STATE BOARD OF EQUALIZATION
OPEN MEETING
MINUTES OF MEETING HELD AUGUST 17, 2021

In attendance: Commissioners Tom Katsilometes, Jeff McCray, Elliot S. Werk, and Janet Moyle; Maria Young, Phil Skinner, George Brown, Tom Arkoosh, David Cooper, Rick Smith, Bwembya Chikolwa

Kolby Reddish, Deputy Attorney General, Becky Ihli, Paralegal for the Tax Commission, Ted Sorenson, witness for appellant, and Erin Cecil, assistant to Tom Arkoosh joined by phone.

Commissioner Katsilometes, Chairman for the State Board of Equalization, reconvened the State Board of Equalization for 2021 (Board) at 9:00 a.m. August 17, 2021. This morning, Mr. Tom Arkoosh, Attorney representing the several non-utility generators (NUGs) will deliver his closing remarks on the case heard August 16, 2021.

Mr. Arkoosh presented his closing remarks. He said these small Hydro projects are being centrally assessed for historic reasons he doesn't understand. These are single-generator projects, but the assessor for the state is relying on a unitary valuation method from WSATA. Mr. Arkoosh reviewed those guidelines for the Board. Risk must be included. Mr. Arkoosh highlighted Mr. Rayworth's qualifications again, versus Mr. Hitchner's qualifications, for evaluations on business entities. The Board must decide who best measured risk. Mr. Arkoosh spoke of the current water flows and the impacts that has on these projects. Mr. Arkoosh also talked about contracts saying they should not have been used in the determination of value, citing Idaho Code 63-602L. Mr. Arkoosh asserted that the comparable companies picked by the state were not comparable.

Mr. Arkoosh presented a composite of the work completed by Mr. Cooper comparing the state's appraisals from 2015 forward. In reviewing the equity yield rate from 2015 to present, the debt-to-equity mix is changed. That is because of litigation and he believes the Board has been told that there was a concession. Commissioner Werk clarified that he understood the reasons for the changes was because of litigation, but the Bureau represented they received real information about the Hydro Companies and built a better model. Mr. Arkoosh said the new information they received was an analysis of the data that was completed by Dunn and Phelps. They looked at that and to settle the litigation, they decided to use an 80/20, with which the companies agree, and Mr. Rayworth apparently did more work after that because he altered it from 80/20 to18/82. Also, there was a commitment to look at the yield rate in later negotiations and they declined. He is unhappy with that settlement. Mr. Nielson objected saying this is a mischaracterization of Mr. Rayworth's testimony. Commissioner Katsilometes said these are simply closing comments. Mr. Nielson only wants the objection noted.

Mr. Arkoosh reviewed the yield rates from 2015 to present and asserted that the change the state made are subjective judgement represented to be a mathematical certainty and reflects a much lesser risk in these companies in an atmosphere that evidence shows as only increasing. He argued that the intent is to determine what a willing seller and a willing buyer agree is fair. The state has rejected that, and he doesn't understand the formula they've used. Mr. Arkoosh reviewed specific examples. He would limit the stream of payments to a 1% increase. Additionally, he addressed future projections saying those projections should only be five years.

Mr. Arkoosh discussed no-cost appraisals and the industry disappointment in this process. The Board is only reviewing about half of the Hydro properties in Idaho. These are advocates and he isn't seeing objective work. The risk has continued to increase. He said there is much the state should have reported to the Board as objective appraisers. They should have told the Board that the contracts are not a part of the evaluation, per statute. Mr. Nielson objected saying Mr. Arkoosh is impugning the integrity of the Bureau and it is not relevant to the question of value. Commissioner Katsilometes noted the objection. Mr. Arkoosh further stated he is disappointed the state did not embrace Mr. Hitchner's experience.

