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**MONTANA FIRST JUDICIAL DISTRICT COURT
LEWIS AND CLARK COUNTY**

QWEST CORPORATION,)	
)	
Petitioner,)	Cause No. CDV-2010-101
)	
vs.)	QWEST'S OPENING BRIEF
)	
STATE OF MONTANA, DEPARTMENT)	
OF REVENUE,)	
)	
Respondent.)	

TABLE OF CONTENTS

I. INTRODUCTION 1

II. STANDARD OF REVIEW 5

III. ARGUMENT 6

 A. The Board Erred In Holding That Qwest Forfeited The Right To Present A Claim Concerning The Value Of Its Intangible Personal Property..... 6

 1. The Legal Standard..... 6

 2. The Department’s Appraisal. 8

 3. The Information Qwest Provided During the Assessment Process. 10

 4. The Board Incorrectly and Unreasonably Failed to Consider the Additional Evidence on Intangible Values Presented at the Hearing. 11

 B. The Board Erred In Applying The 15% Default Deduction For Intangibles..... 13

 1. Customer Relationships, Intellectual Property and Other Marketing Rights are Exempt Intangible Personal Property Under MCA § 15-6-218..... 15

 2. The Evidence Supports Qwest’s Intangible Values..... 19

 C. The Board Wrongly Decided Several Unit Value Issues. 22

 1. Qwest’s Valuation is Consistent with the Unit Method. 22

 2. The Board Erred in Sustaining the Department’s Direct Capitalization Approach. 25

 3. The Board Erred in Sustaining the Department’s Value in the Stock and Debt Approach. 28

 4. The Board Erred in its Conclusions Concerning Obsolescence in the Cost Approach. 30

 D. The Board Erred in Rejecting Qwest’s Constitutional Claim..... 32

IV. CONCLUSION..... 35

Qwest Corporation (“Qwest”) hereby submits the opening brief in its appeal of the decision of the State Tax Appeal Board dated November 30, 2009 (the “Decision”).

I. INTRODUCTION

The Board’s Decision in this case is seriously flawed. It does not include findings or conclusions on many key issues. Where it does make findings, they are not supported by the evidence, and where it does reach conclusions, they often are incorrect as a matter of law. The Decision inappropriately limits Qwest’s right to present evidence, ignores how broadly Montana law defines intangible personal property (which is exempt from taxation), and approves valuation approaches that, in this case, fail to exclude such intangible property.

The focus of Qwest’s business is to provide local telephone service. Once part of the old AT&T company, it was “spun off” as a separate company in the divestiture of that monopoly in 1984. Since 1984, and particularly in the last ten years, Qwest has experienced significant competition, most recently from cellular/wireless companies and from cable companies that offer telephone service using much of the same cable and other property used for television service. As a result, Qwest’s “access lines” in service – those lines running to and from a customer’s home or business – have declined sharply over the last 10 years.¹

The Department of Revenue (“Department”) valued Qwest as of January 1, 2007, using a “unit method” in which it estimated the total value of Qwest nationwide as a business enterprise,

¹ As of January 1, 2001, Qwest was using about 72% of its access lines for service to its customers. (Exh. 3, p. 10.) By January 1, 2007, the utilization percentage plummeted to only 52%. (*Id.*) The steep drop in utilization is important evidence of obsolescence—a topic discussed in Section III(c)(4) of this brief—but was ignored by the Board.

and then allocated part of that value to Montana. (The Montana allocation percentage is not in dispute.) To reach the unit value, the Department used three approaches: (1) a cost approach based on the “book values” of the tangible and intangible assets that are recorded on Qwest’s books; (2) a “stock and debt” market approach based on the value of traded securities of Qwest and its parent company, Qwest Communications International, Inc. (“QCII”); and (3) a “direct capitalization” income approach in which Qwest’s estimated future income is converted to a value estimate using earnings/price ratios derived from the traded stock of other companies.

In the cost approach, the Department estimated a value of \$14.667 billion and assigned that value a 40% mathematical weighting in the process of finalizing a value. (Exh. 7, p. 5, Decision, p. 8.) It made no deduction for obsolescence – an essential adjustment to the “book values” to account for loss in value caused by functional and economic factors. The Department estimated a value of \$26.3 billion in the stock and debt approach, to which it assigned a 35% weight, and a value of \$25.6 billion in the direct capitalization approach, to which it assigned a 25% weight. (*Id.*) Given those weighted values, the Department’s unit value was \$21.5 billion. That total unit value includes both tangible property and intangible property. The Department made no effort to value the intangible property that is tax-exempt pursuant to MCA § 15-2-618. Instead, the Department applied the 15% “default” deduction provided for in its rules to account for intangible property, resulting in taxable unit value of \$18.3 billion. (*Id.*)

Qwest protested, asserting that the total unit value should be lower than \$21.5 billion and that much more than 15% of the total unit value is attributable to intangible property. (Exh. 18, Exh. 7.) Qwest also contended that the Department should rely only on the cost approach, as the best way to assure that intangible property would be excluded. (As noted below, the Department uses only the cost approach for many of Qwest’s telephone competitors, including all wireless

companies and the Bresnan cable company that also provides telephone service.) The Department ignored Qwest's arguments about intangible property and the use of only the cost approach, and made only minor adjustments to the taxable value. (Exh. 7.) Qwest then appealed to the Board.

In a nine-day trial, Qwest presented appraisals of the unit value and of the tangible and intangible property that comprise that unit. Those appraisals were prepared by two experienced appraisal firms – Kane Reece Associates and Willamette Management Associates. Nevertheless, the Board affirmed the Department's value in all respects.

The major errors in the Board's decision are the following:

1. The Board erred in holding that a taxpayer must present all of its evidence of intangible values to the Department during the assessment process, and cannot present additional evidence during a *de novo* Board hearing. (Decision, pp. 26-29.)

Appeals to the Board are governed by MCA § 2-4-612, which provides that “opportunity shall be afforded all parties to respond and present evidence and argument on all issues involved.” (Emphasis added.) The rule relied on by the Board, in determining that Qwest was not entitled to submit additional evidence to the Board, states simply that if a taxpayer considers the default deduction for intangible property to be inadequate, the taxpayer may provide other information or methods to the Department during the assessment process. ARM 42.22.110(2). This is a low threshold at the administrative level. There is no requirement that the “other information or methods” must “satisfy” the Department – if that were the standard, no appeal would ever be possible. Qwest easily met that requirement, and accordingly was entitled to present additional evidence at the *de novo* hearing before the Board.

2. The Board erred in holding that certain categories of intangible property – such as customer relationships – are “too nebulous” to fit within the exemption statute, MCA § 15-2-618. (Decision, pp. 29-32.) The statute covers all property that lacks physical existence. It lists certain examples that fit that definition, “without limitation” to the inclusion of others, and among the examples is the most “nebulous” of intangibles – goodwill. The intangible assets targeted by the Board – customer relationships, intellectual property, and marketing rights – are widely recognized in tax and appraisal contexts, and should be here.

A related erroneous holding is that Qwest did not prove that the value of its intangible property exceeds the 15% default deduction applied by the Department. *Id.* To the contrary, Qwest provided an abundance of reliable evidence – from qualified experts, using established methods – that was un rebutted by any evidence of any different values for these types of property.

