witness testified that several different owners of Aux Sable supply makeup gas under several different contracts although he is not familiar with the terms of the individual contracts. Kelly acknowledged that he has not reviewed the audited financial statements identified as Appellant's Exhibit B in this matter and is not familiar with whether those statements address the purchases of makeup gas or gas balancing through related parties. (TR. 2437) Kelly acknowledged that Aux Sable is a captive purchaser of the rich natural gas as they are at the end of the Alliance Pipeline. (TR. 2458-59)

Kelly reiterated that he treated the fact the plant could handle 2.1 bcf/day, but was receiving 1.6 bcf/day as part of the economic obsolescence; he acknowledged that it could be treated

as super adequacy or extra capacity, but the result would be the same value by the cost approach. Kelly felt it was an economic obsolescence problem as the reason they cannot get the extra capacity at the plant is because it is not economically feasible to build the pipeline as of January 1, 2003, so it is an economic problem, a problem outside the plant itself. The witness did not know whether the plant's rated capacity will ultimately be used; Kelly does not know whether the economics will ever be there to do so. The Fort Chicago report indicated any expansion was 5 to 7 years away. (TR. 2459-61, 2463; Intervenors' Ex. Z)

As to the concept of deficient earnings, the witness did not know if this was a theory commonly used for valuing machinery and equipment. (TR. 2469)

Concerning use of comparable sales, even with a lot of adjustments, Kelly reiterated his opinion that it was better to include the sales approach than to not use it at all. When asked if this was also true for an appraisal of machinery and equipment, the witness responded that he was valuing the plant as an economic unit, not as stand-alone pieces of equipment, so he felt it was appropriate. Having done an appraisal of the plant as one economic unit, Kelly was unable to state the exact percentages of the property that was real property versus machinery and equipment; he estimated about 90% was machinery and equipment. (TR. 2469-71)

On further re-direct and further cross-examination, the witness discussed the differences between the stabilized prices per gallon of the NGL products versus the actual prices achieved by the subject. (TR. 2476-84)

David A. Henderson

Appellant next called David A. Henderson, Chief County Assessment Officer (CCAO) of Grundy County since July 1, 1979, as an adverse witness. Prior to this position, Henderson had been the Supervisor of Assessments in Jefferson County from August 1976 through the end of June 1979. Henderson was also a field appraiser in Fulton County from March 1972 until starting the position in Jefferson County. (TR. 1118-19)

Henderson has held the assessing designation of Certified Illinois Assessing Officer (CIAO) since 1973 as recognized by the Department of Revenue and Illinois statutes; he also belongs to several assessing organizations along with the Illinois Association of County Officials and the Illinois Property Assessment Institute (IPAI) where he has been a board member. (TR. 1120-21; see also TR. 2856)

Henderson has also been a member and held positions within the Chief County Assessment Officer's Association (CCAOA) since 1976. The organization furthers education, addresses legislative issues, and holds semi-annual conferences. The CCAOA has divided Illinois into five areas or regions and the association conducts

regular meetings within the areas where supervisors of assessments meet and discuss issues of common concern. Topics of interest to the assessors vary and have included what constitutes real and personal property; Henderson has answered questions on the topic, but seeks not to offer an opinion since "what I do is what I do within this jurisdiction." (TR. 1121-25)

In Grundy County, Henderson as Supervisor of Assessments, rather than township assessors, assesses industrial properties. Henderson primarily uses the cost approach, but also considers sales and income data when relevant which Henderson has referred to as a 'mix-and-match' method. (TR. 1129)

Prior to commencement of this hearing, appellant's counsel was scheduled to meet with Henderson to go over testimony that he might give and the meeting was cancelled at the direction of the Grundy County State's Attorney. (TR. 1129-30)

Henderson testified that Milt Carlson was the previous Grundy County Supervisor of Assessments who served from 1968 through 1978. Carlson did not leave any written policies to follow on assessing practices; Henderson reviewed files upon first assuming the position and also had a fairly good understanding of the policy through discussions with the county board members and State's Attorney when he was hired. (TR. 1130-31)

In reviewing files, Henderson found a legal opinion offered by the law firm of Hinshaw & Culbertson addressing the issue of machinery equipment as real estate. Since taking the position, Henderson has not adopted any written policies on what should be assessed as real property. Henderson disagreed with the contention that Grundy County had no formal written policy about what should be assessed as real or personal property and answered it was "the Hinshaw letter." (TR. 1131; Intervenors' Ex. A)

Appellant's Exhibit D was a letter to counsel for the appellant from Henderson related to a Freedom of Information Act (FOIA) request made by counsel; by this letter and attachment, Henderson was providing his response on February 4, 2004. (TR. 1131-33) According to Henderson, the FOIA request sought, among other things, a breakout of total assessments by classification for 1960 to 1979 and Henderson's handwritten response of the county-wide breakdown was submitted. (Appellant's Ex. D, p. 2; TR. 1133-34) Henderson gathered the data from the County Clerk's office and initially reported for years 1960 and 1961 the individual totals for "land" and "lots," but for all the remaining years, Henderson simply added the two figures he found and gave one total for real property. (TR. 1139-40, 1142-44) The data also set forth total assessment for each of the listed years for personal property, railroad, and a total column which provides the total of the columns. (TR. 1141-42) In 1961, the personal property of individuals, corporations, utilities, capitol stock, businesses and insurance companies was assessed. (TR. 1141-42)

Approximately 37% of the total assessment of all classes of property in Grundy County in 1970 was derived from personal property. (Appellant's Ex. D, p. 2; TR. 1146-48) Henderson acknowledged that the exhibit depicts substantial fluctuations in the value of personal property assessed in Grundy County between 1968 and 1972 which was due to a reclassification of large components of machinery equipment from personal property to the real property column. (TR. 1148-52) Based upon the information in Henderson's office, in 1972 Grundy County changed the classification of in-line equipment from personal property to real property based upon the Department of Revenue Property Tax Manual and correspondence with the entity then known as the Department of Local Governmental Affairs. (TR. 1152-54)

Building equipment in the form of heating and/or cooling systems was classified for assessment purposes as real property both before and after 1972. (TR. 1152-53) In-line equipment was process equipment other than equipment used to support the building itself. (TR. 1153)

Henderson testified there are a number of pipelines which criss-cross Grundy County throughout various areas and townships carrying petroleum products; some have existed since the 1960s and some have been installed more recently like the Alliance Pipeline. (TR. 1246-47) Henderson acknowledged that there are also gas mains and pipes servicing residential customers in Grundy County. (TR. 1247) Henderson in preparation for hearing reviewed the personal property tax returns submitted in this matter, some of which go back to 1969. (TR. 1247) Gas pipelines in the county range in size from 6" to at least 30" and maybe up to 40." (TR. 1248) None of the pipelines in Grundy County have been assessed as real property since 1979; however, from 1972 to 1979 pipelines were assessed in Grundy County as personal property per the statutes. (TR. 1248) The fact of being a pipeline determined how they were assessed; the diameter of the pipeline(s) may have resulted in differing values for the pipeline or per lineal foot or mile basis. (TR. 1248-50) Henderson acknowledged that each segment of pipeline is essential to the operation of the pipeline to get from point A to point B there must be continuous pipe. (TR. 1250-51)

Henderson testified as to the distinctions between real and personal property in Grundy County as of 2003; an electric saw of 500 pounds resting by its own weight on a factory floor would not be assessed as real estate, even if it was essential to the operation and manufacturing process of that company just like a barber chair would not be treated as real estate. (TR. 1251-52) Even if either the saw or the barber chair were bolted down, they would be treated as personal property. (TR. 1252-54) Henderson would need more specific facts as to the type of business that is being conducted and how it fit into the overall scheme of things to ascertain whether a 500 pound saw essential to the operation of a manufacturing process would be considered real property. (TR. 1253)

Henderson testified that in determining how to assess property in Grundy County as real property versus personal property, for new industries thinking about coming in to the county, the entity provides Henderson with a breakdown of their system and examples of other facilities they have up and running. (TR. 1254) For instance, a shingle assembly manufacturing facility provided a videotape of a similar type of facility so that Henderson was able to make some intelligent determination as to how he would have assessed it. (TR. 1254) When he meets with such entities, Henderson wants to have a general idea of the type of equipment that is going to be at the facility with a list of the items. (TR. 1254)

In distinguishing between real and personal property, Henderson first considers whether there is similar property in the county to fall back on in terms of classification and secondly, Henderson seeks data from the owner of the property as to their processes such as whether the owner considers something permanently affixed, what is Pollution Control Equipment, and a complete breakdown of what is in the facility. (TR. 1255-56) Without knowing the type of business, whether the item is essential to the manufacturing process alone will not dictate its classification to Henderson. (TR. 1256) However, assuming the equipment is essential to the manufacturing process and it is not clearly portable, given that limited information Henderson would consider the item to be classified as real property in Grundy County. (TR. 1256-57)

As Grundy County Supervisor of Assessments, Henderson has sought to keep abreast of legal developments and the distinction between real and personal property which has been of particular concern to Henderson; he has monitored legislation on the topic and reviewed court cases from time to time; he has also spoken with assessors who have had real and personal property questions arise within their respective jurisdictions. (TR. 1261-62) Of the 102 supervisors of assessment in the State, Henderson is one of the senior CCAOs. (TR. 1262-63) The issues of what constitutes real and personal property have come up in the statewide and area meetings of assessors which Henderson attends. (TR. 1263-64)

Henderson testified that in assessing the subject property, a partial year's assessment in 2000 was based solely on original construction figures supplied by appellant which was also published in the local newspaper. (TR. 1280) Henderson did not know what was at the property and how it was operating; Henderson wanted to be fair so he reviewed other township plants to ascertain that 8 - 8½% of total value typically was part of personal property. (Tr. 1280-81) As such, initially Henderson allocated 92% of the value to real property and 8% to personal property based upon comparison, the processes at that time, and the limited information he had available. (TR. 1281) One of the plants reviewed was formerly known as Northern Petrochemical, now known as Equistar, and another was R-Mac. (TR. 1282)

Since that initial assessment, Henderson has not modified the allocation of real and personal property of 92% and 8%, respectively, for the subject property. (TR. 1282) This allocation was an attempt by Henderson to apply a like-kind standard to the subject property based on the limited information he had available. (TR. 1282-83) To create the assessment, Henderson reduced the estimated cost of the facility as he understood it by 8.33% to reflect personal property based upon a comparison of the Aux Sable facility with other chemical facilities, like Equistar, in the area. (TR. 1283)

While the intervenors intend to call this witness as part of its case-in-chief, a few questions were placed on cross-examination. Henderson testified that he asked the Aux Sable company for detailed cost figures and was given a single sheet with a breakdown of the full cost between the downstream and the extraction or upstream costs of the plant. (TR. 1284-85) There was a dollar amount indicated to each component within each process. (TR. 1284-85) The sum of the downstream and extraction processes was $365,000,000 which Henderson utilized as his starting point. (TR. 1285)

The Northern Petrochemical/Equistar facility process equipment had been classified as real property prior to January 1, 1979. (TR. 1285)

At the time of establishing the assessment, Henderson presumed the Aux Sable figure was a total cost, including any personal property. (TR. 1285-86) Henderson was not given any asset records from appellant to determine what, if any, personal property was included in the figure. (TR. 1286) In order to make the personal property determination, Henderson may have looked at other facilities besides the two mentioned, but he thinks he did not; he does not believe he did. (TR. 1289) Henderson reduced the $365 million cost by 8.33% which left a remainder of $324 million approximately as real estate other than the land. (TR. 1289-90)

The witness testified that he believes that the piping that is being assessed at the Aux Sable facility is above-ground piping, but given the limited information he was given, he noted that there may be some underground piping that is still part of the process piping; it is not part of the distribution though. (TR. 1295)

On re-direct examination, Henderson acknowledged that appellant's plant has computers and software which he presumes would be part of the 8.33% deduction. (TR. 1297) Henderson also believes the distribution piping was included within the 8.33% deduction along with any other items of portable property at the facility. (TR. 1297)

During additional cross-examination, Henderson stated that he last toured the subject facility in October of 2000 and thus knows there are computers at the facility. (TR. 1298) The 8.33%

deduction removed about $30.4 million; Henderson does not know if the facility had $30.4 million worth of computers and/or distribution piping. (TR. 1299) Henderson's intent was to classify all process piping at the subject plant as real property. (TR. 1299) Henderson was not, however, familiar with the differences, if any, between process piping and non-process piping. (TR. 1299)

The Alliance Pipeline is distribution piping according to Henderson. (TR. 1300) Based upon the limited information provided and dealing with the totals for each, the downstream and extraction processes, there was no way for Henderson to actually determine "if there's X amount of feet of this pipe, or X amount of feet of that pipe, either distribution or the process." (TR. 1301) Because of that limited information, Henderson felt it necessary to make an adjustment to the overall cost figure because he did not know if it included vehicles, desks, or what was included in the figure. (TR. 1301) Henderson's intent was to treat all of the process piping as real property; because there are numerous pipelines that go every which way underneath the landscape at the facility, Henderson did not want to inadvertently treat any pipeline that may be going through the property as real property or anything else that could be construed to be personal as real property, so Henderson made the adjustment to take those types of items into account. (TR. 1302-04)

The $365 million figure provided by the plant and broken down between extraction and downstream were added together, then Henderson needed to make an adjustment for items that could be construed as personal property by statute, prior practice or whatever, so Henderson applied the 8.33% adjustment for personal property to be all-inclusive; Henderson sought to not inadvertently assess personal property as real property which was Henderson's best guess given the information he had. (TR. 1304-05) Had Henderson been given asset runs for each of the facilities, he would have been able to make a much more detailed or more accurate determination, but he did not have those. (TR. 1305)

Board of review data

The board of review presented its "Board of Review Notes on Appeal" wherein the subject's final assessment for parcel 03-22-100-008 of $77,658,670 was disclosed. The subject's assessment for this parcel alone reflects a market value of $232,999,310 using the 2003 three-year median level of assessments of 33.33% for Grundy County as determined by the Illinois Department of Revenue. After extensions of time to file evidence in this matter, by letter from the Property Tax Appeal Board dated May 2, 2007, the Grundy County Board of Review was advised that it was found to be in default in this proceeding.

Intervenors' case

In support of an increase in the subject property's assessed valuation, the intervenors, Minooka Community Consolidated School District No. 201 and Minooka Community School District No. 111, through legal counsel filed a complete summary appraisal prepared by Nationwide Consulting Company, Inc. as of January 1, 2003 estimating a market value of the subject plant of $321,400,000. (Intervenors' Ex. X)

John J. Connolly

One of the appraisers who prepared the report, John J. Connolly III, a 31-year employee and currently executive vice-president of Nationwide, appeared at the hearing and was subject to cross-examination questions as to how the report was prepared and the methodology in making adjustments. Nationwide is an appraisal consulting company which appraises large facilities all over the world; the company has subsidiaries including a real estate brokerage which brokers primarily petroleum facilities, a compliance division for property tax compliance work, and a sales and use tax company that performs audits in the United States to apply for refunds of sales and use taxes. (TR. 2541-43)

Prior to the hearing, the parties stipulated that Connolly, who has been an appraiser for a total of 37 years, was qualified as an expert in the field of real estate appraisal.[45] Connolly's primary responsibilities at Nationwide are in the consulting appraisal company and the brokerage company.[46] (TR. 2542, 2544)

The appraisal division does mostly commercial and industrial real estate and machinery and equipment and occasionally residential property valued in excess of $10 million. Within this division, Connolly heads up the specialty assignment division in charge of any complex industrial facility assignment, primarily process-related facilities. Connolly's experience includes appraisals of food processing, steel, soup, pickle, chemical, refinery, bulk storage, underground storage, and Boeing plants; he opined he has appraised virtually every industry except automotive. (TR. 2545-47)

Connolly has previously appraised one extraction or fractionation facility for Bank of America and has also appraised gathering plants and chemical plants which he characterized as "all basically the same thing, process-related plants." He estimated

[45] Appellant's counsel did *voir dire* the witness and ascertained that Connolly had never appraised an extraction and fraction plant prior to this one to his recollection. (TR. 2567-68) Connolly also lectured in Reno on quantifying operating obsolescence. (TR. 2568-69)

[46] He shows and tries to find properties to buy and sell and then the firm appraises the property to ascertain the market value and place the property on the market. Clients of the brokerage division include Exxon, Mobil, Chevron, BP and Valero along with smaller companies.

at least 95% of his appraisal work is devoted to heavy industrial plants with machinery and equipment. In his career, Connolly has probably prepared over 500 appraisals of industrial plants, the majority of which were for the land, building, machinery and equipment and a few of which were for the machinery and equipment only. He has performed appraisals for bankruptcy, acquisitions, mergers, allocation of purchase price, financing and property tax purposes. Properties have been located in almost every state and Canada, Mexico, Germany, England, Eastern Europe, Australia, and Japan. (TR. 2547-49)

Connolly is a Senior Member of the American Society of Appraisers[47] certified in both "machinery and equipment" and "real estate" along with having held various positions with that organization[48] and/or its local chapter in New Jersey. Certification requires a minimum of five years and up to seven years of full-time experience in the specialty, passing four courses, and submission of two demonstration reports which are then approved by the board of examiners. (TR. 2550-51)

Connolly is also a certified senior instructor for the machinery and technical specialties level 201 through 206 courses of the American Society of Appraisers and has taught courses for more than 25 years. In addition, he is a New Jersey State Certified Appraiser and from the Institute of Professionals in Taxation[49] he holds the designation certified member of the institute (CMI) in the fields of property taxation and sales tax.[50] He has also lectured on the appraisal of industrial property and process machinery and equipment 15 to 20 times in the past 10 years. Connolly has co-authored three books on the appraisal of machinery and equipment by writing various chapters and commenting on other chapters or topics. Connolly also has taken every course available from the Appraisal Institute to qualify for the MAI designation, but he has not done his demonstration