Commissioner McCray asked Mr. Rayworth questions related to his testimony August 16, 2021. Mr. Rayworth responded. Commissioner McCray also asked Mr. Skinner to explain Idaho Code 63-602L, referenced by Mr. Arkoosh. Mr. Skinner asked for a moment to review the code section. Commissioner McCray then asked Mr. Arkoosh questions related to his presentations saying he is proposing yield rates of 14.5% and 15.5% and asked how that would work. Mr. Cooper responded, referencing Mr. Hitchner's report. Mr. Skinner responded that Kolby Reddish, Deputy Attorney General assigned to the Tax Commission will provide an interpretation of Idaho Code 63-602L due to his knowledge and experience. Mr. Skinner said they will do more research and report back to Commissioner McCray and the Board.

Commissioner McCray asked why all the companies are presented as one. Mr. Nielson responded saying it was the opinion of the Bureau, during the prehearing conference, that the properties be presented individually; however, Mr. Arkoosh declined.

Commissioner Werk noted that what he heard; that the stock market for energy is always negative. Sometimes the stock markets are higher. He also commented on Mr. Nielson's objection and would like that clarified. Mr. Nielson responded, in detail. While there is some truth in that the Duff and Phelps report was a statement of the position taken by the petitioners that led the state to consider changes, the reason they adopted the capitalization structure presented in this case is because of additional information received during litigation, including the contract information. It is not because of the Duff and Phelps report. Commissioner Werk clarified that there has been ongoing hearings and litigation, yet full disclosure of data – that would make it easier to get good values – only came out of litigation. Mr. Nielson said it was in part from litigation, but also in part from working cooperatively with the industry. Commissioner Werk then asked Mr. Arkoosh whether he feels his properties should not be centrally assessed. Mr. Arkoosh said it is statutorily mandated, so it is appropriate in that regard, but he cannot figure out why the county assessors are not conducting the assessments. He realizes that would require a statutory change. Commissioner Werk asked the state's attorneys why the counties are not assessing the properties. Mr. Skinner said that question should be addressed later and isn't something that the Board will need to vote.

Commissioner Katsilometes reminded the Board they need to decide on whether to allow the Hitchner report submitted by the petitioner. Commissioner Werk does not like that they missed the deadline but doesn't see a problem in allowing the report. Commissioner Moyle said they did miss the deadline, and according to Mr. Arkoosh, they didn't even have time to use the report. It makes her wonder whether it should be accepted. Commissioner McCray moved to accept the Hitchner report for the purposes of evaluating this protest. Commissioner Werk seconded the motion, and all voted in favor.

The Board recessed briefly.

Commissioner Katsilometes recognized Mr. Reddish to respond to the question asked prior to the recess related to I.C. 63-602L. Mr. Reddish said he will research the issue further for both the petitioner and the Bureau.

Commissioner Katsilometes instructed the Board to deliberate on the NUG presentations. Commissioner Moyle said she is impressed with the collaboration that has occurred, as well as the knowledge and openness that has been brought forward in this process. She has seen progression and growth on both sides.

Commissioner Werk noted that when the Board first heard these cases in 2017 or in 2018, they asked that if the petitioner wanted a different value to then provide a different value. Once again, the petitioner has said the Bureau isn't necessarily qualified and their experts are qualified, but they will not provide values. They only say that it should be a different value. He would have preferred Mr. Arkoosh present a value instead of criticizing the Bureau for either not being qualified or using the wrong formulas. The petitioner never says exactly what they want.

Commissioner Moyle said many things are subjective. That is the nature of appraisal. However, in looking at how the appraisal was done, it seems the Bureau's appraisal took into consideration much of what was being asked. She cannot find fault in the way the appraisal was done. Her recommendation is that the Board accept the valuations as presented.

Commissioner McCray said he is sympathetic with the petitioner. He is not ready to make a final decision but requests that Mr. Arkoosh develop a decision for each of the operating properties and propose a methodology on how the decision was reached. He is looking for the math behind how they arrive at those values. He specifically requested they don't "make it the Hitchner Report" because that is far too detailed. Part of the reason is that the further the hearing progressed, the more the individual properties were dissected. To get to the right values, they need to be reviewed individually. He would also like to see the Bureau's draft decisions.

