

STATE OF MINNESOTA

TAX COURT

COUNTY OF BENTON

REGULAR DIVISION

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AIM Development (USA), LLC,

Petitioner,

vs.

County of Benton,

Respondent.

**FINDINGS OF FACT,  
CONCLUSIONS OF LAW, AND  
ORDER FOR JUDGMENT**

File No. 05-CV-13-675

Dated: April 10, 2017

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This matter came on for trial before The Honorable Joanne H. Turner, Chief Judge of the Minnesota Tax Court, on June 21 and 22, 2016, at the Benton County Courthouse in Foley, Minnesota.

Nicholas A. Furia, Law Office of Nicholas A. Furia, PLLC, Minneapolis, Minnesota, and Jeffrey J. McNaught, The Law Offices of Jeffrey J. McNaught, Minneapolis, Minnesota, represented petitioner AIM Development (USA), LLC.

Gerald W. Von Korff, Rinke Noonan, St. Cloud, Minnesota, represented respondent Benton County.

At issue in this case is the value of a paper mill and hydroelectric dam in Benton County currently owned by AIM Development (USA), LLC. The parties filed post-trial briefs; closing arguments were heard on January 10, 2017. We find that the assessed value of the subject property overstated its market value as of the valuation date.

The court, having heard and considered the evidence adduced at the hearing and the arguments of counsel, and upon all of the files, records, and proceedings herein, now makes the following:

## FINDINGS OF FACT

1. Petitioner AIM Development (USA), LLC, has sufficient interest in the property to maintain this petition.<sup>1</sup>

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<sup>1</sup> As of the January 2, 2012 assessment date, the property was owned by Verso Paper. Petitioner AIM Development purchased the subject property in 2013. A question therefore arises as to AIM's standing to challenge the January 2, 2012 assessment.

Minnesota Statutes § 278.01, subd. 1(a) (2016) allows “[a]ny person having personal property, or any estate, right, title, or interest in or lien upon any parcel of land” to file a petition claiming that “such property . . . has been assessed at a valuation greater than its real or actual value.” Said claim may be taken to the tax court “at any time following receipt of the valuation notice . . . but prior to May 1 of the year in which the taxes are payable.” *Id.*, subd. 1(c). Reading these provisions together, any person having any interest in or lien on a parcel of land between the valuation date and the filing deadline may challenge the assessment.

During closing argument, counsel for AIM asserted that AIM has the requisite standing because it “receives any benefit of any reduction in value,” citing the terms of the Asset Purchase Agreement between AIM and Verso. Tr. 25 (Jan. 10, 2017). We read the terms of the Asset Purchase Agreement (Ex. 8) differently. The January 29, 2013 Asset Purchase Agreement provides, in pertinent part, that “[a]ll Taxes levied with respect to the Real Property and any Tangible Personal Property relating to time before the Closing Date will be for the account of Seller. Seller will be liable for the proportionate amount of such Taxes that is attributable to the period on or before the Closing Date, and Buyer will be liable for the proportionate amount of such Taxes that is attributable to the period after the Closing Date.” Ex. 8, at ¶ 13(n)(1). In other words, it appears that under the terms of the Asset Purchase Agreement, seller Verso was responsible for paying the tax related to the January 2012 assessment and should receive the benefit of any reduction in value attributable to periods before the sale to AIM, which would include the January 2, 2012 valuation date.

Counsel for AIM nevertheless asserted that AIM paid the property taxes due in 2013 and arising from the January 2, 2012 assessment at issue here, not Verso (which filed for bankruptcy in 2016). Tr. 27 (Jan. 10, 2017); Ex. 1, at 120 (noting Verso Paper's bankruptcy). The County agreed that any refund of property taxes paid to date with respect to the January 2012 assessment would be paid to AIM, rather than to Verso. Tr. 28 (Jan. 10, 2017).

“Minnesota real estate taxes operate exclusively in rem. Our statutes impose no personal obligation upon anyone to pay them.” *Spaeth v. Hallam*, 211 Minn. 156, 158, 300 N.W. 600, 601 (1941). We have never held that a bare obligation to pay property tax, without the requisite estate, right, title, or interest in or lien on the land, is sufficient to confer standing. We need not decide

2. All statutory and jurisdictional requirements have been satisfied and the court has jurisdiction over the subject property and the parties to the petition.

3. On January 2, 2012, the subject property was a single-user paper manufacturing facility, with an associated hydroelectric dam that supplied power to the facility, located in the City of Sartell, Benton County, Minnesota.

4. The subject property was sold to AIM Development in March 2013 and the bulk of the improvements on the site have since been demolished.<sup>2</sup> The remaining buildings have since been sold or are currently for sale.<sup>3</sup>

5. On January 2, 2012, the subject property consisted of eight tax parcels identified by the following Benton County property identification numbers and with the indicated estimated market values (EMVs):

| <u>Parcel Identification No.</u> | <u>2012 EMV</u> |
|----------------------------------|-----------------|
| 18.00001.00                      | \$ 4,399,600    |
| 18.00001.40                      | \$17,036,300    |
| 18.00040.00                      | \$ 100          |
| 18.00071.00                      | \$ 1,138,900    |
| 18.00038.00                      | \$ 184,300      |
| 18.00038.03                      | \$ 100          |
| 18.00034.00                      | \$ 785,100      |
| 18.00001.03                      | \$ 100          |

6. The Benton County Assessor placed a total estimated market value on the subject property of \$23,544,500 as of January 2, 2012.

7. The land area of the parcels making up the subject property is as follows:

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that question here, however: AIM's interest in the property; albeit arising after the valuation date, gives it standing under section 278.01 to challenge the 2012 assessment.

<sup>2</sup> Tr. 30-31.

<sup>3</sup> Ex. 1, at 40.

| Property ID | Gross Land Area<br>(acres) |
|-------------|----------------------------|
| 18.00001.00 | 11.15                      |
| 18.00001.40 | 10.22                      |
| 18.00040.00 | 6.40                       |
| 18.00071.00 | 3.59                       |
| 18.00038.00 | 5.00                       |
| 18.00038.03 | 3.71                       |
| 18.00034.00 | 10.66                      |
| 18.00001.03 | 6.00                       |
|             |                            |
| Total       | 56.73 <sup>4</sup>         |

8. The subject property has a gross land area of 56.73 acres.

9. AIM purchased the subject property in 2013 for \$12,500,000 pursuant to an Asset Purchase Agreement with Verso.<sup>5</sup>

10. In the opinion of AIM's expert, Darren Browen, MAI, the market value of the subject property was \$6,880,000 as of January 2, 2012. Mr. Browen valued the subject property at \$6,750,000 using the cost approach and \$7,000,000 using the sales comparison approach.<sup>6</sup>

11. In the opinion of the County's expert, Clay Dodd, MAI, ASA, the market value of the subject property was \$14,690,000 as of January 2, 2012. Mr. Dodd developed a valuation opinion using only the cost approach.<sup>7</sup>

12. The market value of the subject property as of January 2, 2012, was \$10,452,000.

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<sup>4</sup> The parties' experts' gross land areas differed by 9.03 acres. *Compare* Ex. 1, at 26 with Ex. A, at 8. Petitioner resolved some of the discrepancies in its post-trial brief. Pet'r's Post-Trial Br. 8-9 (filed Sept. 1, 2016). Further reconciliation of parcel sizes is detailed within this memorandum.

<sup>5</sup> Ex. 8, at ¶ 3(a) (Asset Purchase Agreement).

<sup>6</sup> Ex. 1, at 194.

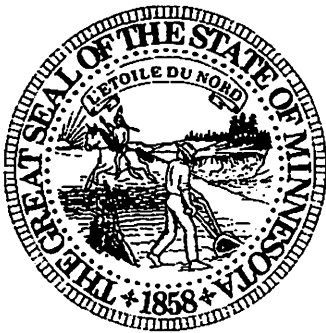
<sup>7</sup> Ex. A, at 120.

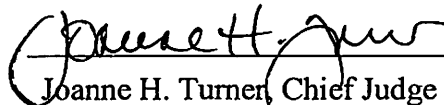
## CONCLUSIONS OF LAW

1. The assessor's estimated market value of the subject property as of January 2, 2012, shall be reduced on the books and records of Benton County from \$23,544,500 to \$10,452,000.
2. Real estate taxes due and payable in 2013 shall be recomputed accordingly and refunds, if any, shall be paid to AIM Development (USA), LLC, as required by such computations, together with interest from the original date of payment.

IT IS SO ORDERED. THIS IS A FINAL ORDER. A STAY OF 15 DAYS IS HEREBY ORDERED. LET JUDGMENT BE ENTERED ACCORDINGLY.

BY THE COURT:



  
Joanne H. Turner, Chief Judge  
MINNESOTA TAX COURT

DATED: April 10, 2017

## MEMORANDUM

At issue in this case is the market value of a paper mill and hydroelectric dam in the City of Sartell, Benton County, Minnesota, as of January 2, 2012. On the assessment date, the facility manufactured coated ground-wood paper, primarily used in magazines, catalogs, and inserts.<sup>8</sup> We discuss the subject property ownership and specifications in some detail.

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<sup>8</sup> Ex. 1, at 102 (Appraisal Report of Nicollet Partners); Ex. A, at 15, 68 (Market Value Appraisal Report of Patchin Messner Dodd & Brumm).

## **I. BACKGROUND**

### **A. THE PAPERMAKING PROCESS**

Because the subject property was, as of the valuation date, a paper mill, a (very) brief description of the papermaking process conducted on the property will be helpful in understanding the various structures to be valued.

When the mill was operating, logs arrived at the north end of the site, where they were stripped of bark and converted to pulp.<sup>9</sup> The pulp was then pumped to one of three paper machines on the site.<sup>10</sup> The pulp was broadcast by the machine's headbox onto a mesh plate (the "forming fabric" of the paper machine) and pressure was applied to drain water from the paper fiber.<sup>11</sup> The paper "web" then moved through a series of rollers to extract more water.<sup>12</sup> Finally, the paper web passed through dryers.<sup>13</sup> This mill manufactured primarily coated paper, which is most commonly used in magazines and catalogs;<sup>14</sup> the paper therefore received a coating on both sides to promote uniform ink absorption, and was dried again.<sup>15</sup> The mill also produced so-called

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<sup>9</sup> See Ex. 1, at 116 (quoting Verso Corporation's 2011 Annual Report); Tr. 28. The removed bark was burned as fuel for the plant's boilers. Ex. 1, at 116.

<sup>10</sup> See Tr. 28-29.

<sup>11</sup> Tr. 33; see Ex. 1, at 116.

<sup>12</sup> Tr. 33; Ex. 1, at 116.

<sup>13</sup> Tr. 33; Ex. 1, at 116.

<sup>14</sup> Ex. A, at 15.

<sup>15</sup> Ex. 1, at 116.

“supercalendered” paper, which passes through another series of rollers (a process called “calendering”) to produce a smooth finish.<sup>16</sup>

## **B. DESCRIPTION OF THE SUBJECT PROPERTY**

The subject property is comprised of eight parcels. Six of the parcels are located between the east bank of the Mississippi River and the Burlington Northern Santa Fe (BNSF) rail right-of-way that runs north to south through the property. These parcels include the main improvements associated with the three pulp and paper mills on the property:

| Property ID | Gross Land Area (acres) | Parcel Improvement Description <sup>17</sup>                                     |
|-------------|-------------------------|----------------------------------------------------------------------------------|
| 18.00001.00 | 11.15 <sup>18</sup>     | Original paper plant (machines 1 and 2), south power plant, wastewater treatment |
| 18.00001.03 | 6.00 <sup>19</sup>      | Vacant (a/k/a river parcel)                                                      |
| 18.00001.40 | 10.22                   | Newer pulp & paper plant; pulp & paper warehouse                                 |
| 18.00034.00 | 10.66 <sup>20</sup>     | Capital stores warehouse, maintenance building, & open yard                      |
| 18.00038.00 | 5.00                    | Vacant (formerly coal bin #1)                                                    |

<sup>16</sup> Ex. 1, at 116; *see* Ex. 18, at 5 (Verso Paper Holdings LLC Form 10-K (filed Mar. 7, 2013, for the period ending Dec. 31, 2012, describing various grades of paper)).

<sup>17</sup> Ex. 1, at 26; Ex. A, at 8.