[47] This organization certifies appraisers internationally in multi-disciplines including real property, machinery and equipment, business valuation, and personal property, namely fine arts and paintings. (TR. 2549)

[48] Connolly was part of the board of examiners for about 20 years, including having been chairman of the board. He estimated having reviewed in excess of 200 demonstration reports in that time. (TR. 252-53) Connolly has been both president and first vice-president of the society during which time he drafted machinery and equipment standards for international valuation standard boards which are the international version(s) of the Uniform Standards of Professional Appraisal Practice (USPAP). (TR. 253-55) Connolly was also on the machinery and technical specialties committee for 10 or 12 years whose responsibilities included editing a current topics newsletter, course development updated twice a year, textbook updates every four to five years, along with development of examinations for machinery and technical specialties (or MTS). (TR. 2555-58, 2563)

[49] This organization, originally called the Institute of Property Taxation, consists of taxpayers, appraisers, consultants and attorneys in the property tax, sales tax, and/or federal income tax fields formed in the 1970s from the International Association of Assessing Officers (IAAO). (TR. 2559) Connolly for two years was chairman of the professional designation committee that ensured integrity of the designation through current educational offerings and seminars. (TR. 2560-61)

[50] In the 1970s certification required five years of full-time experience, a written test, and an oral examination. (TR. 2560)

report. Connolly contends that the Appraisal Institute does not have any courses regarding valuation of processing machinery and equipment. (TR. 2562-65, 2572-73)

At hearing, the witness was tendered as an expert professional appraiser of real estate and heavy industrial processing machinery and equipment to which no objection was raised by opposing counsel. (TR. 2571)

According to the appraiser, the first step in an appraisal assignment, besides internal paperwork, is to send out a request for information to the client seeking things such as a plot plan of the facility[51]; an asset list with dates of acquisition, description and cost; any prior appraisals of the facility; most recent tax bills of the facility; financial statements[52]; insurance information including insured value totals; the past five years of maintenance records; money expended for real property, machinery and equipment; known operating problems; the five-year plan or forecast[53]; any deferred maintenance; and a request for time to meet with plant manager, maintenance, process engineer, financial personnel, and others as necessary. He then ascertains when he might get the documentation and in the meantime, begins researching the industry.[54] He then coordinates the field inspection and interviews. (TR. 2573-75, 2577-79)

Connolly would prefer to have all of the requested documentation in advance of the plant visit, but typically he has 50% or 60% before arriving and obtains the remainder upon arrival. At that time, verification is undertaken. (TR. 2588-89)

Upon arriving at the facility, Connolly typically meets with the plant manager, takes a general inspection tour with someone, meets with accountants[55] and then maintenance and then takes a detailed inspection tour of the facility to view the condition,

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[51] The plot plan provides a general description of the facility and provides Connolly with a layout to discuss how the process flows through the facility.

[52] Certified financial statements for profit and loss statements covering three to five years of the facility examined along with one-year and five-year production plans which are typical for process facilities which will include financial outcomes, major rebuilds, modernization, and capital improvements. The financial statements show if the company is making or losing money, indicating whether it is viable or not and along with the plan may show major renovations, production line changes, or drops in capacity all of which indicates viability.

[53] Production records for three to five years are always part of the requested information along with future production. This data may include number of produced units, cost of the unit which in comparison to the industry may indicate obsolescence. Bottlenecking in production is where linked assets produce at varying rates of speed and may cause a delay in the process in the middle. (TR. 2583-84)

[54] Researching the industry on the internet or firm files to acquire an understanding of the industry, where it is going, how it is financially, and to better understand the project, especially if it is an industry the firm has not worked in before. (TR. 2586-87)

[55] Accountants provide financial information, production cost information, review of the asset list and the capitalization policy in order to understand where the numbers came from. (TR. 2584-85)

observe any physical deterioration and take photos of the property, analyzing the gathered data and then he has an exit conference. (TR. 2591-94) Engineers may detail changes they wish would occur in the plant. These meetings can run from 2 or 3 hours to almost a week. (TR. 2587-89) On a large project, he typically meets with the plant manager for 1 or 2 hours for an overview and then at the end for an exit conference summarizing needed information, whether a return trip is necessary, and what has been gathered. (TR. 2593-94)

Connolly estimated that for a new plant like Aux Sable, the meeting with engineers might last 2 or 3 hours. (TR. 2591)

The witness testified that appraisers are not supposed to blindly accept information, but should independently verify information to the best of their ability. He seeks data on what is normal in the industry for production, is it a cyclical industry, stable or declining. (TR. 2585-87) After gathering documents and meeting with personnel/inspecting the facility, the appraiser begins to analyze the data, formulate a report, issue a draft report, and then perform any additional research that may be necessary. (TR. 2598)

As to use of the gathered information, Connolly testified that every appraisal is different and the appraiser uses the information "where it's applicable." The asset list is used to describe the assets. The financials are used to verify that "there is an income stream that would support your final value." The financial information may be used to quantify any obsolescence. Production records may show economic obsolescence and where the facility stands in the industry. (TR. 2598-2600)

Connolly testified that his appraisal process is typical for industrial property with process machinery and equipment and the process is consistent with the principles of the American Society of Appraisers and their specialty committees. The process is also consistent with Connolly's teachings and writings on industrial property with process machinery and equipment appraisals. (TR. 2600-01)

Connolly contended there are differences between an industrial appraisal concerning only land and buildings versus one that also has process machinery and equipment. In a typical industrial property, the appraiser can perform a cost, sales and sometimes an income approach (for rental properties). However, for industrial properties that also include equipment in the valuation, sometimes the land and building can be performed in the traditional manner and the equipment can be via the cost approach only. Connolly opined that performing an income approach captures both the tangible and intangible assets of the unit or entity. For the sales comparison approach, he contended that most major industrial properties will not be comparable to the subject and if sales are found, the adjustments that must be made make the sale non-usable. (TR. 2603-05)

Connolly believes he had approximately two months to complete the assignment for the instant appraisal which is a short period of time. When hired Connolly intended to perform all the steps in his process as previously described including requesting documentation and access to the facility; he would accomplish this by assigning enough manpower to gather data and visit the facility. (TR. 2618-19) Connolly signed a confidentiality statement and in response to his document request, Connolly was provided with a copy of the 2003 REAC appraisal, some federal tax returns, a balance sheet (perhaps certified), and a plot plan. (TR. 2609-11) Connolly had financial statements and income tax returns for the subject, but he made no use of the income tax return except to look at some of the income information. With an inability to go into detail with anyone about the data, Connolly could not utilize the information. Likewise for the financial statements, documentation without the reasoning behind the numbers is data that Connolly does not feel comfortable using absent a true understanding of the numbers. (TR. 2636-37)

Connolly personally inspected the subject property; he was given a general tour and had a 2 to 3 hour meeting with the plant manager, with the tour taking about ½ of the time. (Intervenors' Ex. X, p. 5 & 7) Connolly was able to ask general questions about the process, what the plant did, if there were any difficulties with process flow and similar general questions. Connolly learned that it was a modern, state-of-the-art facility operating at 1.6 bcf/day and was designed to accept 2.1 bcf/day and was going to go there at an unknown time in the future. The plant manager provided no information as to what it would take to expand to 2.1 bcf/day; Connolly gathered that information from other sources. There were no operating problems and the plant was reportedly running efficiently as of January 1, 2003; as a new plant there had been start-up problems. Questions on financial information, production data and the asset list would have to go through the attorneys of record. (TR. 2595, 2611-14)

The tour began from the Alliance Pipeline and walked the process including looking at the equipment. As a first general tour, this provided a basic knowledge of the facility; with a detailed tour, Connolly would have had an asset list and other information from maintenance personnel in order to perform his verification. (TR. 2613-16)

Having been provided a limited tour of the facility and not a detailed inspection impacted Connolly's appraisal preparation in that he had to rely on information in the REAC report as accurate, which Connolly does not like to do without verification. Eventually Connolly received verification through an e-mail from appellant's counsel that "Mr. Connolly can rely on all the plant-specific data contained in the REAC appraisal of

Aux Sable."[56] With that submission, Connolly had some level of comfort. (TR. 2616; Joint Ex. 1)

The witness was unable to state the time necessary to perform a full inspection of the subject facility if given unfettered access because Connolly did not have an asset list. With an asset list, the witness would spend at least a day at the facility. (TR. 2597-98)

Given the amount of information which was provided along with the tour, Connolly testified that he was able to provide a reasonable and valid estimate of the subject property's market value because he had sufficient information which he thought was documented as a starting point for his reproduction cost and he had information from his trending factors from Marshall & Swift along with good information on physical, functional and economic depreciation in order to estimate market value. (TR. 2617-18)

The appraiser researched the industry in which the subject property operates based on its physical location and areas served,[57] the industry in general, the Fort Chicago report, several annual reports, Oil & Gas Journal, and "various information." (TR. 2626) Connolly was satisfied that the research he performed regarding the subject property's industry was sufficient in order to perform the appraisal. (TR. 2626-27)

Connolly prepared a Complete Summary Appraisal report (Intervenors' Ex. X or "Appraisal") which states that it was performed in conformance with and is subject to the Uniform Standards of Professional Appraisal Practice (USPAP), effective January 1, 2005 and the Principles of Appraisal Practice and Code of Ethics of the American Society of Appraisers and the Appraisal Institute. (Id., p. 7 & 36) The appraisal was performed for the school districts for use in establishing the market value of the subject property. The stated purpose of the appraisal was to determine the market value of the subject property for *ad valorem* tax purposes as of January 1, 2003 by appraising the fee simple rights. The function of the appraisal was for use in establishing the market value of the subject property as an integrated operating unit. The report notes that the subject consists of three separate tax parcels (parcel identification numbers). "Since the facility operates as a single economic unit, it has been valued as such." (Id., p. 1-3)

In the report, Connolly indicated an exposure and marketing time for the subject property of 1 to 2 years which was based on his firm's experience in the industry with chemical plants, petroleum plants and other industrial properties. (Intervenors' Ex. X, p. 9; TR. 2609)

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[56] The e-mail further provided that "[appellant's counsel] will not raise [Connolly's] reliance on the plant-specific data contained in the REAC appraisal as a point to discredit him, or his appraisal."

[57] The subject serves the Midwest as its major geographic market. (TR. 2628)

The appraiser found the highest and best use of the subject site as vacant and as improved is the continued use as a natural gas liquid fractionation and extraction plant. (Intervenors' Ex. X, p. 22)

Based on his tour, Connolly determined there was very little physical depreciation. As an operating plant it appeared to be in very, very good condition. (TR. 2616) The appraiser also considered the actual age of the facility to determine its condition. As a 2-year-old facility, it was rather new and therefore, Connolly "knew there was very little physical depreciation at the facility." (TR. 2625)

According to the witness, the subject NGL fractionation and extraction plant is a large industrial facility which takes sweet gas and breaks it down into five separate products and then reinserts the gas into the pipeline. The plant has input from the Alliance Pipeline and then several processing units followed by a distribution pipeline that goes to various facilities including Equistar, Exxon Mobil, a truck terminal, and other places. Connolly performed some research and found the subject to be a large facility for its type and to be the current state-of-the-art for the industry at the time of the report. (TR. 2620, 2624-25) Investors in Aux Sable were reported to include affiliates of Enbridge, Inc. (42.7%), Fort Chicago (42.7%), and The Williams Companies (14.6%). (Intervenors' Ex. X, p. 16)

"Based on appraisal theory and techniques, it is required to consider all three approaches to value. However, if certain approaches are far less relevant in the valuation of a property, those approaches would not be performed and no value estimate rendered." (Intervenors' Ex. X, p. 11)

As to consideration of the sales comparison approach for this appraisal, the report notes that due to the nature of the property, a specially designed fractionation and extraction facility, the appraiser was unable to uncover sufficient sales of the same or similar total entities, or of complete major components, that could be considered an active marketplace. Moreover, the report noted that this type of facility typically sells as an ongoing operation or in conjunction with other facilities of a similar nature resulting in an allocation of value for federal tax purposes for both tangible and intangible assets. (Intervenors' Ex. X, p. 11-12)

Connolly testified that he could not find any verifiable sales of comparable properties in the marketplace; the only sales found were in a similar industry, but not strictly a fractionation plant. These sales reflected the value of the entire entity, both the tangible and intangible assets, not just the land, building and real property. Connolly opined that utilizing such sales would require tremendous adjustments, tremendous assumptions and yields an answer in most cases that is not

reliable. Other sales found were partial interest sales[58] involving a multitude of properties, stocks, ownership in different companies that also transferred meaning each company would have to be valued; he opined that to try to decipher this information would be a major task he did not think was accomplishable.[59] The witness opined the more assumptions you make, the further from the true facts you get and from the actual market value. He opined that deleting 90% to 95% of the sales transaction to arrive at 5% or 10% as the fractionation plant results in very unreliable information. (TR. 2629-32)

There were no transfers of the subject property's interests in the prior five year period, other than some minority partnership interests in 2002 and 2003. Those transfers, however, were not considered by Connolly because there was a lack of credible documentation to support that they were truly indicative of market transfers.

Similarly, the report notes that the income approach was inappropriate as it was not possible to attribute income to the individual tangible property units which constitute a specially designed operating entity since the tangible assets contribute to earnings only in concert with all other economic factors of operation, including intangibles. Based on this conclusion, analyzing just the income directly attributable to the tangible assets is unreliable at a facility such as the subject. (Intervenors' Ex. X, p. 12)

Connolly testified that he chose not to use the income approach because: (1) the plant was only 2 years old so it did not have an income stream or history that could be followed (it was just getting out of the start-up mode, working out problems, getting on-line); (2) teachings on appraisal of machinery and equipment rarely if ever rely on the income approach as it captures the tangible and intangible assets which results in an entity value or a value of the economic unit which would require separating out all the intangible items for a value of the fractionation plant; (3) for a facility capable of processing 2.1 bcf/day, a small change in a cost number can be a dramatic change in value meaning if the appraiser were off by a fraction of a cent, that could be a major change in value; and (4) this is a very cyclical industry as shown in the REAC report in a graph, so the appraiser cannot take one point in time and truly value an income stream at

[58] The witness reviewed three contracts that were part of the four sales of partial interests in the subject property obtained from intervenors' counsel. He tried to analyze the information, but the transfers of partial interests involved the pipeline, partial interests in six or eight different companies and other things so he could not arrive at a value of just the fractionation plant for a reliable value. (TR. 2633)

[59] An appraiser would have to try to separate out the intangible assets, the assembled workforce, any trademark or trade names that went with it, long-term contracts, know-how, and technology which all must be valued in order to truly analyze the sales comparison approach and arrive at the value of just the tangible assets. (TR. 2631-32)

that point in time, it must be stabilized at a point. (TR. 2635-36)

As to the REAC report with economic obsolescence of about $185 million, Connolly opined that if there was that kind of loss in value the accountants would have noted it in the next financial statement. He ordinarily reviews notes and write-downs in financial statements as part of his performance of an appraisal. Likewise, he examines related-party transactions in financial statements in order to see what was covered, were they done at market or below market, and the type of transaction (transfer from one company to another). In the Aux Sable financial statements, there were several notes to related-party transactions which confirmed to Connolly that he should not perform an income approach because he had inadequate information on the income in order to eliminate any intercompany or interrelated company transactions. (TR. 2643-45, 2647)

Connolly testified that he felt able to perform a cost approach because the facility was only 2 years old and he was provided with cost data. For a 2-year-old facility, he opined the cost approach is probably the most applicable approach to value for the land, building and equipment combined. With a new facility, there is very little change in reproduction cost, little loss in value in physical depreciation, and the appraiser can easily analyze the economic and functional depreciation with good foundations for the original cost, for the replacement or reproduction cost. Connolly testified that his method of performing a cost approach did not capture any of the intangibles of the business value or of the economic unit; it just captures the tangible assets and provides a fair estimate of the fair market value of the subject property. The witness also stated that he has, in the majority of prior industrial plant appraisals with machinery and equipment, relied solely upon the cost approach and market participants have relied upon these appraisals. (TR. 2655-57)

Initially in the cost approach, the appraiser estimated the subject's land value at $2,800,000. To arrive at this figure, sales data for two vacant land sales zoned industrial in Channahon were considered on a price per acre basis. Sale #2 was the subject property and Sale #1 was a sale of 85 acres. The subject of 160.91 acres sold in September 1998 for $2,155,000 or $13,395 per acre consisting of a sale price of $1,320,000 plus demolition costs of $835,000, which was noted as needing a time adjustment. The other sale comparable sold in November 2000 for $2,230,000 or $26,235 per acre. The appraiser contended these were the only comparable land sales available with industrial zoning. He asserted use of another zoning type required many adjustments to try to make it truly comparable to the subject. Adjustments were made for location in terms of road access and size. After adjustments, Connolly concluded an estimated price of $17,500 per acre or, for the subject of 157.91 acres, $2,763,425 which was rounded to $2.8 million. (TR. 2658-60; Intervenors' Ex. X, p. 28-32)

Next in the cost approach, Connolly stated he relied upon the reproduction costs set forth in the REAC appraisal (Appellant's Ex. A, p. 78) as drawn from the Parks cost study in order to estimate the reproduction cost new for the subject property along with reviewing the nationally recognized Marshall Valuation Service - Chemical index factors to adjust by applying a composite trending factor (multiplier) to generate the market value of the property as an integrated operating unit and also for depreciation factors. (Intervenors' Ex. X, p. 27 & 33)

Connolly determined a reproduction cost new for the subject property as a 2-year-old state-of-the-art facility with trending and a staff who reported they would not change the current facility. (TR. 2661) The appraisal report provided the following definition:

> Reproduction cost is the estimated cost to construct, as of the effective appraisal date, an exact duplicate or replica of the improvements being appraised, insofar as possible using the same materials, construction standards, design, layout, and quality of workmanship and embodying all the deficiencies, superadequacies, and obsolescence of the subject.

