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No. A09-2229

STATE OF MINNESOTA

IN SUPREME COURT

Eden Prairie Mall, LLC,

Relator,

vs.

County of Hennepin,

Respondent.

REPLY BRIEF OF RELATOR EDEN PRAIRIE MALL, LLC AND APPENDIX OF UNPUBLISHED DECISIONS

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I. RELATOR DOES NOT ARGUE THAT THE TAX COURT DISREGARDED EVIDENCE; RATHER, THE TAX COURT'S DECISION IS NOT WITHIN PERMISSIBLE LIMITS AND LACKS MEANINGFUL AND ADEQUATE EVIDENTIARY SUPPORT.

Contrary to Respondent's claim, Relator does not argue that the Tax Court disregarded evidence admitted at trial. Rather, Relator argues that the Tax Court's decision is clearly erroneous because it is not within permissible limits and lacks meaningful and adequate evidentiary support in the record at all.

A. Respondent's Confuses the Role of the Tax Court Judge With the Role of the Expert Witnesses.

Respondent mischaracterizes the issue before this Court. Relator does not seek a rule of law that restricts the Tax Court from applying its expertise and judgment to the facts and opinions in the record. Instead, Relator asks this Court to apply the long-standing rule that the Tax Court's decision must be within permissible limits and have adequate and meaningful evidentiary support in the record. See Carson Pirie Scott & Company (Ridgedale) v. County of Hennepin, 576 N.W.2d 445, 451, *citing* Montgomery Ward & Co, Inc. v. County of Hennepin, 482 N.W.2d 785, 791 (Minn. 1992).

The question, therefore, is what are the permissible limits in the present controversy and what adequate and meaningful evidentiary support is found in the factual record in this case? Respondent's answer to those questions essentially confuses the Tax Court's roles and indeed that of Respondent's trial counsel, with the role of the expert witness. The role of the expert witness is to research the market indications of the key factual variables such as rent, vacancy, operating costs, tenant improvements and other relevant facts, and to apply one or more of the traditional approaches to value (*i.e.*: the income approach; the sales comparison approach; and/or the cost approach)[1] to perform an integrated and interrelated analysis of the market evidence upon which the expert's conclusions and opinions are based. The role of Respondent's trial counsel is to summarize the evidentiary record and applicable law to the trier of fact – here the Tax Court. Conversely, the Tax Court serves in a judicial role, and considers the experts' analysis, conclusions and opinions to make the ultimate factual determination of market value within permissible limits based upon adequate and meaningful evidentiary support in the record.

Respondent attempts to support its contention that the Tax Court did not exceed its authority in this case by arguing that the figures the Tax Court used in its calculations are found at some random location somewhere in the record. Respondent's Brief, however, only serves to further highlight a basic and fundamental problem inherent to the Tax Court's decision – that it was not based on any coherent and integrated analysis and appraisal expert opinion in the record. Instead, the Tax Court's decision was based solely upon argument contained in Respondent's Post-Trial Brief for which there was no evidentiary support. Thus, Respondent's argument to this Court is inappropriately based on Respondent's counsel acting as expert witness, and the Tax Court then adopting that same analysis and that same role.

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[1] In the present controversy, only the income approach provides a reliable indication of market value. (See Exhibit 1, p. 24; Exhibit 101, p. 83; Relator's Appendix, p. 42.)

Respondent includes a chart on pages 9-10 of its Brief wherein it allegedly purports to replicate the Tax Court's calculations with specific citations to the record for each figure relied upon by the Tax Court. It is most significant that Respondent had to include no less than eight footnotes to that chart expressly identifying a series of errors (mathematical or transcription) originally contained in Respondent's Post-Trial Brief, for which there is no corresponding citation to the record, but which the Tax Court nevertheless replicated verbatim in its decision. These eight errors serve to highlight the inescapable conclusion that the facts relied upon by the Tax Court are not based upon meaningful and adequate evidentiary support. Instead, in each instance, the Tax Court based its decision solely upon Respondent's attorney's admittedly error fraught calculations included as argument in Respondent's Post-Trial Brief. Yet, there is absolutely no evidentiary support in the record for any of these key income approach factors relied upon as the basis for the calculations adopted by the Tax Court.

B. The Blending of Various Valuation Techniques and Conclusions from the Experts at Trial, Without Any Evidence That Such Blending Is Consistent with Generally Accepted Appraisal Practices, Is Clearly Erroneous and Has Led to an Absurd Result in This Case.