<sup>18</sup> The appraisals indicated different sizes for parcel 18.00001.00: 22.28 acres according to AIM’s appraiser, Mr. Browen (Ex. 1, at 26); 11.15 acres according to the County’s appraiser, Mr. Dodd (Ex. A, at 8). In post-trial briefing, AIM agreed the parcel is 11.15 acres. Pet’r’s Post Trial Br. 8-9.

<sup>19</sup> AIM’s appraiser calculated parcel 18.00001.03 to have a land area of 6.00 acres. Ex. 1, at 43. The County’s appraiser calculated the parcel to have an approximate land area of 5.42 acres. Ex. A, at 8. We credit the figure of 6.00 acres.

<sup>20</sup> AIM’s appraiser calculated parcel 18.00034.00 to have a land area of 10.66 acres. Ex. 1, at 43. The County’s appraiser calculated parcel 18.00034.00 to have a land area of 10.79 acres. Ex. A, at 8, 41. We credit the figure of 10.66 acres.

|             |                    |                               |
|-------------|--------------------|-------------------------------|
| 18.00038.03 | 3.71 <sup>21</sup> | Vacant (formerly coal bin #2) |
|-------------|--------------------|-------------------------------|

The remaining two parcels are located on the east side of the BNSF right-of-way, and include two office buildings, a security guard station, and associated parking:

|             |                    |                 |
|-------------|--------------------|-----------------|
| 18.00040.00 | 6.40               | Office property |
| 18.00071.00 | 3.59 <sup>22</sup> | Office property |

Paper has been made at the subject property since the early 1900s, with some of the buildings on the site dating back more than a century. For example, the building housing paper machines 1 and 2, the buildings associated with those machines, and the hydroelectric dam were constructed in 1905.<sup>23</sup> Paper machines 1 and 2 were replaced in 1960;<sup>24</sup> paper machine 3 was installed in 1982.<sup>25</sup> Additional improvements to the mill were made in 1982, including installation of a coating preparation area; a wood-yard; a wood-room; a pulp mill; a second steam power plant at the south end of the property; conveyors, supercalenders and winders; a large warehouse; and

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<sup>21</sup> AIM's appraiser calculated parcel 18.00038.03 to have a land area of 3.71 acres. Ex. 1, at 37. The County's appraiser, Mr. Dodd, calculated parcel 18.00038.03 to have a land area of 7.10 acres. Ex. A, at 8. At trial, Mr. Dodd conceded that he did not have a basis for his measurement of 7.10 acres. Tr. 256-57. We credit the figure of 3.71 acres.

<sup>22</sup> Petitioner's appraiser calculated parcel 18.00071.00 to have a land area of 4.73 acres. Ex. 1, at 43. Respondent's appraiser calculated parcel 18.00071.00 to have a land area of 3.59 acres. Ex. A, at 8. We credit the figure of 3.59 acres.

<sup>23</sup> See Ex. 1, at Addenda (Building Area Support and Calculations) (listing the structures on the site and the year in which each was built).

<sup>24</sup> Ex. A, at 27.

<sup>25</sup> Tr. 36.

waste treatment facilities.<sup>26</sup> Also in 1982, training facilities were constructed on the east side of the property, along with a bituminous surface parking lot.<sup>27</sup> In 2000, paper machine 3 underwent \$50 million in upgrades, including replacement of its headbox.<sup>28</sup> In October 2011, Verso determined machines 1 and 2 were inefficient and permanently idled them.<sup>29</sup> As of January 2, 2012, therefore, the mill had only one functioning paper machine, with a capacity of 600 tons per day.<sup>30</sup>

Generally, paper mills have heavy foundations, floors, and structural framing and require heavy utility service, including electrical and water.<sup>31</sup> In this case, the mill was powered in part by electricity generated by a hydroelectric dam at the north end of the property. The dam, which spans the Mississippi River between Benton and Stearns Counties, has a licensed nameplate generating capacity of 9.5 megawatts per hour (MWh) and an effective generating capacity of 8.5

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<sup>26</sup> Ex. A, at v; Ex. 1, at Addenda.

<sup>27</sup> Ex. A, at v.

<sup>28</sup> Ex. K, at 14 (unpaginated) (Sartell Mill Centennial brochure).

<sup>29</sup> Ex. A, at 17.

<sup>30</sup> Ex. A, at 17.

<sup>31</sup> Ex. A, at 15.

MWh.<sup>32</sup> The dam was originally constructed with 12 turbine bays but, as of the valuation date, only 11 of the bays were functional.<sup>33</sup>

### C. RECENT OWNERSHIP HISTORY OF THE SUBJECT PROPERTY

As we have indicated, paper has been made at the subject property since the early 1900s. As recited in Mr. Dodd's report, the plant initially produced newsprint, but was converted to the manufacture of ground-wood paper for books and magazines in the 1930s.<sup>34</sup> In 2006, Verso Paper acquired the subject property from its then-owner, International Paper Company.<sup>35</sup> In connection with the acquisition, Verso filed a certificate of real estate value (CRV) with Benton County indicating a purchase price for the real estate alone of \$25,280,800.<sup>36</sup>

On May 28, 2012, an explosion and ensuing fire at the facility killed one Verso employee and injured four others. The incident caused extensive damage to the paper warehouse on the

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<sup>32</sup> Ex. A, at vi. A hydroelectric dam's nameplate capacity is the maximum amount of electricity it can produce under ideal conditions, typically measured in megawatts per hour (MWh). Ex. 1, at 188. The effective capacity is the actual megawattage the dam is expected to produce. *Id.* Its nameplate and effective capacities notwithstanding, the subject dam was operating at an average of 3.3 MWh. Ex. 1, at 63.

<sup>33</sup> Ex. 1, at 182.

<sup>34</sup> Ex. A, at 27.

<sup>35</sup> Ex. A, at 29. According to the County's appraiser, Mr. Dodd, Verso did not immediately acquire title to parcel 18.00001.40 (underlying the number 3 paper machine). *Id.*, at 34. At the time, Mr. Dodd writes, that parcel was owned by a third party and leased to International Paper. *Id.* In 2007, according to Mr. Dodd, International Paper exercised its option to purchase parcel 18.00001.40 for approximately \$38.4 million and then conveyed the parcel to Verso by quit claim deed. *Id.*, at 34-35.

<sup>36</sup> Ex. A, at 33; Ex. 12 (Aug. 21, 2008 Certificate of Real Estate Value).

subject property and its contents, although apparently not to paper machine 3.<sup>37</sup> Operations at the subject property were halted. In August 2012, Verso announced the permanent closure of the facility.<sup>38</sup> In March 2013, Verso sold the subject property to petitioner AIM Development (USA), an acquisition, demolition, and redevelopment company, for \$12,500,000 in cash plus the assumption of certain liabilities.<sup>39</sup>

#### **D. PROCEDURAL HISTORY OF THE LITIGATION**

AIM Development timely appealed of the January 2, 2012 Benton County assessment of the subject property. We issued a scheduling order on March 16, 2015.<sup>40</sup> At trial, AIM Development presented testimony from Mr. Jeff McGlin, AIM's Vice President,<sup>41</sup> and Mr. Darren Browen, MAI.<sup>42</sup> The County presented testimony from Mr. Clay Dodd, MAI, ASA.<sup>43</sup> Each appraiser conducted a retrospective appraisal assuming the property was a "special purpose property;"<sup>44</sup> the highest and best use of the property as vacant was for industrial development and as improved was for continued use as a pulp and paper mill;<sup>45</sup> and separate valuation calculations

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<sup>37</sup> Ex. 1, at 38 (quoting a June 7, 2012 press release).

<sup>38</sup> Ex. 1, at 38 (quoting an August 2, 2012 press release).

<sup>39</sup> Ex. 8, at ¶ 3(a) (Asset Purchase Agreement between Verso and AIM Development).

<sup>40</sup> Sched. Order (March 16, 2015).

<sup>41</sup> Tr. 17.

<sup>42</sup> Tr. 108.

<sup>43</sup> Tr. 204.

<sup>44</sup> Ex. 1, at 17; Ex. A, at 16.

<sup>45</sup> Ex. 1, at 127-28; Ex. A, at iv.

were necessary for the hydroelectric dam.<sup>46</sup> Mr. Browen developed a sales comparison approach and cost approach but did not develop the income approach to valuation.<sup>47</sup> Mr. Dodd developed only the cost approach to valuation.<sup>48</sup> After trial, the parties filed proposed findings of fact and conclusions of law and post-trial briefs. Closing arguments were heard on January 10, 2017.

## II. BURDEN OF PROOF

The assessor's estimated market value is prima facie valid. *S. Minn. Beet Sugar Coop v. Cty. of Renville*, 737 N.W.2d 545, 557 (Minn. 2007) (citing Minn. Stat. §§ 271.06, subd. 6 & 272.06 (2016)). The petitioner may overcome the presumption of validity by introducing evidence that the assessor's estimated market value is incorrect. *Id.* at 558. We conclude that AIM Development presented sufficient evidence, through the testimony of Mr. Browen, to rebut the presumption.<sup>49</sup>

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<sup>46</sup> Ex. 1, at 182; Ex. A, at 154.

<sup>47</sup> Ex. 1, at 21.

<sup>48</sup> Ex. A, at 20-21.

<sup>49</sup> In fact, each appraiser came to a market value conclusion for the subject property significantly lower than the assessed value. Ex. 1, at 2; Ex. A, at ii. AIM argues that, having introduced Mr. Browen's appraisal into evidence, "accordingly, Petitioner has met its burden and overcome the assessment's presumptive validity." Pet'r's Post-Trial Br. 2- 3. To the extent AIM suggests that the introduction of *any* appraisal is sufficient to overcome prima facie validity, we disagree. As AIM acknowledges, the taxpayer must introduce "*substantial* evidence that the subject property's market value differs from the assessment." *Id.* at 2 (emphasis added); see *Conga Corp. v. Comm'r of Revenue*, 868 N.W.2d 41, 53 (Minn. 2015). In other words, to overcome the prima facie validity of the assessment, an appraisal must be (among other things) competent. In this case, Mr. Browen's appraisal is competent and constitutes the required substantial evidence.

When the presumption of validity is overcome, we determine the market value of the subject property based upon a preponderance of the evidence.<sup>50</sup> *Macy's Retail Holdings, Inc. v. Cty. of Hennepin*, Nos. 27-CV-07-07774 et al., 2011 WL 6117899, at \*2 (Minn. T.C. Nov. 28, 2011) (citing *The Pep Boys v. Cty. of Anoka*, Nos. C2-01-2780 et al., 2004 WL 2436350, at \*3 (Minn. T.C. Oct. 26, 2004)).

### III. HIGHEST AND BEST USE

“Appraisers must perform a highest and best use analysis when appraising commercial real estate.” *Berry & Co. v. Cty. of Hennepin*, 806 N.W.2d 31, 34 (Minn. 2011). “The highest and best use of a property is the one that is physically possible, legally permissible, financially feasible, and maximally productive.” *Menard, Inc. v. Cty. of Clay*, 886 N.W.2d 804, 811 (Minn. 2016) (citing *Cty. of Aitkin v. Blandin Paper Co.*, 883 N.W.2d 803, 810 (Minn. 2016)). Analysis of the highest and best use of a property is intended to “identify the most profitable, competitive use to which the subject property can be put.” Appraisal Institute, *The Appraisal of Real Estate* 331 (14th ed. 2013) (sometimes the Fourteenth Edition). A property’s highest and best use is defined as “[t]he reasonably probable use of property that results in the highest value.” *Id.* at 332. “If the value of the property as improved is greater than the value of the site as though vacant less demolition costs, the existing improvements contribute value to the property’s highest and best use, and the improvements should not be demolished at that time.” *Id.* at 346.

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<sup>50</sup> Curiously, AIM’s post-trial briefing asks us to conclude only that AIM “has overcome the prima facie validity of the assessment” and does not ask us to make a finding as to the actual market value of the subject property on the valuation date. See Pet’r’s Proposed Findings Fact Conclusions Law.

In this case, the parties' experts agree that the highest and best use of the subject property on the January 2, 2012, valuation date was continued use as a paper mill and hydroelectric dam.<sup>51</sup> We concur.<sup>52</sup>

#### IV. VALUATION

All property "shall be valued at its market value." Minn. Stat. § 273.11, subd. 1 (2016). Market value is defined as "the usual selling price at the place where the property to which the term is applied shall be at the time of assessment; being the price which could be obtained at a private sale or an auction sale . . . ." Minn. Stat. § 272.03, subd. 8 (2016).

