

<p>BOARD OF ASSESSMENT APPEALS, STATE OF COLORADO 1313 Sherman Street, Room 315 Denver, Colorado 80203</p> <hr/> <p>Petitioner:</p> <p>UNITED AIRLINES, INC.,</p> <p>v.</p> <p>Respondent:</p> <p>PROPERTY TAX ADMINISTRATOR.</p>	<p>Docket No.: 53259</p>
<p>ORDER</p>	

THIS MATTER was heard by the Board of Assessment Appeals on December 15, 2010, with a supplemental hearing on September 12, 2011, James R. Meurer and Sondra W. Mercier presiding. Petitioner was represented by F. Brittin Clayton III, Esq. Respondent was represented by Robert H. Dodd, Esq. Petitioner is protesting the actual value of the subject property for tax year 2009.

PROPERTY DESCRIPTION

Subject property is described as follows:

**Aircraft and Ground Equipment situated in or apportioned to the
State of Colorado.
State File No. AL049**

Petitioner is requesting a 2009 actual value of \$191,575,066.00 for the subject property. Respondent assigned an actual value of \$350,158,300.00 to the subject property for tax year 2009.

Airlines are included within the definition of "public utility" for purposes of the State-assessed unitary valuation statutes. Section 39-4-101(3)(a), C.R.S.

Colorado Revised Statutes section 39-4-102 provides in pertinent part:

(1) The administrator shall determine the actual value of the operating property and plant of each public utility as a unit, giving consideration to the following factors and assigning such weight to each of such factors as in the administrator's judgment will secure a just value of such public utility as a unit:

(a) The tangible property comprising its plant, whether the same is situated within this state or both within and without this state, exclusive of any tangible property situated without this state which is not directly connected with the business in which such public utility is engaged within this state;

(b) Its intangibles, such as special privileges, franchises, contract rights and obligations, and rights-of-way; except that licenses granted by the federal communications commission to a wireless carrier, as defined in section 29-11-101, C.R.S., shall not be considered, nor shall the value of such licenses be reflected, in the administrator's valuation of the carrier's tangible property;

(c) Its gross and net operating revenues during a reasonable period of time not to exceed the most recent five-year period, capitalized at indicative rates; [and]

(d) The average market value of its outstanding securities during the preceding calendar year, if such market value is determinable

In this case, the Board gives consideration to the cost, income, and market approaches when determining the system-wide value of Petitioner's flight equipment. However, in this hearing, both parties relied solely on the cost approach in their valuation analyses.

In determining the actual value, beyond estimating the value of Petitioner's flight equipment, the Board must determine the portion of the total system-wide value to be allocated to Colorado, based on the amount of time Petitioner's aircraft was in Colorado, both on the ground and in the air; this total includes ground equipment allocated to Colorado. The Board also must determine the deductions for aircraft application software (an intangible item), which is an allowable deduction under the Tax Equity and Fiscal Responsibility Act (TEFRA), and for inventories, construction in progress (CIP), and licensed vehicles.

Finally, the Board must determine all forms of obsolescence. This includes all physical, functional, or external obsolescence, which is often in the form of economic obsolescence. Both parties applied a deduction for economic obsolescence.

FACTS

At the hearing, Petitioner presented a cost approach to derive a market-adjusted cost value for the subject property of \$191,575,066.00. Petitioner's witness, Mr. Bruce Cartwright, Managing Director with Duff & Phelps, Tax Services group, relied on the 2009 Fleet Net Book Value of United Airlines to indicate a net book value of \$10,328,878,116.00, as the basis for the

cost approach. Petitioner's witness, Mr. Bill H. Gile, Jr., Manager of Transaction Taxes with United Airlines, Inc., testified that the net book value presented represented a change in reporting that reflected an average economic life of 28.5 years, unlike earlier reports sent to the Division of Property Taxation that were based on a 10-year economic life.

Mr. Cartwright deducted 8.00% for aircraft application software (an intangible item) from the net book value of \$10,328,878,116.00 to obtain a value of \$9,502,567,867.00 for the system-wide value of Petitioner's property in every location Petitioner operates. Excluding the software is an allowed deduction under TEFRA. Mr. Cartwright then calculated Petitioner's hours of operation within the State as a percentage of the total hours of operation. Mr. Cartwright then multiplied that percentage by the \$9,502,567,867.00 net book value to reach the Colorado net book value of \$509,663,468.00 for aircraft.

In order to calculate obsolescence, Mr. Cartwright utilized a rate-of-return deficiency methodology, which is the difference between the required rate of return (amount needed to cover the cost of capital divided by the total value of all assets) and the achieved rate-of-return (actual income divided by the total value of all assets), the difference of which is then divided by the required rate of return.