3. The Board erred in holding that Qwest did not prove the value of its taxable, tangible assets. (Decision, pp. 21-26.) That error lies partly in the Board’s refusal to consider using the cost approach alone and partly in its failure to consider Qwest’s intangible asset valuations. The Department does use the cost approach alone for other telecommunications companies, so its complaints about how that approach does not meet market value standards ring hollow. However, even if other approaches are used and are used properly, the same valuation result is reached by calculating the unit value and then subtracting from it all relevant categories of intangible property. There are significant errors in the Board’s analysis of all three approaches used by the Department to value the unit.

4. The Board erred in rejecting Qwest’s claim that it was taxed in a discriminatory manner relative to Bresnan Telephony, its biggest wireline competitor. (Decision, pp. 32-35.)

The Board held that Qwest did not present evidence showing that Qwest and Bresnan Telephony are similarly situated. Qwest did present such evidence, but in any event these two taxpayers occupy the same class and so are already treated as being similarly situated. The constitutional problem arises because the Department nevertheless allowed most of the assets Bresnan Telephony uses to provide telephone service to be taxed as cable television property, at one-half the rate at which Qwest's property of the same type is taxed.

II. STANDARD OF REVIEW

Under MCA § 2-4-704(2), the Board's decision may be reversed or modified if either (a) it fails to include findings on essential issues or (b) its findings or conclusions are:

- (i) in violation of constitutional or statutory provisions;
- (ii) in excess of the statutory authority of the agency;
- (iii) made upon unlawful procedure;
- (iv) affected by other error of law;
- (v) clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record; [or]
- (vi) arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion[.]

Under this standard, whether the Board's factual findings are clearly erroneous is determined as follows: (1) the court first must review the record to determine whether those findings are supported by substantial evidence; (2) if they are supported by substantial evidence, the court then should determine if the Board misapprehended the effect of evidence; and (3) if the Board did not misapprehend the effect of the evidence, the court may still hold that a finding is clearly erroneous when a review of the record leaves the court with the definite and firm conviction that a mistake has been committed. *Total Mech. Heating & Air Conditioning v.*

Employment Relations Div., Uninsured Employers' Fund, 309 Mont. 84, 50 P.3d 108, 113-14 (2002).

The Board's conclusions of law, however, are reviewed *de novo* for correctness, as are the Board's conclusions on mixed questions of fact and law. *Id. See also Farmers Union Cent. v. Dep't of Rev.*, 242 Mont. 471, 474, 901 P.2d 561, 563 (1995). A careful review of the Board's findings of fact shows that many are not findings at all but merely recitation of the testimony of the various witnesses. *See* Decision, ¶¶ 48-98. No deference is due to either the Board's legal conclusions or its conclusions involving the application of the law to the facts.

III. ARGUMENT

A. **The Board Erred In Holding That Qwest Forfeited The Right To Present A Claim Concerning The Value Of Its Intangible Personal Property.**

1. **The Legal Standard.**

In many states, the "unit" method has been used to value utilities and other centrally assessed taxpayers. The unit method involves valuing a business enterprise as a whole, using the cost, market and income methods of value. The business enterprise value obviously reflects the value of both tangible and intangible assets. Thus, in states that exempt intangible assets from taxation, like Montana, a difficulty with the unit method is the need to extract the value of intangible assets, which the evidence in this case showed is a major element of value for telecommunications companies. *See, e.g., Tr.*, pp. 846, 920-21 (Reilly); Exhs. 51, 55, 56 (companies reporting a substantial portion of their assets as intangible). As discussed below, in the cost approach it is easy to separate the tangible and intangible property, so the difficulty in the unit method arises from the income and market approaches.

Although the unit method is authorized by Montana law, it may only be used if the approaches used in that method accomplish the removal of intangible property:

15-6-218. Intangible personal property exemption.

(1) Intangible personal property is exempt from taxation.

(2) For the purposes of this section, “intangible personal property” means personal property that is not tangible personal property and that:

(a) has no intrinsic value but is the representative or evidence of value, including but not limited to certificates of stock, bonds, promissory notes, licenses, copyrights, patents, trademarks, contracts, software, and franchises; or

(b) lacks physical existence, including but not limited to goodwill.

(3) To the extent that the unit value of centrally assessed property includes intangible personal property, that value must be removed from the unit value.

MCA § 15-6-218 (emphasis added). Thus, whatever method of valuation is used, only tangible assets are to be assessed.

The Department’s rules also heed the statutory mandate that, if the unit method is used, intangible values must be removed from the resulting valuation:

42.22.110 DEDUCTIONS FOR INTANGIBLE PERSONAL PROPERTY

(1) Cost, income and market indicators can generally be expected to include the value of intangible personal property. To the extent that each unit valuation indicator includes intangible personal property it shall not be relied upon unless such value of intangible personal property is excluded or removed...

ARM 42.22.110(1) (emphasis added). This rule goes on to identify specific percentages of “default” intangible values for different industries, using 15% for the telecommunications industry. It then concludes as follows:

(2) If any taxpayer believes that the value of its intangible personal property is greater than that allowed under (1) above, the taxpayer may propose alternative methodology or information at

any time during the appraisal process and the department will give it full and fair consideration. If the department concludes that the value of intangible personal property is greater than that allowed in (1) above, the unit value will be decreased accordingly. In no event, however, will the value of intangible personal property be less than that allowed in (1) above.

ARM 42.22.110(2) (emphasis added).

2. The Department's Appraisal.

The Department used valuation methods that incorporate significant intangible property values, despite the mandate of statutes and rules to exclude intangible property values and to avoid using valuation methods that include them. As noted above, the Department used three methods of value – a cost approach, a “stock and debt” market approach, and a direct capitalization approach applying earnings/price ratios from other companies to Qwest’s projected earnings. The stock and debt approach and direct capitalization approach produced widely disparate results (as compared to the cost approach) because they include the value of all intangible property. The Department’s value in its cost approach, before the 15% “default” deduction for intangible property, was \$14.667 billion; in the stock and debt approach, it was \$26.3 billion – 79% higher; and in the direct capitalization method, it was \$25.6 billion – 75% higher than the cost approach. (See Exhibit 7, p. 5.) The cost approach was given the most weight (40%), is therefore presumably the most reliable, and is used exclusively for many other telecommunications companies. (Exh. 66.)

The huge valuation differences among these methods are caused by their differing tendencies to capture and include intangible values. The cost approach is based on the asset values reported by a company in its financial statements. It is easy to identify what portion of that total value is attributable to tangible assets and what portion is attributable to intangible assets. As shown in the Department’s valuation worksheets, Qwest’s financial statements reflect

a total of \$14.667 billion in property, from which the Department took a flat 15% deduction to exclude intangible property and arrived at a net amount of \$12.467 billion for its cost approach value. (Exh. 7, p. 6.) This arbitrary 15% deduction was unnecessary, because Qwest's financial statements show the actual cost of the tangible property – \$12.995 billion in the “property, plant and equipment” account. (Exh. 1, p. QMT01639.)

While we can precisely identify the breakout of tangible and intangible assets in the cost approach, that is more difficult with the other valuation methods. In theory, the stock and debt method is based on the traded market prices of the taxpayer's stock and debt securities. The principle is that the aggregate value of those securities will reflect the value of the taxpayer's assets. There are a number of problems with using this method for property tax purposes, some of which will be discussed below, but the primary issue here is that securities prices include the value of intangible property as well as tangible assets.