There are three approaches—sales comparison, cost, and income—to determining market value. *See Equitable Life Assurance Soc'y of United States v. Cty. of Ramsey*, 530 N.W.2d 544, 552 (Minn. 1995). Although it is preferable to give weight to each of the approaches to value, under appropriate circumstances we can use a single approach to determine the value of the subject property. *Id.* at 554; *see also Nw. Racquet Swim & Health Clubs, Inc. v. Cty. of Dakota*, 557 N.W.2d 582, 587 (Minn. 1997). "The Court, however, is free to place greater or lesser emphasis on a particular method or methods of valuation." *Pep Boys*, 2004 WL 2436350 at \*3 (citing

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<sup>51</sup> *See* Ex. 1, at 10, 128; Ex. A, at 16, 19, 115-17. Both appraisers acknowledged that the coated paper making industry was in decline at the date of appraisal, but each ultimately concluded that this particular mill was not at the end of its economic life.

<sup>52</sup> AIM argues that the BNSF rail line "impacts the function and use of the property and, accordingly, impacts its value." Pet'r's Post-Trial Br. 7 ("The BNSF rail line confers an exceptional, long-term tarnish on this industrial property, a tarnish that is untypical for paper mills elsewhere. The rail line severely limits prospective development of the site to a use that can accommodate significant limitations on site access and respect the potential dangerousness of the arrangement."). We value the subject property, however, based on its highest and best use as of January 2, 2012, namely, continued use as a paper mill. Given its highest and best use, "prospective development" of the site is not a consideration here.

*Carson Pirie Scott & Co. (Ridgedale) v. Cty. of Hennepin*, 576 N.W.2d 445, 447 (Minn. 1998)).

As the Minnesota Supreme Court has recognized:

[R]eal estate appraisal is at best an imprecise art, and a tax court proceeding is not high-low arbitration where the decision maker must choose the figure submitted by one or the other party. The Tax Court brings its own expertise and judgment to the hearing, and its valuation need not be the same as that of any particular expert as long as it is within permissible limits and has meaningful and adequate evidentiary support.

*Montgomery Ward & Co., Inc. v. Cty. of Hennepin*, 482 N.W.2d 785, 791 (Minn. 1992).

Each appraiser came to a market value conclusion for the subject property lower than the assessed value.<sup>53</sup>

#### **A. VALUATION OF THE MILL PROPERTY**

The parties value the paper mill property and hydroelectric dam separately. We do the same. We begin with the value of the mill property, which both experts considered to encompass all of the structures on the subject land except for the dam, powerhouse, substation, and turbine generators.<sup>54</sup>

#### **1. INCOME CAPITALIZATION APPROACH**

The income capitalization approach uses a suitable discount rate to reduce the anticipated income stream of an income-producing property to its present value. *Ford Motor Co. v. Cty. of Ramsey*, Nos. C5-07-4696 et al., 2014 WL 3888226, at \*12 (Minn. T.C. Aug. 5, 2014), amended, 2014 WL 7277775 (Minn. T.C. Dec. 16, 2014) (citing *Equitable Life Assur. Soc'y*, 530 N.W.2d at 549; *see also Cont'l Retail, LLC v. Cty. of Hennepin*, 801 N.W.2d 395, 402

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<sup>53</sup> Ex. 1, at 2; Ex. A, at ii.

<sup>54</sup> Ex. 1, at 186; *see* Ex. A, at 150 (Mr. Dodd enumerating the structures considered part of the mill property).

(Minn. 2011) (“The income capitalization approach determines the value of income-producing property by capitalizing the income the property is expected to generate over a specific period of time at a specified capitalization yield rate.”). “Any property that has the potential to generate income can be valued using the income capitalization approach.” *Appraisal of Real Estate* 441. The income capitalization approach to value is based on the present value of future rights to income generated by a property, determined by capitalizing anticipated rents generated by the property at market rates less expenses of the property at market rates. *Macy’s Retail Holdings*, 2011 WL 6117899, at \*9 (citing *Space Ctr. Enters., Inc. v. Cty. of Ramsey*, Nos. C4-97-3360 & C4-98-3241, 1999 WL 1018098, at \*4 (Minn. T.C. Nov. 4, 1999)). Meaningful application of the income capitalization approach requires reliable estimates of income and expenses of the subject property and of market rents for competitive income-producing properties. *Appraisal of Real Estate* 463-67.

Neither appraiser used the income approach for the Sartell mill because, in the absence of either rentals of comparable mills or sales of mills with tenants in place, it would not have developed a credible opinion of market value.<sup>55</sup> We agree, and do not reach a value for the mill property under the income approach.

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<sup>55</sup> See Ex. 1, at 21 (Mr. Browen opining that “[t]he Income Approach would have been difficult to complete given the lack of comparable rentals and also sales of paper mill properties with tenants in place from which to extract a going-in capitalization rate.”); Ex. A, at 21 (Mr. Dodd explaining that “[t]he income approach was considered but not performed. Plants such as the subject are normally occupied by the owner, or a closely related entity. The appraiser is not aware of any arm’s length leases between unrelated parties involving paper mills which are similar to the subject.”). Mr. Dodd used an abbreviated income analysis to calculate economic obsolescence. Ex. A, at 22.

## 2. SALES COMPARISON APPROACH

The sales comparison approach assumes, among other things, “that the value of property tends to be set by the cost of acquiring a substitute or alternative property of similar utility and desirability within a reasonable amount of time.” *Appraisal of Real Estate* 379; see *Equitable Life Assur. Soc’y*, 530 N.W.2d at 552 (observing that the sales comparison approach “is based on prices paid in actual market transactions involving comparable properties”). Application of the sales comparison approach requires analysis of recent sales of other properties to determine the comparability of those properties to the subject property, and adjustment of their sale prices as necessary for such features as age, size, location, and condition to make those properties comparable to the subject property. *Appraisal of Real Estate* 381-82. The reliability of this approach therefore depends on the availability of sales information for other properties, and on the comparability of those properties to the subject. *Id.* at 380.

### a. Mr. Browen’s Sales Comparisons

To develop his sales comparison approach, Mr. Browen searched for sales of other paper mills.<sup>56</sup> He refined his analysis by using sales between June 2011 and January 2015 of six paper mills located in Wisconsin, Minnesota, and Maine (including the sale of the subject property in

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<sup>56</sup> See Ex. 1, at 149-177. Mr. Browen also searched the general marketplace for sales of large manufacturing plants near the subject property in Minnesota. See Ex. 1, at 148-153. He did not consider these plants in his final sales comparison approach but provided the details as additional data and for informational purposes. Ex. 1, at 153. Mr. Browen hypothesized that, but for the subject property’s specialized use (i.e., required adjustments for highest and best use), it would have sold much along the lines of these large manufacturing plants, that is, between \$3.00 and \$6.00 per square foot of usable building area. Ex. 1, at 153.

March 2013) and one withdrawn offer.<sup>57</sup> Mr. Browen distinguished between properties sold for continued paper production and properties sold for demolition or for an alternative use.<sup>58</sup> In addition, because only some of the comparable paper mills had hydroelectric plants, Mr. Browen adjusted the sale price of the comparable mills as though the subject property also lacked a hydroelectric plant.<sup>59</sup>

#### **(1) Paper Mills Sold for Demolition**

Mr. Browen examined four sales of paper mills that were sold for demolition, including the 2013 sale of the subject property to petitioner AIM.

##### **(a) Kimberly Newpage Mill**

The Newpage paper mill, located on 94.21 acres in Kimberly, Wisconsin, was sold for demolition on June 30, 2011.<sup>60</sup> According to Mr. Browen, the Kimberly mill had three paper machines with a total capacity of 678,000 tons of coated freesheet and coated specialty papers per year; its three machines had been idled indefinitely as of July 2008.<sup>61</sup> The mill included a rail spur but no pulp mill.<sup>62</sup> It was sold to AIM Demolition (USA), LLC (an affiliate of petitioner AIM),

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<sup>57</sup> Ex. 1, at 177, 181.

<sup>58</sup> Ex. 1, at 177.

<sup>59</sup> Ex. 1, at 149.

<sup>60</sup> Ex. 1, at 156-57.

<sup>61</sup> Ex. 1, at 156. Mr. Browen determined two of the paper machines were modern machines contributing 546,000 tons of paper to the overall plant capacity.

<sup>62</sup> Ex. 1, at 156. The Kimberly hydroelectric dam sold in March 2010, before the sale of the mill itself. *Id.*, at 157. Accordingly, Mr. Browen did not subtract the value of the dam from the mill's June 2011 sale price. *Id.*, at 177.

for a total of \$8,637,500.<sup>63</sup> Mr. Browen reduced the sale price by his estimate of the furniture, fixtures, and other equipment (FF&E) included in the sale but increased it for an smaller land-to-building ratio, arriving at a final adjusted sales price of \$4,798,131 (\$4.37 per square foot of first-floor area; \$3.09 per square foot of usable area).<sup>64</sup>

**(b) Brainerd Wausau Mill**

The Brainerd Wausau paper mill, located on 81.92 acres in Brainerd, Minnesota, was sold for demolition on August 13, 2014.<sup>65</sup> According to Mr. Browen, this paper mill had two paper machines with a combined capacity of 182,000 tons of paper per year.<sup>66</sup> Although neither machine was modern, seller Wausau Paper had invested \$27 million in 2011 to rebuild them and to convert them to making coated specialty paper.<sup>67</sup> The mill closed in April 2013, when Wausau left the specialty paper market.<sup>68</sup> The mill included a rail spur but no pulp mill.<sup>69</sup> It was sold to the Brainerd Industrial Center, LLC for a total of \$1,600,000.<sup>70</sup> Mr. Browen adjusted the sale price

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<sup>63</sup> Ex. 1, at 156.

<sup>64</sup> Ex. 1, at 177.

<sup>65</sup> Ex. 1, at 160-62.

<sup>66</sup> Ex. 1, at 161.

<sup>67</sup> Tr. 119; Ex. 1, at 162. Coated specialty paper is used in food packaging, among other things. Ex. 1, at 162.

<sup>68</sup> Ex. 1, at 162.

<sup>69</sup> Ex. 1, at 161. The Wausau Mill hydroelectric dam was sold to the City of Brainerd in July 2014, before the sale of the mill itself. *Id.*, at 162. Accordingly, Mr. Browen did not subtract the value of the dam from the mill's August 2014 sale price. *Id.*, at 177.

<sup>70</sup> Ex. 1, at 161.

for its inferior location compared to the subject property and for its larger land-to-building ratio, arriving at a final adjusted sale price of \$1,312,000 (\$3.28 per square foot of first-floor area; \$2.05 per square foot of usable area).<sup>71</sup>

(c)      **Sartell Verso Mill**

The subject property, located on 69.50 acres, was sold for demolition in March 2013.<sup>72</sup> Mr. Browen analyzed the subject property as having only one paper machine, with the capacity to produce 215,000 tons of coated ground-wood and supercalendered paper per year.<sup>73</sup> The mill included a rail spur, pulp mill, hydroelectric dam, ash disposal site, and two permanently idled paper machines.<sup>74</sup> It was sold to petitioner AIM Development for a total of \$12,500,000.<sup>75</sup> Mr. Browen made adjustments to the sale price for FF&E, the hydroelectric dam, and accompanying ash disposal site, arriving at an adjusted sale price for the mill itself of \$3,240,000 (\$5.34 per square foot of first-floor area; \$3.60 per square foot of usable area).<sup>76</sup>

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<sup>71</sup> Ex. 1, at 177.

<sup>72</sup> Ex. 1, at 164.

<sup>73</sup> Ex. 1, at 164.

<sup>74</sup> Ex. 1, at 164-65.

<sup>75</sup> Ex. 1, at 164. Mr. Browen testified that he used this sale to form a “salvage buyer’s perspective as the minimum value a market participant would have paid as of the valuation date.” Tr. 118.

<sup>76</sup> Ex. 1, at 164.