Even setting aside for the moment the fact that Respondent's own Brief admits that many of the figures relied upon by the Tax Court as the factual basis for its income approach calculations are erroneous and contained nowhere in the record, Respondent's argument that the Tax Court is permitted to pick and chose at random *any* figure contained somewhere in the record as the basis for "blending" the various valuation techniques and conclusions from any of the experts at trial is without merit. Relator acknowledges that Tax Court is a specialized tribunal that brings a certain level of expertise and judgment to the hearing. Carson Pirie Scott & Company (Ridgedale), 576 N.W.2d at 451, *citing* Montgomery Ward & Co, Inc., 482 N.W.2d at 791. However, this Court has also long held that the Tax Court's decisions must be within permissible limits and have meaningful and adequate evidentiary support. Id. The Tax court is not free to blend at random the conclusions, opinions and techniques employed by the conflicting experts when there is no adequate and meaningful evidence that the blended synthesis is consistent with generally accepted appraisal practices or the opinions of the expert witnesses.

The inherent flaw in the Court's decision to blend the various appraisal conclusions, opinions and techniques without any evidence that the resulting blended approach is supported by any adequate and meaningful evidentiary support is that the appraisal process involves "integrated, interrelated and inseparable techniques and procedures designed to produce a convincing and reliable estimate of value..." The Appraisal Institute, The Appraisal of Real Estate, 409 (10th Ed. 1992). See also, The Appraisal Institute, The Appraisal of Real Estate, 130 (13th Ed. 2008). The *proper* application of those techniques and procedures (i.e.: application within permissible limits and in accordance with generally accepted appraisal practices) is critical to reaching an appropriate conclusion. See Id. at 561, (*emphasis added*). Mr. Messner expressly acknowledged this necessary and appropriate appraisal principle in his appraisal report. Respondent's expert expressly limited the use of his appraisal analysis, conclusions and opinion "for any purpose by any person . . . and in any event only with properly written qualification and *only in its entirety*." (Exhibit 101, p. 102, *emphasis added.*)

The restriction against the use of Mr. Messner's appraisal in any form other than in its entirety is required, because as in all appraisals, there are inter-relationships between the various appraisal approach factors that the expert has considered and the many conclusions subsumed into his opinion. For example, the level of market rent achievable may change if the level of vacancy and credit loss is changed. A change in the level of market rent may occur if there is a change in the amount of tenant improvements provided by the landlord. A change in the level of operating expenses may affect the level of rent and the level of retail sales, thereby impacting rent, overage rent and specialty leasing.

Here, the Tax Court accepted that invitation in Respondent's Post Trial Brief to do precisely what Respondent's own expert expressly stated was an inappropriate use of his appraisal analysis, techniques and conclusions and therefore a restricted and prohibited use. Here, no expert has testified that the Tax Court's random selection of figures forming the basis of its calculations maintains the integrity of the many interrelationships between the various integrated factors or adheres to generally accepted appraisal practices. Ultimately, the conclusion that the Tax Court's decision is clearly erroneous, because it is not within permissible limits and lacks adequate and meaningful evidentiary support, is resoundingly demonstrated in the Tax Court's internally inconsistent and contradictory analysis of the income approach to reach its final conclusion of value falling many millions of dollars outside the range of the evidence admitted.

Specifically, the Tax Court states in its decision on page 20 that:

> (w)hile we agree with some of the adjustments Mr. Lennhoff made in his income approach, we adopt an approach more like that used by Mr. Messner in valuing the Subject Properties.

(Respondent's Appendix, p. 20.) However, the Tax Court's calculations of the value under the income approach, which are later expressed in its decision, *directly* apply the format and model of Mr. Lennhoff's analysis, not Mr. Messner's, while at the same time making radical changes to many of the integrated factors that Mr. Lennhoff testified are necessary to reach a reasonable conclusion of value of the real property in issue in accordance with the requirements of Minnesota law. Consequently, the Tax Court reaches a value not only millions of dollars higher than Mr. Messner, but nearly twice that of Mr. Lennhoff. (See Exhibit 1, p. Facing 40; Exhibit 101, p. 82.). When the Court picks and chooses numbers from conflicting and contradictory expert testimony, and combines them into blended valuation calculations upon which no expert has testified is proper, the Court reaches a decision that lacks meaningful and adequate evidentiary support and risks reaching an absurd result, as it did in the present controversy.

1. Respondent's Position Would Render Meaningless Any Review by This Court and the Holding of Carson Pirie Scott & Company (Ridgedale) v. County of Hennepin, 576 N.W.2d 445 (Minn. 1992).