(Intervenors' Ex. X, p. 25 citing to Appraisal of Real Estate, 12th Ed., p. 357-58)

Recognizing that a copy of the Parks report was not included in the REAC appraisal prepared by Kelly, Connolly opined that if the document were a mere summary listing, he would not include the document in his appraisal either; if, however, the report was a detailed breakdown setting forth each of the categories, then Connolly would have included it an appraisal report such as Kelly's. (TR. 2666, 2668)

The details of the calculation for Connolly's determination of reproduction cost new were set forth on page 44 of the Addenda in the Appraisal. The total cost reported by REAC for the subject was $451,663,000. From this figure, Connolly deducted the reported overtime and fast track premiums of $42,894,000; he deducted the direct owners cost reported to be $18,700,000; he deducted the off-site assets reported to be $14,234,000 because they are not physically at the subject location; and he deducted the pollution control equipment reported to be $40,421,000 because he understood these items were nontaxable. This resulted in a reproduction cost of $335,414,000 which also included the reported cost of change orders of $38,282,000. (TR. 2661-62, 2665-66, 2680-82)

Connolly testified that it was his opinion that cost over budget for fast-tracking premiums did not add to value, so he deducted that amount from the total cost. However, he felt change orders were a proper component of the project as changes in the construction requirements during the construction of the facility

(mostly due to a changeover from electric generators to diesel generators) should be included in the components as it adds value to the facility because with electric generators the cost of goods sold would be exceptionally higher. Moreover, from the diesel generators, there was a heat benefit thus requiring less heat in one of the processes; it was a good business decision when acceptable electrical rates could not be assured. Connolly removed the direct owner's cost due to the limited information available, in order to be conservative; this was reportedly items such as commissions and other similar items. Connolly felt some of this may have been in the land value; he acknowledged that some portion of this item probably should have remained, but he removed it entirely. (TR. 2662-65)

Connolly then trended the reproduction cost figure by a composite factor of 0.950 as shown on page 43 of the Addenda.[60] The composite factor consists of two components: a trending factor (multiplier) to measure the change in purchasing power of a dollar over a period of time which was based upon Marshall Valuation Service - Chemical index factors (Addenda pages 45-47) and an adjustment for normal depreciation in terms of physical, functional or economic aspects of the property. On page 43, Connolly applied physical depreciation based on the data on page 48 in the Addenda. The years 2002 and 2001 trending factors reflect averages for those years; "typically that comes about because you put on the average half of your assets in the first half of the year, half of your assets in the second half of the year, so that's why we use the average for the year on those two." Connolly found neither functional obsolescence as it was a current state-of-the-art facility nor could any economic obsolescence be proven. Application of the trending factor results in a figure of $318,643,300 or rounded to $318,600,000 as shown on page 44. (TR. 2658, 2669-71, 2674-75, 2679)

The appraiser asserted that Marshall Valuation Service is commonly used when valuing machinery and equipment as it provides very reliable trending information. Other indexes for machinery and equipment are available, but Connolly is not aware of other manuals. The appraiser used the trending line for the chemical industry because that is the one he believed was applicable and most closely related to the subject's industry. (TR. 2671-72)

To determine the 20-year life, Connolly looked at various sources of information including IRS guidelines and from his own experience working in the chemical and petroleum industries. One reference from those industries indicated a 22-year life which

[60] The "index" column depicts the data drawn from pages 45-47. The "multiplier" column reflects a mathematical computation; the year valuing (2003) always has a value of 1.00. The next reflects the index factor of the change in the dollar value for the chemical industry from 2002 on average, divided by the base year, for a factor of 1.016; then for 2001, divided by 2003 for a factor of 1.021. The "% good" column reflects the physical depreciation cost in value for the facility which Connolly calculated per the Marshall Valuation Service, Section 97, page 18, as shown on page 48 of the report, for a 20-year life reflects the loss in value per year. (TR. 2673-74)

Connolly felt was a little bit high,[61] so he thought a 20-year life was a more conservative figure. The witness acknowledged that physically the items will last longer, but in that 20-year period the major operating units will probably be rebuilt two or three times. (TR. 2675-77)

Page 34 of the appraisal references data published in the Internal Revenue Service's Publication #946 but this was an error; Connolly actually used Bulletin F published by Commerce Clearinghouse for a guide and then adjusted it to 20 years as it states in the next sentence on page 34 of the report. (TR. 2678)

Adding the estimated market value in the cost approach of $318,600,000, rounded, to the estimated land value of $2,800,000, Connolly opined a market value of the subject property as of January 1, 2003 of $321,400,000. Connolly testified that his value conclusion covered all the real property located at the plant (the tangible assets), but did not include anything for inventory, working capital or goodwill. (TR. 2685)

Connolly testified that his fee for preparing this appraisal was not contingent upon any determination of market value. Connolly and/or his firm have no interest in the subject property or the parties involved in the proceeding. (TR. 2685-86)

Based on its market analysis, the intervenors requested a finding of $321,400,000 as the fair market value of the subject as of the assessment date.

Next the intervenors presented Connolly's testimony regarding a review appraisal report, Intervenors' Exhibit Y, dated June 22, 2006 which he prepared regarding the REAC appraisal report presented by the appellant. Connolly has performed numerous review appraisals, 30 to 40 of which were like the instant one. (TR. 2689)

According to the witness, for a review appraisal as was done here, the appraiser looks at what is contained in the report, the methodology, the foundation, and the value conclusion. The review is to determine if someone can rely on the document based on the information that is supplied within the document. (TR. 2688-89)

In summary, Connolly set forth on pages 1 and 2 of the review, his opinions. As to 'completeness,' he stated "The report as presented is incomplete with inadequate documentation." As to 'adequacy and relevance of data,' he stated "The report is based on vague information and proper support was not in evidence." In his conclusion, Connolly found the factual description of the

[61] The 22-year figure is shown on page 50 of his report under chemicals, alkaline products. Page 50 is from Bulletin F of the federal tax guide reports, depreciation rate tables and useful life for various industries published by Commerce Clearinghouse. Connolly commonly uses this resource and others when preparing appraisals of industrial plants with machinery and equipment. (TR. 2676-77)

property, the natural gas market industry and other items related to the operation of the property were well presented. He found, however, that the valuation sections for the cost, income and sales comparison approaches "lack support, documentation or thorough analysis." (Intervenors' Ex. Y, p. 1-2)

As a reviewer, Connolly found the income approach in the REAC appraisal was not appropriate because it captured both tangible and intangible assets, not just tangible assets; as a cyclical industry and a very limited income stream,[62] the REAC analysis can result in large value discrepancies; teachings for machinery and equipment appraisers very rarely utilize the income approach because it captures intangibles by looking at an enterprise or entity value[63]; and since this is a large complex, the reviewer asserted that any small error in a cost number or revenue number can have a significant impact on the result which would also carry over into the cost approach where Kelly also relied on income approach data. (TR. 2693; Intervenors' Ex. Y, p. 8)

The witness contended that an interested buyer of the facility is going to look at the past income, but is going to look more to the future and how they can fit the facility into their operation; buyers do not buy past income streams, they buy future income streams. As a cyclical industry, Connolly finds the income approach prepared by REAC was hypothetical. (TR. 2692-94) He further asserted the value can be significantly distorted by taking part of the formulas as historical data and part of the formulas as industry standards. Connolly opined that Kelly's income approach valued the entity, tangible and intangible assets. (TR. 2697-98, 2701-02; Intervenors' Ex. Y, p. 8-11)

On page 10, the reviewer included an example of the 2002 actual figures versus the 2003 projected figures in order to show why the income approach is not used. Connolly further noted this discrepancy flowed through the economic obsolescence calculation in the cost approach as it was based on this income stream data. Connolly testified if the economic obsolescence were removed in the REAC cost approach, the two appraisers practically agree on a value conclusion in their respective reports. (TR. 2700)

The witness further opined that Kelly's application of a direct capitalization approach[64] in performing his income analysis with a remaining life of 28 years was an improper assumption that

[62] The witness found there was not enough history of the subject for a good foundation of the operating history of the facility. With a 3-year period and the first year being a startup year, Connolly asserted there will be operating problems, kinks to work out so that is not good to be relied upon, meaning very little weight should be placed on that data.

[63] Connolly testified that one of his books discusses the use of the income approach for an appraisal of a property like the subject and, in essence, says utilization of the income approach by machinery and equipment appraisers is very rarely, if ever, used. Appraisers are cautioned in the textbooks to ensure they are not capturing intangible values. (TR. 2695-96)

[64] It is a process of capitalizing one year's stabilized income stream into the remaining life of the asset to be valued. (TR. 2703)

there will be a steady income stream for a period of time.[65] The assumption is not valid for the subject property because, as shown in the REAC graph covering 1990 to 2002, there is not a stable income stream. The reviewer asserted that if the scope of the appraisal is the land, building and equipment, the appraiser cannot use the direct capitalization approach because it captures things outside the scope of the appraisal report. (TR. 2702-05, 2707)

The witness was also aware of the relationship in the ownership between the Alliance Pipeline and the Aux Sable facility, knew there was a contractual agreement to process all the gas put through the pipeline, being captive for the next 13 years of the 15 year agreement, but despite this arrangement Connolly testified that the income approach was not applicable. (TR. 2708-12)

As a reviewer, the witness next addressed the cost approach in the REAC appraisal. He noted many of the land sales were unreliable indicators of value either due to size and/or zoning differences; only Sale #5 and the sale of the subject were deemed to be comparable to the subject, although no discussion of a time adjustment, if any, for the subject's sale was provided.[66] Connolly testified that he has never seen a land sale adjustment to change zoning from agricultural to industrial that was supportable; zoning changes involve permits and costs, and there is no guarantee. As written in the review report on page 6, "[b]ased on this information, the land value conclusion appears reasonable." (TR. 2719-22; Intervenors' Ex. Y, p. 5-6)

Next as part of the review, Connolly analyzed REAC's cost new for the subject. The witness stated that he wrote the review prior to preparation of his own appraisal. At that time of the review, Connolly concluded, based on the data depicted on page 78 of the REAC report, that the cost new figures were reasonable. The witness has since changed his opinion and asserted that the figures are not accurate because (1) change orders of $38,282,000 were improperly deducted; (2) further research has suggested that the change orders added value since they primarily concerned moving from electric to diesel-fired generators which resulted in a cost savings; and (3) REAC used a Means Cost Manual, which is for buildings only, thereby inflating the numbers whereas the Marshall Valuation Service cost manual would be appropriate. (TR. 2723-25)

[65] Connolly opined that it was totally inappropriate for REAC to capitalize for 28 years a net income derived during the 2001/2002 time period that was at the bottom of the cycle because it underestimates the market value of the property; it is based on unreliable information; it is based on an income stream for a startup facility; and it is based on no projections. (TR. 2707-08)

[66] The witness acknowledged in his appraisal of the property his Sale #2 was the sale of the subject land and no time adjustment was made in his appraisal. (TR. 2722-23; Intervenors' Ex. X, p. 30)

As set forth in the review, the reviewer found the technique to determine physical depreciation (straight line technique) was poor as REAC gave no weight to the various components making up the shorter-lived and longer-lived operating units. In the review, Connolly also noted that no functional obsolescence was deducted. At hearing Connolly testified that his opinion has since changed; the straight line technique was correct, but the remaining life was incorrect at 30 years whereas Connolly, through preparation of his own appraisal report, determined a 20 year life was proper. In his experience, Connolly has very rarely seen machinery and equipment last 30 years unless it is an electric generating facility which lasts 30 to 40 years. Likewise, as to functional obsolescence, at the time of the review Connolly was not convinced that there was none and thus disagreed with the determination. As of the time of hearing, however, Connolly agrees there was no functional obsolescence. (TR. 2725-27; Intervenors' Ex. Y, p. 6)

As to the REAC determination of economic obsolescence, as discussed on pages 6 through 8 of the review, Connolly found this totally inappropriate as it was based on an income analysis that was not a proper technique for valuing machinery and equipment as it values the entity and should not be used, especially with such a cyclical industry. The reviewer was further concerned by the REAC analysis finding that a 2-year-old facility lost 60% of its value in two years because in his experience he has never seen anything close to that kind of loss in value. (TR. 2728-29)

On pages 6 and 7 of the review, Connolly agreed with the REAC assertion that there can be economic obsolescence at the facility if you are valuing the enterprise, but he contended this was not true if you are valuing the machinery and equipment. To bolster his point, Connolly in the review document on pages 7 and 8 adjusted the stabilized earnings and arrived at economic obsolescence of only about $6 million as compared to REAC's calculation of $187 million which then carried through in the REAC cost approach to a greater value conclusion of $312,840,000. (TR. 2729-31)

In reviewing the sales comparison approach, Connolly found the reliability of the approach questionable due to the magnitude of adjustments, lack of consideration of age, utility, function or location differences, and relationships of parties in partial interest sale transactions. Connolly opined that use of partial interest sales requires many adjustments because partial interests were sold in a fractionation plant, a pipeline and various other limited partnerships and entities in Canada. Each of those items has to be adjusted out to arrive at the value just of the fractionation plant and there is no evidence in the appraisal that any of that was done. Moreover, having heard Kelly's testimony that he used allocations from the contracts and accepted them as being at market value, Connolly opined that such an approach without independent verification is improper. Connolly also could not explain what Kelly did to arrive at a 5% minority interest discount, but Connolly thought it should be

substantially higher. (TR. 2734-39, 2757, 2760, 2767, 2775-76; Intervenors' Ex. Y, P. 11-12)

As to REAC's use in its sales comparison approach of the EBITDA multiplier analysis, Connolly opined it is an inappropriate technique as it captures the value of the tangible and intangible assets including the value of the management, long-term contracts, and everything else that is intangible, thereby it values the entity, not the hard assets. Moreover, he asserted that the data on page 141 compares 'apples and oranges.' Sale #1 is not just a fractionation plant, but a gathering, treating, processing, transmission system with 1900 miles of pipeline. Sale #2 is a partial interest sale with 10,677 miles of gas transported assets. Sale #3 is a partial interest sale with a pipeline. Sale #4 in the EBITDA analysis was Sale #1 in the sales comparison approach, however, Connolly noted for Sale #1 the sales price was adjusted, but in the EBITDA analysis there was no adjustment to the price. (TR. 2776-79)

Connolly acknowledged that he has done appraisals where he placed minimal weight on the sales comparison approach due to the large number of adjustments that were necessary or he has excluded the approach entirely and stated sales in a narrative without engaging in a full analysis to display to the reader that there were sales, but they were not useable. (TR. 2781-83)

In performing his appraisal of the subject property, Connolly did not include a comparable sales approach because he "found no fractionation plants that sold." The sales found, including four partial sales of the subject, were not just for the fractionation plant, but were for a combination of entities and properties and other available sales were not comparable. Connolly opined that for his own appraisal of the subject, he would not use the six sales in the sales comparison approach and the four sales in the EBITDA analysis of the REAC report. (TR. 2783-85)

In Intervenors' Exhibit Y on page 12, Connolly discussed the REAC appraisal for the subject with a valuation date of January 1, 2001, but Connolly did not perform a formal review of the 2001 report. The reviewer believed he had an obligation to note this report under USPAP guidelines. He further stated he believes "this totally supports all my conclusions." The witness pointed out that these REAC value conclusions reflect a dramatic swing in a two-year-period; in examining the two reports, the differences were in the economic depreciation calculation which in the latest report increased by $160 million. In addition, the value of the pollution control equipment was reduced in two years by 30% per year. Also in the sales comparison approach, Connolly noted the per barrel unit prices changed from 2001 to 2003 resulting in a 50% change in the sales comparison approach. Connolly further noted there was no foundation for any of the swings in the 2003 report. (TR. 2785-88)

Based on data in the Fort Chicago report, information from the plant manager and from data in Oil & Gas Journal, Connolly stated

the subject plant's rated capacity as of January 1, 2003 was 2.1 bcf/day. (TR. 2788-89) The plant in 2001 and 2002 was operation at 1.6 bcf/day based on information from the plant manager, the REAC report and other industry data. (TR. 2789) Based on reading the articles and talking with the plant manager, Connolly understood the full intention was to expand in the future; it was cheaper to build it now and increase operations in the later years than to go back and reinvent the entire facility; they built in excess capacity. The articles indicate the plant has a special niche in the Midwest because it captures gas coming down from Canada and it can process all the extra gas. (TR. 2789-90)

Connolly testified that a purchaser of the subject property would consider its additional capacity because a buyer could possibly expand the facility's intake; they might have other sources, a local pipeline they could use, and one article addressed expanding the Alliance Pipeline by adding 14 substations given the excess capacity of the plant. Connolly further opined that a potential buyer would be willing to pay more for the additional capacity because the potential of using it and the potential of having a greater income stream. According to Connolly, a seller such as Aux Sable would also want to recover its cost for building the additional capacity upon sale of the property. (TR. 2790-93)

On cross-examination, Connolly testified that after the site visit, he met with counsel for the intervenors and made a request for additional information as to forecasts, cash flows, projections, other information, and industry data; the witness was told "we could not get any of that information from the facility. What we have is what we are going to get." (TR. 2997)

Connolly acknowledged his appraisal of the subject property was not just a machinery and equipment appraisal as it included the land, buildings and operating equipment of Aux Sable. On page 2 of his report, Connolly stated the appraisal was establishing the market value of the subject property as an integrated operating unit. Connolly agreed that it is correct to say the property rights inherent in the ownership of the integrated operating unit are the subject of his report. This is not a market value for removal appraisal; it is an appraisal for fair market value and continued use. (TR. 2815-16; Intervenors' Ex. X, p. 2) The witness acknowledged that his use of the 12th Edition of <u>The Appraisal of Real Estate</u> concerned portions of the subject property, but not the entire facility, and in particular, not for the process machinery and equipment. (TR. 2989-92)

Connolly prepared a complete summary report which is the same as a summary report. USPAP sets forth standards of what should be contained in a summary appraisal which is distinguished from a self-contained appraisal that includes all the information significant to the solution of the appraisal problem and thus includes a more detailed presentation than a summary. Connolly agreed that a summary appraisal report should contain a summary of all information significant to the solution of the appraisal

problem. The witness contends his appraisal meets that requirement. (TR. 2817-18, 2820, 2822, 2824-25)