**(d) Port Edwards Domtar Mill**

The Domtar paper mill located on 192 acres in Port Edwards, Wisconsin, was sold for demolition on March 22, 2013.<sup>77</sup> Although Mr. Browen had no information on the number of paper machines or the mill's paper production capacity per year at the time of purchase, he was aware that, before its closing in 2008, the mill had a production capacity of 200,000 tons per year.<sup>78</sup> The mill included a rail spur and pulp mill.<sup>79</sup> Domtar A.W., LLC sold the mill to DMI Acquisitions, LLC, for \$10,000,000.<sup>80</sup> Mr. Browen made adjustments for FF&E, location, and land-to-building ratio to reach a final adjusted sale price of \$5,200,000 (\$6.25 per square foot of first-floor area; \$4.62 per square foot of usable area).<sup>81</sup>

**(2) Mills Sold For Continued Use**

Mr. Browen located only two paper mills sold on or around the valuation date for continued use as paper mills: Biron, Wisconsin; and Rumford, Maine. The Biron paper mill is located on 79.40 acres in Biron, Wisconsin.<sup>82</sup> According to Mr. Browen, the Biron mill had two modern paper machines capable of producing 355,000 tons of coated ground-wood paper.<sup>83</sup> The mill sale

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<sup>77</sup> Ex. 1, at 166-68.

<sup>78</sup> Ex. 1, at 167.

<sup>79</sup> Ex. 1, at 167. The hydroelectric dam was not included in the sale, seller Domtar having retained the dam to provide power to one of its nearby mills. *Id.*, at 168.

<sup>80</sup> Ex. 1, at 167.

<sup>81</sup> Ex. 1, at 177.

<sup>82</sup> Ex. 1, at 170.

<sup>83</sup> Ex. 1, at 170.

included a rail spur but no hydroelectric dam or pulp mill.<sup>84</sup> The Rumford mill is located on 117.60 acres in Rumford, Maine.<sup>85</sup> According to Mr. Browen, the Rumford mill had three modern paper machines capable of producing 515,000 tons of coated ground-wood, coated freesheet, and coated specialty paper.<sup>86</sup> The Rumford mill included a rail spur and pulp mill but no hydroelectric dam.<sup>87</sup> Each was sold by Newpage to resolve antitrust litigation brought against Newpage by the U.S. Department of Justice. *See United States v. Verso Paper Corp.*, Case No. 1:14-cv-2216 (TSC), 2015 WL 9991580, at \*1-2 (D.D.C. Dec. 11, 2015) (ordering Verso to divest itself of one mill and Newpage to divest itself of two mills).

The two mills sold for a combined price of \$62.4 million plus assumption of \$94.5 million in liabilities.<sup>88</sup> To arrive at the price paid for each mill individually, Mr. Browen relied on the buyer's allocation of the purchase price.<sup>89</sup> According to Mr. Browen, buyer Catalyst determined the total fair value of the assets acquired in the purchase was \$194 million, of which Catalyst allocated a total of \$77.4 million to property, plant, and equipment.<sup>90</sup> Mr. Browen in turn allocated that \$77.4 million between the Biron and Rumford mills based on relative production

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<sup>84</sup> Ex. 1, at 170, 172.

<sup>85</sup> Ex. 1, at 174.

<sup>86</sup> Ex. 1, at 174.

<sup>87</sup> Ex. 1, at 174, 176.

<sup>88</sup> Ex. 1, at 171, 175.

<sup>89</sup> Ex. 1, at 171.

<sup>90</sup> Ex. 1, at 171.

capacity: \$31,746,317 (41%) to the Biron mill and \$45,683,724 (59%) to the Rumford mill.<sup>91</sup> Mr. Browen made adjustments to each amount for FF&E, market conditions, location, and land-to-building ratio.<sup>92</sup> He determined an adjusted sale price for the Biron mill of \$5,690,329 (\$7.79 per square foot of first-floor space; \$4.57 per square foot of usable area).<sup>93</sup> For the Rumford mill, Mr. Browen arrived at an adjusted sale price of \$9,220,689 (\$8.78 per square foot of first-floor space; \$5.36 per square foot of usable area).<sup>94</sup>

### (3) Offer to Purchase (Kimberly New Page)

Finally, Mr. Browen considered an offer (eventually withdrawn) to purchase the Newpage mill in Kimberly, Wisconsin, for continued use as a paper mill.<sup>95</sup> According to Mr. Browen, the offer was “about \$4 million higher than the price that AIM Demolition USA, LLC acquired the property for,” or about \$12,000,000.<sup>96</sup> Mr. Browen adjusted the offer upward for “conditions of sale” and downward for FF&E, resulting in a final adjusted offer of \$8,925,638 (\$8.13 per square foot of first-floor area; \$5.75 per square foot of usable area).<sup>97</sup>

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<sup>91</sup> Ex. 1, at 171.

<sup>92</sup> Ex. 1, at 177.

<sup>93</sup> Ex. 1, at 177.

<sup>94</sup> Ex. 1, at 177.

<sup>95</sup> Ex. 1, at 157.

<sup>96</sup> Ex. 1, at 157. AIM Development USA, LLC, eventually acquired the Kimberly mill for \$8,637,500. *Id.*, at 156.

<sup>97</sup> *See* Ex. 1, at 177.

#### (4) Mr. Browen's Conclusions

After applying the above adjustments and making the requisite calculations, Mr. Browen concluded that a buyer purchasing the mill for salvage would pay \$4.50 to \$6.25 per square foot of first-floor area (\$3.00 to \$4.50 per square foot of usable area).<sup>98</sup> Mr. Browen concluded that a buyer purchasing the mill for continued use as a paper mill would pay \$8.00 to \$8.50 per square foot of first-floor area (\$5.00 to \$5.50 per square foot of usable area).<sup>99</sup> Giving "more emphasis" to sales for continued use, Mr. Browen arrived at an indicated market value of the subject property of \$8.25 per square foot of first-floor building area (\$5.50 per square foot of usable area) for a total value for the mill property of \$5,000,000.<sup>100</sup>

#### b. Dodd Sales Comparisons

Mr. Dodd considered, but did not fully develop, the sales comparison approach, determining that "[a]ny useful sales involve the transfer of an entire plant, as equipped. Thus, sales of operable paper mills include substantially more than the real property . . . ." <sup>101</sup> Mr. Dodd indicated that, in this case, a sales comparison approach was particularly difficult: many of the

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<sup>98</sup> Ex. 1, at 181.

<sup>99</sup> Ex. 1, at 181.

<sup>100</sup> Ex. 1, at 181.

<sup>101</sup> Ex. A, at 21. AIM criticizes Mr. Dodd for not applying the sales comparison approach, calling his analysis "incomplete." Pet'r's Post-Trial Br. 2; *see also Id.* at 13 ("Mr. Dodd performed a market value appraisal of the subject without considering its market."). We disagree. "[I]t is not error for a court to rely exclusively on the cost approach when valuing special purpose property." *S. Minn. Beet Sugar*, 737 N.W.2d at 556; *see also American Express Fin. Advisors Inc. v. Cty. of Carver*, 573 N.W.2d 651, 657 (Minn. 1998) (noting that "the very nature of special purpose property is such that market value cannot readily be determined by the existence of an actual market") (citation omitted).

recent sales of comparable properties were “not relevant to appraising a paper mill whose highest and best use is to continue to function as a paper mill” because (1) the plant was not operating at the time of the sale; (2) the sale involved multiple facilities, thereby requiring allocation of the purchase price; or (3) the sale required closure of the facility.<sup>102</sup>

**c. Discussion**

For several reasons, we give Mr. Browen’s analysis under the sales comparison approach little or no weight.

**(1) Unit of comparison**

The sales comparison approach requires the appraiser to “[s]elect the most relevant units of comparison used by participants in the market . . . and develop a comparative analysis for each unit . . . that explains market behavior.” *Appraisal of Real Estate* 382. The particular unit of comparison selected “depend[s] on the appraisal problem and nature of the property.” *Id.* at 386.

In this case, Mr. Browen’s unit of comparison was price per square foot of first- and second-floor or of usable building area.<sup>103</sup> The record indicates, however, the appropriate unit for valuing paper mills for continued operation is price per ton of production capacity. In making this determination, we rely on the materials prepared by Verso Paper to market the mill for sale in 2012.<sup>104</sup> Those materials indicate the size of the mill site (60.6 acres) and the production capacity of each of the three paper machines, but say nothing about the square footage of any of the

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<sup>102</sup> Tr. 224; Ex. A, at 21.

<sup>103</sup> Ex. 1, at 148.

<sup>104</sup> Tr. 50-51; Ex. 4 (Sartell Mill Confidential Information Memorandum (undated)).

structures, much less their first-floor or usable areas.<sup>105</sup> We also note that in allocating the price paid by Catalyst between the Biron and Rumford mills, Mr. Browen used relative production capacity, rather than square footage of the structures acquired.<sup>106</sup>

**(2) Difference in highest and best use**

“A major premise of the sales comparison approach is that an opinion of the market value of a property can be supported by studying the market’s reaction to comparable and competitive properties.” *Cont’l Retail*, 801 N.W.2d at 402 (quotations omitted). To qualify as a “comparable” property, “the highest and best use of the properties should be very similar, if not the same, as that of the subject property.” *Appraisal of Real Estate* 423. Both appraisers opined that the highest and best use of the Sartell mill as of January 2, 2012, was continued use as a paper mill. Accordingly, the sales comparison approach should be limited to market sales of properties that are intended to continue operation following the sale; if sold for an alternative use, the sales price must be adjusted accordingly. *See Appraisal of Real Estate* 423 (noting that “comparable

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<sup>105</sup> See Ex. 4. We cannot conclude that the Verso materials were prepared strictly to market the subject property for salvage. For example, the materials specifically indicate that all permits required to operate the mill (such as air emission, wastewater discharge, water appropriation, and liquid storage) are still in force—matters of little interest to someone seeking to purchase the mill solely for its land or for some alternative use. *See id.*

<sup>106</sup> Ex. 1, at 171. Although Mr. Dodd did not develop an opinion of value under the sales comparison approach, he indicated that because mills are typically sold as “entire businesses,” the appropriate unit of comparison would be price per ton of paper production. Ex. A, at 21.

Using Mr. Browen’s adjusted sale prices for the Biron and Rumford mills, and dividing each by the production capacity of the mill, we arrive at an adjusted sale price of \$16.03 per ton for the Biron mill (\$5,690,329/355,000) and \$17.90 per ton for the Rumford mill (\$9,220,689/515,000). *See Ex. 1*, at 171, 177.

properties with a different current or highest and best use may be analyzed and the sales prices may be adjusted accordingly”).

Four of the paper mills used by Mr. Browen as comparables (Kimberly Newpage, Brainerd Wausau, Sartell Verso, and Port Edwards Domtar) were sold for demolition, rather than for continued use as a paper mill.<sup>107</sup> Mr. Browen made no adjustments for the difference in their highest and best use, although the record is clear that mills sold for continued use sold at higher prices than mills sold for demolition. Without an adjustment for the difference in their highest and best use, these properties cannot be considered reliable indicators of the value of the subject property, and we give them no weight in our analysis.

### **(3) Atypical conditions of sale**

The sales of the Biron and Rumford mills used by Mr. Browen were consistent with the highest and best use of the subject property, but fail as comparable sales because they cannot be considered market transactions.

The definition of “market value” requires typically motivated buyers and sellers with no pressure on either party to consummate the sale. *Appraisal of Real Estate* 410. “[A]typically motivated sales are not considered arm’s-length transactions.” *Id.* In this case, the Rumford and Biron mills were sold as part of the settlement of antitrust litigation brought by the federal government. *See Verso Paper*, 2015 WL 9991580, at \*2 (requiring Newpage to first offer the Rumford and Biron mills to Catalyst and, if not purchased by Catalyst, to “promptly [] make known, by usual and customary means, the availability of the [Rumford and Biron] Mills for sale”). To resolve the antitrust litigation, Newpage was further required to “inform any person making

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<sup>107</sup> Ex. 1, at 157, 162, 165, 168.

inquiry regarding a possible purchase of the [Rumford and Biron] Mills that they are being divested pursuant to this Final Judgment and provide that person with a copy of this Final Judgment.” *Id.* at \*2. Newpage and Verso had no more than 70 days in which to reach an agreement with Catalyst, after which the court would (at the government’s request) appoint a trustee of its choosing “to effect the divestiture of the [Rumford and Biron] Mills” at a price to which Newpage and Verso essentially could not object. *Id.* at \*4.