Mr. Skinner explained the process this year, as opposed to years past, that the Board of Equalization will function much like a court in that each side is asked to prepare a draft decision. The Board will then review those and decide. Mr. Skinner said, as the Board's legal advisor, he needs time to review the decisions and make any adjustments requested by the separate members of the Board. He requested the draft decisions be delivered by Thursday at 10:00 a.m. Mr. Arkoosh clarified the request. Mr. Cooper said he will do his best.

Commissioner Werk commented that this is the second year, and we still don't have those values. It's been disappointing to have the gist of the hearings has been that "we have better experts and don't think you're qualified." He is willing to review these draft decisions but warned the petitioner that if they are one minute late, he will not look at any decision.

Mr. Nielson commented on the statutory qualification requirements of someone that will be offering an assessment. Mr. Arkoosh said an owner can provide estimates and the Board hears to those. Commissioner Werk asked if it is required the petitioner legally qualify as an assessor. Mr. Nielson provided the statutory reference, 63-201 1(b). Commissioner McCray asked if it is not the Board of Equalization to determine value. Mr. Skinner said he will review the statute.

The Board recessed until 1:30 p.m.

The Board reconvened for the presentation of Lumen Technologies, Inc. Richard G. Smith, Attorney is representing Lumen Technologies, Inc., and Brett Jarvis, Deputy Attorney General assigned to the Tax Commission is representing the Operating Property Bureau. The Board will take breaks periodically.

At the Prehearing Conference held August 3, 2021, Mr. Smith and Mr. Jarvis estimated they will each take approximately two and one-half (2-1/2) hours for their presentations, for a total of five hours.

Maria Young, Secretary to the Board, and Phil Skinner, Legal Advisor to the Board will track the time for each presentation. Mr. Smith will present first since he has the burden of showing that the Operating Property Bureau's values are incorrect. After Mr. Smith is finished, Operating Property Bureau will present their case.

Mr. Smith will be allowed an opportunity to respond and offer closing statements. All individuals who will testify today are asked to please stand and Maria Young will swear in those that will be testifying.

Bwembya Chikolwa, Lumen Technologies, Inc., will testify for the appellant and Jerott Rudd, Operating Property Bureau Chief and Jim Powell, Senior Appraiser for the Tax Commission will testify for the state. All parties were sworn in by Maria Young.

Rick Smith said in many ways this case presents relatively classic valuation issues that are seen in centrally assessed valuation cases. He described the various issues in valuing properties using different approaches. What struck him, in this case, is staffs' approach to the cost approach; not only in not adjusting for obsolescence, which should be obvious to any observer of the telecommunications industry, but then, with no adjustment for obsolescence, having given the cost approach 50% weight. Lumen's revenues are supplemented by broadband. Lumen's access lines, which are access to customers, have fallen from 14 million in 2012 to 8 million in 2020. That says nothing about what happened before 2012 because there was a steady decline from 2001 to 2012. Regardless of the number of customers, the copper wire is still in the ground and will probably never produce revenue.

In addition to obsolescence is the difference in staffs' cost approach value and the income approach value. The staffs' cost approach value is $57 billion. Its income approach value is $28 billion. That should be a sign that something is wrong. One of the fundamental principles of appraisal is to do the best job to adjust a valuation method as much as possible to get to the right value, then reconcile the two indicators of value. There are Idaho-recognized methods for adjusting a cost-approach value. Mr. Smith outlined the methods. Mr. Smith believes the reason no adjustment was made is due, in part, to the reliance on the Western States Association of Tax Administrators (WSATA) handbook which instructs not to make any adjustment for obsolescence, regardless of how obvious the source. He further believes that due to a proposed transaction in 2021, where some of the legacy access line assets may be sold (there was an announcement that would happen, and he believes the price was $7.5 billion). Events after the evaluation date are irrelevant. In addition to irrelevance, it is very incomplete. The transaction will not close until 2022. No one knows what is being purchased nor where it is being allocated.