The same problems infect the Department's direct capitalization method, which resulted in a value nearly as high as the Department's “stock and debt” method. The direct capitalization method compares the stock prices of other companies in the telecommunications industry to the earnings of those companies to develop an earnings/price ratio (E/P), which is then applied to earnings of the subject company (*i.e.*, Qwest) to develop a price (*i.e.*, value) for that company. Since this method is based on stock prices, like the “stock and debt” method, it is subject to the same flaw: it fails to address the fact that the “comparable” companies' intangible property far exceeds the 15% “default” deduction used by the Department. The Bell South merger, discussed below, demonstrates this fact.

3. The Information Qwest Provided to the Department During the Assessment Process.

Qwest did not have a full-blown appraisal completed at the time of the Department's annual assessment process. The cost and time required for such an appraisal were well-documented during the trial. (Exhs. 37, 38.) However, Qwest did provide substantial information showing that the percentage of intangible property was well in excess of 15%, and also demonstrating that the Department's stock and debt approach and direct capitalization method failed to exclude sufficient intangible values. Qwest also provided pro forma schedules showing alternative calculations that exclude some of the intangible property value that is exempt. In addition to the information provided with Qwest's annual return to the Department (which includes financial statements), Qwest provided data to the Department that included the following:

- A schedule showing, for certain recent sales of telecommunications companies, the percentage of the purchase price represented by tangible assets and certain intangible assets. One of these transactions occurred very near to the January 1, 2007 valuation date involved in this case: In December 2006, AT&T acquired Bell South, the telecommunications company closest in size to Qwest. One of the Department's witnesses described Bell South as a "good comparable" to Qwest. (Eyre, Tr. pp. 1519-20.) Using the relationships of tangible and intangible property from this and other recent transactions, Qwest's schedule showed a value of its Montana tangible assets of \$184,592,352. (Exh. 9, Bates Q07-DOR 003735.) This value compares to the Department's Montana value of \$417.6 million. (Exh. 7, p.5.)
- Qwest also presented separate analyses under each approach to value – cost, income and stock and debt – with each of those approaches showing an estimated intangible

property deduction. (Exh. 9, Bates pp. Q07-DOR 003736-3739.) For instance, the intangible property value percentage in the stock and debt analysis was 18.63% for customer relationships and 39.09% for goodwill – well in excess of the 15% default percentage. (*Id.*, Bates p. Q07-DOR 003736.) When the net values from those approaches (after deducting intangible property) were correlated into a final value, the result was a system value of \$10,669,505,560. (*Id.*, Bates pp. Q07-DOR 003739.) That value is reasonably close to the value Qwest presented at trial for the taxable, tangible assets – \$9.6 billion.

- Qwest provided copies of the annual reports from the transactions that gave the detail behind these calculations, including the AT&T report showing the values assigned to the tangible and intangible assets in the Bell South acquisition. (*Id.*, Bates p. Q07-DOR 003747.)

The foregoing analyses supported Qwest’s claim that the Department should not have given any weight to the stock and debt or income approaches that obviously included intangible values far exceeding the 15% figure the Department uses as its default percentage. It also supported Qwest’s claim that the Department should have adjusted its stock and debt and income approaches if it insisted on using those approaches and giving weight to them. *See* Exh. 8 (Qwest’s initial protest letter).

4. The Board Incorrectly and Unreasonably Failed to Consider the Additional Evidence on Intangible Values Presented at the Hearing.

The issue here is not whether the Department or the Board agreed with the analyses Qwest initially presented to the Department. Instead, the issue is whether Qwest complied with Rule 42.22.110(2), which provides, as noted above, that if a taxpayer believes the default percentage is insufficient, “the taxpayer may provide alternative methodology or information at any time during the appraisal process....” Qwest plainly provided both a methodology and additional information showing intangible values that substantially exceeded the 15% default

deduction. (See, e.g., Exh. 9, p. Q07-DOR 003736 (18.63% for customer related assets and 39.09% for goodwill).)

In its Decision, the Board summarized some of the foregoing evidence, and noted that the Department had not accepted that evidence and instead had applied its standard 15% deduction for intangible personal property. Decision, p. 27. But whether that preliminary showing was accepted by the Department is irrelevant in a *de novo* hearing before the Board. All that is relevant is that alternatives were presented to the Department, not whether they were accepted.

Nevertheless, the Board then held that Qwest was foreclosed from presenting additional evidence on intangible property value at the Board hearing. Decision, pp. 27-29. Thus, the Board effectively held that not only must a taxpayer offer evidence to the Department during the annual appraisal process sufficient to satisfy the Department that the 15% default deduction is inadequate, but that such evidence is the only evidence the taxpayer may ever offer, even before the Board. Such a holding is contrary to Montana law.

MCA § 15-2-302(4) provides that the Board shall hear appeals “in accordance with the contested case provisions of the Montana Administrative Procedure Act.” That Act provides, in MCA § 2-4-612, that “opportunity shall be afforded all parties to respond and present evidence and argument on all issues involved.” (Emphasis added.) This statute is very broad, and its plain language unambiguously allows an unfettered right to present evidence on all issues. Indeed, the ability of a litigant in an appeal under the APA to present additional evidence at the hearing cannot seriously be subject to question. See *Dep’t of Revenue v. Burlington N. Inc.*, 169 Mont. 202, 213-14, 545 P.2d 1083, 1090 (1976) (Board may receive “additional evidence, on a firsthand basis, so as to reach a fair, just and equitable holding”); *DeVoe v. Dep’t of Revenue*, 223 Mont. 190, 193, 759 P.2d 991, 993 (1988) (Board erred by not allowing testimony of

property owner). The Board itself has previously stated that its duty is to “find the facts in this matter and arrive at a proper taxable value.” *PacifiCorp v. Dep’t of Revenue*, Case No. CT-2005-3, Findings of Fact and Principles of Law, Conclusions of Law and Board Discussion, p. 28 (July 31, 2007) (copy to be provided to the Court).

The Board equates the annual process before the Department with the requirement to exhaust administrative remedies. Decision, p. 28. The Board cites *Bitterroot River Protection Association v. Bitterroot Conservation District*, 309 Mont. 207, 45 P.3d 24 (2005), for the proposition that the exhaustion doctrine is sound because it allows “a governmental entity to make a factual record and to correct its own errors within its specific expertise before the court interferes.” Decision, p. 28, quoting *Bitterroot*, 45 P.3d 24, ¶ 22. However, the Department does not make a factual record during the assessment process; it does not hold evidentiary hearings; and it does not make findings of fact. The Department is not charged with the duty to hold hearings where parties are given the “opportunity ... to respond and present evidence and argument on all issues involved.” MCA § 2-4-612. Instead, that is the Board’s responsibility.

As noted above, the law does not limit the Board to considering evidence presented at the Department’s informal conference, and indeed it contemplates that additional evidence will be presented. *See, e.g., Burlington*, 543 P.2d at 1090. There is nothing in ARM 42.22.110(2) that requires otherwise. Qwest complied with that rule and preserved the issue for appeal concerning whether the intangible property exceeds 15% of the unit value.

B. The Board Erred In Applying The 15% Default Deduction For Intangibles.

The Board attempted to backstop its holding that Qwest did not present information in a timely manner with the insupportable conclusion that the categories of intangible property Qwest sought to deduct from the unit value were not in fact types of intangible property at all. As it

often did in the Decision, the Board made broad and inaccurate statements that have no basis in law or in fact, including the claim here that “there is no evidence which demonstrates that [customer relationships, intellectual property or marketing rights] should be properly included as intangible property.” Decision, p. 31 (emphasis added). The Board further stated that the types of intangible property claimed by Qwest are “too nebulous,” and that Qwest failed to present “credible data” supporting the existence of such intangible assets. *Id.* The Board’s assertions are plainly incorrect under Montana law and based on the overwhelming evidence at trial.