The circumstances of the sales of the Rumford and Biron mills to Catalyst do not suggest typical motivations, at least for seller Newpage. Indeed, the record indicates that Catalyst paid far less than the market value of the two mills.<sup>108</sup>

#### **(4) Portfolio sales**

According to Mr. Browen, the Biron and Rumford mills were sold for the lump sum of \$62.4 million plus assumption of liabilities, requiring him to allocate the consideration paid between the two properties.<sup>109</sup> Mr. Browen did so on the basis of relative production capacity, allocating 41% of the sale price to the Biron mill and 59% of the sale price to the Rumford mill.<sup>110</sup>

On several occasions, we have discussed the problem of relying on sales of portfolios of properties in the sales comparison approach. We have said that “[a]llocations from portfolio sales are generally not reliable indicators of value.” *Federated Retail Holdings, Inc. v. Cty. of Ramsey*, Nos. 62-CV-08-5061 & C0-07-4069, 2011 WL 3821296, at \*11 (Minn. T.C. Aug. 23, 2011), *rev’d on other grounds*, 820 N.W.2d 553 (Minn. 2012). Indeed, we have declined to treat a portfolio

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<sup>108</sup> See Ex. 1, at 171 (Mr. Browen indicating that Catalyst paid only \$156.9 million (\$62.4 million plus assumed liabilities of \$94.5 million) for assets with a fair value of \$194 million).

<sup>109</sup> Ex. 1, at 171.

<sup>110</sup> Ex. 1, at 171.

sale as a real estate transaction “unless there is a separate real estate contract specifying an agreed-upon sale price of the property conveyed.” *Am. Crystal Sugar Co. v. Cty. of Polk*, Nos. C3-05-575 & CX-06-373, 2009 WL 2431389, at \*11 (Minn. T.C. Aug. 5, 2009) (internal quotation omitted). But we have not declined to consider a portfolio sale altogether; rather, we have announced standards for deriving the price paid for the real property from the sale of the business itself:

The factors we will examine include: (1) how the portion of the overall purchase price allocated to real estate was determined; (2) whether there was an appraisal upon which the allocation was based; (3) who did the appraisal; (4) what was the basis of the appraisal; (5) evidence and testimony, if any, that tends to support or rebut the values listed in the [certificate of real estate value] and (6) evidence, if any, that extraneous considerations influenced the allocation amount.

*Jennie-O Foods v. Cty. of Stearns*, Nos. C8-99-1236R & C5-00-1332R, 2000 WL 1733568, at \*3 (Minn. T.C. Nov. 21, 2000) (citing *Richfield-Bloomington Honda v. Cty. of Hennepin*, No. TC-9351, 1990 WL 126613 (Minn. T.C. Aug. 29, 1990)).

In this case, we have Catalyst’s allocation of the purchase price among the categories of assets acquired, but no information about the specific allocation to real estate.<sup>111</sup> Nor do we know whether the allocation (if there was one) was based on an appraisal, much less who conducted the appraisal or the basis on which it was conducted. Without more information, we decline to consider the sales of either the Biron or Rumford mills.

**d. Conclusion under the sales comparison approach**

That leaves only the withdrawn offer for the Kimberly mill from which to make a determination of value under the sales comparison approach. We decline to do so, for several reasons. First, the offer never matured into an actual sale and, in fact, was eventually withdrawn.

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<sup>111</sup> Ex. 1, at 172 (Mr. Brown indicating that Catalyst’s specific allocation to real property “was not available”).

Second, we lack information about the reasons for the withdrawal of the offer, and therefore can draw no conclusions about value from it. Third, even if we had that information, we would decline to make a determination of value on the basis of a single comparable property. We therefore decline to make any determination of value under the sales comparison approach.

### 3. COST APPROACH

“In the cost approach, a property is valued based on a comparison with the cost to build a new or substitute property. The cost estimate is adjusted for the depreciation evident in the existing property.” *Appraisal of Real Estate* 561. The cost approach is based on the concept that “an informed buyer would pay no more for the property than the cost of constructing new property having the same utility.” *Equitable Life Assur. Soc’y*, 530 N.W.2d at 552. “Under the cost approach, the market value of the subject property is determined by adding the land value and the replacement cost of the improvements, less depreciation and reductions for functional and external obsolescence.” *Guardian Energy, LLC v. Cty. of Waseca*, Nos. 81-CV-10-365 et al., 2014 WL 7476215, \*14 (Minn. T.C. Dec. 9, 2014) *aff’d in part, rev’d in part on other grounds*, 868 N.W.2d 253 (Minn. 2015) (citing *Am. Crystal Sugar Co. v. Cty. of Polk*, Nos. C1-05-574 & C4-06-367, 2009 WL 2431376, at \*16 (Minn. T.C. Aug. 5, 2009)).

Having concluded that neither the sales comparison approach nor the income approach can be used for this special-purpose property, the cost approach is the only remaining approach to value. Although appraisers should apply at least two approaches to value, we can rely exclusively on the cost approach in valuing special-purpose property. *S. Minn. Beet Sugar*, 737 N.W.2d at 556 (citing *Fed. Reserve Bank of Minneapolis v. State*, 313 N.W.2d 619, 623–24 (Minn. 1981)); *see also In re McCannel*, 301 N.W.2d 910, 924 (Minn. 1980) (noting that “[t]he very nature of special

purpose property is such that market value cannot readily be determined by the existence of an actual market”).

Mr. Dodd structured his cost approach by breaking the facility into parts, building by building or function by function, to achieve an overall value of the subject property; distinguishing between above- and below-grade areas; assigning a cost; and applying adjustments accordingly. Mr. Browen determined his cost approach value by viewing the subject property as a single economic unit with an effective age of 40 years; adjusting the replacement cost (new) based upon usable area; assigning a cost based on class of space; and applying adjustments accordingly.<sup>112</sup>

**a. Land Valuation**

“In the cost approach, the estimated market value of the land or site is added to the depreciated cost of the improvements.” *Appraisal of Real Estate* 569. The value of the land depends on the highest and best use of both the subject property and comparable property. *Id.* Each appraiser selected comparable fee-simple land sales to conduct a land sales comparison.<sup>113</sup> In using the sales comparison approach for land value, each appraiser estimated the market value of the subject land, as vacant, as of the date of appraisal.<sup>114</sup>

The parties differed on the sizes of five of the parcels constituting the subject property. Mr. Dodd calculated a total site size of 59.97 acres;<sup>115</sup> Mr. Browen calculated a total site size of 57.87

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<sup>112</sup> Tr. 146, 156.

<sup>113</sup> Ex. 1, at 130; Ex. A, at 121.

<sup>114</sup> Ex. 1, at 130; Ex. A, at 121.

<sup>115</sup> Ex. A, at iv.

acres.<sup>116</sup> As explained above, we determine that the gross land area of the subject property is 56.73 acres.<sup>117</sup>

### (1) Browen's Approach

Mr. Browen selected three properties, each intended for industrial use, that he determined to be comparable to the subject property.<sup>118</sup> Mr. Browen assumed that the entire gross land area of Comparables 1 and 3 was usable, but that only a portion of Comparable 2 was usable. Mr. Browen then determined a "usable area" for the subject property in arriving at his ultimate land value.<sup>119</sup>

#### (a) Browen Land Sale 1

Land sale 1 is an irregularly shaped 53.69-acre site located along the south frontage road of Interstate 94 in St. Joseph Township, Minnesota.<sup>120</sup> The property sold in September 2010 for \$2,338,736 or \$1.00 per square foot of gross land area.<sup>121</sup> The site was purchased for construction of an electrical power substation.<sup>122</sup> The property was not placed on the open market,

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<sup>116</sup> Pet'r's Post-Trial Br. 10. Petitioner originally calculated the gross land area as 69.00 acres but, after further examination, corrected this value. See Ex. 1, at 26; Pet'r's Post-Trial Br. 9.

<sup>117</sup> See *supra* notes 26-30 (reconciling parcel sizes).

<sup>118</sup> Ex. 1, at 135. Mr. Browen states two different sale dates for land sale 3: July 2012 (Ex. 1, at 135) and "Sep-12" (Ex. 1, at 134). This was not clarified during the trial.

<sup>119</sup> Ex. 1, at 135.

<sup>120</sup> Ex. 1, at 132.

<sup>121</sup> Ex. 1, at 132, 135. Mr. Browen used the same square footage for both gross land area and usable land area. *Id.*, at 132.

<sup>122</sup> Ex. 1, at 132, 135.

the buyer and seller having privately agreed to the price.<sup>123</sup> Mr. Browen made no adjustment for this condition of sale, but concluded its location was superior to that of the subject property and made a 10% downward adjustment to its sale price.<sup>124</sup> Mr. Browen thus arrived at an adjusted sale price of \$0.91 per square foot.<sup>125</sup>

**(b) Browen Land Sale 2**

Land sale 2 is an irregularly shaped 51.94-acre site located just south of Interstate 94 in St. Joseph, Minnesota.<sup>126</sup> The property sold in October 2010 for \$282,000, or \$0.32 per square foot of gross land area.<sup>127</sup> The site was purchased to construct an office/warehouse/shop building with outdoor storage.<sup>128</sup> This property has a significantly smaller proportion of usable land area than the other comparable properties or the subject property due to wetlands.<sup>129</sup> Mr. Browen made no additional adjustments for land use conditions, but concluded the location was superior to that of the subject property and made a corresponding 10% downward adjustment, arriving at an adjusted sale price of \$0.29 per square foot of usable area.<sup>130</sup>

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<sup>123</sup> Ex. 1, at 132.

<sup>124</sup> Ex. 1, at 135.

<sup>125</sup> Ex. 1, at 135.

<sup>126</sup> Ex. 1, at 133.

<sup>127</sup> Ex. 1, at 133. Mr. Browen used different square footages for gross land area (2,262,506 square feet) and usable land area (871,200 square feet). *Id.*, at 132.

<sup>128</sup> Ex. 1, at 133.

<sup>129</sup> Ex. 1, at 132-135.

<sup>130</sup> Ex. 1, at 135.

**(c) Brown Land Sale 3**

Land sale 3 is a rectangular 18.34-acre parcel on 35th Avenue South, southeast of Minden Township, Minnesota.<sup>131</sup> The property sold in July 2012 for \$160,000, or \$0.20 per square foot of gross land area.<sup>132</sup> An overhead power line easement limits the use of the northern portion of the property.<sup>133</sup> Mr. Brown adjusted the price upward by 25% to account for its inferior location, arriving at an adjusted sale price of \$0.27 per square foot of gross land area.<sup>134</sup>

Mr. Brown's calculation resulted in an overall average sale price of \$0.49 per square foot of gross land area of the comparable land sales.<sup>135</sup> Inexplicably, however, Mr. Brown used the figure of \$0.75 per square foot to value the subject property.<sup>136</sup>

**(2) Dodd's Approach**

Mr. Dodd selected for his land-sale analysis five fee-simple sales with typical conditions of sale and cash financing that sold between July 2008 and August 2011.<sup>137</sup>

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<sup>131</sup> Ex. 1, at 134.

<sup>132</sup> Ex. 1, at 134. Mr. Brown used the same square footage for both gross land area and usable land area. *Id.*, at 134.

<sup>133</sup> Ex. 1, at 134.

<sup>134</sup> Ex. 1, at 135.

<sup>135</sup> Ex. 1, at 135.

<sup>136</sup> Ex. 1, at 137.

<sup>137</sup> Ex. A, at 129.

**(a) Dodd Land Sale 1**

Land sale 1 is a 7.21-acre parcel on Heatherwood Road in St. Cloud, Minnesota.<sup>138</sup> The property sold in August 2011 for \$784,862, or \$2.50 per square foot.<sup>139</sup> Mr. Dodd added to the purchase price \$286,000 of special assessments for a total purchase price of \$1,070,862, or \$3.41 per square foot.<sup>140</sup> Mr. Dodd adjusted this sale price downward by 30% for the property's superior location; downward by 20% for its smaller size; downward by 10% for its rectangular shape; and downward by 10% for its superior access, for an indicated value of \$1.53 per square foot.<sup>141</sup>

**(b) Dodd Comparable No. 2**

Land sale 2 is a 51.94-acre parcel located west of Brockton Lane in Rogers, Minnesota.<sup>142</sup> The property sold in February 2011 for \$2,100,000 or \$0.928 per square foot.<sup>143</sup> Mr. Dodd adjusted the property's sale price downward by 10% for its superior location; downward by 10% for its rectangular shape; downward by 10% for its superior access; but upward by 10% for its rolling terrain, for an indicated value of \$0.82 per square foot.<sup>144</sup>

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<sup>138</sup> Ex. A, at 123.