For tax year 2009, the required rate of return established for the passenger airlines by the Division of Property Taxation was 15.05%. Mr. Cartwright then calculated a 4.36% estimated achieved rate-of-return based on operating results from 2006 and 2007. Years 2004, 2005, and 2008 were not used, as Petitioner reported net operating losses for those years. Mr. Cartwright supported the rate-of-return used with data, indicating a return on assets for other airline industry participants. Petitioner provided examples of where the Division of Property Taxation had applied a rate-of-return deficiency methodology to other companies operating in Colorado. Thus, based on Mr. Cartwright's calculations, Petitioner's property was approximately 71.1% obsolete ($15.05\% - 4.36\% = 10.69\%$ divided by 15.05%). Based on the 71.1% obsolescence rate, the depreciated value of the flight equipment sourced to Colorado is \$147,532,011.00 (\$509,663,468.00 less 71.1%).

Petitioner added ground equipment allocated to Colorado at \$159,339,543.00 and deducted \$7,188,587.00 for inventories, CIP, and licensed vehicles. After consideration of obsolescence of 71.1% for these items, the allocated market value of the ground equipment was shown by Petitioner as \$44,043,056.00. Petitioner added allocated market value of the flight equipment of \$147,532,011.00 and ground equipment of \$44,043,056.00 to reach an actual value of \$191,575,066.00 for tax year 2009.

Respondent presented a cost approach to derive a value of \$350,158,300.00 for the subject properties. Respondent relied on the Airliner Price Guide to determine the book value for the aircraft. Total net book value of operating property was valued by Respondent at \$8,731,010,000.00. Respondent applied an 8.00% deduction to reflect aircraft application software (an intangible item), which is an allowed deduction under TEFRA, resulting in a value of \$8,032,529,200.00.

Respondent allocated flight property of \$431,446,202.00 to Colorado, below what was indicated by Petitioner. Respondent added ground equipment of \$159,339,542.00 and applied a deduction of \$7,188,587.00. This resulted in a value after deductions of \$583,597,157.00 allocated to Colorado.

Respondent applied economic obsolescence of 40% to the subject property. Respondent's witness, Mr. Mark Walker, Division of Property Taxation, testified that he assigned economic obsolescence of 40% as part of a "stabilized value methodology." Respondent's Summary Appraisal Report explains:

It is not in the Division's interest, being positioned between the state assessed companies and their Colorado counties, to chase isolated factors up and down, or to anticipate factors up and down. The Division prefers a Stabilized Value methodology with consideration for multiple factors, because that is what the companies and counties want, and a smoothed business cycle is consistent with capitalization into perpetuity.

Mr. Walker testified that the market-to-book ratio was set based on appraiser judgment and history, and that he believed Petitioner should be at a market-to-book ratio of 60%, which results in obsolescence of 40%.

Respondent applied a 60% market-to-book ratio to the value allocated to Colorado after deductions of \$583,597,157.00 to reach the current assigned actual value of \$350,158,300.00 for the subject property for tax year 2009.

ISSUES

Petitioner contends that the revised net book value reflecting an average economic life of 28.5 years is a reliable indicator of the value of flight property allocated to Colorado. Petitioner contends that values indicated by the Airliner Price Guide are not well documented and do not provide the most reliable indication of value. Petitioner contends that using a rate-of-return deficiency methodology to determine obsolescence is reasonable and is the methodology that has been applied to other companies operating in Colorado by the Division of Property Taxation.

Respondent contends that the Airliner Price Guide produced the most accurate indication of the value of the flight property in Colorado, and reflected a deduction for all forms of depreciation. Respondent contends that no additional deduction for depreciation is required, yet, the Division generously made a deduction of 40% to reflect economic obsolescence.

Respondent contends that the net book values set by Petitioner at a "fresh start" after bankruptcy and write-downs for "impairment" resulted in incorrect values. Mr. Walker testified that it was important to apply a stabilized value methodology, which led to the determination of the market-to-book ratio used to calculate obsolescence. Respondent contends that the value requested by Petitioner is neither rational nor fair to other taxpayers, and that Mr. Walker correctly applied appraisal judgment in determination of obsolescence.