Connolly valued the improvements based on their continued use as a natural gas liquid fractionation and extraction plant for a market value, continued use, appraisal. That is consistent with valuing them at market value for continued use. (TR. 2826-27, 3140) Connolly had sufficient information available to prepare what he considered to be an adequate appraisal and estimate of value for the subject plant. Likewise, he had sufficient information available to prepare what he considered to be an adequate estimate of functional obsolescence at the subject plant. (TR. 2994-95)

The witness agrees that market value as defined by the American Society of Appraisers (ASA) includes the assumption that there are sufficient business earnings to support the valuation conclusion as to the assets in question. It is also a fact that according to the ASA the appraiser has two options in dealing with the issue of adequate business earnings to, first, assume there are sufficient earnings; Connolly disagrees for machinery and equipment appraisers that the second method is to actually test to see if the business earnings are sufficient. (TR. 3140-41)

The subject plant is a modern, state of the art facility. There were partial interest sales of the plant both a few months before and a few months after the date of valuation. In Connolly's opinion, if the plant were placed on the market on or about the appraisal date, there would be a demand for it, there would be a market for the facility, and he believes it would bring his estimated market value. Thus, Connolly opined that the subject plant was a salable asset on the appraisal date. (TR. 2998-99)

The witness testified that ownership of the Aux Sable plant as set forth in his report was drawn from the REAC appraisal. A review of page 133 of the REAC report did not reveal an ownership interest by Duke as reported by Connolly. Connolly does not know if the four companies, Fort Chicago, Enbridge, Duke and Williams, own any portions of each other. Connolly is not sure if these businesses compete with one another and/or control one another. The witness did not recall if he found anything in the audits showing related party transactions at Aux Sable were not at market prices. (TR. 3108-13)

Connolly's appraisal considered only two land sales; common practice is to utilize all the sales that the appraiser can find that are truly comparable. As each appraisal assignment is different, the witness could not set forth what is 'common' in terms of the number of land sales in a given appraisal. (TR. 3129-31) Connolly acknowledged he made a time adjustment to Land Sale #2 as shown on page 30 of his appraisal, but it was not reflected in his comments on the property. (TR. 2799)

On page 31 of the appraisal, Connolly stated in part that there are multiple access points to the subject property; when asked to describe those multiple access points, Connolly could not recall without a plot plan. He mentioned a dirt road went into the facility next to some 80-acres with a chain link fence as an access; the main entrance; and perhaps a service entrance. For appraisal purposes, adequate vehicle access means truck access without any problems, vehicle access, making turns into the facility; not restricted access. The witness agrees that location is a very important factor in adjusting for differences in land sales. One of Connolly's land sales, comparable #2 of 161-acres, was 'right next door'; the witness stated no location adjustments were made for the comparable land sales if they had adequate vehicle access. Land Sale #2 was purchased by Aux Sable in 1998 from Chicago Title and Trust. The witness does not recall the location of Land Sale #1 in relation to the subject. (TR. 3134) Connolly did not seek out assistance from any local appraisers in determining land values. (TR. 3131-34)

As to page 44 of Connolly's appraisal regarding the trended reproduction cost, he combined the trending factor and the depreciation factor into a composite factor of .950 as shown on the page. Connolly agrees that his adjusted cost of $335,414,000 would properly be trended up by 1.021% for a trended reproduction cost of $342,458,000, rounded. If the appraiser next applied the .93% good, it results in a figure of $318,500,000, rounded. (TR. 2807-08)

For every appraisal assignment, the appraiser must determine if physical depreciation, functional obsolescence and/or economic obsolescence is present and, if so, to quantify each.

The useful life Connolly set forth in his appraisal was based upon Bulletin F for alkaline chemical plants with an adjustment that lowered the figure from 22 to 20 years. Connolly was not familiar with what raw materials are processed at an alkaline chemical plant; he also was not familiar with what finished products are produced at alkaline chemical plants. The witness asserted the manufacturing process was a chemical process, but he did not know the specifics; "most of your chemical processes are very similar." Connolly testified there are a lot of similarities in the machinery and equipment at a chemical plant and the subject plant, "because the chemical plants use the same type of stainless steel tubing, same type of reactors, same type of pumps, cogeneration facilities, dust collectors. There would be a lot of similarities in there." (TR. 3126-28) The witness reiterated that alkaline was "the one that I felt comfortable with, and I adjusted it to 20." The others which could have been chosen with 15, 16 or 17 year lives did not truly reflect the expected life of the facility. (TR. 3128)

For his only determination of depreciation, Connolly applied his useful life figure to the Marshall depreciation table (page 48 of the Appraisal). The table states at the top its use is "as a check against [the appraiser's] other methods of determination of

the total depreciation of equipment." The table stops at 80%. The witness contended each industry must be looked at differently; for instance, using this table in the automotive industry might result in adjustments for different factors. The appraiser must inspect, observe the condition of equipment, how well it has been maintained; for two year old industries, this table probably can be used, but for older industries perhaps not. The tables are not industry specific but are developed from multiple assets. (TR. 3136-40)

Connolly agrees as a general definition, economic obsolescence is "the loss in value or usefulness of a property caused by factors external to the asset." The appraiser agreed it is a possibility that even a new efficient plant with no functional obsolescence could be affected by economic obsolescence. Based on his research, Connolly found no economic obsolescence affecting the subject plant on the appraisal date. (TR. 2999-3000)

An appraiser evaluating for economic obsolescence generally would look for symptoms of rising raw material prices, OSHA compliance, environmental cleanup, or the move of a market from your product where distribution shifts from the Midwest to the west coast suddenly. With only the fact of a plant consistently operating below its rated capacity,[67] Connolly cannot answer whether that would be an indication of the presence of economic obsolescence; the total picture must be examined. The witness also opined that a period of two to three years for a new, state of the art plant is a 'start-up period' to work out the bugs; there may be some obsolescence in there; there may be a lot going on with the company, acquiring contracts which is an obsolescence; putting the assembled work force together which is not obsolescence; but there would be a variety of factors as to why a new plant would consistently lose money. (TR. 3001-04)

The witness was questioned about using financial data (submitted as part of appellant's evidence in this proceeding) to determine economic obsolescence. He testified he got very confused with the plant figures as the financial statements for 2002 indicated a loss of approximately $10 million and the tax return said $100 million. Therefore, Connolly could not draw a correlation as to which was correct, the audited statements or the tax return. The audited financial statement for 2001 had a loss of $26 million, but Connolly found again this did not tie in with the tax returns which were significantly higher. Based on the foregoing differences between the audited financial statement and the tax returns, Connolly, in the absence of the ability to sit down with someone and obtain an explanation as to the differences, had no way to know which was right and which was wrong; furthermore, Connolly recognized that the loss from 2001 to 2002 was substantially reduced from the certified financial statement from $26 million to $10 million which is an important factor. (TR.

[67] A plant operating consistently below its rated capacity could be caused by economic and/or by functional obsolescence, and/or could be caused by a variety of different factors. (TR. 3004)

3013-15) The witness was aware that for income tax purposes, an entity may deduct depreciation where it is warranted. Depreciation is not, however, deducted on financial statements. (TR. 3135)

Connolly acknowledged that appraisers are taught that it is possible to measure economic obsolescence within the cost approach. They are also taught that one method to estimate economic obsolescence within the cost approach is to develop an inutility penalty. Connolly has estimated inutility penalties many, many times, but he did not do so in this case. He testified 'we' do not teach analyzing industry returns in valuing machinery and equipment or in teaching Machinery Technical Specialist (MTS) appraisers. The witness also did not do an industry returns analysis in this matter. Another method to analyze economic obsolescence is for the appraiser to analyze supply and demand; Connolly did not perform an analysis of supply and demand in this appraisal. MTS appraisers often refer to the text Valuing Machinery and Equipment published by the American Society of Appraisers. (TR. 3017-20)

In general Connolly agrees with the following statement:

> Whenever the operating level of a plant or an asset is significantly less than its rated or design capability and the condition is expected to exist for some time, the asset is less valuable than it would otherwise be.

(TR. 3078) Connolly also agrees in general:

> Such a penalty for inutility can be a measure of the loss in value from this form of economic obsolescence. There are at least two methods of measuring this loss of value using the cost approach.

(TR. 3079) These were quotes/concepts contained in Connolly's presentation in 2007 to the Western States Petroleum Association. (TR. 3079, 3093-94; Appellant's Ex. S) Connolly believes there is a similar quote in the textbook Valuing Machinery & Equipment. Connolly also believes the concept was in the 1989 edition of Appraising Machinery & Equipment. Thus, use of the inutility penalty to measure economic obsolescence is an approved and accepted methodology if all the factors that support the penalty are present. (TR. 3079-80)

A long-term situation for use of the inutility penalty is one, according to Connolly, that would affect it over its remaining economic life. In Appellant's Ex. S on page 25, an example refers to a situation with a specific item of machinery at a plant with excess operating costs which were quantified and projected for the remainder of the asset's physical life after adjusting for taxes. There is no statement on pages 24-25 of the document stating the functional penalty must exist for the remaining physical life of the property unless they cure it. (TR. 3095-98, 3100) On page 30 of Appellant's Ex. S, the text

refers to the condition existing "for some time" and that the penalty "can be a measure of the loss of value from this form of economic obsolescence." It does not state that the reduced operating level of a plant has to exist for the entire useful life of the property. Connolly also agrees that a penalty can exist for less than the useful life and constitute obsolescence. (TR. 3101-02)

Connolly disagrees that analyzing gross margins is a method of quantifying economic obsolescence; it is not in the textbook for valuing machinery and equipment; it is for valuing the entity. Connolly also disagrees that a way to measure economic obsolescence within the cost approach is to analyze raw material price changes. Connolly also disagrees that analyzing stock price is a method of estimating economic obsolescence in the cost approach. (TR. 3020-21)

Connolly has never seen an appraiser analyze comparable sales transactions as a way to estimate obsolescence within the cost approach. Connolly disagrees that economic obsolescence in the cost approach can be analyzed by considering the relationship between the replacement cost new and the cash flows that the replacement facility is capable of generating. (TR. 3021)

Besides the inutility penalty, economic obsolescence may also be measured by direct dollar and excess operating cost. Direct dollar is the amount to be expended over a period of time to correct deficiencies, such as in OSHA requirements or environmental problems. The direct dollar method was not applicable to this appraisal project according to the witness. Excess operating cost is another direct dollar method where the subject facility is compared to a better facility on a cost per unit and was not applicable to this assignment. The excess operating cost method can be used to measure economic and/or functional obsolescence. Likewise, the inutility penalty can be used to measure either or both economic and functional obsolescence. (TR. 3022-24)

Connolly acknowledged that there is a reference to each of the aforesaid methods of measuring economic obsolescence in the text Valuing Machinery and Equipment, 2nd Edition to which the witness had input in the text along with about 30 other individuals. (TR. 3024-25, 3027-34; Appellant's Ex. R, p. 101-02) Some economic obsolescence can be specific to a piece of machinery and equipment, such as OSHA compliance and environmental cleanup. The witness asserted obsolescence usually does not affect the entire facility, but rather individual assets. The witness acknowledged that with a good factual foundation, including fully investigating the facts, an appraiser may assume economic obsolescence did or did not exist in a given situation. (TR. 3035, 3037-41)

In comparison, the REAC appraisal on page 85 in the depreciation analysis began with a reproduction cost of $358,143,733 less physical depreciation of $23,995,630 resulting in $334,150,000,

rounded. Connolly was then asked to remove the $17,583,539 that Kelly accounted for the pollution control equipment resulting in about $317 million, rounded. Based on these calculations, Connolly agreed that in the cost approach, he and Kelly were about .5% apart on their depreciated cost new calculations. (TR. 2808-10)

Connolly testified that his and Kelly's reproduction cost less physical depreciation figures would be similar since the facility was only 2 years old and both appraisers were starting from the same cost figures. Neither appraiser found any functional obsolescence. Having performed a review of Kelly's appraisal, Connolly knew that Kelly had taken a large deduction for economic obsolescence and in his report Connolly took no deduction for economic obsolescence. (TR. 2810-11)

Connolly did not prepare a sales comparison approach for this appraisal although he was aware that there were sales of partial interests in the subject property. Connolly did not contact either the buyers or the sellers of those partial interests; 'we' had some of the information on some of the sales. While Kelly listed other partial interest sales in his appraisal, Connolly did not contact the buyer or seller in those transactions either. (TR. 3041)

As to the subject property, Connolly testified that it is very difficult to get a facility comparable that would sell on the market; that is why Connolly disregarded the sales Kelly used other than the partial sales as they were not comparable in his opinion at all; there were no sales of fractionation plants so the only thing was the partial interest. Besides the sales in Kelly's report, there were other sales that Connolly rejected for one reason or another such as Koch Oil to Flint Hills which was too small and was a distress sale and two or three facilities in the sale. (TR. 3043-45)

Connolly acknowledged that his normal appraisal process included preparation of a draft appraisal which he did in this matter. Connolly approximated there was a maximum of two weeks' time between the draft and final report in this matter. The witness provided the draft to intervenors' counsel who offered comments and/or suggestions regarding the report. Counsel suggested some minor narrative changes; Connolly also had a battle with Attorney Lane over the exclusion of the pollution control equipment and counsel's desire that a 22 year life be used. Connolly discussed with intervenors' counsel his reasons for removing certain items from the cost and contended in the absence of an asset list, his professional appraisal judgment was to remove the items. Connolly testified that the entirety of page 44 remained unchanged from the draft to the final version of his report. (TR. 2812-14)

Connolly agreed that the Aux Sable plant's ability to generate an income stream depends in part on the prices it can obtain for the products it sells and on the cost of goods sold. One item a

hypothetical buyer would be concerned about was the prices that had been obtained for the products sold at the plant in the past, the current prices at the time of sale, and the future prices. Likewise, the hypothetical buyer would be concerned about the historic cost of goods sold, current cost of goods sold, and future cost of goods sold. (TR. 2831-32)

Connolly testified that he did not summarize revenues that Aux Sable has obtained for the products that it sold in the past, project cash flows or prepare a projection of business earnings because it was not appropriate to use the income approach to value intangible assets as stated in his report. (TR. 2832, 2995-97, 2834; Intervenors' Ex. X, p. 12) He also took no steps to investigate fixed fee income charges in the natural gas industry as that was outside the scope of the report and would have captured the value of the tangible and intangible assets. (TR. 2795) Connolly stated, "It is not possible to attribute income to the individual tangible asset units that constitute a specially designed operating entity since the tangible assets contribute to earnings only in concert with all other economic factors of operation including tangibles. Because of the foregoing, analyzing just the income directly attributable to the tangible assets is unreliable at a facility such as the subject." (TR. 2833)

Based on an agreement of the parties to this proceeding (Joint Ex. 1), Connolly had a right to rely on the statement of revenues and cost of goods sold that were set forth in the REAC report. The witness stated, however, that he did not rely on those numbers "because I could not verify them. I got the reliance on the numbers strictly as I saw it on the cost numbers that were being utilized. Not on the production numbers. That is how I interpreted that, on the cost numbers." Connolly further testified that he would not accept the authorization for reliance on plant specific data for operating expenses and revenue without independently verifying that information as it would be totally insufficient. The witness was unable to obtain any information to verify whether the income and expense data reported in the REAC appraisal was correct or incorrect. Similarly, the figures on the amount of NGLs extracted and/or fractionated at the plant in its first two years of operation were not verifiable. (TR. 2835-36, 2993-94)

As part of his review appraisal, Connolly presented what he saw as potential weaknesses in Kelly's approach to assist Attorney Lane in evaluating the completeness and dependability of REAC's 2003 appraisal of the subject property including pointing out any significant errors or omissions that he was aware of in the course of the review. When Connolly prepared the review, he knew the property was in contention and there was a chance of litigation, but he believed it would be settled. (TR. 3048-50)

The witness was questioned about the differences in his review report which accepted the 58,500 barrel capacity reported by REAC and his appraisal that discusses the subject's design to recover

70,000 barrels of NGLs per day. (Intervenors' Exs. Y and X) The witness reported that upon first reviewing the REAC report, he learned how the actual input of 1.6 bcf/day impacted the plant's ability to produce NGLs and it was only during Kelly's testimony in this proceeding that Connolly learned why Kelly used the 58,500 barrel per day capacity. (TR. 2843-44, 3076-77) The witness acknowledged that he did not mention the input versus design capacity differences anywhere in his appraisal. (TR. 3074)

The witness agreed that the design rated capacity of the plant allows it to process about 2.1 bcf/day of rich natural gas; at the time of valuation, the plant could only process about 1.6 bcf/day because of constrictions in the amount of gas that was delivered to the plant. The plant also had a design or rated capacity allowing it to produce about 70,000 barrels of NGLs per day; but for the same lack of natural gas, the plant could only process a maximum of 58,500 barrels of NGLs per day. Factually also, the plant from 2001 to 2002 actually operated producing about 45,000 to 50,000 barrels of NGLs per day. Thus, Connolly acknowledged that the plant's actual operating level is less than its design capacity as of the date of valuation which was also true when Connolly toured the plant. (TR. 3080-82)

Connolly made no calculations to determine when the supply of natural gas to the subject plant might be increased; he only did an investigation and found that it would be in the near term, within the next four to five years from the appraisal date was Connolly's understanding. Connolly contends that the plant manager indicated that it was economically feasible to expand the pipeline and also the Fort Chicago report discussed increasing the capacity assuming it is economically feasible to do it. (TR. 3088-89, 3094, 3102-04) In Connolly's opinion, a 2.1 billion capacity pipeline would not have been built if it was not economically feasible to upgrade the Alliance Pipeline. (TR. 3104) Noted that Intervenors' Ex. Z, a 2001 Fort Chicago annual report on page 4, asserts expansion of the Alliance Pipeline is likely five to seven years away. (TR. 3090) The witness made no calculation to determine whether or not it was financially feasible to bring additional gas to the plant. (TR. 3094-95) Connolly looked at the facts that the facility was built with surplus capacity to be utilized at a future date as stated in the Fort Chicago report. (TR. 3105-07; Intervenors' Ex. Z, p. 3) The heading on page 3 of the report is "Long-term Growth Potential," not 'long-term growth plans.' (TR. 3108)