<sup>139</sup> Ex. A, at 123. Mr. Dodd calculated the sales price of each comparable property on a per-acre basis; we present the sale on a square-foot basis to facilitate comparisons with Mr. Browen's approach.

<sup>140</sup> Ex. A, at 123.

<sup>141</sup> Ex. A, at 128.

<sup>142</sup> Ex. A, at 124.

<sup>143</sup> Ex. A, at 124.

<sup>144</sup> Ex. A, at 128.

**(c) Dodd Land Sale 3**

Land sale 3 is an 80.20-acre parcel located on County Road 15 Northwest in Big Lake, Minnesota.<sup>145</sup> The property sold in August 2010 for \$2,077,500 or \$0.5947 per square foot.<sup>146</sup> Mr. Dodd adjusted the property's sale price upward by 20% for its larger size; downward by 10% for its rectangular shape; downward by 10% for its superior access; and upward by 20% for its lack of public utilities, for an adjusted sale price of \$0.67 per square foot.<sup>147</sup>

**(d) Dodd Land Sale 4**

Land sale 4 is a 10-acre parcel located on Fifth Street South in Waite Park, Minnesota.<sup>148</sup> The property sold in July 2010 for \$653,400, or \$1.50 per square foot.<sup>149</sup> Mr. Dodd adjusted its sale price downward by 10% for its superior location; downward by 15% for its smaller size; downward by 10% for its rectangular shape; downward by 10% for its superior access; and upward by 5% for its lack of public utilities, for an adjusted sale price of \$1.15 per square foot.<sup>150</sup>

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<sup>145</sup> Ex. A, at 125.

<sup>146</sup> Ex. A, at 125.

<sup>147</sup> Ex. A, at 128.

<sup>148</sup> Ex. A, at 126.

<sup>149</sup> Ex. A, at 126.

<sup>150</sup> Ex. A, at 128.

**(e) Dodd Land Sale 5**

Land sale 5 is an 8.71-acre parcel located on Roosevelt Road in St. Cloud, Minnesota.<sup>151</sup> The property sold in July 2008 for \$925,000, or \$2.44 per square foot of gross land area.<sup>152</sup> Mr. Dodd adjusted its sale price downward by 30% for its superior location; downward by 20% for its smaller size; downward by 10% for its rectangular shape; downward by 10% for its superior access; and upward by 10% for its lack of public utilities, for an adjusted sale price of \$0.98 per square foot.<sup>153</sup>

The average adjusted sale price of Mr. Dodd's comparables was \$44,885 per acre (about \$1.03 per square foot). Mr. Dodd arrived at an estimated market value for the subject land of \$45,000 per acre (about \$1.03 per square foot).<sup>154</sup>

**(3) Discussion**

**(a) Unit of comparison**

To make the sale prices of comparable properties truly meaningful, they must be calculated on the same basis, whether gross square footage or usable square footage. *Appraisal of Real Estate* 386. Mr. Brown calculated the sale price of his land sale 2 on the basis of usable square footage, but used gross square footage for land sales 1 and 3—even though because of overhead

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<sup>151</sup> Ex. A, at 127.

<sup>152</sup> Ex. A, at 127.

<sup>153</sup> Ex. A, at 128.

<sup>154</sup> Ex. A, at 128, 131

power lines, the usable square footage of land sale 3 is surely less.<sup>155</sup> Had Mr. Browen used gross square footage consistently, he would have arrived at an adjusted sale price for land sale 2 of \$0.11 (instead of \$0.29) per square foot.

**(b) Dodd Land Sale 2: adjustment for commissions**

Mr. Dodd's land sale 2, located in Rogers, sold in February 2011. According to Mr. Dodd's report, this was a private sale without market exposure (and as to which no commissions apparently were paid).<sup>156</sup> To make this sale comparable to the others, we increase its adjusted sale price by 5% to account for commissions that would have been associated with the sale. With that adjustment, the adjusted sale price of Mr. Dodd's land sale 2 is \$0.86 per square foot.

**(c) Adjustments for parcel size**

At sizes ranging from 7.21 to 18.34 acres, Mr. Browen's land sale 3 and Mr. Dodd's land sales 1, 4, and 5 are each likely too small to accommodate construction of a paper mill and, in that respect, are not true substitutes for or alternatives to the subject property.<sup>157</sup>

Mr. Browen made no adjustment to the sale price of his land sale 3 for its smaller size (at 18 acres, about one-third the size of the subject property).<sup>158</sup> Because smaller parcels generally sell for more per square foot than larger parcels, *see Appraisal of Real Estate* 199, we adjust the

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<sup>155</sup> Ex. 1, at 135. According to Mr. Browen's report, because of an overhead power line, "eventual development on the site will be south of the power line." *Id.*, at 134.

<sup>156</sup> Ex. A, at 124.

<sup>157</sup> Mr. Browen's land sale 3, located in Minden Township, is 18.34 acres. Ex. 1, at 135. Mr. Dodd's land sale 1, located in St. Cloud, is 7.21 acres. Ex. A, at 128. Mr. Dodd's land sale 4, located in Waite Park, is 10.0 acres. *Id.*, at 128. Mr. Dodd's land sale 5, located in St. Cloud, is 8.71 acres. *Id.*

<sup>158</sup> Ex. 1, at 135.

sale price of Mr. Browen's land sale 3 downward by 15%, for an adjusted sale price of \$0.23 per square foot (instead of \$0.27). With that adjustment, the average adjusted sale price of Mr. Browen's three comparable land sales is \$0.42 per square foot instead of \$0.49.

Although Mr. Dodd adjusted the sale price of each of his land sales for size differences,<sup>159</sup> we conclude those adjustments were not sufficient to capture the likely impact of parcel size on sale price. We adjust the sale price of land sales 1, 4, and 5 further downward by 5%. By doing so, land sale 1 is \$1.45 per square foot (instead of \$1.53), land sale 4 is \$1.09 (instead of \$1.15), and land sale 5 is \$0.93 (instead of \$0.98). Accordingly, we arrive at an average adjusted sale price for Mr. Dodd's comparable land sales of \$1.00 per square foot.<sup>160</sup>

We average Mr. Dodd and Mr. Browen's sale prices, as adjusted, and arrive at a value of \$0.78 per square foot of gross land area. Using our indicated gross land area for the subject property of 2,471,159 square feet (56.73 acres), the indicated market value of the subject property's land is \$1,927,504.

**b. Replacement Cost (New)**

Having determined the value of the land, we turn to the cost (as of the valuation date) to build the improvements on the subject property. The estimated cost of the improvements can be developed as either a reproduction cost or a replacement cost. Reproduction cost is the cost to construct an exact duplicate or replica using the same materials, construction standards, design,

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<sup>159</sup> Mr. Dodd based his adjustments on an assumed parcel size for the subject property of only 47.20 acres, essentially without some of the vacant parcels. *See* Ex. A, at 128. Even then, we think his adjustments for size too small.

<sup>160</sup> *See* Ex. A, at 128.

and layout. Replacement cost is the cost to construct a substitute using contemporary materials, standards, design, and layout. *Appraisal of Real Estate* 569-70. Both experts estimated replacement, rather than reproduction, cost.<sup>161</sup>

**(1) Mr. Browen's Approach**

Mr. Browen began his estimate of replacement cost (new) by categorizing the improved portion of the subject property by type of space: first- and second-floor space (900,479 square feet), basement space (64,994 square feet), and mezzanine/upper-floor space (150,131 square feet).<sup>162</sup> Mr. Browen then applied a base cost per square foot, derived from the Marshall Swift Valuation Service, to each type of space. Mr. Browen treated all first- and second-floor space as Class C (Low Cost) Heavy Manufacturing space at a base cost of \$80.91 per square foot.<sup>163</sup> Mr. Browen determined a base cost for basement space of \$30.80 per square foot (Class CDS, Average Cost) and a base cost of \$20.89 per square foot for mezzanine space (Class CDS, Average Cost).<sup>164</sup>

Mr. Browen added to these figures for heating and cooling (53,474 square feet of office space at \$5.45 per square foot; 847,005 square feet of warehouse and manufacturing space at \$2.70 per square foot).<sup>165</sup> Mr. Browen also included the cost of adding sprinklers to all 1,115,604 square

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<sup>161</sup> Ex. 1, at 138; Ex. A, at 132.

<sup>162</sup> Ex. 1, at 140. Mr. Browen's calculations of each type of space are found in the Addenda to his report (Ex. 1), and are based on a document (Ex. 7) provided by Verso to prospective buyers of the property after the May 2012 explosion. Tr. 57-58.

<sup>163</sup> Ex. 1, at 140.

<sup>164</sup> Ex. 1, at 140.

<sup>165</sup> Ex. 1, at 140. Mr. Browen's calculations of the amount of office, warehouse, and manufacturing space are also found in the Addenda to his report. *Id.*, at Addenda.

feet of building space at \$1.50 per square foot.<sup>166</sup> In all, Mr. Browen arrived at an average replacement cost (new) per square foot of \$91.34.<sup>167</sup> Mr. Browen made adjustments to this base cost for perimeter (0.849), for story height (1.231), and for location (1.090), to arrive at an adjusted replacement cost (new) of \$104.05 per square foot.<sup>168</sup> Mr. Browen therefore arrived at a total replacement cost (new) for the buildings on the subject property of \$93,694,752.<sup>169</sup>

To this amount, Mr. Browen added \$810,000 for the cost of the rail spurs serving the subject property (5,400 lineal feet at \$150 per square foot); \$1,000,000 for the cost of the wastewater system (five clarifiers and two sludge aeration basins); and \$1,412,000 for the asphalt driveways and parking lots (353,000 square feet at \$4.00 per square foot).<sup>170</sup> Mr. Browen added 7% for indirect costs and entrepreneurial profit to reach a total replacement cost (new) as of December 2015 of \$115 per square foot, or \$103,700,000 for the entire property.<sup>171</sup> Mr. Browen then adjusted the figure of \$115 per square foot for inflation to reach a replacement cost (new) as of December 2011 (roughly the valuation date of January 2, 2012) of \$106 per square foot (\$95,210,000 total).<sup>172</sup>

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<sup>166</sup> Ex. 1, at 140.

<sup>167</sup> Ex. 1, at 140.

<sup>168</sup> Ex. 1, at 140.

<sup>169</sup> Ex. 1, at 140.

<sup>170</sup> Ex. 1, at 140.

<sup>171</sup> Ex. 1, at 140.

<sup>172</sup> Ex. 1, at 140.

## (2) Mr. Dodd's Approach

Mr. Dodd also used the Marshall Swift Valuation Service to estimate the replacement cost (new) of the improvements on the subject property. Where Mr. Browen categorized all square footage as either heavy industrial, basement, or mezzanine, Mr. Dodd used different categories for different structures on the subject property depending on their use: heavy industrial for production buildings, office buildings for office space, warehouse for warehouse space, and so on.

For example, Mr. Dodd classified nine structures associated with paper machine 3 as above-grade average Class S heavy manufacturing space and good-storage Class A-B below-grade space.<sup>173</sup> Together, these nine structures included 312,480 square feet of above-grade space and 193,943 square feet of good storage Class A-B below-grade space.<sup>174</sup> Mr. Dodd applied a base cost of \$93.96 per square foot of above-grade space and a base cost of \$57.50 per square foot of below-grade space, each adjusted for heating and cooling (\$3.58 per square foot) and for sprinklers (\$1.25 per square foot).<sup>175</sup> Mr. Dodd also adjusted both figures for perimeter, story height, and location.<sup>176</sup> In addition, Mr. Dodd adjusted both figures to January 2012.<sup>177</sup> Mr. Dodd

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<sup>173</sup> Ex. A, at 133. The nine structures included in this group were: the wood room (40,346 square feet), the TMP pulp plant (59,894 square feet), the number 3 machine room (181,821 square feet), the supercalenders and winders building (78,362 square feet); the coatings and additives building (42,631 square feet); tank farm number 2 (6,968 square feet); the roll grinder building; (44,301 square feet); the shops and stores buildings (32,500 square feet); and the salvage winder (19,600 square feet). *Id.*, at 92.