Respondent contends that Petitioner's argument on what constitutes a "unit" valuation is faulty and misleading, resulting in unnecessary confusion. Respondent contends that "a unit value" as required by section 39-4-102, C.R.S., is a value "giving consideration to the following factors and assigning such weight to each of such factors as *in the administrator's judgment* will secure a just value of such public utility as a unit." (Emphasis added). Respondent concludes that "if in the administrator's judgment, one or more of the factors do not lead to a "just value," those factors must be discounted or disregarded, as appropriate. Not every factor need be given weight. It depends on the particular facts of the company being valued." (Respondent's Closing Document page 3). Respondent notes that both parties used the cost approach, reached a summation of the value based on all the tangible operating property and plant of Petitioner, as a unit, within and without Colorado, and then allocated a portion of the value to Colorado. (Respondent's Closing Document, pages 4 and 5). Respondent says that if consideration is given to the revenues of Petitioner, that constitutes application of the income approach, which both parties agreed was inappropriate as it would include the value of goodwill and other intangibles, which are not taxable for airlines in the state of Colorado.

CONCLUSIONS OF THE BOARD

Both parties agreed that the cost approach was the only reliable approach to the valuation of the subject. Both parties applied an 8.00% deduction to reflect aircraft application software allowable deduction under TEFRA. The parties apportioned similar hours of operation to Colorado, applying approximately 5.4% of the total system-wide value to Colorado. Both parties agreed to the existence of some form of external obsolescence. Petitioner and Respondent were in near agreement regarding the value of ground equipment with Petitioner valuing the equipment at \$159,339,543.00 and Respondent valuing it at \$159,339,542.00, and they were in agreement for the deduction of \$7,188,587.00 for inventories, CIP, and licensed vehicles.

The Board finds that Petitioner presented sufficient probative evidence and testimony to prove that the subject property was incorrectly valued for tax year 2009. The Board finds the net book value of flight property of \$509,663,468.00 allocated to Colorado by Petitioner is supported. Despite the inclusion of "fresh start" values and deductions for "impairment," Petitioner's value exceeds the value shown by Respondent. The Board agrees that prior values submitted by Petitioner based on a 10-year economic life were incorrect.

The Board was convinced that the passenger airline industry had been affected by high fuel prices and a depressed economy. Information provided by Petitioner indicated that this decline was for the industry as a whole, not just an issue of Petitioner.

"The passenger airline industry has faced significant financial challenges since 2001. These challenges continued during 2008. The industry was beset with a sharp increase in oil prices which culminated with a record high price of approximately \$147 on July 11, 2008. Most major US carriers responded to this sharp increase by reducing capacity, implementing fuel surcharges, and unbundling normal services, e.g. charging for checked bags, in-flight food, etc. While fuel prices have declined significantly from their peak in July 2008, they have done so as the result of the weakening worldwide economy. The weakening economy has resulted in a decline in passenger travel demand." *Capitalization Rate Study for the Domestic Air*

Transportation Industry Major and Non-Major Passenger Airlines, dated January 1, 2009, prepared by Thomson Reuters. (Petitioner's Exhibit 20). "For 2008, Standard & Poor's expects higher jet fuel costs, along with a modest reduction in passenger travel demand, to lead to a \$4.1 billion loss." *Industry Surveys Airlines*, Standard & Poor's, December 18, 2008. (Petitioner's Exhibit 23).

The Board finds that giving consideration to the revenue generated by use of the assets in order to calculate obsolescence does not equate to application of the income approach. In fact, an analysis of the income production of an asset is often used by appraisers to determine the extent of economic obsolescence to be applied in the cost approach. Further, "administrator judgment" does not negate the requirement of the administrator to "determine the actual value" by giving consideration to the cost, income and market approaches to value. Sections 39-4-102 and 39-1-103(5)(a), C.R.S.

This statute reflects the view that the true measure of value of the property of a public utility is its worth as an integrated and operating unit rather than the sum of the values of the various components making up that unit. . . .

* * *

In fact, it is precisely because the real value of the operating property and plant of a public utility may be either more or less than the sum of the values of the tangible assets and intangible rights considered individually, some of which do not exist or are of questionable value apart from the utility as a whole, that the unitary valuation concept is used for assessment purposes. Whether the rights at issue could command a particular price, or any price, if offered separately in an open market is not dispositive.

U.S. Transmission Systems, Inc. v. Board of Assessment Appeals, 715 P.2d 1249, 1256 (Colo. 1986) (citations omitted).