To put this issue in context, it is important to distinguish among the various types of intangibles, a task the Board did not perform in its analysis of this issue. The categories of intangible property claimed by Qwest were as follows:

- Customer relationships – \$946 million among four customer groups
- Customer contracts – \$3.199 billion
- Software – \$2.892 billion
- Intellectual property/patents – \$300 million
- Trademarks/tradenames – \$920 million
- Other intangibles/marketing rights – \$553 million
- Goodwill – \$583 million

Exh. 11, p. QMT 01753. Neither the Department nor its experts made any effort to value any of these assets. With respect to whether there is a legal basis for including this property as “intangible personal property,” several of these items are specifically included within the examples in MCA § 15-6-218. Contracts, patents, trademarks, software and goodwill are all referenced in the statute and represent \$7.894 billion of the total \$9.393 billion in exemption claims.² The Decision does not discuss contracts at all (\$3.199 billion in intangible value), and only briefly discusses the large software and trademark valuations, as discussed later in this brief.

² The Utah Tax Commission, an appeal body similar to the Board, issued a decision on July 30, 2009 in a similar appeal by Qwest for the 2008 tax year. It accepted the valuations

Since the focus of the Board’s analysis was on the intangible categories of customer relationships, intellectual property and marketing rights, Qwest will address separately the legal issue of whether these items qualify as intangible personal property under MCA § 15-6-218, and will then discuss the Board’s analysis of the evidence in support of the value of the intangible property.

1. Customer Relationships, Intellectual Property and Other Marketing Rights are Exempt Intangible Personal Property Under MCA § 15-6-218.

The definition of intangible personal property in MCA § 15-6-218 is very broad. It is property that has no intrinsic value but is representative of value, or lacks physical existence. By its terms, the statute recites certain types of intangible assets that are covered within the definition, including the amorphous “goodwill,” but that listing is preceded by the phrase “including but not limited to....”

The Board held there is “no evidence” demonstrating that customer relationships, intellectual property and marketing rights should be included as “intangible personal property.” Decision, p. 31. There was, in fact, substantial evidence showing that these types of property are widely accepted as types of intangible property. The Financial Accounting Standards Board – the governing body that sets accounting standards for the recognition and measurement of assets – includes customer relationships and many types of intellectual property and other intangibles as separable and identifiable intangible assets. Thus, if a company were to purchase Qwest, it

of customer relationships, software and trademarks/tradenames, which were presented by the same firms involved in this case. *Qwest Corporation v. Property Tax Division*, Case No. 08-1325, ¶¶ 23-24. The case has been appealed to the state district court. Qwest will assert on appeal that it was incongruous to allow customer relationships as an exempt intangible but not contract relationships with those same types of customers, which is effectively what the Commission held.

would be required to value the customer relationships, contracts, tradenames, and other intangibles much as Qwest's experts did in this case. (Tr., pp. 287-88 (Kane), p. 1828 (Reilly); Exh. 18, pp. 4-5.) Another example of the evidence supporting the existence of such intangible property is Section 197 of the Internal Revenue Code, which defines "customer-based intangibles" as "composition of market," "market share," and "any other value resulting from future provision of goods or services pursuant to relationships (contractual or otherwise) in the ordinary course of business with customers." 26 U.S.C. § 197(d)(2)(A) (discussed in the testimony at Tr., pp. 287-88 (Kane), 1826-28 (Reilly)). That definition includes the customer-related assets valued by Qwest's experts in this case. *Id.*

Case law also supports recognizing customer-related intangibles as intangible property. *See, e.g., Shubat v. Sutter County Assessment Appeals Bd.*, 17 Cal. Rptr. 2d 1 (Ct. App. 1993) (subscriber list, franchise, and right to do business were intangible assets improperly included in valuation assessment); *County of Orange v. Orange County Assessment Appeals Bd.*, 16 Cal. Rptr. 2d 695, 700 (Ct. App. 1993) (existing franchises or licenses, subscriber base, and other intangible assets improperly included in taxable value); *Heritage Cablevision v. Bd. of Review*, 457 N.W.2d 594, 598 (Iowa 1990) (comparable sales figures "failed to exclude the substantial value which the buyers were receiving from the business enterprise"; a franchise, an established customer base and other intangible assets were improperly captured in the comparable sales method of valuation). In *Qwest Corp. v. Property Tax Division*, (Utah State Tax Commission, Docket No. 03-0226, June 8, 2004), the Utah Tax Commission recognized that customer-related intangibles are a form of intangible property, even where they are not reflected on the books of the company, and it accepted an income approach method of valuing this intangible asset.

Moreover, market evidence demonstrates that buyers are willing to pay value for these types of intangible property. For instance, AT&T allocated a large part of the purchase price it paid for Bell South to customer relationships. AT&T paid about \$18.5 billion for the tangible assets, \$9.2 billion for customer relationships, and about \$25.5 billion for goodwill. (Exh. 51.) The latter two intangible assets represent 65% of the total of these asset groups, compared to the Department's 15% assumption. Other evidence in the record, all totally ignored by the Board, showed that market participants put significant value on these types of intangible assets – far exceeding 15%. (Tr., pp. 475-78 (Ott); Exhs. 55-56 (annual reports of telecommunications companies showing high percentages of intangible value).) Even though Qwest focused on the Bell South acquisition during the hearing and in its briefing, and even though the Department's expert Mr. Eyre conceded it was a good comparable to Qwest, the Board inexplicably never mentioned that transaction in its decision.

There is no support for the Board's implicit holding that intangibles do not qualify as exempt if they are not included within the specific examples set forth in MCA § 15-6-218,³ and the Board did not make a meaningful attempt to support its holding beyond the conclusory statements summarized above. The only cite the Board offered for any of its conclusions is the testimony offered by the Department's witness Brent Eyre, and the definitions he proposed for the identification of "intangible personal property." At pages 30 and 31 of the Decision, the Board referred to its Finding of Fact No. 96, which is not a finding of fact at all but a summary of what Mr. Eyre "claimed" concerning the legal definition of intangible personal property under

³ The statute defines intangible property as "including but not limited to" the listed items, making them mere examples of intangible property. *State v. Good*, 323 Mont. 378, 382-83, 100 P.3d 644, 648 (2004).

Montana law. His definition, implicitly adopted by the Board, is directly contrary to the plain terms of the Montana statute. For example, Mr. Eyre includes a requirement that an asset must be capable of being sold separately from the unit. (Exh. 30, p. 30.) However, a company's goodwill would not meet that definition since it is associated only with the business enterprise to which it relates.⁴ Yet, goodwill is one of the intangibles that is recognized in MCA § 15-6-218.

Another requirement superimposed by Mr. Eyre on Montana law is that "Separating the asset from the unit must not materially affect the defined unit as a going concern." (Exh. 30, p. 30.) According to this theory, intangible property such as software would not be exempt because a telecommunications company could not operate without it. However, MCA § 15-6-218 specifically includes software as an exempt intangible, so again Mr. Eyre's position is contrary to Montana law.