In essence, Respondent effectively asks this Court to reverse its holding in Carson Pirie Scott & Company (Ridgedale) to remove the critical requirement that the Tax Court's decision be "within permissible limits and [have] meaningful and adequate evidentiary support." Carson Pirie Scott & Company (Ridgedale), 576 N.W.2d at 451, *citing* Montgomery Ward & Co, Inc., 482 N.W.2d at 791. See also, Lewis v. County of Hennepin, 623 N.W.2d 258, 261 (Minn. 2001) (the Tax Court's decision must be reasonably supported by the evidence as a whole); Marquette Bank Nat'l Ass'n v. County of Hennepin, 589 N.W.2d 301, 305-306 (Minn. 1999) (reversal is appropriate if this Court is left with a definite and firm conviction that a mistake has been made); American Express Fin. Advisors v. County of Carver, 573 N.W.2d 651, 654, 658 (Minn. 1998) (tax court may not use illogical reasoning to reject an expert's opinion); and Schmieg v. County of Chisago, 740 N.W.2d 770, 773 (Minn. 2007) (this Court should not uphold the Tax Court's decision if it determines that insufficient evidence exists for Tax Court's conclusions).

Respondent proposes that this Court disregard Mr. Messner's limitation that his analyses, conclusions, and opinions be only used *in their entirety* for any purpose by any person. Instead, Respondent proposes that the figures utilized in the Tax Court's calculations need only be found in some random location in the trial record, and that they may be mixed and matched in any configuration and mathematical calculation, even though the resulting mathematical calculations are not based on any expert testimony or comply with generally accepted appraisal practices. There is a quantum difference between what Respondent proposes and holding that the Tax Court's calculations must be based on valuation analysis, conclusions and opinions that are consistent with generally accepted appraisal practices as testified to by some expert witness at trial. To hold as the Respondent contends would effectively remove the words "permissible limits" and "meaningful and adequate" from this Court's holding in Carson Pirie Scott & Company

(Ridgedale), and indiscriminately permit the Tax Court unfettered discretion to act not as judge but as expert witness, so long as the Tax Court uses figures in its calculations that appeared somewhere in the record, no matter how utterly absurd the result.

2. Respondent Necessarily Fails in Its Attempt to Minimize the Multi-Million Dollar Disparity Between the Experts' Opinions and the Tax Court's Decision By Mis-Citing Its Own Expert's Opinion and Fabricating Additional Valuation Testimony Found Nowhere in the Record.

Respondent attempted to minimize the multi-million dollar disparity between the experts' opinions at trial and the Tax Court's decision by mis-citing its own expert's opinion and fabricating yet another valuation methodology for which there is no evidentiary support in the record. Respondent's attempts only further support Relator's position.

Respondent first argues that the Court's conclusion was only 1.4% higher than Respondent's expert's opinion at trial. This is not true. After correcting his error of initially failing to include a management fee deduction, Mr. Messner did conclude to a value under the income approach of $118,510,000 as of January 2, 2006. (Exhibit 101, p. 82.) However, his final opinion of value remained unchanged at $115,000,000. (Exhibit 101, p 84.) Thus, the Tax Court's conclusion, of $120,142,410 as of January 2, 2006, (Relator's Appendix, p. 31), is 4.5% than Respondent's expert's opinion at trial. Moreover, as discussed in detail in Relator's Brief at page 14, the difference as of January 2, 2005, was 11.7%, or nearly $13 million.

Respondent next argues that if one adjusts Mr. Messner's income approach "to be tax neutral," the value "increases from $110,600,000 to $121,000,000 for January 2, 2005, and from $118,510,000 to $136,500,000 for January 2, 2006 – right in line with the Tax Court's ultimate conclusion." (Respondent's Brief, p. 18.) Respondent's argument ultimately serves to highlight the inherent problems created when one departs from generally accepted appraisal practices and treats the appraisal process as a result-oriented numbers game where counsel makes-up valuation methodologies to reach higher values than those testified to by the experts, and constitutes additional techniques and mathematical calculations that contradict generally accepted appraisal practices and lack adequate and meaningful evidentiary support.

As an initial matter, Mr. Messner's income approach analysis already is tax neutral. A review of page 82 of Exhibit 101 (Mr. Messner's appraisal report) and his testimony clearly establishes that he added back real estate taxes paid to his net operating income, and then loaded his capitalization rate with the effective tax rate, so that his income approach is tax neutral. (Tr. 1200: 10 – 21.) The analysis contained in Respondent's Brief, where the real estate recoveries and expenses are removed from the analysis and then the capitalization rate is loaded by the effective tax rate as applied only to the portion of taxes paid directly by the Relator, is simply an alternative method of adjusting an income approach to make it tax neutral. Assuming all other factors remain the same, and no other errors are introduced by Respondent's counsel, the outcome will be mathematically consistent.

A further problem with Respondent's argument, however, is that all other factors have not remained the same. The chart included on pages 16 to 17 of Respondent's Brief is not even remotely consistent with Mr. Messner's income approach analysis. While Mr.