<sup>174</sup> Ex. A, at 133.

<sup>175</sup> Ex. A, at 133.

<sup>176</sup> Ex. A, at 133.

<sup>177</sup> Ex. A, at 133. We addressed the use of current versus historical pages from Marshall Valuation Service (MVS) in *Guardian Energy*, 2014 WL 7476215, at \*18. In that case, Mr. Dodd

therefore arrived at a combined replacement cost (new) for those nine structures of \$60,270,357.<sup>178</sup> To this subtotal, Mr. Dodd added 1% for indirect costs and 5% for entrepreneurial profit, for a total replacement cost for the indicated structures of \$63,916,714.<sup>179</sup>

Similarly, Mr. Dodd determined that the pulp and paper warehouses were average Class C storage buildings with a base cost of \$38.28 per square foot.<sup>180</sup> The base cost for warehouse space assumes 6.0% of the space is finished office area, but Mr. Dodd determined that 14.2% of the pulp and paper warehouse was finished office space and adjusted accordingly.<sup>181</sup> Mr. Dodd also adjusted the base cost for the presence of sprinklers (\$1.25 per square foot).<sup>182</sup> Mr. Dodd therefore arrived at an adjusted base cost for the pulp and paper warehouses of \$42.32 per square foot.<sup>183</sup> Mr. Dodd then made perimeter and story height adjustments, as well as adjustments for location

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(testifying for the County) relied on figures from Marshall Valuation Service published at or near the valuation date at issue; the taxpayer's expert relied on current pages. *Id.* Each side argued the other's methodology was flawed. *Id.* We found "no fault in Mr. Dodd's approach," that is, in using figures published at or near the valuation date. *Id.*

In this case, Mr. Dodd similarly relied on figures from Marshall Valuation Service published at or near the valuation date at issue and adjusted structure-by-structure from the publication date to January 2012. Ex. A, at 133-45. Mr. Browen valued the entire property as of December 2015 and used a comparative cost multiplier to adjust the total back to December 2011. Ex. 1, at 140. We find no fault in either approach.

<sup>178</sup> Ex. A, at 133.

<sup>179</sup> Ex. A, at 133.

<sup>180</sup> Ex. A, at 136.

<sup>181</sup> Ex. A, at 136 (adding \$2.79 per square foot).

<sup>182</sup> Ex. A, at 136.

<sup>183</sup> Ex. A, at 136.

and time, to arrive at an indicated cost per square foot of \$54.63.<sup>184</sup> Multiplied by the building area of 147,460 square feet, Mr. Dodd came to a subtotal of \$8,055,740.<sup>185</sup> Because the warehouse shared a common wall with two other buildings, Mr. Dodd subtracted the cost of that wall (\$516,037).<sup>186</sup> Mr. Dodd added indirect costs of \$80,557 (1% of \$8,055,740) and entrepreneurial profits of \$381,013 (5% of \$8,055,740), to reach an estimated replacement cost (new) for the pulp and paper warehouses of \$8,001,723.<sup>187</sup>

In all, Mr. Dodd arrived at a total replacement cost (new) for the structures on the subject property of \$105,918,564.<sup>188</sup>

### **(3) Discussion**

As we have indicated, Mr. Browen estimated the replacement cost (new) of the structures on the subject property using only three classes of space: heavy manufacturing (\$80.91 per square foot), basement (\$30.80 per square foot), and mezzanine/upper-floors (\$20.89 per square foot).<sup>189</sup> In doing so, Mr. Browen misestimated the replacement cost of many of the structures on the subject property. From the descriptions of the subject property in both expert's reports, not all of the

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<sup>184</sup> Ex. A, at 136.

<sup>185</sup> Ex. A, at 136.

<sup>186</sup> Ex. A, at 136.

<sup>187</sup> Ex. A, at 136.

<sup>188</sup> Ex. A, at 147.

<sup>189</sup> Ex. 1, at 140. Mr. Browen's figures for total industrial space (900,479 square feet), basement space (64,994 square feet), and mezzanine space (150,131 square feet) sum to 1,115,604 square feet.

structures on the subject property were heavy manufacturing or industrial buildings, yet Mr. Browen calculated their replacement cost as though they were.

For example, according to Mr. Dodd's calculations, the base replacement cost of even modestly finished office space is \$98.36 per square foot<sup>190</sup>—\$17.45 more per square foot than the replacement cost of heavy industrial space. Mr. Browen assumed 53,474 square feet of such office space;<sup>191</sup> at \$17.45 per square foot, Mr. Browen underestimated the replacement cost of such space by a total of \$933,121.<sup>192</sup> At the same time, Mr. Browen's calculations overestimate the replacement cost of other spaces. For example, as we have indicated, the subject property includes two pulp and paper warehouses. According to Mr. Dodd's report, the Marshall Swift base cost of average Class C warehouse space is \$38.28 per square foot, or \$42.63 per square foot less than the cost of heavy manufacturing industrial space.<sup>193</sup> Mr. Browen's calculations therefore overstate the replacement cost of the pulp and paper warehouses.

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<sup>190</sup> Ex. A, at 143 (Mr. Dodd reporting the base cost of average Class C office space is \$98.36 per square foot).

<sup>191</sup> Mr. Browen's calculation of the amount of office space appears limited to the security and training buildings and excludes the 6,936-square-foot main office building. Ex. 1, at Addenda. Instead, Mr. Browen considered the main office building to be part of the mill property, that is, heavy manufacturing space, and calculated its base cost accordingly. *Id.* Mr. Browen included the office space in the main building and the mezzanine of the pulp and paper warehouses in his calculation of total office space, but only for the purpose of the adjustment for heating and cooling, not with respect to base cost. *Id.*, at 140 & Addenda.

<sup>192</sup> To be sure, Mr. Browen adjusted the base cost of heavy manufacturing space upward by \$5.45 per square foot of office space, but only as an adjustment for heating and cooling. Ex. 1, at 140.

<sup>193</sup> Ex. A, at 136; Ex. 1, at 140.

In addition, Mr. Browen's calculations appear to omit other improvements to the subject property altogether. For example, it does not appear that Mr. Browen calculated the replacement cost of the fencing at the subject property.<sup>194</sup> Mr. Dodd estimated its replacement cost to be \$160,290.<sup>195</sup> Nor does it appear that Mr. Browen's calculations include the sludge thickener, the reaeration basin, or the coal bunker.<sup>196</sup> Mr. Dodd estimated the replacement cost of these improvements total \$442,823.<sup>197</sup>

For these reasons, we give Mr. Browen's calculations of replacement cost (new) little weight in our analysis. We adopt Mr. Dodd's calculations of replacement cost (new) with minor adjustments:

- In his calculation of the replacement cost of the pulp and paper warehouses, Mr. Dodd deducted \$516,037 for the cost of the common wall between the warehouses and the adjacent pulp plant and machine room.<sup>198</sup> Having made that deduction, however, Mr. Dodd calculated indirect costs and entrepreneurial profits on the basis of the replacement cost of the structures as though they were separate structures with no common wall.<sup>199</sup> We calculate indirect costs and entrepreneurial profit on the cost of the warehouses with the common wall, that is, after deducting the cost of one wall. We therefore arrive at a replacement cost of \$7,995,855 (rather than \$8,001,273).

- Mr. Dodd adjusted the base costs of the training center and the security building, but not the main office building, upward by \$5.05 per square foot for a heating and cooling system capable of handling extreme (rather than moderate or normal)

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<sup>194</sup> Ex. 1, at 142.

<sup>195</sup> Ex. A, at 145.

<sup>196</sup> See Ex. 7 (table of square footage calculations).

<sup>197</sup> Ex. A, at 145.

<sup>198</sup> Ex. A, at 136.

<sup>199</sup> Ex. A, at 136.

temperatures.<sup>200</sup> We agree with the adjustment for the security building given its location; the fact that it would likely be used 24 hours a day, 7 days a week, 365 days a year; and the fact that security personnel would likely be stepping in and out of the building frequently throughout the day and night. We similarly agree with the adjustment for the training center. But we conclude that Mr. Dodd should also have adjusted the base cost of the main office building for heating and cooling.<sup>201</sup> We therefore arrive at a replacement cost (new) for the main office building of \$704,154 (rather than \$669,730).

With these adjustments, we arrive at total replacement cost for the improvements of \$105,947,570.

**c. Depreciation/Useful Life**

Each expert estimated depreciation using the breakdown method.<sup>202</sup> The breakdown method “segregates total depreciation into individual component parts,” namely, physical deterioration, functional obsolescence, and external obsolescence. *Appraisal of Real Estate* 614. The appraiser can either calculate each type of depreciation separately and add them together, or calculate total depreciation by some other method “and then apply the breakdown method to allocate total depreciation into more precise components.” *Id.* In this case, each expert applied some variation of the former technique, calculating each form of depreciation separately and then adding them together to reach a total.<sup>203</sup>

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<sup>200</sup> Ex. A, at 142.

<sup>201</sup> See Ex. A, at 142. At trial, Mr. Dodd explained that “Minnesota is considered an extreme climate for heating and manifests itself in office buildings like that, and so the base cost is going to include—is going to generally envision a building in an average climate, you know, probably, oh, midway down a little latitudinally and so we adjust up for higher levels of heating in Minnesota.” Tr. 261. As for the main office building, Mr. Dodd testified at trial that he did not adjust its base cost for a heating and cooling plant appropriate for extreme climates “given [its] age.” Tr. 261-62. When estimating the replacement cost (new), however, the question is not whether such a heating plant would have been included in the building when it was constructed in 1957, but whether such a heating plant would be included if the building were being constructed now. See *Appraisal of Real Estate* 570. We conclude that it would be.

<sup>202</sup> Ex. 1, at 142; Ex. A, at 146-50.

<sup>203</sup> Ex. 1, at 142-47; Ex. A, at 151.

## **(1) Physical deterioration**

Physical deterioration recognizes a loss of value due to “wear and tear from regular use, the impact of the elements, or damage.” *Appraisal of Real Estate* 576. Physical deterioration can be curable or incurable. *Id.* Physical deterioration is considered incurable when the cost to repair is more than the anticipated increase in value that would result from repair. *Id.* at 599. Physical deterioration may also be incurable when it is not physically possible to cure it. *Id.* at 618.

### **(a) Mr. Browen’s approach**

Under the breakdown method used by Mr. Browen (and Mr. Dodd), all physical deterioration falls into one of three categories: deferred maintenance, short-lived physical deterioration, or long-lived physical deterioration. *Appraisal of Real Estate* 617-18. Deferred maintenance refers to “items in need of immediate repair on the effective date of the appraisal,” such as a leaking roof, and is measured by the cost to repair the item or otherwise restore it to new or reasonably new condition. *Id.* at 618. In this case, Mr. Browen concluded that the subject property suffered from no deferred maintenance on the valuation date.<sup>204</sup>

Once deferred maintenance has been estimated, any remaining physical deterioration is attributable to either short-lived or long-lived building components. *Id.* at 619. The Fourteenth Edition defines short-lived building components as “those that are not ready to be replaced on the date of the opinion of value but will probably have to be replaced in the foreseeable (i.e., whatever is considered short-term) future,” such as flooring and water heaters. *Id.* A long-lived building component is anything, such as exterior and foundation walls, not considered deferred maintenance or a short-lived component. *Id.* at 620.

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<sup>204</sup> Ex. 1, at 145.

In this case, Mr. Browen estimated total physical deterioration of both short-lived and long-lived components using the age-life method. The age-life method of estimating depreciation assumes “an improvement or component loses all of its value over the course of its life.” *Id.* at 598. To estimate physical deterioration using the age-life method, the appraiser compares the effective age of the subject property to its estimated useful or physical life. *Id.* at 600-01. A property’s effective age “is indicated by the condition and utility of a structure.” *Id.* at 600. Useful life, in contrast, is “the period of time over which the components of the improvement may reasonably be expected to perform the functions for which they were designed.” *Id.* at 603.

Relying on Marshall Swift, Mr. Browen assumed the subject property had an estimated life expectancy (that is, a physical life) of 50 years.<sup>205</sup> Mr. Browen further estimated both the effective age and the weighted-average actual age of the subject property to be 40 years.<sup>206</sup> Mr. Browen

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<sup>205</sup> Ex. 1, at 142.