Mr. Smith said the income approach, on an income producing company, is the superior approach. The cost approach looks at costs, depreciation techniques that arbitrarily allocate value over time. The result is unreliable and in inferior to the income approach. That is borne out in the

WSATA manual. Lumen is not a rate-based company. Revenue is not based on cost. There is really no relevance to cost. Staff has acknowledged this with small power producers. As an attachment to their opening memorandum, they included a scheduled with some alternatives if the Board wishes to consider alternatives to what either staff or the taxpayer have proposed. The schedule shows a weighted 75% income approach and 25% cost approach. That results in $199 million, compared to staffs $240 million. It’s still above the value the taxpayer contends is appropriate, which is $180 million. Giving 0% weight to the cost approach, which they believe is appropriate, the value goes down to $162 million.

Mr. Smith described the process associated with the sale transaction noted earlier. The amount allocated for tangible assets is less that what is on the books. There is no premium of value paid over the value of the tangible assets. Instead, the write-down reflects there was obsolescence at the time of the transaction. Most of their presentation will address the cost approach. Mr. Smith noted normalization, but staff did not do that in this case. Lumen did. They will also discuss the capital yield rates.

Commissioner Werk asked how long Lumen Technologies has been in existence. Mr. Smith replied that in one form or another since about 1905. Commissioner Werk asked if they are the same as CenturyLink; Mr. Smith said there was a name change to Lumen Technologies, Inc.

Brett Jarvis, Deputy Attorney General representing Operating Property, asked the Board to review the four issues in play that are laid out in the Notice of Appeal and the various briefings. He believes Mr. Smith has done a good job defining what the Board is being asked to answer today. The four questions are: 1) whether there was external obsolescence that wasn’t accounted for in the cost approach, in terms of the legacy assets; 2) the “normalization of income,” but it’s really the CAF-2 funding that is ending this year and the question is, “does the Bureau’s appraisal of forecasted income consider termination of that Connect America Fund-Phase II (CAF-2) funding.” 3) the capitalization rate, and there are several components to that, but they will answer whether the capital asset pricing model (CAPM) component adequately captures the risk that is facing Lumen. They will discuss the dividend growth model. They will also discuss the fact that the equity rate and the debt rate in the capitalization rate are only two points apart; 4) the reconciliation of the two approaches and the factors the appraiser accounted for when he decided to use 50% weight to cost and 50% income to income approaches. Their conclusion is the state completed these appropriately. They will ask the Board to accept the Bureau’s appraisal.

Mr. Smith introduced Bwembya Chikolwa, the Senior Tax Manager with Lumen Technologies, Inc. Mr. Smith interviewed Mr. Chikolwa and asked him to provide his education and background. Mr. Chikolwa said he has a Ph.D. in Economics and Finance, several appraisal accreditations, he is a senior appraiser with the American Institute of Appraisers, a chaptered surveyor with the Royal Institution of Chaptered Surveyors and is a certified rate of return analyst. He has 28 years’ experience in public service and academia on three continents. He worked for eight years as a staff appraiser for the state of Texas; he held the same designations as his colleagues with the state of Idaho. He is well versed as a utility appraiser. Mr. Smith asked him to explain the Royal Institution of Chaptered Surveyors and how it relates to his qualifications in this case. Mr. Chikolwa said it is an international organization, outside the United States. In the United States, it is either the American Society of Appraisers or the Appraiser Institute. Mr. Smith clarified that Mr. Chikolwa also has a certification with the American Society of Appraisers. Mr. Smith noted there has been a great deal of information submitted for this case. Mr. Chikolwa will review the presentation that is before the Board.

Mr. Chikolwa said both parties have done a good job of explaining the issues before the Board. Lumen feels what has been determined exceeds the fair market value of the assets. They will provide details of declining revenue numbers to support their contentions. Mr. Chikolwa reviewed the presentation. When they review an income-producing asset, it is counterintuitive that their values should be increasing. From 2019 to present, their value has gone down 3.5%. In 2019, they were assessed at $196 million. They could have been here having the same hearing last year because, initially, they were assessed $221 million. They managed to negotiate to $205. Keep in mind, their revenue is still going down. This year it jumped to $240 million and that is why they are here this year. Mr. Chikolwa reviewed the access lines lost. It isn't by coincidence their revenue numbers are going down. They have tremendous capacity, but people don't want land lines. What do they do about all the copper wire in the ground? Commissioner Werk asked if there have been any sales of business segments that results in additional decline. Mr. Chikolwa said no. Commissioner Katsilometes asked what they can do with the copper wire. Mr. Chikolwa said there are two alternatives, of which the first is what they are doing now: leave it there. The second is, if they could find a buyer, they can sell it and the buyer can do what they wish. Commissioner Katsilometes asked how much value he places on the copper. Mr. Chikolwa said when they completed the Level 3/Century Link transaction, the copper was figured at a percentage of net book value and was 54%.