Messner included the mall's actual operating results in his appraisal report for reference purposes only, he did not rely upon these figures in his income approach, as the charts included in Respondent's Brief suggest to this Court. Rather, Mr. Messner commences his income approach analysis with a projected net operating income of $10,000,000 as of January 2, 2005 and $10,300,000 as of January 2, 2006, (Exhibit 101, p. 80), not the $11,000,000 and $12,000,000 as cited by Respondent. The capitalization of these significant differences in net operating income result in many millions of dollars of difference in value, leading Respondent to advocate to this Court yet another, albeit different, absurd result many millions of dollars outside of permissible limits and the range of the evidence (even more so than the decision of the Tax Court) based solely on Respondent's counsel's imagination, creativity, and advocacy, but no evidence actually contained anywhere in the record.

C. Due Process Is Denied When A Trial Court Makes Findings Without Adequate Evidentiary Support.

Respondent argues that Relator's due process rights were not violated by the Tax Court's decision relying solely upon valuation calculations contained in Respondent's Post-Trial Brief as opposed to evidence that was submitted at trial, because Relator had the opportunity to submit a post-trial reply brief challenging Respondent's counsel's valuation methodology or to move to strike the calculations comprising the methodology when it filed its post-trial motion. Respondent essentially confuses the difference between argument and evidence.

The issue is not whether Relator's counsel had an opportunity to argue that the unsupported methodology was improper. The issue is that Relator did not have the opportunity to present any evidence to the Tax Court on Respondent's counsel's manufactured valuation analysis at all. Advocacy and argument are permitted in the context of a brief. However, if, like here, the argument has no evidentiary support in the record, it is not appropriate as the basis of a trial court's decision and it constitutes reversible error for a trial court to rely solely upon that argument.

The Tax Court erroneously relied solely upon argument contained in Respondent's Post-Trial Brief as if that argument was an "adjudicative fact." Respondent argues with this summary of the evidentiary record, claiming that "adjudicative facts" are only found in prior court records and proceedings and here, there were no prior court proceedings. Respondent misunderstands the meaning of the phrase "adjudicative fact" and mis-cites In Re Matter of Welfare of D.J.N, et al., 568 N.W.2d 170 (Minn. 1997) for the proposition that adjudicative facts are limited to facts determined in prior judicial proceedings.

While a fact determined in a prior judicial proceeding might be an adjudicative fact, an adjudicative fact can consist of many different types of facts not in the record, but which are otherwise noticed by the trial court. An adjudicative fact "must be one not subject to reasonable dispute in that it is either (1) generally known within the territorial jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned." Minn. R. Evid. 201(b). A trial court may take judicial notice of an adjudicative fact, but only if the parties are afforded an opportunity to be heard as to the propriety of taking judicial notice of the fact. Minn. R. Evid. 201(e).

Here, by relying on argument contained solely in Respondent' Post-Trial Brief, rather than evidence in the trial record, the Tax Court effectively converted the advocacy in Respondent's brief into an adjudicative fact without providing Relator an opportunity to present evidence on the subject at all. Moreover, contrary to the prerequisites of judicial notice, the valuation calculations adopted by the Tax Court are certainly: (i) subject to reasonable dispute; (ii) not generally known within the territorial jurisdiction of the court; and (iii) not capable of accurate and ready determination by resort to sources whose cannot be questioned. Accordingly, it was improper for Respondent to create new valuation analysis and testimony in its post trial brief, and then in turn for the Tax Court to treat the valuation analysis in Respondent's Brief like an adjudicative fact and give it judicial notice.

D. Relator Does Not Seek Special Treatment For Tax Court Litigants.

Respondent argues that the Relator is seeking special treatment for tax court litigants, because it is asking for an absolute limit with respect to a tax petitioner's potential risk. That is not an accurate statement. Relator is asking this Court to apply a long-standing rule to conclude that a Tax Court decision cannot, by its nature, be within permissible limits or be based on meaningful and adequate evidentiary support if it falls many millions of dollars outside the range of values as opined to by any of the experts at trial. Such a rule would not serve to limit either the taxpayer's or the taxing authority's risk in any manner whatsoever, as long as there is ample support in the record for the Tax

Court's decision. If the Tax Court's decision were many millions of dollars *less than* the opinion of any expert on the basis of a comparable evidentiary record, the same rule would reasonably apply.

Respondent's claim that the Relator is asking this Court to prohibit the Tax Court from reaching a value conclusion that significantly exceeds the opposing expert's opinion is accurate in some instances. However, such a rule only seeks to keep the Tax Court's decision within a permissible and reasonable range. Moreover, such a rule is not inconsistent with the rules applied in other courts. As detailed by the Amicus Curiae in its brief, for example, if a jury issues an unreasonable damage award that is beyond what the evidence supports, the trial judge can set aside the verdict as excessive with further review through the appellate process if required. See e.g, Meuller v. Sigmond, 486 N.W.2d 841, 845 (Minn. Ct. App. 1992) (citing McPherson v. Buege, 360 N.W.2d 244, 347 (Minn. Ct. App. 1984) (holding that the award was "within the bounds of the highest sustainable award under the evidence.")