From page 4 of his review, Connolly agrees with the statement made by Kelly that essentially if there is no margin, there is no profitability for a processor such as Aux Sable. On further questioning, Connolly testified that the margin between the cost of the gas and the finished liquid product is an important factor; he was not sure that it was the most important factor. Nowhere in his appraisal did Connolly analyze the margins experienced by Aux Sable or by the industry in general. (TR. 3050-52)

Connolly agreed with Kelly that the subject did not have any functional obsolescence. The witness stated that Kelly cannot quantify economic obsolescence for him because "there is none existent at the facility." He also disagreed with Kelly's statement that he determined market value of the product; the market value is determined by the market itself. Therefore, Connolly found several inconsistencies in Kelly's statement on page 83 of the REAC appraisal. (TR. 3054)

From Connolly's perspective, first, REAC used the wrong natural gas price and secondly, REAC's analysis is subject to large fluctuations if you simply change one input like natural gas price. Pages 7-9 of the review appraisal deal only with one input variable, namely, the natural gas price. REAC used a price of $3.96 per million BTUs of gas which was a projection made by Petral for natural gas prices in 2003; Connolly's analysis in the review report was based on a lower natural gas price of $3.44. On page 9, Connolly reported Aux Sable's actual year ending 2002 price for natural gas was $3.44 per million BTUs based on information in the REAC report on page 103.[68] The witness upon further questioning acknowledged this may have been an average figure given the testimony of Kelly. (TR. 3060-61) On page 10 of the review report, Connolly showed how this lower price of natural gas would affect the cost of goods sold as calculated by Kelly in the REAC report. With the lower price per million BTU for natural gas, the result is a lower cost of goods sold. The witness did not examine what the impact would be of the lower price of natural gas on the income of Aux Sable although in general if the price of natural gas declines, the price of NGLs also tends to decline meaning in the example about a 13% decrease. (TR. 3063-67)

Connolly is not a licensed appraiser in Illinois. (TR. 3129) The witness was paid $50,000 for his appraisal and review appraisal in this proceeding which included a premium for the turn-around time. In addition, Connolly's agreement is to be paid for his time in regard to this proceeding partly on an hourly basis with a cap of 10 hours per day, even if more hours are worked in a given day. (TR. 2848) Connolly's rate for attending the hearing and listening to other witnesses testify was $300 per hour and time in testimony and preparation for testimony was $425 per hour. (TR. 2848-49) Connolly's travel time between New Jersey and Morris, Illinois is capped at 10 hours per day. (TR. 2852)

In his consulting role during the hearing, Connolly sought to assist counsel in advocating the intervenors' case which included passing notes to counsel for use in questioning witnesses, some of which were used and some of which were ignored. (TR. 2851) The witness sat through almost all of the Kelly direct and cross-examination and from time-to-time during both he conferred with

[68] Page 103 of the REAC appraisal reports "gas cost for 2002" and Connolly assumed that was year end.

the intervenors' attorneys. Connolly's task was to listen and if he heard something that he thought was important and counsel was going off track, to assist counsel in getting back on track. (TR. 3045-46)

The Hearing Officer inquired of Connolly regarding the function of the report as stated on page 2 of Intervenors' Ex. X. The witness stated this refers to unit value of the tangible assets, not business value which would be the entity capturing the income stream rather than just the hard assets. (TR. 3154) In this context, Connolly defines the phrase "integrated operating unit" as tangible assets only of the land, building, piping, vessels, tanks, process units, etc. (TR. 3154)

During additional re-direct examination, the witness stated that he used the same rate for physical depreciation for both long-lived and short-lived assets of the subject facility because the appraisal was for the "operation as a unit." The appraisal did an average lifing with everything on the same rate. Connolly opined that if he had been provided with an asset list, it would have been much more beneficial in applying a different type of depreciation and in allowing Connolly to specifically address the short-lived and the longer-lived items. With an asset list, Connolly would have applied separate rates of depreciation because typically buildings would be longer-life assets and pumps, piping and vessels would have had a shorter lifeline; some of the tanks would have a longer life. With an entire asset list, Connolly may have had three or four different lives. The rate of depreciation for buildings would have been lower than the rate determined for machinery and equipment. (TR. 3155-57) Adjusting just the buildings would have increased the estimated market value of the subject. (TR. 3157-58)

Addressing Appellant's Ex. R, pages 101-02 of the textbook Valuing Machinery & Equipment, method of determining economic obsolescence, the witness asserted that "analysis of industry returns" was not used in this appraisal because it is a method utilized with valuing the enterprise rather than specifically tangible property; it is a method utilized to capture the tangible and intangible assets. Each of the bullet points in Appellant's Ex. R are typically taught in business valuation courses; if the scope of the report requires, the appraiser may want to combine records with the business valuation person. (TR. 3158-59)

Addressing Appellant's Ex. S, p. 30, the witness noted two methods for estimating economic obsolescence are described. The first method measures the loss in value by reducing the capital investment from rate of capacity to actual operating level to balance the plant. Reading up before that on the second full paragraph, there are at least two methods of measuring this loss of value using the cost approach: the first method (illustrated below) assumes there are no fixed expenses associated with the plant or production line for which the subject is part of (which is an unrealistic assumption in most situations). It is just an

example, not that it could be done; it is very rarely used according to the witness. The subject Aux Sable plant has fixed expenses and would not fall into this category. Also on page 30 of Appellant's Ex. S, the information came from MTS 202 or 203, one of the two courses that are taught for certification of machinery and technical specialty appraisers; this is a ½ day session in a course. (TR. 3161-63)

As additional cross-examination, Connolly indicated that he used neither method referenced in Appellant's Ex. S for the subject as there was no economic obsolescence. The witness knew there was no economic obsolescence after he examined all the pertinent information, after he reviewed the REAC report and his meetings with management and formulated his opinion. (TR. 3228)

David A. Henderson

Intervenors' next witness was David Henderson, Grundy County Supervisor of Assessments, who was previously called for testimony in this matter by the appellant. As Chief County Assessment Officer (CCAO) in Grundy County, Henderson's responsibilities are to insure that all property is uniformly assessed, administer numerous exemptions that have been approved by the legislature, maintain property tax maps, property records cards, and ownership lists. (TR. 2858-59)

In performing his duties, Henderson has had to classify property as real or personal. (TR. 2859-60)

There are a few township assessors in Grundy County who act as extensions of the CCAO's field workers to view property; these persons pick up primarily new residential and commercial construction and turn in the data for computation of the assessment. For those townships without township assessors, field staff of the CCAO's office performs the same work and the office bills the township for the work. (TR. 2861)

In July 1979 when Henderson began his employment with Grundy County, he had to close out the 1978 assessment books as the board of review was in the process of finishing the 1978 assessment year at that time. As he began his employment, Henderson learned that the Grundy County policy for classification of large components of machinery and equipment were treated as real estate since the 1972 assessment which policy has remained in force continually to the date of hearing. Henderson has to the best of his ability enforced and carried out that policy, including the assessment of the subject property. (TR. 2861-63)

Referencing Intervenors' Ex. A, the 1973 legal opinion letter from the Hinshaw law firm, the witness testified that he has the original letter in his office which was in the office's files when he began his position in Grundy County. He read the document within the first week or so of his employment and this opinion letter is part of the basis upon which Henderson learned

of the policy in Grundy County along with the review of other records maintained in the office. (TR. 2865-66, 2879) Office records included documents that presented the background of Grundy County's classification of machinery and equipment as real property since 1972. (TR. 2881, 2883) In the first three days on the job, Henderson went through files in the office relating to various industrial properties within the county. (TR. 2879-81)

The witness discussed Intervenors' Ex. C which is a hand-written breakdown of the assessed valuation by classification of property from 1977 through the assessment year 2000 which Henderson prepared to determine what portion of Grundy County's valuation was personalty and what portion was 'other facilities' which are the large components of machinery and equipment which are valued as real estate in the county.[69] (TR. 2886-87) Henderson maintains records of the breakdown of assessed valuation by type of property and by percentage including the total tax valuation and the tax dollars attributable to the 'other facilities' assessed valuation. (TR. 2893-94)

The witness has visited the Aux Sable facility about three or four times during various construction phases; he has not been to the plant since construction was completed. Henderson's last visit to the plant was in October 2000 when he was informed by plant officials that the facility was not yet complete. A press release was issued shortly after Thanksgiving that the plant would be fully operational on or about December 1st. Henderson placed a partial assessment on the Aux Sable property for the 2000 assessment year because of statutory changes regarding new construction; given the announcement that the plant was ready for its intended use, Henderson had to value it from that date through the end of that particular assessment period. (TR. 2972-74, 3233; Intervenors' Ex. FF)

Henderson classified the Aux Sable property as real property in order to assess it in a uniform manner with other property located within Grundy County that was in existence prior to the January 1, 1979 cutoff date. (TR. 2878-79) Based upon how Henderson has treated the other property within the county, the other like-kind chemical facilities, such as Equistar, Reichold Chemical, and ARMAK, he determined how to classify the machinery and equipment of Aux Sable. (TR. 2974-75)

For the 2000 assessment, after deducting about $31 million for personal property, Henderson made an adjustment for the portion of the year the plant was taxable based upon a 365-day calendar year (partial year assessment). (Tr. 3272-73)

[69] The term 'other facilities' was used on property record cards that were developed in 1972 referring to the machinery and equipment components of the industrial facilities. (TR. 2894) Henderson has continued to use the term, but also tries to maintain a more detailed breakdown. (TR. 2894)

Henderson also did the assessment for the Aux Sable property as of January 1, 2003. The basis for the assessment was the cost figures provided to Henderson by the company during the construction phase back in 2000. The company provided the $365 million cost figure as a one-page Excel format sheet with a cost breakdown for each one of the facilities, the downstream and the extraction with a sum total. Henderson found it was hard to derive any personal property figures from the sheet because "of the generalization of the accounts." Henderson believes there was a breakdown in both extraction and downstream, but he could not make a true analysis as to what portion was real or personal. Henderson did not ask the company any questions about the data on the sheet. The witness did not ask the company for a cost breakdown of the real property at the Aux Sable plant; he requested "like a construction budget for the facility." (TR. 3240-43)

Henderson then made an adjustment to those figures for personal property. After adjusting the $365 million cost figure for personal property, the remainder was about $324 million something according to Henderson. This about $31 million deduction was gleaned as a percentage Henderson had from looking at other industrial facilities in that area; the percentage of personal property those facilities had. Area facilities included Equistar and Akzo Chemical. (TR. 3265, 3268-69) Then using Marshall & Swift for the petroleum or the refinery age/life, Henderson took it at the low end of about 13 years, applied the depreciation factor to that and then also applied a trending factor to it before the depreciation. Again, using Marshall & Swift, Henderson inadvertently used 2002 as the base for the calculation of the trend factor and compared that to the 2003 when he should have used the 2001 beginning year factor because that was when it was the first year, so Henderson understated the trend factor for 2003. The witness asserts he understated the assessment because he used the wrong base year. Henderson then also removed the pollution control devices from the amount as well. Then he had a dollar amount allocated to the extraction, a dollar amount allocated to the downstream facility, and Henderson then divided that by three for the assessed valuation of the improvement. (TR. 3232-38, 3265)

Henderson testified that the fact whether a TIF exists or does not exist has no relevance on Henderson's determination of an assessment. Henderson has to value the subject property according to state law regardless if there is a TIF or not. With the subject property, the situation is by agreement and Henderson therefore does additional things beyond the scope of his statutory requirements as CCAO. (TR. 3291-93)

Henderson was familiar with Hydrocarbon Transportation, Inc. and UPG, Inc. That company is still in operation in Grundy County and has machinery and equipment which is taxed as real property. Prior to 1979, the machinery and equipment at that property was taxed as real property. Hydrocarbon Transportation, Inc. and UPG, Inc. in 1978 listed the equipment as personal property on

the personal property tax return which was then lined out by the county and not included in the assessed valuation on that personal property return. (TR. 2977-78)

Reichold according to Henderson has piping involved in the process and the piping is classified as real property and has been according to the county records prior to January 1, 1979. Henderson also testified that piping at other industrial properties in Grundy County, such as Commonwealth Edison Company, has been classified as real property prior to January 1, 1979. (TR. 2979-80)

As part of cross-examination, Henderson agreed that 1979 was the first year that corporate personal property was not assessed in Illinois. This was also Henderson's first year on the job in Grundy County. Henderson agrees that property that had been lawfully assessed as personal property before 1979 could not thereafter be assessed as real property. Likewise, property that had been lawfully assessed as real property before 1979 remained as real property. (TR. 3330-31)

In 1979, Henderson continued to carry the assessments over to classify property as real or personal in the same way that such property had been assessed before 1979. In order to determine what property had been assessed as real property before 1979, Henderson reviewed pre-1979 property record cards. (TR. 3331)

Henderson did not review pre-1979 personal property tax returns to determine what was classified and assessed as personal property. (TR. 3331)

In the first five years of his employment, Henderson spoke with Grundy County Board of Review members regarding the county's assessment and classification of real and personal property. Henderson spoke with member David Barr who discussed the county's reclassification of property from personal property to real property in the early 1970's. Barr stated to Henderson that the county was concerned that the legislature would not develop a replacement tax and that the county would lose personal property tax revenues it had received up until 1979. (TR. 3331-32)

In answer to questions posed by the Hearing Officer, the witness testified that process machinery and equipment in Grundy County that is assessed are those apparatuses that are intended for the production of a product, that the business of the company is there to provide. He stated that a photocopy business will not have its copy machines assessed nor will a barber chair in a barbershop be assessed as the building can still be used for other purposes. In Grundy County, with large industrial complexes which are basically special-use properties, it is how the item fits into the operation of the special use properties. (TR. 3352-54)

After hearing the testimony and considering the evidence, the Property Tax Appeal Board finds that it has jurisdiction over the

parties and the subject matter of this appeal. The Board further finds, after considering the testimony of the witnesses and reviewing the appraisals submitted by the parties, a change in the subject's assessment is not justified.

Lawfulness of reclassification issue - machinery & equipment

The first legal issue raised to the Board by the appellant is whether the reclassification of 'other facilities' property in Grundy County from personal to real in the early 1970's was unlawful. Appellant asserts the reclassification decision was designed to thwart the purpose of the Constitution of 1970 abolishing taxation of personal property and thus, by its very nature was unlawful. It is undisputed on this record that beginning in 1972, Grundy County reclassified in-line process machinery and equipment ('other facilities') from personal property to real property. Appellant asserts that this reclassification was done to avoid the impact of the 1970 Constitutional Amendment prohibiting the taxation of personal property. Appellant argues "this decision and its effects were unlawful and, as a result, the County may not now classify and tax Aux Sable's machinery and equipment as realty." (Appellant's initial post-hearing brief, p. 7)

The intervening taxing districts maintain that the subject's machinery and equipment is properly classified as real property pursuant to the Replacement Tax Act as the classification occurred prior to January 1, 1979. Moreover, the assessing officials are consistent and uniform in the treatment and classification of machinery and equipment in Grundy County.

As a matter of Board jurisdiction, the Property Tax Code clearly authorizes the Property Tax Appeal Board to determine "the correct assessment of property which is the subject of an appeal." (35 ILCS 200/16-180) It is not clear that the Board has authority to determine the lawfulness of the reclassification engaged in by Grundy County. See People ex rel. Thompson v. Property Tax Appeal Board, 22 Ill. App. 3d 316 (2nd Dist. 1974) (only authority and power placed in the Board by statute is to receive appeals from decisions of boards of review, make rules of procedure, conduct hearings, and make a decision on the appeal). Assuming, *arguendo*, that the Board can make a lawfulness determination, the Board finds that the Grundy County reclassification carried out uniformly and consistently beginning in 1972 was lawful. (Lake County Board of Review v. Property Tax Appeal Board, 192 Ill. App. 3d 605 (2nd Dist. 1989) (the Board as an administrative agency has the authority to construe statutory provisions in making decisions and determinations).

As of January 1, 1979, the *ad valorem* taxation of personal property was abolished by the Illinois Constitution, Article IX, §5(c):

> On or before January 1, 1979, the General Assembly by law shall abolish all *ad valorem* personal property

> taxes and concurrently therewith and thereafter shall replace all revenue lost by units of local government and school districts as a result of the abolition of *ad valorem* personal property taxes subsequent to January 2, 1971. Such revenue shall be replaced by imposing statewide taxes, other than *ad valorem* taxes on real estate, solely on those classes relieved of the burden of paying *ad valorem* personal property taxes because of the abolition of such taxes subsequent to January 2, 1971. If any taxes imposed for such replacement purposes are taxes on or measured by income, such replacement taxes shall not be considered for purposes of the limitations of one tax and the ratio of 8 to 5 set forth in Section 3(a) of this Article.

See also Client Follow-Up Co. v. Hynes, 75 Ill. 2d 208 (1979). Subsequently in 1979, the legislature enacted what is now known as Section 24-5 of the Property Tax Code which states in part that:

> *Ad valorem* personal property taxes shall not be levied on any personal property having tax situs in this State. ... No property ***lawfully*** assessed and taxed as personal property prior to January 1, 1979, or property of like kind acquired or placed in use after January 1, 1979, shall be classified as real property subject to assessment and taxation. No property ***lawfully*** assessed and taxed as real property prior to January 1, 1979, or property of like kind acquired or placed in used after January 1, 1979, shall be classified as personal property. [Emphasis added.]