In the process of determining fair market value of their assets, Mr. Chikolwa completed an appraisal to compare his results to the states. A summary is included in the materials submitted to the Board. Using the cost approach, they both start at the same place and go through the same process. Where they differ is where he asks for additional obsolescence on the $8.8 billion. They are looking at the design capacity versus what is being used. Mr. Chikolwa continued reviewing the presentation. On average, on a system-wide basis they are only using 14.9%. He touched on the definitions that are included in the presentation and showed how he arrived at 62% obsolescence. Mr. Chikolwa detailed their access line capacity versus the usage although they must maintain the capacity.

Mr. Chikolwa has provided evidence of why they believe the adjustments are appropriate. Mr. Smith clarified that Mr. Chikolwa did not justify the calculations based on the Idaho-specific assets; it's system-wide. Commissioner Katsilometes asked if they receive any government subsidy for any of the wire. Mr. Chikolwa said with the deregulation of telecommunications, there is no subsidy. The subsidy they are currently receiving is for broadband, which is fiber and entirely different. Commissioner Moyle asked, with all the changes, whether the company is moving more into fiber. Mr. Chikolwa said the transaction with Level 3 was to get away from the legacy assets. Level 3 was primarily a fiber company, and their business model is more on Enterprise, or Wholesale. They recognize land lines are going away and their forecast is more focused on fiber. Commissioner Werk asked if it is Mr. Chikolwa' s contention that, within the Bureau's evaluation, it isn't that there is no obsolescence, but that it is inadequately taken into account by the Bureau. Mr. Chikolwa said the standard approach is that they do the appraisal, then the depreciation, and then make the adjustment. The state has failed to do that, and it is the $8.8 billion they are asking for. He asserted the Bureau didn't make that fundamental adjustment and does not reflect fair market value. Commissioner Moyle asked about the alternative values that were presented earlier and asked if there is a preference. Mr. Smith said those were a part of the prehearing conference memorandum as sensitivity calculations. Either of those would be their preference over what the staff did. If they aren't going to make the obsolescence adjustments that are necessary, then they shouldn't allow the cost approach anyway; however, if they want to give it some weight, then 25% is an option.

Mr. Chikolwa discussed the normalization issue. With CAF-2 funding, the premise is that this is income not generated by the company. The Federal Communications Commission (FCC) gives them money to expand broadband. This was a 6-year CAF-2 “Connect America” fund that was extended to a 7th year. It will end this year. Details are available in the presentation. In Idaho, they are receiving approximately $6.2 million. Their contention is that it is appropriate to make an adjustment. He also looked at the methodology. They know for a fact that funding is ending this year. Mr. Chikolwa did provide documentation explaining how they arrived at their numbers. Commissioner Werk clarified they received money and put in fiber, so what they are doing is extending the value of the company by putting all that fiber in the ground to reach more people. Mr. Chikolwa explained how the money was allocated and accounted.

Mr. Chikolwa continued through the presentation and discussed the capitalization rate. They are not receiving a commensurate rate of return on the assets they hold. They don’t have issue with the cost of debt the state reflected as 7.5%. The cost of equity is problematic. Mr. Chikolwa reviewed what that entails. The rate of return that an investor would require as an alternative from investing in bonds. An equity investor accepts more risk. What level of compensation should that investor be given for accepting that extra risk? Investing in bonds or treasuries are guaranteed to have a return on the investment; investing in equity shares offers no such guarantee. It is the level of composition that is at issue with this case. They contend that the 200 basis points is not enough; on average, they’ve seen that just by looking at historical numbers, 500 basis points, or 5% is usually deemed appropriate. They’ve provided evidence to support that. Mr. Chikolwa reviewed the state’s methodology and the alternatives he prepared.