Mr. Eyre's legal conclusions regarding intangible property value are entitled to no consideration from this Court, and should not have influenced the Board. As the testimony at trial demonstrated, goodwill is the most amorphous of intangible assets. (Tr., Kane, pp. 396; Ott, pp. 423, 604-05; Reilly, pp. 1826-29.) Where the statute cites goodwill as one of the exempt intangibles, together with the phrase "including but not limited to," and also uses a broad definition that includes simply the lack of physical existence, one must conclude that other, more identifiable intangibles, are exempt. These would logically include customer-related intangibles

⁴ Mr. Eyre conceded that using his definition, goodwill would not be considered intangible property. He also said he does not believe software represents intangible property. (Tr., p. 1369.) Therefore, he admitted that his definition, relied on by the Board, does not comply with Montana law.

recognized as intangible assets by the accounting profession, other tax laws, and a panoply of court cases. (*See* pp. 15-17, *ante*.)

The other two property types the Board included in this “nebulous” category were intellectual property and marketing rights. Decision, pp. 30-31. It is confusing why the Board would include intellectual property in its “nebulous” category, since the only type of intellectual property included in the Qwest appraisal was patents, and patents are one of the intangible property items specifically referenced in MCA § 15-6-218. Furthermore, and as explained by the evidence at trial, the “marketing rights” category is the equivalent of the “franchise” value that is also specifically referenced in section 15-6-218. *See* Exh. 8, p. 79.

2. The Evidence Supports Qwest’s Intangible Values.

In addition to criticizing the types of intangible personal property Qwest claimed as exempt, the Board stated that it was not persuaded by the evidence presented with respect to the value of those intangibles. (Decision, pp. 31-32.) The Board’s discussion of Qwest’s evidence on this issue is selective and incomplete, and its conclusions concerning the evidence it did discuss are inaccurate:

- p. 29: “There was no evidence at the hearing that Qwest attempted to prove the industry as a whole has more than 15% intangible personal property.” (Emphasis added.) In making this comment, the Board overlooked or ignored the overwhelming evidence supporting exactly that proposition. That proof included market evidence of a transaction involving the company most comparable to Qwest (Bell South), where the percentage of intangible personal property in the transaction was over 50% (Exh. 51), and financial statements for telecommunications companies showing similar intangible property value. (Exh. 9, Fairpoint Communications, Exhs. 55 and 56, CenturyTel and Windstream Communications). Mr. Kane,

Mr. Ott and Mr. Reilly all testified that in the real world of telecommunications, intangible property value represents far more than 15% of the total company value. Tr., pp. 301-02 (Kane), pp. 475-79 (Ott), pp. 846, 921-22 (Reilly).

- pp. 29-30: The Board questions why Qwest's initial filings with the Department showed only \$435 million of intangible personal property, while its submissions later in the assessment process showed intangible property valuations in the range of \$2 billion to \$13 billion. The initial filings with the Department were based only on what the financial statements reflect, and the lower figures in that range reflect the fact intangible personal property is not "booked" to the financial statements until a transaction occurs similar to the AT&T/Bell South merger. Tr., pp. 840-51.⁵ The submissions during the assessment process have already been discussed. They were preliminary, based on the information available at that time. There was a wide range of intangible values because different calculations were submitted for each valuation approach, consistent with the Department's rule asking taxpayers to propose other values and/or methodologies within each approach if the 15% default percentage is inadequate.

- p. 31: "We do not agree it is proper to use a company-specific risk premium in determining a business enterprise value in this instance." The use of a company-specific risk premium has little relevance to whether the intangibles were properly valued here. That premium increases the cost of capital and decreases a value estimate, so if anything it would lower the value of the intangible claim. See Tr., pp. 1775-81 (Reilly).

⁵ The California Assessor's Manual published by that state's Board of Equalization has a good explanation of this and other intangible property issues discussed in brief. The Manual recognizes that "Many intangible assets and rights, though they may exist, will not be shown on a company's books." CALIFORNIA ASSESSOR'S MANUAL, *Advanced Appraisal*, p. 162 (1998).

- p. 31: “We question the value of Willamette’s appraisal values when Willamette accepted the cost of capital, a critical component of valuation, directly from Qwest. FOF 84 & 88. Thus, we cannot consider the value of the software or trademarks as persuasive.” The cost of capital was not even used in the valuation of the software, *see* Exh. 14, so the Board’s comment is completely irrelevant with respect to this \$2.892 billion exemption, and the Board offered no other reason for rejecting this intangible property claim. With respect to the trademark valuation, Willamette did use the cost of capital provided by the company, but that cost was consistent with the cost of capital later developed by Kane Reece. Tr., p. 826 (Reilly). If Willamette had used the Department’s even lower cost of capital, the trademark value would have been even higher because a lower cost of capital results in a higher value. *Id.*

- pp. 31-32: The Board accused Qwest’s experts of being motivated “to look for lower taxable value” and of presenting a “correlated unit value that uses an odd hybrid of the cost approach and the discounted cash flow approach . . . conceptually inconsistent with unit valuation.” As explained further in the next section of this brief, the values Qwest presented were completely consistent with unit valuation, and the use of the cost approach in valuing some components of that unit (tangible and intangible) is the same practice market participants use when they buy telecommunications assets. (Tr., pp. 259, 1813-16.) As for whether the appraisers were motivated to find a lower value, the evidence at the hearing was that although the appraisers and the company representatives knew the valuation was being performed for tax purposes, that did not affect their analysis in any way. *See* Tr., pp. 1879-83 (Mathis). Appraisers often know that their appraisals are being prepared for tax purposes, but that does not suggest the conclusions are biased. *See* Tr., pp. 852-53 (Reilly). If anyone had the potential for bias in this case, it was the Department’s Mr. Eyre, who was aware of both the Department’s

value and the Kane Reece opinions before he did his analysis. (Exh. 30, in which he compared the Department values to the Kane Reece values and then developed his own.) It was a simple matter for Mr. Eyre to mold his opinion of value to be consistent with that of his client.

In summary, the Board's analysis is superficial and incorrect at every level – legally and factually. There is no support for the Board's conclusions that the types of intangible property identified by Qwest are not within the exemption, or that Qwest did not offer credible evidence demonstrating the value of that exempt property. Indeed, there was overwhelming evidence showing that the value of the intangible property vastly exceeded the 15% default deduction applied by the Department and approved by the Board.

C. The Board Wrongly Decided Several Unit Value Issues.

1. Qwest's Valuation is Consistent with the Unit Method.

Qwest's argument concerning the unit valuation method, consistently presented during this case, is as follows: Since all intangible personal property is exempt in Montana, only tangible property is taxable. There are two ways to value the tangible assets: directly, through a cost approach method, or indirectly through the unitary method with a deduction for all intangible personal property. Qwest presented evidence on both methods. The tangible asset value, determined through a cost approach, was \$9.607 billion. This was a "bottoms up" approach to valuing only the tangible assets as part of the business enterprise. Qwest also presented a "top down" unit valuation analysis showing the valuation of the business enterprise at \$19 billion, and then a deduction for each category of identifiable intangible property. Once goodwill is accounted in this analysis (which is specifically exempt in Montana), the value also reconciles to \$9.607 billion. Tr., p. 420-23 (Ott), Exh. 11, pp. QMT1745-48.