II. RESPONDENT MISINTERPRETS THE PROPER APPLICATION OF CASE LAW RELATING TO 11 U.S.C. §362(a)(1) TO THE FACTS OF THIS CASE.

Respondent argues that the Tax Court's Judgment increasing Relator's tax liability did not violate the automatic stay imposed by 11 U.S.C. §362(a)(1), solely because the underlying Tax Court proceeding was initiated by the Relator. As explained in detail in Relator's brief, however, that fact is not relevant much less dispositive. Rather, the automatic stay applies to any "action or proceeding against the debtor." Id. Accordingly, a court does not look solely to the posture of litigation at the commencement of the proceedings. In re General Associated Investors Ltd. Partnership, 159 B.R. 551, 553-554 (Bankr. Ariz. 1993). A court looks to all actions occurring during the proceedings, and the automatic stay applies to any counterclaim brought against a debtor, even if the debtor originally initiated the lawsuit. Koolik v. Markowitz, 40 F.3d 567, 568 (2d Cir. 1994).

Respondent cites Carson Pirie Scott & Co. v. County of Hennepin, 508 N.W.2d 200, 202 (Minn. 1993), in support of its claim that this Court has already held that the automatic stay does not apply to a Minnesota property tax appeal, and that Relator is asking this Court to overrule its prior decision. Respondent is wrong. Carson Pirie Scott & Co. is wholly inapposite to the case before the Court today.

It is true that, in dicta, this Court stated that "tax petitions filed by Carson are proceedings initiated by the debtor, not against the debtor, and, consequently, the automatic bankruptcy stay of subparagraph (a)(1) does not apply to the petitions and proceedings thereunder." Id. However, the operative facts of Carson Pirie Scott & Co. are completely different from the facts in this case, and therefore, its holding has no application or precedential value here.

The issue in Carson Pirie Scott & Co. was whether the automatic stay provision of the bankruptcy code precluded an ***automatic statutory dismissal*** of a property tax appeal for the failure to pay taxes under to Minn. Stat. §278.03. Under Minn. Stat. §278.03, the failure to pay a specific percentage of one's property taxes when due "shall operate automatically to dismiss [a property tax] petition and all proceedings thereunder." In Carson Pirie Scott & Co., this Court acknowledged that a cross claim or counter claim against a debtor in an action is subject to the automatic stay. However, because the statutory dismissal under Minn. Stat. §278.03 is automatic, this Court determined that no affirmative "action" against the debtor had been taken, but instead that the dismissal was triggered only by the passage of time. Id. at 202-203. As the Court stated, "the dismissal of the petition is not an action or an act, but simply an event which occurs automatically by statutory mandate when the taxes are not paid." Id. at 303.

Conversely, here, while no formal counter claim is authorized by law, Respondent undoubtedly performed actions that sought an increase in Relator's tax liability during the trial at a time prior to Relator's filing for bankruptcy protection. Respondent again expressly sought an increase in Relator's tax liability in Respondent's post-trial brief, which was filed in violation of the automatic stay, and an increase in Relator's tax liability was ultimately ordered by the Tax Court while Relator's bankruptcy petition was pending. Surely, introduction of Mr. Messner's appraisal and the filing Respondent's post-trial brief constituted "action(s) or proceeding(s) against the [Relator] to recover a claim against the [Relator] that arose before the commencement of the [bankruptcy] case. . . ." 11 U.S.C. §362(a)(1).

Moreover, Respondent's claim that Relator cited no cases in its Brief involving proceedings brought initially by the debtor is simply false. Relator cited In re General Associated Investors Ltd. Partnership, 159 B.R. 551 (Bankr. Ariz. 1993). Like here, the debtor in that case had filed a property tax appeal prior to filing for bankruptcy. Post bankruptcy, the taxing authority then filed a motion seeking to dismiss the debtor's appeal. The Arizona Bankruptcy Court held that the taxing authority's motion to dismiss constituted an "action" against the debtor in violation of the automatic stay. Id. at 553-554.

The facts here are even more unmistakable. Here, Respondent not only sought to dismiss Relator's appeal without reduction, but also explicitly sought to increase Relator's tax obligation, actions by Respondent that resulted in a money judgment being issued against Relator while Relator's bankruptcy case was still pending. Under 11 U.S.C. §362(a)(3), a party who attempts to obtain possession or control over property of the bankruptcy estate violates the automatic stay. Seeking entry of a money judgment against a bankruptcy petitioner is a direct attempt to obtain possession or control over a portion of the bankruptcy estate.