The Board recessed briefly.

Brett Jarvis described the flow of their presentation: Jim Powell, Senior Appraiser will briefly testify and Jerott Rudd, Operating Property Bureau Chief, will address issues raised in the appeal, and then Mr. Jarvis will close.

Mr. Jarvis asked Mr. Powell to review how he arrived at the numbers in his appraisal and how he did his appraisal. Mr. Powell said he has been an appraiser with the Property Tax Division since 1991 and doing assessments since 1982. The appraisal process involves the three approaches: cost, market, and income along with completion and reconciliation of the three approaches to a final reconciled value estimate. He reviewed the premise of the cost approach, which is what an investor will pay, less depreciation costs. Mr. Powell reviewed his appraisal with the Board. He used the operating income provided by Lumen. He added the operating income for the impairments that are goodwill impairments, one-time charges for loss in value with goodwill, not a typical operating expense, back. He reviewed the formulas and the math. He explained that he uses a 50/50 weighting across the board because he doesn’t have time to complete a discounted cashflow for every company and to keep all the telephone company’s uniform. They’ve been doing it that way for decades. Mr. Jarvis clarified, asking if he put 50% on cost and 50% on income. He didn’t put any weight on stock and debt, he only used it as a cross check. Mr. Powell agreed. Mr. Smith was allowed to clarify points with Mr. Powell, who responded to his questions with some assistance from Mr. Jarvis.

Mr. Rudd presented the response to the appeal issues raised by Lumen today. The first issue addressed is economic obsolescence. As Mr. Powell described, they typically use the three approaches to value. Lumen claims there is another $8.8 billion of value that should be removed from the historical cost-less-depreciation (HCLD) approach. That is the cost approach they use for unitary valuation. As Mr. Smith mentioned, there are some assets over 100 years old on the books. Some of them are depreciated almost to nothing but are still being used in the system of assets. The WSATA handbook provides guidance to the state regarding unitary valuation. Mr. Rudd shared a quote from the WSATA handbook regarding the HCLD. Mr. Rudd said the information used is derived from the taxpayer. At the time of the appraisal, the state did not feel it appropriate to remove additional obsolescence. They also have market data that substantiates their decision.

Mr. Rudd shared an article indicating that Lumen had reached an agreement "…to sell its ILEC (incumbent local exchange carrier) assets, including its customer, small business, wholesale and mostly copper-served enterprise customers and assets, in 20 states to funds managed by affiliates of Apollo Global Management, Inc. for $7.5 billion, …" He emphasized this is not something that could have been considered during the completion of the appraisal in January, but it substantiates the opinion that there wasn't additional economic obsolescence. The assets sold were only a fraction of the legacy assets they own. They retained the most valuable portion for their own use. Commissioner Moyle questioned the relevance. Commissioner Werk offered his understanding that this reinforces the Bureau's assertion that the obsolescence they allowed already was appropriate. Mr. Rudd said that is a correct assessment. Commissioner Moyle maintained that this has no bearing on this hearing.

Mr. Rudd continued to review the presentation for the Board. He explained the components of determining a weighted average cost of capital. He explained the formula. They use guideline companies that are as close to the entity being appraised as possible. Mr. Rudd talked about the equity risk premium, saying the higher the rate, the lower the taxable value. Mr. Chikolwa explained this very well earlier. Mr. Rudd also discussed the risk-free rate. They attempt to use as much market data as possible instead of guessing what might or might not happen. One of Lumen's arguments is that the CAPM is not reliable because the risk-free rate is artificially low due to government monetary policy. Mr. Rudd reviewed the risk-free rate that has steadily declined since 1985. The state evaluates what the market is saying and believe a normalized risk-free rate is inappropriate to apply when developing a cost of equity.