The Board criticized Qwest's evidence as being inconsistent with the unit method (Decision, pp. 21-23), but as the foregoing summary shows, Qwest's approach is completely consistent with that approach. However, Qwest did also argue that the Department should have used only the cost approach method for Qwest, as it has used for other telecommunication companies. See Exh. 66. The Board disagreed with this alternative argument. Citing *DOR v. Pacific Power and Light*, 171 Mont. 334, 558 P.2d 454 (1976), the Board determined that the cost of the physical plant is not equal to the taxable value, and that there is an "enhanced value" to the equipment "by virtue of its being a component part of the system." (Decision, p. 23.) There are several problems with the Board's analysis. First, if the cost approach does not measure the taxable value of the tangible assets, why is it acceptable for many other telecommunications taxpayers? Second, the Board relied on cases decided prior to 1999, which provide little guidance anymore given the enactment that year of the extremely broad exemption for intangible personal property.⁶ With the new exemption applying to all intangible property, the only taxable property is tangible property, and if the use of a cost approach is the only reliable method to ensure that only tangible property is taxed, the Department should use only that approach. See *County of Orange, supra*, *Heritage Cablevision, supra*.

Third, the concept of "enhanced value" referenced by the Board is indistinguishable from "goodwill," which is exempt under MCA § 15-6-218. Even the Department's expert Mr. Eyre

⁶ The only post-1999 case cited by the Board was *DOR v. PPL Mont., Inc.*, 2007 MT 310, 172 P.3d 1241, and the use of the unit method was not at issue in that case. Even the Department's rules acknowledge that the unit method is not always to be used, but should be used "whenever appropriate." ARM 42.22.111(1).

acknowledged that the two concepts are synonymous. He defined goodwill as “the difference between a sales price and the appraised value of identifiable assets,” and enhancement as “the difference between the market value of a unit and the summation of the value of its component parts.” (Tr., pp. 1516-17, emphasis added.) Thus, for goodwill he is referring to the sales price of a business and for “enhancement” he refers to the market value of a unit; these terms are equivalent because a sales price would represent market value. He then compares those terms to the “value of the identifiable assets” for goodwill and to “the summation of value of [the unit’s] component parts” for “enhancement.” Those two terms are also obviously equivalent, so Mr. Eyre’s distinction between “enhancement” which he considers taxable and goodwill, which is not, is a distinction without a difference. *See* Tr., pp. 1850-52 (Reilly).

Even though Qwest did present evidence of the unitary value using an income approach, with appropriate deductions for intangible property to get to a taxable, tangible value, there is support for the conclusion that the tangible assets should simply be valued directly in the cost approach. As noted above, one of the Department’s own experts testified that he does not use the stock and debt and direct capitalization components of the unitary method because he typically only values the tangible assets (the same task here) and because those methods incorporate too much intangible value. (Tr., Barreca, p. 1189.) Another, Mr. Eyre, stated that extracting intangible property value is a daunting task, and he complained that if intangible assets such as goodwill are removed, “What is left of the unit value?” (Exhibit 30, pp. 29-30.) He asserted that, “Given the nature of unitary valuation, dividing up the unit in order to exempt certain assets is problematic at best, and may effectively destroy the unit.” (*Id.*, p. 29.) In other words, since goodwill and other types of intangible property are exempt, following the law by excluding such intangible assets would destroy the unit.

If it is too difficult to extract intangible property value from the unit, as the Department's experts claim, then the task should be to use a method that does not incorporate those intangible property values in the first place. That method is the cost approach, which is easier to apply to only the tangible assets of the company and is more reliable in valuing only those tangible assets. As noted, the Department itself uses the cost approach alone for many telecommunications companies, including all wireless companies, so any complaints about how using the cost approach alone "destroys the unit" are obviously unfounded. *See also* Tr., pp. 1829-30, 1853-54 (Reilly). That is also the approach taken by more recent cases and authorities, including the courts in Florida and Iowa.⁷ Also included in that list are the Utah State Tax Commission and the Minnesota Department of Revenue,⁸ both of which rejected Mr. Eyre's advice to give greater recognition to the stock and debt and direct capitalization methods. Tr., pp. 1501-10 (Eyre). Finally, and most importantly, using the cost approach alone is the method suggested by the Department's own rules. Those rules, as noted above, direct that a method not be used if the intangible value cannot be extracted. ARM 42.22.111.

2. The Board Erred in Sustaining the Department's Direct Capitalization Approach.

The unit value submitted by Qwest at the hearing was \$19 billion, from which it demonstrated the existence and value of intangible personal property that supported a tangible, taxable value of \$9.607 billion. The Department's unit value was \$21.5 billion, from which it

⁷ *GTE Florida v. Todora*, 854 So.2d 731 (Fla. Ct. App. 2003) (cost approach only must be used to accommodate the policy reflected in Florida law that only tangible assets may be taxed); *Heritage Cablevision, supra*, , 457 N.W.2d at 598-99 (comparable sales method could not be used because it captured intangibles in the valuation).

⁸ *See* Utah Rule 62; Minnesota Rule 8100.0300, p. 641.

deducted only 15% for intangible personal property, for a taxable value of \$18.3 billion. Although many of the valuation disputes revolve around that intangible property deduction, there are also serious issues concerning the differences between the unit value estimates of \$21.5 billion from the Department and \$19 billion from Qwest. Three of those issues are addressed in this and the next two sections of this brief.⁹

One component of the Department's unit approach is the direct capitalization method, in which the Department determined a value of \$25.56 billion before the intangible property deduction (compared to its \$14.667 billion using the cost approach). The Board devoted no analysis to Qwest's claims that the use of the direct capitalization method using E/P ratios is inappropriate in general, and in particular that it was wrongly applied in this case. At page 20 of the Decision, the Board summarily affirmed the Department's use of the E/P ratio methodology as one the Board has "previously supported," and the Board held simply that Qwest failed to demonstrate error on the part of the Department, without addressing any of the errors Qwest showed during the hearing.

Space limitations here do not permit a full explanation of all the conceptual problems with the E/P direct capitalization approach, but suffice it to say that the approach in general is invalid for reasons that include those identified recently by Judge McCarter in *PacifiCorp v.*

⁹ Not addressed herein because of space limitations is an appraisal issue the Board did not analyze thoroughly – the appraisal justification for a company-specific risk premium in the cost of equity capital in the income approach. Qwest submits that the statements made by the Board at p. 31 of the Decision are incorrect and not consistent with the credible testimony at trial. *See, e.g.,* Tr., pp. 1775-91 (Reilly); Exh. 18, p. 10, Exh. 19, pp. 1-2, Exh. 22, pp. 16-17. However, the arguments made herein for adjustments to the direct capitalization and stock and debt approaches (if the Court even accepts the use of those methods), would reduce the Department's unit value to a level consistent with the evidence presented by Qwest, and thus this issue would not be material.

Department of Revenue, Case No. ADV-2007-709 (Feb. 25, 2010) (copy to be provided to the Court). *See also* Tr., pp. 1799-1809 (Reilly); Exh. 18, pp. 12-13; Exh. 22, pp. 13-16.