(35 ILCS 200/24-5).[70] The appellant has challenged that the actions of Grundy County did not result in a "lawful" assessment or reclassification of property from personal to real property. The Board finds in light of case precedent, this argument lacks merit.

The Illinois Supreme Court stated with regard to the term "lawfully" of Section 24-5 of the Property Tax Code in the case of Continental Illinois Nat'l Bank & Trust Co. of Chicago v. Zagel, 78 Ill. 2d 387, 414 (1979):

> The legislative debates reveal that the primary purpose of this [lawful] restriction on property classification is to prevent the new tax from exceeding its replacement function. As the sponsor of this provision reasoned:

[70] In 1983, Section 24-5 of the Property Tax Code was amended by inserting the phrase "or property of like kind acquired or placed in use after January 1, 1979" in order to "freeze" not only the pre-1979 property as real or personal, but also any other property of "like kind" subsequently acquired. County of Whiteside v. Property Tax Appeal Board, 276 Ill. App. 3d 182 (3rd Dist. 1995).

> "This was meant as a replacement and not as a new tax. And, therefore, any property lawfully assessed as personal property under the Act prior to January 1st could not be reclassified as real property and also any property not, or any property lawfully assessed and taxed as real property prior to January 1st could not then be reclassified as personal property. We don't want a wholesale switch back and forth. There may be some isolated circumstances where indeed a piece of property was unlawfully classified. In that case it could, the classification could be changed, but I think it would be challenged in court and they would have to show that prior to the reclassification that it was indeed unlawfully classified." (81st Gen. Assem., 1st Sp.Sess. 11 (Aug. 6, 1979).)

See also Trahraeg Holding Corp. v. Property Tax Appeal Board, 204 Ill. App. 3d 41 (2nd Dist. 1990) (taxpayer has burden of proving property was lawfully assessed and taxed as personal property prior to January 1, 1979).

Likewise, the Board finds the legislature's intent in passing Section 24-5 of the Property Tax Code, or what became known as the Replacement Tax Act, was to "freeze" classifications of property to their pre-January 1, 1979 classifications. Property that was lawfully classified as real property or personal property before January 1, 1979 cannot be reclassified as personal property or real property after that date. [Emphasis added.] Central Illinois Light Co. v. Johnson, 84 Ill. 2d 275 (1981); People ex rel. Bosworth v. Lowen, 115 Ill. App. 3d 855 (3rd Dist. 1983). "We think the statutory language is perfectly clear that property which was lawfully classified as personal property before January 1, 1979, cannot be reclassified as real property after that date, whether the original classification was by agreement of the parties or not." Bosworth, *supra* at 864.

The Board further finds that the taxation of appellant's machinery, equipment and process piping are founded upon the Replacement Tax Act. Moreover, the Board finds that Grundy County beginning in 1972 made a wholesale change in all of its personal property classifications ('other facilities') and changed those to real property. The Property Tax Appeal Board finds that Grundy County had a consistent method in 1972 and onward, and hence a lawful method, of assessing machinery and equipment or property of like kind (prior to January 1, 1979) as real property. See Christian County Board of Review v. Property Tax Appeal Board, 368 Ill. App. 3d 792 (5th Dist. 2006); Cherry Bowl, Inc. v. Property Tax Appeal Board, 100 Ill. App. 3d 326 (2nd Dist. 1981) (prohibitions against reclassifying property only apply to assessments subsequent to 1978).

Henderson, as the CCAO of Grundy County, has been employed in that position since July 1, 1979. Henderson testified that his duties involve assessing industrial properties in the county. Evidence was presented by Henderson based on a review of the county records, discussions with county board members and the State's Attorney that the county had a general policy of assessing machinery and equipment as real estate for the purposes of *ad valorem* taxation. Based upon the information in Henderson's office, in 1972 Grundy County changed the classification of in-line equipment from personal property to real property based upon the Department of Revenue Property Tax Manual and correspondence with an entity then known as the Department of Local Government Affairs. (TR. 1152-54) The Board also finds the record has no evidence of any instances where such machinery and equipment after 1972 was classified as personal property. Based on this record, the Board finds that Grundy County had a uniform consistent practice of classifying and assessing machinery and equipment as real property prior to 1979. As a result, since Grundy County has such a consistent practice it also has a 'lawful' method of assessing machinery and equipment and property of like kind prior to 1979 such that Section 24-5 of the Property Tax Code 'froze' the classification of machinery and equipment as real property. Compare Christian County Board of Review, *supra* at 797; Board of Educ. of Gibson City-Melvin-Sibley Comm. Unit School Dist. No. 5 v. Illinois Property Tax Appeal Board, 354 Ill. App. 3d 812 (4th Dist. 2005); see also Boone County Board of Review v. Property Tax Appeal Board, 276 Ill. App. 3d 989 (2nd Dist. 1995) (the statutory test focuses on the assessing jurisdiction's classification of the property prior to January 1, 1979); People ex rel. Bosworth, *supra*, (property lawfully classified and assessed as personal property prior to January 1, 1979, could not be reclassified as real property after that date).

As further guidance, the Illinois Supreme Court in Central Illinois Light Co. (CILCO) wrote that "the assessment of property is not a judicial function but a legislative one, the propriety of which courts will not review absent charges that the assessment was a product of fraud." Central Illinois Light Co. v. Johnson, 84 Ill. 2d 275, 282-83 (1981). Since there was no contention of fraud involved in the 1974 agreement of how to classify and value CILCO's Duck Creek Station, the Court held that the property which had been classified and taxed as personalty prior to January 1, 1979, could not, under the Replacement Tax Act, now be reclassified as real property for purposes of taxation. Id.

In People ex rel. Paschen v. Morrison Hotel Corp., 9 Ill. 2d 187, 191 (1956), the Supreme Court wrote, "Our constitution provides that the assessment function is to exercised 'by some person or persons, to be elected or appointed in such manner as the general assembly shall direct, and not otherwise.' Ill.Const., Art. IX, sec. 1, S.H.A. By implication, courts may not intervene to nullify or modify an assessment where the duly authorized officials have exercised honest judgment and there is nothing to

establish fraud (either actual or constructive) **or illegal conduct on their part**. See, generally, Cushman, 'The Judicial Review of Valuation in Illinois Property Tax Cases,' 35 Ill.L.Rev. 689." [Emphasis added.] See also, Henkhaus v. Barton, 56 Ill. App. 3d 767 (5th Dist. 1977).

"Section 1 of article 9 of the Illinois Constitution . . . requires that taxation shall be by general law uniform as to the class upon which it shall operate. This court adheres to the doctrines that this provision of the Constitution means uniformity as applied to a class. No prohibition against classification of property and taxpayers into different classes can be read into the Constitution." People ex rel. Toman v. Olympia Fields Country Club, 374 Ill. 101, 103 (1940) citing Coal Run Coal Co. v. Finlen, 124 Ill. 666, 17 N.E. 11 and The Hub v. Hanberg, 211 Ill. 43, 71 N.E. 826. "It is well established that it is unlawful for an assessor to exempt one kind of property while classifying the same kind of property in the same district as nonexempt." Oregon Community Unit School Dist. No. 220, et al. v. Property Tax Appeal Board, 285 Ill. App. 3d 170, 178 (2nd Dist. 1996) citing Kankakee County Board of Review v. Property Tax Appeal Board, 131 Ill. 2d 1, 20 (1989).

Furthermore, the Illinois Supreme Court stated in People ex rel. Murray v. City of St. Louis, 297 Ill. 199 (1921), "[e]ven where there is a different classification or method in the levying of taxes, so long as no person or class is denied the same protection of the laws afforded other persons in the same class or in like circumstances, such classification is not held to be in violation of the Fourteenth Amendment as to due process of law or the equal protection of the laws." Citing Greene v. Fish Furniture Co., 272 Ill. 148 (1916); Price v. City of Elgin, 257 Ill. 63 (1912); Giozza v. Tiernan, 148 U. S. 657 (1893); Detroit v. Parker, 181 Ill. 399 (1901). In this matter, the appellant has not asserted any lack of uniformity in the reclassification of personal property to real property prior to January 1, 1979 in Grundy County.

Treatment of process piping

The second legal issue raised before the Board by the appellant is that the appellant's piping is not assessable as 'like kind' to gas mains and pipes located in the county. (Appellant's initial brief, p. 57) The appellant relies in part upon "statute and practice" whereby Illinois has classified gas mains and pipes as personal property. (Id., p. 53) Under the Revenue Act of 1939:

> Gas mains and pipes, water mains and pipes, and similar utility property laid entirely or partly in roads, streets or alleys . . . shall be held to be personal property, and shall be listed and assessed as such . . . .

Ill.Rev.Stat. ch. 120, para. 544; see also Ill.Rev.Stat. ch. 120, para 14 (1880). Therefore, appellant asserts the subject plant's piping are personalty. The appellant also contends that the subject's piping is physically and functionally of "like kind" to non-taxable gas mains and pipes bringing the natural gas into the subject plant and taking the NGLs out of the plant. Since the assessing officials do not assess gas mains and pipes that are "like kind" to the subject's pipes, the appellant asserts that the subject's pipes may not be assessed as real property. (Id., p. 57)

The intervening taxing districts maintain that the machinery, equipment and piping are properly classified as realty. Intervenors stress the permanency and use of the machinery, equipment and piping; as support for their position, intervenors rely on extensive cross-examination of White concerning the plant and of Henderson referencing other similar industrial facilities within Grundy County which have piping that is assessed as real property.

The Property Tax Appeal Board finds for the reasons stated below that the subject's process piping is properly classified as part of the 'other facilities' under the Grundy County classification system and assessed as real property.

The Board finds appellant's argument misguided in several respects. First, the Board finds that the cited Revenue Act of 1939 provides that for the limited purpose of the assessment of personal property taxes, a utility's mains are to be regarded as personal property. In other words, the legislature has declared "gas mains and pipes" to be statutorily exempt as noted on page 66 of the Appellant's initial post-hearing brief. Second, the subject pipes are not laid entirely or partly in roads, streets or alleys as referenced in the statute cited, but rather these pipes are shown in photographs in the appellant's appraisal as connecting in many instances above-ground from one piece of equipment to another on the subject's land. (Appellant's Ex. A, p. 36-40) Third, the subject as a private industrial enterprise which cannot be characterized as a "utility" property as referenced in the statute. Instead, the subject plant consists of process piping which is necessary to the functioning of the plant process(es). Fourth, the cited statutory provision was repealed in December 1982. (P.A. 81-1, 1st Sp.Sess., Sec. 11, eff. Dec. 31, 1982.)

Furthermore, Henderson testified that from 1972 to 1979 gas pipelines which criss-cross Grundy County throughout various areas and townships were assessed as personal property per the statutes and none of those pipelines in the county have been assessed as real property since 1979. (TR. 1246-48) Based on this evidence, the appellant argues that the subject's pipes are "like kind" and should not be assessed as real property. The appellant argues the facility's pipes perform the same function and are physically similar to the Alliance Pipeline which is not assessed by Grundy County. Specifically, appellant cites to the

testimony of White that the pipes at the subject plant have to coordinate the pressures, temperatures and flow rates of the Alliance Pipeline coming in, the pipes within the facility from process to process, and the NGL downstream delivery pipes.

However, Henderson also testified regarding other industrial facilities located in Grundy County, such as Reichold and Commonwealth Edison Company, which have piping involved in their respective processes which has been classified as real property prior to January 1, 1979. (TR. 2979-80) Moreover, since Henderson developed his assessment for the subject plant from construction cost data supplied by the appellant to his office, Henderson considers that the pipes which connect from one piece of machinery to another within the complex have been assessed as part of the construction cost data. (TR. 3354)

The most detailed explanation of the purpose of the piping at the Aux Sable facility was provided by White, the plant's Technical Services Manager. According to White, the piping at the facility simply moves the products to and from different locations within the facility and perform no function beyond distribution of the gas and liquid from one point to another. However, White also acknowledged that in order to produce all of the products at the Aux Sable plant, the entire extraction and fractionation process, including the piping, is integral and necessary to flow from one spot to another in the process. He further acknowledged that the piping at the plant is not laid in roads, streets or alleys. (TR. 623-26) Upon examination, White further described inlet and outlet pipes, flare blow-downs, pressure safety valves, and instrumentation piping among other components and all of which were necessary to perform the plant's processes.

The Board finds based on the evidence that the subject's towers, spheres and all other equipment cannot perform their respective functions without the pipes which convey the raw natural gas/vapors/NGLs from one location to another.

> The mains and wires, being directly connected with these engines and boilers, which are personal property for the purposes of taxation under the doctrine of the Johnson Case [Johnson, Collector v. Roberts, 102 Ill. 655 (1882)], can as well be held to be a part of the machinery as of the realty to which the machinery is attached. If they are a part of the engines and boilers with which they are connected, they may, like such engines and boilers, be regarded as personal property for the purpose of taxation.

Shelbyville Water Co. v. People ex rel. Craddick, 140 Ill. 545, 549 (1892). In this matter, the pipes of which appellant contests the assessment for purposes of taxation are a part of the apparatuses for the extraction and fractionation of natural gas and, as such, constitute a part of the subject's machinery and equipment. In light of the Shelbyville case, the Board finds the subject's pipes were properly assessed as real property by

the Grundy County assessing officials under their classification system.

This finding is further supported by more recent case precedent such as Ayrshire Coal Co. v. Property Tax Appeal Board, 19 Ill. App. 3d 41, 45-46 (3rd Dist. 1974) which stated in pertinent part:

> Many authorities take the position that any and all machinery essential to the proper functioning of a plant, mill, or similar manufacturing is a fixture or is at least so presumed to be . . . . This view is sometimes referred to as the 'integrated industrial plant' doctrine and represents the modern trend of decisions. [citations omitted]
>
> C.J.S. Taxation, s 73 states, 'Machinery used in a mining or manufacturing or other business establishment constituting a part of the plant and indispensable to its operation as such is commonly taxed with, and as part of, the realty, ...

In Ayrshire, the dispute concerned certain items of coal extraction equipment including coal conveyors used in coal processing. Similarly in Ayrshire, the disputing party conceded that the concrete foundations to which the equipment was bolted or otherwise attached were assessable real property. Furthermore, among the machinery and equipment described by the court were nine conveyors which were found to be necessary to the coal extraction process conducted on the land and therefore were part of the real estate for tax purposes. For purposes of this case, in essence the piping at the Aux Sable facility operates as a 'conveyor belt' for vapor and/or NGLs and is necessary to the extraction and fractionation process conducted by the Aux Sable facility. See also Beeler v. Boylan, 106 Ill. App. 3d 667 (4th Dist. 1982) (under 'integrated industrial doctrine' all machinery of a factory or plant necessary for its operation as a complete going concern is considered to be part of the freehold).

Much of the foregoing analysis was reviewed and considered by the Illinois Appellate Court, Second District, in the case of Commonwealth Edison Co. v. Property Tax Appeal Board, 219 Ill. App. 3d 500 (2nd Dist. 1991). In that case, the court held the utility's machinery, consisting of piping system, pumps, turbine generators, nuclear reactor vessel, control rods, and fuel handling system were properly assessed as real property.

Based on the foregoing, the Board finds that the piping at the subject plant is necessary to the industrial process of Aux Sable and therefore, is assessable as real property as classified in Grundy County. Therefore, the Board will not further address the appellant's presentation of evidence from White concerning the value of the piping and the related arguments of the parties concerning this issue.

Sufficiency of evidence presented

A third legal issue before the Property Tax Appeal Board raised by the appellant is whether the intervenors' appraisal is insufficient as a matter of law. (Citing to Cook County Board of Review v. Illinois Property Tax Appeal Board, 384 Ill. App. 3d 472, 894 N.E.2d 400 (1st Dist. 2008), *opinion supplemented on denial of reh'g* (9-8-08)) [herinafter referred to as "Omni"]. The court's original opinion in Omni broadly declared that "[w]here the correctness of the assessment turns on market value and there is evidence of a market for the subject property, a taxpayer's submission that excludes the sales comparison approach in assessing market value is insufficient as a matter of law." Omni, 384 Ill. App. 3d at 487. It is primarily this statement of the court by which appellant seeks to have the Property Tax Appeal Board make a finding that intervenors herein failed to meet the burden of going forward since their appraisal excluded a sales comparison approach.

The Property Tax Appeal Board agrees that it is a rare instance where a property is not "salable." In seeking to distinguish the instant case from the facts in Omni, intervenors argued since the 'subject property' is the fee simple interest in the land, buildings, and other improvements including permanent fixtures, but is not the business enterprise of Aux Sable Liquid Products, L.P., "there is no market data for the subject property to use in a sales comparison approach." (Intervenors' Reply Brief, p. 9) Specifically, intervenors' appraiser asserted a facility such as the subject typically sells as an ongoing concern or in conjunction with other facilities of a similar nature. (Intervenors' Ex. X, p. 11-12) In contrast, the rebuttal record in Omni included testimony by the taxpayer's own review appraiser during cross-examination that it would be "a 'critical problem' to *even venture* a thought of wanting to omit the sales comparison approach [for the subject property]." Id. at 484. [Emphasis in opinion.]

As stated in the original opinion in Omni, the sales comparison approach "must be presented in a taxpayer appraisal to satisfy Illinois case law that market value be established to properly decide property tax assessment except where no market exists for the sale of the property." Id. at 486. In its supplemental opinion, the court wrote, "Our opinion simply holds that a *single* approach appraisal is inadequate as a matter of law to warrant a 'best approach' decision except when there is 'no evidence of an actual or potential market for the subject property.' [Citation omitted.]" Id. at 487. [Emphasis in opinion.] On rehearing before the court, the Property Tax Appeal Board expressed a concern that "appraisers [must] now fully develop a sales comparison analysis regardless of its probative value." Id. at 487. The court firmly disagreed with the Board's concerns contending that typical practice is the inclusion of the sales comparison approach and exclusion of the approach is the exception. In the original opinion, the court stated:

> It is also no answer to call the sales approach "problematical" in light of the "unique character" of the Omni building. Being problematical says nothing more than it might be difficult to do.