The Board was convinced that Petitioner's application of an "income shortfall" methodology (synonymously described as the "rate of return deficiency" method) for calculation of economic obsolescence was appropriate. In the supplemental hearing, Petitioner presented documentary evidence in the form of appraisal publications, class materials, and articles showing that this methodology is regularly used and accepted in the appraisal industry. As requested by the Board, Petitioner presented alternative methods of calculating economic obsolescence, convincing the Board that the methodology selected best reflected a greater number of economic issues including quantity changes, price changes, competitive circumstances, labor relations, as well as any other type of external economic forces that could affect the value of the property. Although not relied upon by the Board as a basis for this decision, the Division of Property Taxation has applied this rate-of-return deficiency methodology to other Colorado companies.

The Board was convinced that Petitioner correctly calculated obsolescence of 71.1% by applying an estimated rate of return of 4.36% and a weighted average cost of capital of 15.05%. Petitioner's application of a 4.36% estimated rate-of-return was found reasonable by the Board,

based on data presented by Petitioner showing return on property, plant, and equipment of positive 3.9% for 2006, positive 3.1% for 2007, negative 7.7% for 2004, negative 3.6% for 2005, and negative 42.9% for 2008. This rate-of-return was further supported by industry data, which showed an industry-wide average of negative 1.65% for 2008.

Petitioner relied on the Division's weighted average cost of capital of 15.05% as published in the Colorado State Assessed Final Capitalization Rates Tax Year 2009 study. Petitioner cited the *Capitalization Rate Study for the Domestic Air Transportation Industry Major and Non-Major Passenger Airlines*, dated January 1, 2009, prepared by Thomson Reuters, which concluded to a weighted average cost of capital of 19.45% for major passenger airlines.

Respondent provided insufficient evidence for use of the Airliner Price Guide rather than the net book value presented at hearing by Petitioner. The net book value presented by Petitioner produced an allocated value for flight property that was over \$78 million higher than use of the Airliner Price Guide.

Respondent acknowledged that a deduction for obsolescence was reasonable by applying 40% obsolescence. However, insufficient market evidence was presented to support the percentage used by Respondent. Further, Respondent provided insufficient evidence to support setting obsolescence based on appraisal judgment in order to comply with a "stabilized value methodology." The Board was convinced that obsolescence of 40% was selected by the Division in order to conclude to a final value that was comparable to historical values. Respondent's witness, Mr. Curt Settle, testified that "the value stabilization method involves starting with the prior year's appraisal and considering what has changed." The Board finds that Respondent did not present sufficient evidence to show that the "stabilized value methodology" used to "level" values satisfied the requirements listed in section 39-4-102(1), C.R.S., which requires that "[t]he administrator shall determine the actual value of the operating property and plant of each public utility as a unit." While Respondent contends that obsolescence of 71.1% is unreasonable, Respondent provided insufficient evidence to the contrary.

Petitioner and Respondent were in near agreement regarding the value of ground equipment with Petitioner valuing the equipment at \$159,339,543.00 and Respondent valuing it at \$159,339,542.00, and they were in agreement for the deduction of \$7,188,587.00 for inventories, CIP, and licensed vehicles. Because these figures were either exact or represented a minute difference, the Board agrees with the value set forth by Petitioner with no further analysis required.

The Board concludes that the 2009 actual value of the subject property should be reduced to \$191,575,066.00.

ORDER:

Respondent is ordered to reduce the 2009 actual value of the subject property to \$191,575,066.00.

The Property Tax Administrator is directed to change her records accordingly.

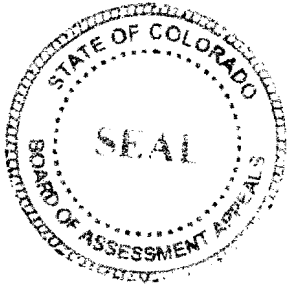
APPEAL:

Any Petitioner or any other public utility, assessor, or board of county commissioners adversely affected or the administrator may appeal any decision of the Board denying a petition in whole or in part to the Court of Appeals.

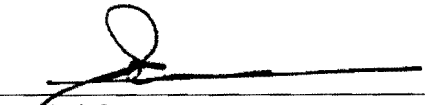
Any appeal may be taken to the Court of Appeals according to the Colorado appellate rules and the provisions of section 24-4-106(11), C.R.S. (commenced by the filing of a notice of appeal with the Court of Appeals within forty-five days after the date of the service of the final order entered), after the decision of the Board is issued.

Section 39-4-109(1)-(2), C.R.S.

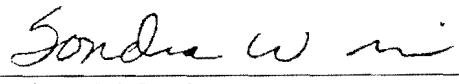
DATED and MAILED this 19th day of October, 2011.



BOARD OF ASSESSMENT APPEALS




James R. Meurer



Sondra W. Mercier

I hereby certify that this is a true and correct copy of the decision of the Board of Assessment Appeals.



Milla Crichton