Mr. Rudd discussed the Beta which is a measure of risk. There is a suggestion that the state's lower rates this year are because they must think Lumen's assets are less risky than they were last year. They further say in their appeal that this cannot be supported considering the events of the pandemic and the economic uncertainty. Mr. Rudd is unsure what to say in response to that other than the state was looking at the market. The Beta for Lumen Technologies has gone down over the last two or three years or has at least remained stable. It isn't consistent with Lumen's argument that the state is artificially trying to come up with a lower rate. Commissioner Werk asked if they are using a Beta of 1, as of December 2020. Mr. Powell supplied that it was 0.91. Commissioner Werk asked how the guideline companies apply to the specific company being assessed. Mr. Rudd said they select a group of guideline companies and pull the Beta from Value Line, a commonly used resources for market data, for each guideline company and then look at the averages of the Beta for the industry. Commissioner Werk asked if there is a Beta in Value Line for Lumen, why not just use that? Mr. Rudd said they are trying to establish a weighted average cost of capital for the whole industry. They develop one rate for the entire industry, as opposed to a different rate for each company. Mr. Rudd said, over the professional resources available, all rates are decreasing and is the cause of the lower cost of capital.

There is suggestion that the Tax Commission's cost of debt and the cost of equity are too narrow at 2%. While it's true there would generally be a bigger spread between the two, but rather than believing, as Lumen does, that the cost of equity is too low, Mr. Rudd believes the cost of debt is too high. In Idaho, they've been using one CAP rate for the entire telecommunications industry.

That requires taking a broad look at guideline companies. Idaho has more guideline companies in their groups than Duff and Phelps have in their study. In that mix of guideline companies, they are using some very small companies that may not be the best comparison to Lumen Technologies. Commissioner Werk asked if the higher the cost of debt actually lowers the value. Mr. Rudd said yes. Idaho's cost of debt is higher than all other states.

Mr. Rudd continued through his presentation. In looking at the income estimates, he would focus on the two- and three-year averages. The state does not believe an adjustment for CAF-2 funding is appropriate because that CAF-2 funding was provided to the company to build assets, to increase their broadband footprint. That property exists and is taxable. Lumen argues the CAF-2 funding is going away, but there has been some form of telecommunications subsidy since the late 1990's. There is no foregone conclusion those subsidies will end, and it is inappropriate to remove that value from the income approach.

In closing, Mr. Rudd would like the Board to consider the estimates of value that have been derived for the purposes of Lumen's valuation. He discussed the state Tax Commission's indicators of value and the values determined by Lumen Technologies. Mr. Rudd reviewed further guidance from the WSATA handbook. Idaho rule requires Tax Commission staff to choose and explicitly identify the weight that will be placed on indicators of value. That is why they show weighting.

If there truly is obsolescence of $8.8 billion, regardless of how it's measured, the company would be required to identify that; $8.8 billion is almost 1/3 of their net book value. Commissioner Moyle asked if all this is true, why was the stock and debt not used? Mr. Rudd said they talk to taxpayers and attempt to give the benefit to the taxpayer. They've attempted to put weight on the stock and debt approach in the past and it tends to create conflict or contention with the taxpayer.

Mr. Rudd said there has been a suggestion that the $205 million of last year and $240 this year is unjustifiable. The only numbers over which the Tax Commission has control are, while limited due to the average cost of capital and the income projection, is the system value. The system value for Lumen Technologies, from 2020 to 2021, increased 2.124%. Those numbers come directly from the appellant's operator's statement. The exempt tangibles reported were less this year than last. Among other things, they reported no licensed vehicles this year. Commissioner Werk clarified that of the 17.7% increase, 15% is derived from input from the company. If the input had stayed the same, the increase would have been 2.7%? Mr. Rudd said he believes it would be close to that. The system value increased 2.4% year over year.

Commissioner Werk asked Mr. Rudd about Mr. Powell's statement saying he used the 50/50 because it's been used for years. He isn't getting a sense of why they've used 50/50 and not 60/40 or 70/30. Why should they believe 50/50, based on what they've heard, would be more appropriate than 60/40? Mr. Rudd said it is unfortunate they argue about weighting, however, it is a judgement call of the appraiser and they don't make any of these decisions in a vacuum. They attempt to arrive at a value they think is fair and makes sense with some of the other indicators of value they may have. While they may not put any weight on a stock and debt, they calculate it and consider it as a cross-check for their values. They don't do a discounted cashflow on all the companies, but when it's done, it is to ensure the values make sense. They've tried, over the years, to come to a point where they feel comfortable putting 100% on the income approach. It's taken several years to get to that point. It is ultimately a judgement call.