Similarly, Respondent's argument that actions taken during the trial asking that Relator's taxes be increased somehow do not constitute the bankruptcy law equivalent of a counter claim is without merit. As described above, Respondent's position at trial ultimately resulted in a money judgment being issued against the Relator. The fact that no formal answer, return or other pleading by the taxing authority is permitted under Minn. Stat. §278.05, subd. 1 does not change that result.

Respondent is correct that in In re Objections to Real Property Taxes. Southdale Circle Partnerhip v. County of Hennepin, 424 N.W2d 536 (Minn. 1988), this Court declined to imply a counterclaim in a property tax case when it held that a taxpayer has the right to dismiss its appeal over the County's objection prior to trial. However, the law is clear that a taxpayer has no such right to dismiss once the trial has commenced. See e.g., Gale v. County of Hennepin, 609 N.W. 2d. 887, 892 (Minn. 2000) (stating that once the tax court trial commenced, the litigant lost their right to withdraw their petition and accept the original assessment); and Ervin A. and Vivian R. Walvatne v. County of Hennepin, File No. TC-24065 (Minn. Tax Ct. Dec. 27, 1995) (finding that the petitioner's right to dismiss its case ended once the trial commenced). Here, the trial was commenced and completed, and Respondent had already sought an increase in Relator's taxes, before Relator filed for federal bankruptcy protection.

III. RESPONDENT INCORRECTLY CLAIMS THAT THE TAX COURT COULD NOT DEDUCT FOR PERSONAL PROPERTY, BECAUSE THE RECORD LACKED EVIDENCE REGARDING MARKET VALUE.

Respondent argues that the Tax Court appropriately did not deduct for furniture fixtures and equipment ("FF&E") as personal property and not taxable real property in its decision, because there was insufficient evidence in the record on the subject to make the deduction. Respondent is factually wrong.

The Tax Court determined that the deduction for FF&E should be based on market value as opposed to historical cost, but then, in its calculations, it failed to make any deduction for FF&E at all. (Relator's Appendix, pp. 24 and 29-30.) Respondent claims that the Tax Court's failure to make this requisite deduction was not error, because both parties' appraisal experts based their FF&E deductions on historical cost, and therefore, the record was devoid of evidence upon which the Tax Court could base its deduction.

Respondent's argument necessarily fails, because the Tax Court expressly found (and apparently believed) that Respondent's expert, Mr. Messner, based his deduction for FF&E on market value, not historical cost. (Relator's Appendix, p. 24.) Accordingly, the Tax Court found that the record did contain the requisite evidence – Mr. Messner's

$300,000 FF&E deduction. (Exhibit 101, p. 82). The Tax Court did not include the deduction it believed was appropriate for FF&E in its calculations because it copied its value calculations verbatim from Respondent's Post-Trial Brief, which included not less than eight errors in its made-up computations, and included no FF&E deduction.

The evidentiary record also fails to support Respondent's claim that Mr. Messner based his FF&E deduction on historical cost. Respondent failed to cite anywhere to the record in support of its claim. The written explanation of the FF&E deduction in Mr. Messner's appraisal report sheds no light on the issue. (See Exhibit 101, p. 82.) While there was some testimony at trial suggesting Mr. Messner based his FF&E deduction on historical *and anticipated* cost (Tr. 1461: 25 – 1461:3), there remains no evidentiary support for Respondent's argument from a factual perspective in the evidentiary record. The Tax Court, nonetheless, expressly found that Mr. Messner's FF&E deduction was based on market value (Relator's Appendix, p. 24).

IV. RESPONDENT'S ARGUMENT THAT THE TAX COURT CORRECTLY IGNORED TENANT IMPROVEMENTS FAILS TO ADDRESS THE PROVISIONS OF MINNESOTA STATUTES THAT PROVIDE THAT TENANT IMPROVEMENTS ARE NOT TAXABLE REAL PROPERTY.

Respondent's entire argument relating to the issue of tenant improvements fails to address the real issue raised by Relator in this appeal. The issue is not whether the experts utilized a discounted cash flow method or a direct capitalization method for calculating value under the income approach. The issue is whether tenant improvements are taxable real property under Minnesota law. Because tenant improvements are not real property under Minn. Stat. §272.03, subd. 1, as Relator explained in detail in its initial

Brief, their value must be separately analyzed and deducted, regardless of whether an appraiser performs a discounted cash flow analysis or direct capitalization analysis under the income approach.

Respondent's claim that tenant improvements need only be deducted from value if an appraiser performs a discounted cash flow analysis is illogical, without citation and lacks any evidentiary support. The Minnesota Tax Court has approved a deduction for tenant improvements on multiple occasions when the appraisers relied upon a direct capitalization analysis under the income approach. See e.g., IRET Properties v. County of Hennepin, File No, 30776 (Minn. Tax Ct. Aug. 25, 2005); Paddock Properties, LLC v. County of Hennepin, File Nos. 27971, 28803 and 39088 (Minn. Tax Ct. Sept. 19, 2002); Space Center Enterprises, Inc. v. County of Ramsey, File Nos. C4-97-3360 and C4-98-3241 (Minn. Tax Ct. Nov. 4, 1999).