Id. at 485. To the foregoing statement, the court added this footnote:

> It was not demonstrated that employing the sales comparison approach would have resulted in *unreliable* estimates of the fair market value of the Omni property. [Emphasis in opinion.]

Id. at 485. Intervenors herein contend that the evidence in this record does establish that employing the sales comparison approach would have resulted in an unreliable estimate of the fair market value of the subject facility.

Upon rehearing and in its supplemental opinion, the First District Appellate Court in Omni declared that an appraisal excluding the sales comparison approach had to be justified with more than unsupported conclusions that adjustments would be too subjective and that the sales comparison approach could not be employed because there were no sales of properties similar to the subject. Id. at 488. The court further noted in Omni that of the three appraisers who presented testimony, two agreed the sales comparison approach was appropriate for the subject property; only the taxpayer's principal appraiser relied solely on the income approach and did so "without any showing that either of the other two approaches would provide results that were not 'meaningful.'" Id. The First District Appellate Court concluded that in reliance upon case law and the Administrative Code, matters before the Property Tax Appeal Board "require a showing be made before a single approach appraisal, which excludes the sales comparison approach, can be relied upon as the 'best evidence of market value.'" Id. Thus, based upon this decision, the Property Tax Appeal Board will examine the instant record to ascertain whether a showing has been made to justify a single approach appraisal which excludes the sales comparison approach. This approach has been further affirmed by the court in Board of Educ. of Meridian School Dist. No. 223 v. Illinois Property Tax Appeal Board, ___ N.E.2d ___ (2011 WL 6096308) (2nd Dist. 2011) *modified upon denial of r'hrg*.

There is no doubt on this record that plants like Aux Sable are sold from time to time, however, the question becomes whether the data reflects comparable sales. On behalf of the intervenors, Connolly contended sales were either not verifiable or were not of comparable properties in that they were not both extraction and fractionation facilities. He further contended that other sales involved partial interests with a multitude of properties, stocks, and ownership in various companies included in the transaction. "To try to decipher this information would be a major task that I don't think is accomplishable." (TR. 2629-30)

The sales that were presented by Kelly on behalf of the appellant admittedly presented challenges in the sales comparison approach. He stated the difficulties include that plants such as the subject rarely if ever sell as a stand-alone facility; typically there are a few companies that own many plants resulting in sales that include other off-site assets such as pipelines. (TR. 1419-20) Further complicating the consideration of the sales data was that four of the six sales that were presented by Kelly involved partial interest sales of the subject property. In addition, with complex ownership issues including contractual relationships allowing for first right of refusal on sales of partial interests of the subject property, given these facts the Board finds that a partial interest sale of the subject cannot be characterized as an arm's-length transaction. As the court stated in People ex rel. Korzen v. Belt Railway Co. of Chicago, 37 Ill. 2d 158, 165 (1967), "the inter-relationship of the parties through their common corporate owners, even though the interests are not entirely common or equal, cannot be ignored . . . ." Thus, for purposes of this matter, the Board finds that all of these factors taken together severely detract from consideration of the sales data as a reliable indicator of the property's fair cash value. Thus, Kelly performed a sales comparison approach where the majority of the sales considered, specifically four of six sales, were questionable partial interest sales of the subject property by and among related corporate entities. In this regard, the Board finds that unreliable non-arm's-length sales transactions made up the majority of the sales transactions which were analyzed in order to arrive at a value conclusion in the Kelly appraisal under the sales comparison approach. The Board finds that since the underlying data did not consist primarily of arm's-length sales transactions, the resulting conclusion of value under the sales comparison approach is similarly unreliable.

As outlined by the court in the Omni decision and reiterated by the court in the Meridian Community Unit School Dist. No. 223 case, the Property Tax Appeal Board finds that this record justifies the exclusion of the sales comparison approach in that Kelly was unable to present reliable sales data. The sales considered were either partial interest transactions and/or they did not represent sales of reasonably comparable property.

The Fourth District Appellate Court has previously found it appropriate for the Property Tax Appeal Board to determine which expert appraiser's approach to value was most persuasive and to rely on that. Board of Review of Macon County v. Property Tax Appeal Board, 295 Ill. App. 3d 242 (4th Dist. 1998). The Property Tax Appeal Board acknowledges that the sales comparison approach is a preferred valuation method in many instances,[71] however, as established on this record there are circumstances where a property is so unique and/or where the sales data that are available involve highly complex transactions of multiple

[71] Where there is evidence of *comparable* sales, the market approach should be used. Chrysler, *supra*; Willow Hill Grain, *supra*; County of Alexander, *supra*.

properties, business value and/or intangible assets that it is nearly impossible to decipher the purchase price of a single property with any level of certainty. See Chrysler Corp. v. State Property Tax Appeal Board, 69 Ill. App. 3d 207 (2nd Dist. 1979).

The Property Tax Appeal Board finds on this record that a showing has been made which justifies a single approach appraisal excluding the sales comparison approach can be relied upon as the 'best evidence of market value' in accordance with the opinion of the First District Appellate Court in Omni. Thus, the Property Tax Appeal Board finds that the intervenors' submission of an appraisal relying only upon the cost approach to value was sufficient to challenge the correctness of the assessment of the subject property (86 Ill.Admin.Code §1910.60(e) & §1910.63(d)) and the underlying assessment without the inclusion of a sales comparison approach given the available sales data with regard to the valuation of an extraction and fractionation plant like the subject where the sales transactions were typically comprised of multiple assets and/or interests. See also Board of Education of Meridian Community Unit School District No. 223 v. Illinois Property Tax Appeal Board, ___ N.E.2d ___ (2nd Dist. 2011) (2011 WL 6096308) *modified upon denial of rehearing* October 24, 2011.

It should also be noted that intervenors' repeated protests during the hearing concerning lack of production of documents or records was understood by the Board. However, the Board also finds that the record in this proceeding is devoid of any request for a subpoena by the intervenors to compel production. In fact, much of the intervenors' own chronology of events acknowledges that intervenors made a conscious decision to proceed to present an appraisal and respond to the appellant's evidence rather than take the potentially time consuming route of pursuing a subpoena for production of documents under Section 1910.68 of the Official Rules of the Property Tax Appeal Board. (86 Ill.Admin.Code Sec. 1910.68) Having not pursued the avenue of a subpoena, the intervenors cannot now argue at the hearing and/or in post-hearing briefs that appellant did not produce documents and/or that access to data from the appellant was denied when it was never formally requested through the means available under the Board's Rules. See LaSalle Partners v. Illinois Property Tax Appeal Board, 269 Ill.App.3d 621 (2nd Dist. 1995); Foutch v. O'Bryant, 99 Ill. 2d 389 (1984).

Evidence presented

The appellant contends overvaluation as the basis of the appeal. Except in counties with more than 200,000 inhabitants that classify property, property is to be valued at 33 1/3% of fair cash value. (35 ILCS 200/9-145(a)). Fair cash value is defined in the Property Tax Code as "[t]he amount for which a property can be sold in the due course of business and trade, not under duress, between a willing buyer and a willing seller." (35 ILCS 200/1-50). The Supreme Court of Illinois has construed "fair cash value" to mean what the property would bring at a voluntary

sale where the owner is ready, willing, and able to sell but not compelled to do so, and the buyer is ready, willing, and able to buy but not forced to so to do. Springfield Marine Bank v. Property Tax Appeal Board, 44 Ill.2d 428 (1970). When market value is the basis of the appeal the value of the property must be proved by a preponderance of the evidence. National City Bank of Michigan/Illinois v. Illinois Property Tax Appeal Board, 331 Ill.App.3d 1038 (3rd Dist. 2002). Proof of market value may consist of an appraisal of the subject property, a recent sale, comparable sales or construction costs. (86 Ill.Admin.Code §1910.65(c)). After considering the evidence presented by the parties during the oral hearing, the Board finds a change in the subject's assessment is not warranted.

The subject property under appeal consisting of one parcel had a total assessment of $77,658,670. The subject's one-parcel assessment reflects a market value of $232,999,310 including land based on the 2003 three-year median level of assessments for Grundy County of 33.33%. In actuality, there are two other parcels which should be included to comprise the entire subject property, however, those two parcels were not appealed and those two parcels have 'minimal' assessments on them as shown in this record.[72]

The appellant submitted an appraisal and presented the testimony of real estate appraiser Michael Kelly of REAC estimating the subject property along with the two additional parcels had a market value of $150,000,000 as of January 1, 2003. The intervenors jointly submitted an appraisal and presented the testimony of John Connolly of Nationwide Consulting Company, Inc. estimating the subject property along with the two additional parcels had a market value of $321,400,000 as of January 1, 2003. The intervenors also presented Connolly as a rebuttal witness as he separately prepared a review appraisal of the REAC report.

Before analyzing the respective appraisals and as an additional preliminary matter, the Board will address the appellant's argument that intervenors' appraiser Connolly violated the Uniform Standards of Professional Appraisal Practice (USPAP) by acting as both an appraiser and an advocate in this matter. The intervenors dispute this characterization as an inappropriate and unsupported personal attack on Connolly.

It should be noted that at the commencement of hearing, a motion to exclude witnesses, with the exception that each party was entitled to have a consulting appraisal expert present, was granted. (TR. 4-7) The Hearing Officer characterized this person as a technical advisor for the respective parties. (Id.) Both parties had their respective advisors present at various points throughout the lengthy hearing. As to the question of

[72] Parcel -009 consisting of 7.3-acres has a total assessment of $12,590 and parcel -011 consisting of 31.55-acres has a total farmland assessment of $980, which given the statutory treatment of farmland for assessment purposes, would not be reflective of 33 1/3% of fair cash value for this parcel.

'advocacy,' Connolly acknowledged that he sought to assist Attorney Lane by conferring with counsel, that he passed notes with potential questions, and that he provided suggestions in formulating questions to assist counsel in more effectively presenting his case. Based on the totality of the proceedings in this matter, the Property Tax Appeal Board finds no merit in the appellant's argument that Connolly's actions as outline herein and in his role as a technical advisor during the course of the hearing should result in a negative credibility determination and rejection of his appraisal report due to improper advocacy. To the contrary, the Board finds that Connolly's actions were mere efforts to provide expert input to counsel, who engaged in the actual advocacy. Connolly's role was to provide input on complex topics of appraisal theory and valuation related to process machinery and equipment so counsel could make meaningful inquiries of opposing witnesses. The Board, in conclusion, finds that such actions do not impact Connolly's credibility in the analysis of his report for this proceeding.

As to the appraisal evidence presented by the parties, the Board finds the appraisers were in agreement with respect to the calculation of the land area of all three parcels which they included in their respective appraisals and they also had similar descriptions of the machinery and equipment that compose the primary improvements. The appraisers also agreed that the subject plant was a new, state-of-the-art extraction and fractionation facility that processed raw or rich natural gas that was shipped down from Canada on the Alliance Pipeline. Each appraiser also had a similar conclusion as to the highest and best use of the subject property as improved as being its current or existing use.

After considering the testimony and reviewing the REAC appraisal, the Board finds Kelly underestimated the value of the subject property and the conclusion of value was not credible as of the assessment date at issue. As a result, the Board finds the appellant's evidence does not support a reduction in the subject's assessment for 2003. Furthermore, due to deficiencies in the valuation report submitted by the intervenors, the Board finds the intervenors' evidence does not support an increase in the subject's assessment for 2003.

Both appraisers utilized the cost approach to value in their respective reports. With respect to the cost approach, the Board finds both appraisers arrived at similar per-acre land values, despite have considered only two identical sales. The REAC appraisal contained seven land sales and of these seven sales, only two were of industrially zoned parcels whereas Connolly's report contained only two land sales which were both zoned industrial. The appraisers did not differ much on their per acre land value conclusions. Kelly arrived at a figure of $17,000 per acre after considering seven land sales and three offerings; Connolly arrived at an estimated land value of $17,500 per acre. Thus, from these respective estimated land value conclusions, the appraisers Kelly and Connolly only differed in total land value

for the three parcels they examined by a total of $100,000, rounded.

Despite the appraiser's contention that he did not rely on the smaller parcel sales, the Board finds Kelly's use of several sales involving very small amounts of acreage detracts from his analysis. Furthermore, the Board finds merit in the contention that similarly zoned properties should be utilized if available for estimating a land value for the subject property as part of the cost approach to value. In this regard, Connolly's criticism of Kelly's land sales/offerings of agriculturally zoned parcels with adjustments made under the notion that they could possibly be rezoned is at best speculative. While Connolly presented some confusing statements as to land sale #2 in his report concerning the Aux Sable purchase of the subject property, in the end the Board finds that Connolly's consideration of sales of industrially zoned properties is more persuasive evidence of the land value of the subject property. Thus, the Board finds Connolly's land value finding of $17,500 per acre to be more persuasive evidence of the subject's estimated land value.[73]

Commencing with the replacement cost (a trended original cost, less physical depreciation and pollution control equipment), Kelly estimated about $316.5 million whereas Connolly's trended original cost, less physical depreciation and pollution control facilities was estimated at about $318.5 million. Although the depreciated replacement costs differed between the appraisers at this stage of the analysis by only about one-half of one percent, the differences between their figures were the treatment of change orders and inclusion or exclusion of the cost of the pollution control equipment. Given these differences, it is worthwhile to review how the appraisers arrived at their varying calculations.

Kelly and Connolly both began with the Parks' report of $451,663,000 for the total cost of the facility. Both appraisers deducted from this figure costs over budget of $42,894,000, direct owners costs of $18,700,000, and off-site assets of $14,234,000. The first point of diversion in the cost approach between the appraisers was treatment of the pollution control equipment in their analyses; both appraisers deducted the equipment since pursuant to the Property Tax Code it is to be assessed by the Illinois Department of Revenue separately (see 35 ILCS 200/11-5 et seq.), but the appraisers deducted differing values of the equipment for differing reasons at differing stages of their respective analyses.

Connolly deducted the entire reported cost of $40,421,000 for the pollution control equipment viewing it as an item that was included in the Parks' report but which should not be included in the appraised value under Illinois law for *ad valorem* tax

[73] This finding, however, has no impact on the land assessment determination in this appeal as the appeal does not include 38.85-acres which are contained in two parcels that were not appealed in this matter.

purposes. In contrast, Kelly left the value of the pollution control equipment as part of the original costs from the Parks' report, trended that original cost, adjusted for both physical depreciation and economic obsolescence on that total, and then before arriving at a conclusion under the cost approach, deducted what he calculated to be a depreciated value of the pollution control equipment of $17,583,539. The Board finds that Kelly's methodology in this regard inappropriately retained the full cost of the pollution control equipment throughout the analysis process and then, only after having made a number of adjustments, removed what Kelly calculated to be a "depreciated" value of the pollution control equipment resulting in a skewed analysis under the cost approach. The Board finds that Connolly's method of removing the reported original cost of the pollution control equipment from the Parks original cost figures was the more logical and credible method to more accurately reflect the depreciated replacement cost new of the subject real property as defined in the Property Tax Code for purposes of this appraisal assignment.

Another point of divergence in the cost approach methodology by the appraisers concerned the treatment of change orders. Kelly deducted the entire reported cost of change orders of $38,282,000 whereas Connolly made no deduction for change orders characterizing them as a proper component of the project. In light of the evidence that some portion of the change orders resulted in a change from use of electric-operated turbines and the associated use/purchase of electricity from a third party to power those turbines to the use of gas-powered turbines which had the side benefit of providing heat for use in another system at the plant, the Board finds that it would be appropriate for the appraisers to deduct some portion of the cost of change orders for foundations and other items that did not ultimately alter the operational systems of the plant. However, the benefits of the gas turbines were of such a nature as to result in potentially beneficial changes to the plant operation. The Board finds that neither party clearly articulated the benefits and thus the record is not specific as to the breakdown of the change orders that were beneficial and those that simply were necessary design and foundation changes. As a consequence, the Board finds that both appraisers approached the treatment of change orders in what they each deemed were logical and appropriate methods, but the Board finds that with a more developed record only some unknown portion of the change orders should have been deducted to arrive at the subject's replacement cost new in the cost approach. In summary, as Kelly deducted the entire reported cost of change orders, the Board finds that his replacement cost new figure was erroneous in this regard along with the improper inclusion of the pollution control equipment costs and, conversely, having failed to deduct any portion of the cost of change orders, the Board finds that Connolly's replacement cost new was excessive.

Having determined that neither appraiser's methodologies were ideal for determining an accurate replacement cost new of the subject property, the Board finds that neither appraisal report

can be relied upon. In summary, the Board finds that Connolly's replacement cost new without pollution control equipment of $335,414,000 was excessive by an unknown amount as it includes the costs of foundation changes that did not ultimately benefit the productivity and/or operation of the plant. Likewise, Kelly's replacement cost new including the pollution control equipment of $337,553,000 was also excessive as it included the full cost of the pollution control equipment that should not logically be part of the appraisal calculation under the Property Tax Code to determine assessable real property and the Kelly figure was also erroneous due to the full deduction of change orders of $38,282,000.

Both appraisers trended the original cost data up for the two year period since construction. The Board finds that Kelly provided the better and more credible articulation of the trending factor of 1.061 than did Connolly who arrived at a composite trending factor and physical depreciation determination which in part was based upon equipment costs in the chemical industry. In this regard, the Board finds that Connolly was unable to satisfactorily articulate why the alkaline chemical industry was an appropriate gauge for physical depreciation for the subject extraction and fractionation plant along with other criticisms of his technique and use of a depreciation table that were raised in the course of the hearing. In addition, significant questions were raised concerning his remaining life determination, how it was chosen and what was used to help determine it. Given the multitude of issues in calculating physical depreciation, the Board affords less weight to Connolly's methodology in determining physical depreciation.

Next in the cost approach, both appraisers considered the issue of obsolescence, but only Kelly found that there was obsolescence that needed to be deducted. As a new and modern plant, Kelly found no functional obsolescence present at the subject property, but given what he found to be an income shortfall and losses experienced by the subject property, he ascertained that there was economic obsolescence present at this 2-year-old extraction and fractionation plant.