Even if the approach were valid as a general matter, the evidence at the trial, completely unaddressed by the Board, was that the method was incorrectly applied in this case. The Board suggested that Qwest's evidence was "merely demonstrating different methodology" (Decision, p. 20), but that was far from the case. Qwest pointed out that even if it were proper to use "comparable" companies to develop E/P ratios for this purpose, the companies used by the Department were not sufficiently comparable.¹⁰ Tr., pp. 1806-09 (Reilly). Mr. Eyre actually adjusted for one facet of this problem in his direct capitalization analysis, and if that adjustment is made to the Department's value in this approach, and another correction discussed below is made in the stock and debt approach, the Department's unit value is actually very close to that proposed by Qwest.¹¹

¹⁰ "If an appraiser uses P/E ratios, it is vital that the ratios be for 'comparable' companies, *i.e.*, be derived from companies sufficiently similar to the company being evaluated to make use of the ratios analytically meaningful." *Union Pac. R.R. Co. v. Dep't of Revenue*, 843 P.2d 864, 874 (Or. 1992) (emphasis added).

¹¹ With Mr. Eyre's adjustment for the wireless influence in the "comparable" P/Es, his direct capitalization value is \$22,809,685,379 (Exh. 30, p. 58), about \$2.7 billion lower than the Department's value of \$25,568,891,879. (Exh. 7, p. 7.) If Mr. Eyre's direct capitalization value is used at the Department's 25% weighting, combined with the correction of the stock and debt value noted below using only the Qwest debt (and not an allocation of its parent company's debt), at a 35% weighting, and the Department's cost approach at its 40% weighting, the result is \$18,986,558,858, almost matching the Kane Reece value. The calculation is as follows: the Eyre direct capitalization value, \$22,809,685,379 x 25% = 5,702,421,345; + the corrected stock and debt value of \$21,192,769,412, *see* note 11 below, x 35% = \$7,417,469,294; + the Department's cost approach value of \$14,666,670,548 (Exh. 7, p. 6), at a 40% weighting = \$5,866,668,219. The correlation of those values equals \$18,986,558,858.

3. The Board Erred in Sustaining the Department's Value in the Stock and Debt Approach.

Another valuation approach in the Department's unit valuation was the "stock and debt" market approach, in which the Department derived a \$26.3 billion value before the intangible property deduction (compared to \$14.667 billion using the cost approach). As with other issues, the Board's discussion of the issues involving this approach was simplistic and conclusory. The Board simply stated that it has previously supported the use of this method, but did not address any of the arguments Qwest presented for why the method should not be used in this case, at least in the manner in which it was used here. Decision, p. 20.

The stock and debt method has the premise that the market values of the stock and debt securities used to finance assets are proxies for the values of the assets themselves. *See Union Pacific, supra*, 843 P.2d at 883. One of the issues with the stock and debt approach is the assumption that prices paid for small units of stock or debt can be extrapolated into the tangible asset value for an entire business enterprise. *See Soo Line R.R. v. Dep't of Revenue*, 278 N.W.2d 487, 800 (Wisc. App. 1979). Another issue is that the prices paid by investors reflect their assessment of the future growth opportunities of the business – related to the value of assets that have not even been acquired yet and that cannot be subject to ad valorem taxation. *See Union Pacific v. State Bd. of Equalization*, 776 P.2d 267, 273-76 (Cal. 1989) (discovery of long-range plans limited because of tendency to include value of assets acquired after the assessment date). The major issue, as with the direct capitalization method, is that the values of the stock and debt securities also reflect the value of the intangible personal property, an issue discussed above. *See Tr.*, pp. 1799-1805 (Reilly); Exh. 18, pp. 13-15; Exh. 22, pp. 13-16. This Court should hold that the problems with the stock and debt approach are too great to justify its use in this case.

Even assuming the stock and debt method could be used, there was a dramatic error in the way the Department applied it here. One of the difficulties with the stock and debt method relates to the need to extract information about the taxable unit from a larger holding company. Qwest's parent company, Qwest Communications International, Inc. ("QCII"), has debt on its balance sheet with a value of about \$16.1 billion (Exh. 7, p. 12), but what is needed to apply this method is the debt of Qwest. The Department used an allocation process to estimate Qwest's share of the total QCII debt at about \$13.33 billion. (Exh. 7, p. 13.)

The Department should have avoided the difficulty of allocating the QCII debt value by simply using the traded market value of Qwest's own debt. Qwest is required to file its own Form 10-K with the SEC, and must report the market value of its debt in the same part of its 10-K where the \$16.1 billion QCII debt is located on the QCII 10-K. (Exh. 1, p. 55.) That reported value is \$8.2 billion, about \$5.1 billion lower than the \$13.33 billion value allocated to Qwest by the Department and Mr. Eyre from the parent company.¹²

The Department's appraiser, in response to a Board member's question, admitted that using the Qwest debt directly – rather than allocating it from QCII – is an acceptable option: "you could do it either way." (Tr., p. 1060.) However, as Mr. Reilly testified, you could indeed

¹² The \$5.1 billion reduction is simply the difference between (i) the \$13.33 billion that Mr. Hofland effectively calculated by taking his "operating percentage" of Qwest to the QCII total (82.81%) times the QCII debt (\$16.1 billion x 82.81% = \$13.33 billion), *see* Exh. 7, p. 13; and (ii) the actual Qwest debt of \$8.2 billion. The stock value of his stock and debt analysis would stay the same: \$15,689,855,588 of QCII stock multiplied by the "operating percentage" of 82.81%, or \$12,992,769,412. Adding the actual Qwest debt to that figure produces a total of \$21,192,769,412, which again is about \$5.1 billion lower than his total of \$26,326,567,633.

do it either way arithmetically, but one way would be completely wrong – the way the Department chose for its valuation: “If we know the value of this glass of water was a hundred dollars, we wouldn’t have to add up the value of all the glasses of water in this courtroom and subtract the value of the glasses of water we don’t know about to get to the value of the glass of water we do know about.... As a valuation premise, you’d never allocate a certain number to an uncertain number when, in fact, you have the certain number.” (Tr., pp. 1805-06.) In other words, if you already know the number you are using in an analysis, why attempt to estimate that number by allocating from a larger number?

As noted, just using the actual debt values for Qwest, which the Department’s appraiser said was a correct alternative, the stock and debt value would be about \$5.1 billion lower. At his 35% weighting for the stock and debt approach, that single difference would cause a \$1.79 billion reduction in the Department’s correlated value.

4. The Board Erred in its Conclusions Concerning Obsolescence in the Cost Approach.

Montana law requires that the Department “fully consider” reductions in value for obsolescence in the cost approach. *See* MCA § 15-8-111.¹³ Such an adjustment may be necessary where the book value of the company’s property, as reflected in its books and records and financial statements, does not reflect loss in value from functional and economic factors. In Qwest’s case, the evidence points to the existence of obsolescence, including a drop in utilization

¹³ *See also Crown Pacific Ltd. Partners v. Dep’t of Revenue*, Cause No. BDV 97-15 (MT 1st Dist. Ct., Dec. 29, 1998, Judge Sherlock), pp. 12, 14: “The Department fails in its function if it sits back and makes the taxpayer prove the existence or non-existence of economic obsolescence. This should be a factor that the Department thoroughly investigates and considers.... To require the Taxpayer to prove the amount of economic obsolescence is not “fully considering” economic obsolescence as mandated by the Legislature.”

of access lines to a point where, as of the assessment date, only 52% of those lines were being utilized. *See* note 1, *ante*, p. 1.

The Department made no adjustment. At trial, the Department's appraiser testified that the higher stock and debt and direct capitalization indicators of value suggested that his lower cost approach value did not warrant any downward adjustment. (Tr., p. 1069.) However, this conclusion fails to account for the fact that there is significant intangible asset value included in the stock and debt and direct capitalization indicators, a fact that is borne out by the market evidence from the Bell South transaction and others like it. *See, e.g.*, Exhs. 51, 55, 56.