Similarly, Respondent's argument based on the capitalization rates reported in the Korpacz reports are not responsive to the issue that tenant improvements are not taxable real property. The capitalization rates reported in the Korpracz report capitalize net operating income from the total assets of the businesses of the reporting regional malls. This includes income derived from property that the Minnesota legislature has not legally classified as taxable real property under Minnesota law. In Minnesota, because tenant improvements do not constitute real property under Minn. Stat. §272.03, subd. 1, they are not taxable as part of the real estate. Accordingly, their removal from the income stream is not only appropriate, but legally required, regardless of how any other regional malls in other jurisdictions may report their net operating incomes for the Korpacz report.

V. THE TRIAL COURT'S RELIANCE UPON MR. MESSNER'S CONCLUSION THAT THERE IS NO INTANGIBLE BUSINESS VALUE IN THE EDEN PRAIRIE MALL IS ERRONEOUS, BECAUSE IT IS INCONSISTENT WITH THE EVIDENCE, GENERALLY ACCEPTED APPRAISAL PRACTICES AND MR. MESSNER'S OWN TESTIMONY AT TRIAL.

Respondent argues that the Court did not err when it rejected Mr. Lennhoff's adjustments for intangible business value because Mr. Messner testified that no intangible business value exists in the mall. However, Mr. Messner did not testify on this subject in the manner Respondent suggests. Rather, Mr. Messner acknowledged that items like rental differences for similar stores in a mall, the sale of utilities by the mall owner, start-up costs and the owner's development, management and marketing skills can add intangible value to a mall. (Tr. 1118: 5 – 119:10; Exhibit 101, p. 2.). While acknowledging that these items are intangible, Mr. Messner simply concluded, contrary to generally accepted appraisal practices, that such items were so "intertwined" with the value of the real estate, that they could not be separately sold, and that therefore, the value of those intangibles must be included with his opinion of the value of the taxable real property. (Id.)

There are several problems with Mr. Messner's testimony and conclusions. First, they are untrue at their foundation. The undisputed evidence in the record is that the "business" of running a super-regional mall often is separately sold apart from the real estate alone. Relator offered evidence that it operates and manages many malls that it does not actually own. (Tr. 41: 4 – 42: 13.) Mr. Messner's suggestion that this aspect of business value is adequately adjusted through a management fee deduction is incorrect.

As Mr. Lennhoff testified, only a portion of the management fee is attributable to business value. (Tr. 317: 7-16; Exhibit 36.)

Second, Mr. Messner's testimony and conclusions are inconsistent with generally accepted appraisal practices as well as Minnesota law. As explained by both Mr. Lennhoff at trial and by The Appraisal Institute in the leading appraisal textbook, The Appraisal of Real Estate, (13th Ed. 2008), intangible property includes items like "reputation, work force, contracts, copyrights, patents, trademarks, residual income and good will." (Exhibit 4, p. 30; Exhibit 1, Facing p. 5; Tr., 105: 9-21.) There is no indication – indeed there is no mention – in the 13th Edition, or anywhere else, of any requirement that one be able to sell these assets independently from the real estate in order to segregate their value. In fact, by their very nature, many of the intangible assets that are listed, such as reputation, in-place workforce and goodwill, simply cannot be sold separate and apart from the business entity to which they belong; yet, the most widely-cited statement of generally accepted appraisal practices requires that they be separately identified as intangibles.

Generally accepted appraisal practice as promulgated by the Appraisal Standards Board through the Appraisal Foundation in its Uniform Standards of Property Appraisal Practice ("USPAP") simply and unmistakably *requires* that the intangible assets of a business, including things like reputation, work force, favorable contracts and good will, *must* be identified and separately analyzed with regard to their effect on the value as a whole, just like personal property must be identified and separately analyzed under

Minnesota law. (USPAP, Standard 1-2e(iii); Exhibit 23; Exhibit 1, p. 3; Exhibit 101, pp. 1-2; Tr. 1046: 10–1047: 2.)

Appraisers are not afforded the self-indulgence of claiming that the complexities of separating the intangible assets from the real estate are just too difficult for them to do. The Appraisal of Real Estate, (13th Ed. 2008) specifically states that "it might be difficult to separate the market value from the land and building from the total value of the business, but such a division. . . may [nevertheless] be required." (Exhibit 4, p. 30.) Appraisers are expressly cautioned that "only qualified practitioners should undertake these kinds of assignments, which *must* be performed in compliance with appropriate professional standards." (Id., *emphasis added.*) Appraisers are further cautioned that "the appraiser should be careful that he or she has the experience and competence to complete this type of valuation assignment," and that "it may be necessary for the real estate appraiser to collaborate with a . . . business appraiser . . . on such an assignment." (Id. at p. 29.)