To arrive at his economic obsolescence calculation, Kelly relied upon his income approach to value methodology. In this regard, Kelly examined the "historical" income and expenses for the subject facility determining variously at the end of 2001 a net operating income of -$12,955,000 and at the end of 2002 a net operating income of $3,539,000. Given these divergent figures on only two years of operating experience, in his review Connolly characterized Kelly's analysis as purely hypothetical and in the absence of further details as to contract prices and/or market prices the conclusion in Connolly's opinion could not be relied upon. The Property Tax Appeal Board agrees with Connolly in this regard.

The record reveals that 2001 was the first year of operation of the plant with some start-up issues as would ordinarily be

expected. Given the evidence in this matter, the Board finds that use of just two years' of purported revenues is simply unsupportable and a speculative analysis of the subject's revenue generating capacity. This analytical problem was not cured by Kelly's income analysis using a fixed fee for the subject as there is nothing in the record to indicate that the subject could achieve a fixed fee given its current processing contract(s) and the data utilized to ascertain an appropriate fixed fee was not well supported on the record through Fasullo's testimony. Thus, the Board finds that Kelly's deduction of $186,990,912 for economic obsolescence is not credible and not a reliable analysis as it was based on Kelly's flawed income analysis of two years' of "historical" income information for the subject which was poorly supported and/or explained.

Furthermore, contrary to the arguments put forth by appellant's counsel, Connolly did consider the financial record data before him. Additionally, he defined in his report on page 34 that "economic obsolescence is adverse conditions external to the property such as poor market demand for the product, industrial reorientation, unavailability of raw materials, or excessive governmental regulations." First, Connolly determined that Kelly's use of 2 years' of revenues at the start of operations was not an appropriate measure of income for the subject property. Second, Connolly stated on cross that examination of the 2001 and 2002 financial information that was available to him was at best confusing in the absence of being able to review the data with accountants or other officers of Aux Sable as the financial statements reflected one loss figure and tax returns reflected a loss figure much greater.

In briefing this matter, appellant's counsel argued that the excess/unused production capacity of the Aux Sable plant was evidence of obsolescence. However, in the same breath, counsel argued that the production capacity was being limited by the Alliance Pipeline's "inability" to deliver more raw natural gas to the plant. The Board finds this argument by appellant to be highly disingenuous. Intervenors repeatedly inquired of certain witnesses if the Aux Sable plant could obtain raw natural gas from sources other than the Alliance Pipeline to which appellant's counsel repeatedly objected. While the record did not resolve the issue of what sources of natural gas could be available to the Aux Sable plant, the record did reveal that the plant was intentionally built with this excess capacity so that if and/or when the pipeline put out 2.1 bcf/day of raw natural gas, the Aux Sable plant would be ready and able to extract and fractionate that quantity of input. In this regard, the Board finds that there was no error or over-estimation of the need for the Aux Sable plant resulting in excess/unused plant capacity. Instead, the owners/investors/creators of the Aux Sable plant intentionally chose to build the facility in the manner in which they did; the Board finds that for the appellant to now try to have such intentional action characterized as detracting from the value of the facility for obsolescence is a highly suspect argument to put forward.

For all of the foregoing reasons, the Board finds that neither appraiser presented a credible, fully supported value conclusion for the subject property through the use of the cost approach to value to alter, either by increase or by decrease, the subject's estimated market value as reflected by its assessment.

The appellant also contends that intervenors' appraiser should have performed an income approach to value as did appellant's appraiser Kelly. The appellant developed an income approach to value using the subject's actual income and expenses that were largely impacted by start-up issues, a short history and unstable natural gas prices. In this regard, the Board finds that Connolly, who is an experienced appraiser of machinery and equipment, provided the most credible explanation of why the income approach was not an appropriate methodology for the subject property. Connolly testified that he chose not to use the income approach because: (1) the plant was only 2 years old so it did not have an income stream or history that could be followed (it was just getting out of the start-up mode, working out problems, getting on-line); (2) teachings on appraisal of machinery and equipment rarely if ever rely on the income approach as it captures the tangible and intangible assets which results in an entity value or a value of the economic unit which would require separating out all the intangible items for a value of the fractionation plant; (3) for a facility capable of processing 2.1 bcf/day, a small change in a cost number can be a dramatic change in value meaning if the appraiser were off by a fraction of a cent, that could be a major change in value; and (4) this is a very cyclical industry as shown in the REAC report, so the appraiser cannot take one point in time and truly value an income stream at that point in time, it must be stabilized at a point.

Kelly in his testimony as much as acknowledged these points raised by Connolly in performing an income approach to value on the subject property. Kelly acknowledged the prime driver of the subject's revenues would be the margins -- the difference between what it costs the plant for the natural gas versus what the plant can sell the NGLs for. Moreover, Kelly noted that the price of crude oil impacts the subject because if substitute feedstocks to NGLs are available, buyers will substitute a less expensive feedstock. Aux Sable's costs also include the cost of make-up gas which was noted by Kelly as a spot market price along with fixed expenses for labor and fuel to operate the machinery. The cyclical nature of the industry was acknowledged by Kelly when he presented data on the natural gas market from page 17 through page 25 of his appraisal report setting forth natural gas prices over time. The Board also recognizes that Kelly performed a second income analysis using a fixed fee structure, but the record reveals and the Board finds that the subject is contracted to provide extraction/fractionation services for 15 years so that in the absence of renegotiating that contract, the subject could not operate on a fixed fee basis for the foreseeable future.

The Board finds this argument that the subject's assessment is excessive when applying an income approach based on the subject's actual income and expenses unconvincing and not supported by evidence in the record. In Springfield Marine Bank v. Property Tax Appeal Board, 44 Ill.2d 428 (1970), the court stated:

> [I]t is the value of the "tract or lot of real property" which is assessed, rather than the value of the interest presently held. . . [R]ental income may of course be a relevant factor. However, it cannot be the controlling factor, particularly where it is admittedly misleading as to the fair cash value of the property involved. . . [E]arning capacity is properly regarded as the most significant element in arriving at "fair cash value".

Many factors may prevent a property owner from realizing an income from property that accurately reflects its true earning capacity; but it is the capacity for earning income, rather than the income actually derived, which reflects "fair cash value" for taxation purposes. Springfield Marine Bank v. Property Tax Appeal Board, 44 Ill.2d at 431.

Actual expenses and income can be useful when shown that they are reflective of the market. The Board finds that the appellant did not adequately demonstrate that the subject's actual income and expenses are reflective of the market. As one example, REAC depicted the average processing margin from August 1990 to August 2002 was 13.2 cents per gallon. (Appellant's Ex. A, p. 34) While intervenors in their brief argue that use of this average processing margin per gallon would significantly raise Kelly's value estimate of the subject, in reply the appellant argues that the depicted average for a 13-year-period for Gulf Coast producers would not be an appropriate measure as of the valuation date with a downward trend in margins for a facility located in the Midwest. Also, in appellant's reply brief, counsel acknowledged that Kelly based his estimate for fixed costs on actual Aux Sable costs with no record evidence presented of industry data for fixed costs. (Appellant Reply Brief, p. 18, fn. 8)

As an additional factor weighing against Kelly's income analysis is the fact that the subject facility is operating below its rated capacity. Admittedly, the facility is processing all of the raw natural gas fed to it by the Alliance Pipeline, however, the record has made it abundantly clear that the plant could process more natural gas and it was constructed to do so. The Illinois courts have previously determined that it is the capacity for earning income, rather than the income actually derived, which reflects 'fair cash value' for taxation purposes. Springfield Marine Bank v. Property Tax Appeal Board, 44 Ill. 2d 428, 431 (1970). On page 101 of his report, Kelly stabilized the Aux Sable facility production, but he began the analysis with the premise of 21,352,500 barrels of product (per year) based on

58,500 barrels of production per day which is below the plant's rated capacity of 78,000 barrels per day.

Connolly also stated, "It is not possible to attribute income to the individual tangible asset units that constitute a specially designed operating entity since the tangible assets contribute to earnings only in concert with all other economic factors of operation including tangibles. Because of the foregoing, analyzing just the income directly attributable to the tangible assets is unreliable at a facility such as the subject." (TR. 2833)

On pages 9 and 10 of his review appraisal, Connolly illustrated how one figure, in this case the cost of natural gas, could substantially alter the conclusion in the income approach. Kelly reported Aux Sable's actual year ending 2002 price for natural gas was $3.44 per MBTU and the same item for 2001 was $4.28 per MBTU which for purposes of the appraisal, Kelly stabilized at $3.96 per MBTU. In his review report, Connolly illustrated how application of the $3.44 per MBTU actual cost for 2002 would decrease the total cost of goods sold by $32,429,497 for just one year and would result in a capitalized value under the income approach based on the 2002 actual cost of natural gas of $327,726,000. (Intervenors' Ex. Y, p. 9-11)

For all of the reasons cited by Connolly and set forth above, the Board finds that an income approach to value for the subject property consisting primarily of machinery and equipment operating as a natural gas extraction and fractionation plant under an existing 15 year contract is not a reliable valuation method for *ad valorem* taxation purposes. The Board does not find credible Kelly's consideration of 2 years' operating income along with the EBITDA calculations, consideration of past and anticipated future prices for natural gas, and then stabilizing such figures which have little credence as part of the foundation of a value conclusion using the income approach to value. As noted by Connolly, the Board agrees that this value estimate by Kelly is essentially hypothetical having been derived from very speculative income figures, cost figures and related projections and estimates.

Having previously determined that the exclusion of the sales comparison approach by Connolly in his appraisal report did not, as a matter of law, make the report insufficient, the Board will now examine the sales comparison approach that was performed by REAC on behalf of the appellant.

The record reveals that Kelly examined six sales of properties he deemed to be comparable to the subject; most importantly, four of those six sales were partial interest sales of the subject facility among buyers and sellers with various relationships to the subject facility. The other two sales were of properties in Louisiana and Alberta, Canada. For these latter sales, Kelly did not discuss their location, age, utility, function or other issues specific to these properties as compared to the subject's

location and/or characteristics. Furthermore, Kelly found it necessary to make a 125% upward adjustment to the Louisiana property which the Board finds on its face raises questions of comparability. In contrast, for Sale #2, Kelly noted that he was unable to quantify and allocate the extensive off-site assets of this property resulting in analysis of the sale price of $196,000,000 or $3,161 per barrel of daily fractionation capacity. Recognizing that sales of properties in this industry typically sell along with significant off-site assets such as pipeline and storage facilities, among other complexities of the transactions, Kelly presented an analysis which broke down the sale into a unit of comparison of total price per barrel of fractionation capacity. In appellant's initial post-hearing brief, counsel argued that consideration of the sales comparison approach to value was available and "even if such data is imperfect, it should have been considered [by Connolly] as part of the analysis." (Appellant's initial brief, p. 47)

Contrary to appellant's argument on page 48 of its initial brief that the sales relied upon by Kelly "presented good indications of what a willing buyer and willing seller considered the value of the subject [emphasis in original] to be," the Board finds Kelly's sales comparison approach is not a reliable or credible indicator of value as it relied heavily upon partial interest sales of the subject property which were transactions that may well be characterized as related party transactions and thus, potentially not of an arm's length nature. "[U]nder the terms of the Aux Sable partnership Agreement, all partners are given a right of first refusal, which Fort Chicago exercised to participate in the El Paso transaction . . . ." (Appellant's initial brief, p. 48-49) As the court held in Ellsworth Grain Co. v. Illinois Property Tax Appeal Board, 172 Ill. App. 3d 552, 559 (4th Dist. 1988), the appealing party failed to prove that the price paid reflected fair cash value for the property, to-wit: the price was fairly arrived at by and between a willing buyer and a willing seller, without collusion, and neither party being under compulsion. In Residential Real Estate Co., v. Property Tax Appeal Board, 188 Ill. App. 3d 232, 242 (5th Dist. 1989) the court favorably quoted a federal court opinion:

> If the taxable transaction is at arm's length, the price charged and paid is taken to be an accurate representation of the true worth; that is, the fair market price. But if the transaction is not at arm's length, some other manifestation that the price is nonetheless an accurate portrayal of the article's worth is required. The price must be more than 'fair'; it is not enough that the price compensate the manufacturing company for costs-and even provide a profit. The price must be a 'market' price; it must be the price which independent buyers in arm's length transactions would be willing to pay.

Citing Crème Manufacturing Co., Inc. v. United States of America, 492 F.2d 515, 520 (1974). In Crème, the court further found that

"[m]ere transfer of stock among the family members [parents and children] did not transform the intercompany sales into arm's length transactions." Id. at 521. Additionally, the facts in Residential Real Estate, *supra*, included findings that the property had not been offered for sale or lease to anyone outside the family; it had not been appraised or inspected for purposes of comparison with similar property; the property was owned as a family-owned corporation that holds title to the property and only leases it to a 'sister corporation' which is similarly owned by family members that own the subject property. Id. at 244.

The Property Tax Appeal Board finds in this appeal, the appellant has similarly failed to establish that the partial interest sales of the subject property met these foregoing principles and/or were an accurate reflection of the market value of various proportional interests in the subject property rather than transfers among 'sister corporations' or other similar related parties. Additionally, the data on Sales #1 and #2 which were considered by Kelly lack details for a complete understanding of the properties as related to the subject. (Distinguished from Willow Hill Grain v. Property Tax Appeal Board, 187 Ill. App. 3d 9 (5th Dist. 1989), where the record was replete with evidence of sales of other facilities similar to the subject). At best, analyzing Sales #1 and #2 which Kelly determined to reflect $3,161 and $5,154 per barrel of daily capacity (see p. 139 of the appraisal) applied to the subject's rated capacity of 70,000 barrels per day, the Board finds that the subject would have an estimated market value of either $221,270,000 or $360,780,000 including "goodwill and working capital" based on these two sales. Furthermore, the subject's current estimated market value as reflected by its assessment of approximately $233,000,000 seems to be supported by the two best sales in the record.

A final consideration as to the reliability or lack thereof of the Kelly appraisal report for 2003 is consideration of the 2001 REAC appraisal of the subject property also prepared by Kelly. (Intervenors' Ex. S) In this 2001 report, REAC estimated the subject's value "including personal property, after deduction for the contributory value of the Pollution Control Equipment" as of January 1, 2001 as $270,000,000. Without going into a detailed analysis of the 2001 report, this appraisal employed the cost, income and sales comparison approaches to value with value conclusions of $265,000,000, $270,000,000 and $293,000,000, respectively. In summary, the reconciliation section of this 2001 appraisal indicates that minimal emphasis was placed on the sales comparison approach "because [of] the inability to allocate portions of the sale price to the off-site pipelines included in each sale" and maximum emphasis was placed on the income approach. (Intervenors' Ex. S, p. 125) The Board finds that, in the absence of a reasoned explanation for a market value difference of $120,000,000 in a two-year period, the reliability of the REAC opinion of value as of January 1, 2003 is specious.

On the basis of the foregoing analysis, the Board concludes that the appellant has failed to provide sufficient evidence that the

subject property was overvalued based on its assessment. Likewise, in light of the foregoing discussion of the intervenors' evidence, the Board concludes that the intervenors have failed to provide sufficient evidence that the subject property was undervalued based on its assessment. Therefore, the Property Tax Appeal Board finds that no change in the assessment of the subject property is warranted on this record.

As a final matter raised concerning the correct assessment of the subject property, the appellant argued that the subject's assessment as determined by the Grundy County Board of Review must be reduced by 8.33% to account for personal property of the Aux Sable facility as Henderson as the CCAO has done for other facilities of a similar nature in the county. Reviewing the evidence closely reveals that Henderson asserted a personal property deduction of 8.33% was made for the Aux Sable property like was done for other similar properties in the county. (TR. 1283, 1289-90, 1297-99, 1304-05) In appellant's initial post-hearing brief on page 71, the appellant contends a question placed by the Hearing Officer reflects that no such personal property deduction was made. The Board finds that the record evidence as set forth above clearly depicts that an 8.33% deduction was made. Any different conclusion as argued by the appellant based on one question by the Hearing Officer is against the manifest weight of the evidence. Thus, contrary to the appellant's argument no further deduction for personal property of the subject plant is justified on this record.

This is a final administrative decision of the Property Tax Appeal Board which is subject to review in the Circuit Court or Appellate Court under the provisions of the Administrative Review Law (735 ILCS 5/3-101 et seq.) and section 16-195 of the Property Tax Code.

Chairman

Member

Member

Member

Member

DISSENTING:

C E R T I F I C A T I O N

As Clerk of the Illinois Property Tax Appeal Board and the keeper of the Records thereof, I do hereby certify that the foregoing is a true, full and complete Final Administrative Decision of the Illinois Property Tax Appeal Board issued this date in the above entitled appeal, now of record in this said office.

Date: February 24, 2012

Clerk of the Property Tax Appeal Board

IMPORTANT NOTICE

Section 16-185 of the Property Tax Code provides in part:

"If the Property Tax Appeal Board renders a decision lowering the assessment of a particular parcel after the deadline for filing

complaints with the Board of Review or after adjournment of the session of the Board of Review at which assessments for the subsequent year are being considered, the taxpayer may, within 30 days after the date of written notice of the Property Tax Appeal Board’s decision, appeal the assessment for the subsequent year directly to the Property Tax Appeal Board."

In order to comply with the above provision, YOU MUST FILE A PETITION AND EVIDENCE WITH THE PROPERTY TAX APPEAL BOARD WITHIN 30 DAYS OF THE DATE OF THE ENCLOSED DECISION IN ORDER TO APPEAL THE ASSESSMENT OF THE PROPERTY FOR THE SUBSEQUENT YEAR.

Based upon the issuance of a lowered assessment by the Property Tax Appeal Board, the refund of paid property taxes is the responsibility of your County Treasurer. Please contact that office with any questions you may have regarding the refund of paid property taxes.