The Board's reasoning is similarly flawed. It pointed to the fact that the Department's unit value increased from 2006 to 2007, but that assumes the Department's values for either 2006 or 2007 are correct, and thus begs the question in this case. Decision, p. 24. It also pointed to the increase in the stock price of Qwest's parent company, QCII, but again there is little correlation between a parent company stock price and the value of the underlying tangible assets.

The Board acknowledged that the physical size of Qwest's plant and its customers were declining, but it then pointed to the increase in the number of access lines. The Board ignored the fact that while Qwest added new lines to service new subdivisions, old customers were leaving the company in droves. Tr., pp. 89-91 (Brigham); Exh. 3. It is obviously the net number that is significant in determining the utilization and value of property.

The Board also misunderstood the testimony of Qwest's witnesses, whom it cited as supporting the conclusion that there is no "economic obsolescence." Decision, p. 24. Mr. Reilly did not testify that there was no economic obsolescence in the tangible assets. In the portion of his testimony to which the Board refers, Mr. Reilly stated that there was no additional obsolescence beyond what had already been recognized in the appraisals. (Tr., pp. 922-24.)

Ms. Torrence's testimony was that Qwest's technology was state-of-the-art (Tr., p. 177), but also that it is significantly underutilized and that there is redundant equipment due to technological change (Tr., pp. 179-80).

The Kane Reece appraisal set the tangible asset value at \$9.6 billion, a reduction of about 22% below the book value used in the Department's cost approach. When AT&T acquired Bell South – the closest comparable to Qwest, according to the Department's expert – it wrote down the book value by 15%. (Exh. 51.) This analysis, never discussed in the Decision, further supports an obsolescence adjustment in the cost approach.

D. The Board Erred in Rejecting Qwest's Constitutional Claim.

Qwest is taxed as a telephone company pursuant to MCA § 15-6-156, which provides for a 6% tax rate for Class 13 property. The Bresnan Telephony division of Bresnan Communications also is taxed in that classification. (Exh. 43.) However, not all the property Bresnan uses in its telephony operations is reported to the Department as Class 13 property. The cable and related property that carries the telephone and television signals to the customer's home or business is reported and taxed by its cable television affiliate as Class 8 property subject to tax at only a 3% rate. MCA § 15-6-156. *See* Exh. 40, O'Hara Depo, pp. 4-38, and p. 29 (there is no property reported by Bresnan Telephony from the customer location to the central office); Exh. 3 thereof, p. 0089 (showing no cable and wire investment reported for telephone company Class 13 investment); Exh. 20 thereof, pp. 0275, 0278, 0283, 0286, 0292, 0295, 0298, 0301 (showing cable and wire investment reported locally for Class 8 assessment).

The Board incorrectly described Qwest's claim as follows: "Qwest's complaint, in summary, is that the Montana Legislature has set up a different tax structure for cable companies and telephone carriers." Decision, p. 33. The Board then discusses how the legislature has the

power to create different classes of property and treats Qwest's claim as a challenge to the legislature's placement of cable television companies in a separate class: "The mere allegation of competition from a company classified differently is not sufficient to show unconstitutional treatment." Decision, p. 34 (emphasis added). "Qwest argues cable and related outside plant is not properly reported as Class 13 property, but presents no specific tax filings, market value indicators, or other information so we can verify the companies are similarly situated." *Id.* (emphasis added). The Board mischaracterizes Qwest's claim.

Qwest's claim in this case is not that the legislature does not have the power to place cable television companies in a different class than telephone companies, or that pure cable television companies are "similarly situated" to telephone companies. The Department already includes Bresnan Telephony as a telephone company, so this is not a case of a taxpayer claiming that another class is unfairly advantaged. Instead, this is a case where companies within the same class are being treated differently. Bresnan Telephony's cable investment is being taxed entirely in class 8 at a 3% rate. The comparable property for Qwest represents about half its system value, *see* Exh. 157, and is being taxed at a 6% rate.

Contrary to the Board's conclusion that there was no evidence that the companies are similarly situated, there was substantial evidence to this effect, and the Department itself treats them as such. The clear and undisputed evidence was that the cable and related property owned by Bresnan Telephony performs the same function as the cable and wire owned by Qwest: transmitting telephone signals to and from customers. *See* Tr. 142-49 (Torrence).

Qwest is not arguing that its property does not represent Class 13 property. However, because much of the same property used by Bresnan for the same purpose has been reported and taxed as Class 8 property, the same categories of property owned by Qwest should be taxed in

the same manner. Because it is not, the remedy is to reduce or “equalize” the assessment of Qwest to match that of the other company which has been wrongfully assessed. *See Sioux City Bridge Co. v. Dakota County*, 260 U.S. 441, 446 (1923); *see also Dep’t of Revenue v. State Tax Appeal Bd.*, 188 Mont. 244, 250, 613 P.2d 691, 694 (1980) (reduction is required for property correctly valued where it is impossible to meet both true value and equality standards).

The Department concedes that similarly situated property owned by Bresnan Telephony should also be taxed in Class 13:

The Department may only centrally assess companies with telephony operations if they are operating a single and continuous property in more than one county or state. With respect to those companies it is the Department’s position that any and all property used to provide telephony services is to be centrally assessed, as Class 13 property, in accordance with State law.

(Exh. 5, Answer to Interrogatory No. 5, p. 4, emphasis added.) In other words, it does not matter if property used for telephony operations is also used to provide other services. As long as it is used to provide telephony services, it should be taxed at the same rate as Qwest’s property.

The Board points to differences between Bresnan Telephony and Qwest in how they are regulated, Decision, pp. 34-35, but again, this misses the point. The point is that these companies have already been classified as similar companies for tax purposes – the determination of “similarly situated” has already been made.

In summary, the Board’s decision is fundamentally wrong in the way it characterized Qwest’s claims, and then in how it decided them. Bresnan Telephony is in the same class as Qwest. Its property should be assessed in the same manner. As the Department itself has stated, all of the property Bresnan uses for telephony services should be assessed in Class 13. Because it is not, there is a violation of equal protection of the law.

IV. CONCLUSION

The Court must reverse the Board's decision and remand this matter to the Board with instructions to order the Department to revalue Qwest's tangible assets by either (i) directly valuing those assets in the cost approach in the same manner as many other telecommunications companies, or (ii) properly using unitary valuation methods and deducting values for those categories of intangible personal property represented by customer relationships, contracts, software, trademarks/tradenames, patents, marketing rights and goodwill from a unitary value of \$19 billion, according to the evidence presented at trial; and to impose on Qwest the same, lower tax rate that was imposed on Qwest's competitor, Bresnan Telephony, for similar property owned by Qwest which is taxed to Bresnan at that lower rate.

DATED THIS 17th day of May, 2010.

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CERTIFICATE OF SERVICE

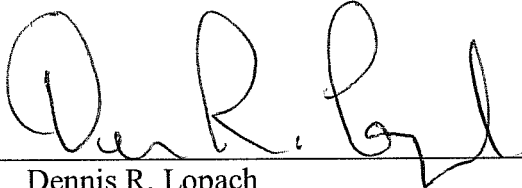
I HEREBY CERTIFY that on this 17th day of May, 2010, I caused to be served a true copy of the foregoing QWEST'S OPENING BRIEF by the method indicated below, and addressed to each of the following:

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