Ultimately, Mr. Messner's own testimony contradicted Respondent's conclusory assertion that no intangible value exists in the subject mall. Mr. Messner acknowledged in his appraisal report that deducting management fees is one of the generally accepted appraisal methods for segregating and deducting business value. (Exhibit 101, p. 2.) Prior to trial Mr. Messner amended his appraisal report to deduct a management fee, since he initially forgot to do so. Moreover, on cross examination, Mr. Messner actually admitted that intangible value exists in a mall and it is often transferred from department stores to malls when malls subsidize their anchors. As he stated, there is basically:

> a transfer of value from the department store to the mall itself. Anchors are typically subsidized because they provide a benefit to the mall shops, which is, to generate traffic and enhance sales of the mall itself.

(Tr. 1641: 1-4.) While Mr. Messner attempted to backtrack on this admission by arguing the asset being transferred was real estate and not an intangible, his argument made no logical sense; ultimately, he had no choice but to admit that no actual bricks or mortar or other real property improvements were transferred from the department store to the mall. (Tr. 1641: 13-15.)

VI. THE TAX COURT'S CAPITALIZATION RATE CONCLUSION WAS INCONSISTENT WITH ITS OWN FINDINGS AS WELL AS MR. MESSNER'S TESTIMONY AND REPORT.

Respondent argues that the Tax Court's capitalization rate conclusion was supported by the evidence, because (i) Mr. Messner calculated the retail sales per square foot at the subject mall excluding the AMC theater sales, and (ii) that calculation places the mall in the Korpacz Class B+ range. In its initial Brief at pp. 44-49, Relator described in detail why excluding the AMC theater sales is not consistent with generally accepted appraisal practices and ignores the significant risk associated with 77,500 square feet of the mall, resulting in a capitalization rate that is too low. Relator will not repeat those arguments herein.

With regard to the classification of the mall, however, Respondent simply misses the mark. If the theater sales are excluded, the mall's retail sales per square foot fall within Korpacz's Class B+ range. However, in concluding to his capitalization rates, Mr. Messner did not rely on Korpacz's capitalization rates for Class B+ malls. Rather, Mr.

Messner concluded the subject property is a Class B+/A- mall, justifying a lower capitalization rate than suggested by the Korpacz Class B+ range. (Exhibit 101, p. 80.)

A review of the capitalization rates concluded to by Mr. Messner and adopted by the Court establish that they are lower than the average of the Korpacz Class B+ range and instead fall closer to the median of the Korpacz Class A range. (Exhibit 108, p. 10; Exhibit 111, p. 14.) There was simply no evidence presented at trial that the Eden Prairie Center is, ever was, or ever will be a Class A mall as defined in the Korpacz study. Thus there is no support in the evidentiary record for the Tax Court applying a capitalization rate lower than the rate identified as the Class B+ capitalization rate.

CONCLUSION

Based on the foregoing, the Relator respectfully requests this Court hold that the Tax Court's Judgment is:

(a) illogical, inconsistent with the evidence admitted at trial and constitutes reversible error in violation of both Minnesota state law as well as U.S. federal bankruptcy law; and

(b) clearly erroneous because it is not within permissible limits and lacks adequate and meaningful evidentiary support.

Relator respectfully requests that this Court reverse the decision of the Tax Court and remand with directions to determine the value of the taxable real property components of the Mall by making the deductions for personal property and intangible assets described in Relator's initial Brief, and by capitalizing the real property income into value based on the overall capitalization rate estimated by Relator's expert.

In the alternative, Relator respectfully requests that this Court vacate the Judgment entered by the Tax Court as void or enter its decision that the claim of Respondent for additional real estate taxes is extinguished under federal bankruptcy laws.

Further in the alternative, Relator respectfully requests that this Court reverse the decision of the Tax Court and remand the case back to the Tax Court with instructions to enter its Order that the legal presumption of the prima facie validity of the assessment remains, because sufficient credible evidence has not rebutted that presumption.

Respectfully submitted,

Dated: February 22, 2010

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CERTIFICATE OF COMPLIANCE
WITH MINN. R. APP. P 132.01, Subd. 3

The undersigned certifies that Relator's Reply Brief submitted herein contains 6,850 words, exclusive of the pages containing the table of contents and table of authorities, and complies with the type/volume limitations of the Minnesota Rules of Appellate Procedure 132. This Brief was prepared using a proportional spaced font size of 13 pt. The word count is stated in reliance on Microsoft Office Professional Edition 2003, the word processing system used to prepare this Brief.

Judy S. Engel

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