Commissioner Werk asked Mr. Rudd to provide the thought process for the use of the 50/50 weighting. Mr. Rudd said there are many things to consider. There is guidance in the WSATA handbook, the subjectivity of the income approach, they consider whether the HCLD approach is right for Lumen Technologies. They must consider the concerns of the taxpayer and do the best they can looking at all the different variables in the reconciliation to come up with a number. He admits it isn't uncommon, in a mass appraisal environment to attempt to maintain consistency from year to year. If they've used 50/50 in the past, then they will continue. In the future, if they felt the income approach better represented the value for a particular company, they may put more weight on it. They aren't at that point yet with Lumen Technologies and that is the reason for the weighting.

Mr. Jarvis said he will forego closing comments in consideration of the time. Commissioner Katsilometes allowed Mr. Smith the opportunity to question Mr. Rudd. Mr. Smith reviewed the reconciliation page. The appraiser put no weight on the stock and debt approach. Mr. Rudd said Mr. Powell and Mr. Chikolwa have discussed that.

Mr. Smith noted that in the beginning of his testimony, Mr. Rudd mentioned an article dated August 3, 2021 about a sale. Mr. Smith read from the article saying the deal would not close until early 2022. The sales price was $7.5 billion, well below the netbook value. Mr. Rudd said they can see what was purchased. Mr. Smith said the point of this is they don't know the net book value of the assets being sold. Mr. Rudd said that is correct. Mr. Smith discussed that the CAPM is complex. Mr. Rudd said it is a simple formula that requires some subjective input.

Mr. Smith asked Mr. Rudd about the progression of Betas in the state's presentation. There was some reference to the fact that Lumen's Beta, as of December 2020 was 0.91. Mr. Rudd said the Beta used in the yield rate study was 0.91. The Beta specific to Lumen Technologies from Value Line is 1.0. Mr. Smith questioned Mr. Rudd about using the buildup model.

The Board recessed briefly.

Mr. Smith said he can defer his closing until tomorrow but asked Mr. Chikolwa to address questions raised by the state. He asked Mr. Chikolwa to discuss the 50%/50% HCLD approach. In what context is the HCLD unadjusted for obsolescence? Mr. Chikolwa said both sides talk about the WSATA handbook which is the bible for appraisers. The problem is the interpretation. The state has cited portions supporting their position and Lumen has cited portions supporting their position. The difference is the context. Mr. Smith commented about the copper wire and asked Mr. Chikolwa to explain whether all copper wire is obsolete. Mr. Chikolwa said that isn't what they are saying. In their submission, he provided it is only about 21% dead weight. Of the 79% remaining, only a certain percentage of that is being used by customers and that goes to the utilization numbers discussed earlier. Mr. Chikolwa said the reason they are here, as stated earlier, is because their revenue has been falling but their value has gone up. For an income-producing property that is counterintuitive. If they were a rate-regulated company, they would address their issues to the Public Utilities Commission and ask for a rate adjustment. Mr. Smith said that in the state's presentation, they pointed out that the financial statements for Lumen show the cost numbers and those costs have not been impaired subject to an impairment adjustment. Is there a complex process involved in determining what an impairment is necessary for reporting purposes? Mr. Chikolwa said it is a very high bar. Most companies will wait a couple of years before going through and impairment. He agreed with Mr. Smith that it is not a fair market value process.

Commissioner Werk thanked Mr. Chikolwa for coming today.

Commissioner Katsilometes asked if there is any discussion about the presentations. Closing statements will be heard at 9:00 a.m. Wednesday, August 18, 2021.

Commissioner Katsilometes recessed the Board until 9:00 a.m. on Wednesday, August 18, 2021.

Maria Young	Tom Katsilometes
Secretary	Chairman of the Idaho State Board of Equalization