<sup>206</sup> Ex. 1, at 142; *see id.*, at Addenda (Building Area Support and Calculations). Mr. Browen calculated the actual age of the entire facility using a weighted-average. To do so, Mr. Browen multiplied the square footage of each structure by the year in which it was built, summed the total for the entire property, and divided the sum by the square footage of the entire property.

For this calculation, Mr. Browen grouped the subject property into just four categories: office property, maintenance property, coal bin property, and main mill property. Ex. 1, at Addenda. Mr. Browen identified four structures as “coal bin property”: the coal unloading/shaker building, the coal crusher building, the coal transfer tower, and the primary sludge pump building. *See id.* To calculate the average age of the coal bin property, Mr. Browen multiplied the square footage of each (excluding basement space) by the year in which it was built, added the products, and divided by the total square footage of all “coal bin property.” For example, Mr. Browen multiplied 1,730 (the square footage of the ground-floor area of the coal unloading building) by 1982 (the year in which it was built) to reach a product of 3,428,860. *Id.* Similarly, Mr. Browen multiplied 355 (the square footage of the second-floor area of the coal unloading building) by 1982 (the year in which it was built) to reach a product of 703,610. *Id.* The primary sludge pump building was built in 1980; Mr. Browen multiplied its ground-floor area (1,479 square feet) by 1980 to reach a product of 2,928,420. *Id.* Summing those products yields a total of 12,537,972 with respect to 6,327 square feet; dividing those two figures yielded 1981.66—the weighted

therefore concluded that the subject property was 80% physically depreciated (that is, 40 of 50 years) as of the valuation date.<sup>207</sup> Mr. Brown applied that percentage to his estimate of total replacement cost (\$95,210,000) to arrive at total physical deterioration of \$76,168,000.<sup>208</sup>

**(b) Mr. Dodd's approach**

Like Mr. Brown, Mr. Dodd assumed no deferred maintenance.<sup>209</sup> As for physical deterioration, Mr. Dodd also used the effective age/useful life technique. Unlike Mr. Brown, however, Mr. Dodd separately estimated the useful life and effective age of each of the major improvements. Mr. Dodd estimated the useful life of the property's heavy manufacturing buildings to be 80 years, reasoning that such structures "normally enjoy prolonged physical lives, as evidenced by the subject's original plant buildings."<sup>210</sup> Other structures (the security building, the coal buildings, the common maintenance shops, and the main offices, for example) were estimated to have useful lives of between 50 and 70 years.<sup>211</sup> Various other site improvements were estimated to have useful lives ranging from 30 years (the parking lot) to 45 years (the coal bunker and chain link fence) to 50 years (the security building and rail siding) to 60 years (the

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average year the coal bin property was built—for an average age (as of January 2012) of 30 years. *See id.*

<sup>207</sup> Ex. 1, at 145.

<sup>208</sup> Ex. 1, at 145.

<sup>209</sup> Ex. A, at 146 (noting that AIM reported no deferred maintenance as of the valuation date and "[t]he vast majority of the improvements are no longer available for inspection").

<sup>210</sup> Ex. A, at 146.

<sup>211</sup> Ex. A, at 146-47.

main offices, training center, chip bin storage building, train shed, and wastewater treatment basins).<sup>212</sup>

As for effective ages, Mr. Dodd noted that several of the major improvements were completed in 1982 in conjunction with the installation of paper machine number 3; he estimated their effective ages to be their actual ages, or 30 years.<sup>213</sup> Mr. Dodd estimated the effective age of the original paper plant buildings (associated with machines 1 and 2) and the north power plant to be 65 years.<sup>214</sup> Mr. Dodd estimated the effective age of the main offices to be 50 years but the effective age of the wastewater treatment basins to be 40 years.<sup>215</sup> Other structures were estimated to have effective ages ranging from 20 years (the training center, capital stores, and security buildings and the parking lot) to 30 years (the rail siding and chain link fence, for example).<sup>216</sup>

Applying these estimates, Mr. Dodd calculated rates of physical deterioration for each subcategory of improvement. For example, the newer paper plant buildings (30 years old, with a useful life of 80 years) were calculated to be only 37.5% depreciated.<sup>217</sup> The common maintenance shops (65 years old, with a useful life of 70 years), on the other hand, were calculated to be 92.86%

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<sup>212</sup> Ex. A, at 146-47.

<sup>213</sup> Ex. A, at 146-47 (assuming an effective age of 30 years for the “newer paper plant buildings,” chip bin storage building, pulp and paper warehouse, south power plant, wastewater treatment buildings, and coal buildings, among others).

<sup>214</sup> Ex. A, at 147.

<sup>215</sup> Ex. A, at 147.

<sup>216</sup> Ex. A, at 147.

<sup>217</sup> Ex. A, at 147.

depreciated.<sup>218</sup> Mr. Dodd multiplied these percentages by his calculated replacement cost (new) for each subcategory to calculate the amount of physical deterioration. Altogether, Mr. Dodd assumed physical deterioration totaling \$46,941,642.<sup>219</sup>

**(c) Discussion**

As did Mr. Browen and Mr. Dodd, we conclude that the subject property suffered from no deferred maintenance as of January 2, 2012.

With respect to physical deterioration, we decline to adopt Mr. Browen's single-facility approach. As we have indicated, Mr. Browen assumed (without explanation) a useful life for the entire facility of 50 years.<sup>220</sup> Yet not every structure in the facility has an expected life of 50 years, even according to Marshall Swift. For example, according to Marshall Swift, the life expectancy of heavy industrial manufacturing structures—which comprise the vast majority of the usable space at the subject property, according to Mr. Browen—can be as much as 60 years.<sup>221</sup> The life expectancy of a warehouse can range from 40 to 55 years, according to the Marshall Swift service.<sup>222</sup> The expected life of a material storage building is shorter, at just 25 to 30 years.<sup>223</sup>

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<sup>218</sup> Ex. A, at 147.

<sup>219</sup> Ex. A, at 147.

<sup>220</sup> Ex. 1, at 142.

<sup>221</sup> Ex. I, at Sec. 97, page 12 (excerpts from Marshal Valuation Service showing the typical building life of heavy manufacturing space of good or excellent construction as 60 years (Class A and B)).

<sup>222</sup> Ex. I, at Section 97, page 12.

<sup>223</sup> Ex. I, at Section 97, page 15.

There is no evidence in our record that in arriving at his estimated life of 50 years, Mr. Browen took these variations into account.<sup>224</sup>

Similarly, Mr. Browen offered no support for his estimated single-facility effective age of 40 years.<sup>225</sup> Moreover, at trial Mr. Browen conceded that although he considered the buildings housing paper machines 1 and 2 to be obsolete, he nevertheless included them in the calculation of the weighted average actual age of the facility, the effect of which was to increase his calculation of the average age of the facility and, by extension, the amount of physical deterioration.<sup>226</sup> We therefore give little weight to Mr. Browen's calculation of physical deterioration.

Turning to Mr. Dodd's approach, AIM argues that he erred in using useful lives for certain structures on the subject property of as much as 80 years because the Marshall Swift Valuation Service (MVS) indicates a useful life for heavy manufacturing buildings of no more than 60 years:

[R]ather than following the outline by MVS to determine useful life, effective age, and depreciation, Mr. Dodd concluded to a useful life of 50-80 years for the subject property. . . . [I]n determining a useful life, he vastly departed from the MVS guideline values. Mr. Dodd's 80 years for the subject's heavy manufacturing buildings is 33% higher than the longest useful life/economic life that MVS presents for heavy manufacturing properties (which is 60 years).<sup>227</sup>

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<sup>224</sup> Presumably, Mr. Browen could have calculated a weighted-average expected useful life for the entire facility, as he did in calculating the weighted average age of the entire facility.

<sup>225</sup> According to the Fourteenth Edition, effective age "is the age indicated by the condition and utility of a structure, and an estimate of effective age is based on an appraiser's judgment and interpretation of market perceptions." *Appraisal of Real Estate* 600. We acknowledge that the actual structures were not available for Mr. Browen to inspect. Nevertheless, there is no indication in Mr. Browen's report that he consulted with Mr. McGlin, who inspected the site on AIM's behalf, as to either condition or utility.

<sup>226</sup> Tr. 129-30.

<sup>227</sup> Pet'r's Post-Trial Br. 13-14.

But the Marshall Swift service acknowledges the concept of “extended life expectancy,” namely, “the increased life expectancy due to seasoning and proven ability to exist.”<sup>228</sup> In other words, the Marshall Swift service itself allows the possibility that a structure’s actual useful life could exceed its guideline life—particularly structures that are already at or beyond their indicated useful life.

AIM further claims that Mr. Dodd “presented no evidence as to how he came to the conclusion of 50-80 years as the useful life of the buildings within his appraisal.”<sup>229</sup> AIM acknowledges that Mr. Dodd’s appraisal describes paper mills in other states that operated for nearly a century or even more.<sup>230</sup> But AIM contends that Mr. Dodd’s knowledge of those mills and their economics was insufficient to support his reliance on them, citing Mr. Dodd’s inability to recall—on the witness stand—the names of the owners of the mills, the age of the machines in the mills, or when the paper machines in them were most recently rebuilt.<sup>231</sup> We disagree with AIM’s assessment of Mr. Dodd’s knowledge. Mr. Dodd did not disclaim all knowledge of such

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<sup>228</sup> Ex. I, at Sec. 97, page 1 (“Extended life expectancy is the increased life expectancy due to seasoning and proven ability to exist. Just as a person will have a total normal life expectancy at birth which increases as he grows older, so it is with structures and equipment.”).

<sup>229</sup> Pet’r’s Post-Trial Br. 13.

<sup>230</sup> See Ex. A, at 19 (“The research reveals that paper mills can often reach 80 to 100 years before they are shut down. The subject’s original plant, including the No. 1 and 2 paper machines, provides a case in point. A couple other examples include a plant in Joliet, Illinois, which had been in operation for 97 years when it was shut down in 2011; and a mill in Blue Heron, Oregon which had operated over a century before it was shut down in 2011.”).

<sup>231</sup> Pet’r’s Post-Trial Br. 14; see Tr. 213-14.

things as the ownership of the mills or their age; indeed, Mr. Dodd indicated that such matters were recorded in his notes.<sup>232</sup>

Significantly for our decision, we need look no further than the subject property to confirm that the useful life of a paper mill may exceed the useful life of other heavy manufacturing facilities. The buildings housing paper machines 1 and 2 and the other structures supporting manufacturing in those buildings were a century old or older and were, until the fall of 2011, still in continuous use.<sup>233</sup> More importantly, although paper machines 1 and 2 were permanently idled in 2011, the record indicates it was for financial reasons—not because of the condition of the buildings housing them.<sup>234</sup>

For these reasons, we adopt Mr. Dodd's estimates of physical deterioration. Because we reached a different figure for the replacement cost of the pulp and paper warehouse and for the ETDC training center, we adjust Mr. Dodd's figures for physical deterioration accordingly, and arrive at total physical deterioration of \$46,967,828.

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<sup>232</sup> Tr. 214.

<sup>233</sup> See Ex. 1, at Addenda. For example, Mr. Browen describes the building housing paper machines 1 and 2 as having been built in 1905. *Id.* The supercalender building associated with paper machines 1 and 2 was built in 1912, as was the roll storage and finishing building. *Id.* Verso idled machines 1 and 2 in the fall of 2011. Ex. A, at 17.

<sup>234</sup> Ex. 1, at 63 (“Verso permanently shut down machines Nos. 1 and 2 in October 2011 citing the following in a press release, ‘The demand for supercalendered papers remains fairly stable in the marketplace; however, despite our employees’ diligent efforts, the cost structure of the two SC machines to be shut down at the Sartell Mill remains unfavorable.’ ”); Ex. A, at 17 (“On or about October 11, 2011, Verso announced it would idle its No. 1 and 2 paper machines . . . .”).

## (2) Functional Obsolescence

“Functional obsolescence is caused by a flaw in the structure, materials, or design of an improvement when the improvement is compared with the highest and best use and the most cost-effective functional design requirements at the time of the appraisal.” *Appraisal of Real Estate* 623.

### (a) Mr. Browen’s approach

In this case, Mr. Browen considered the subject property to have “functional obsolescence associated with building area for machines Nos. 1 and 2 that [are] no longer contributing to value.”<sup>235</sup> Mr. Browen estimated that paper machines 1 and 2 occupied 124,369 square feet of building area.<sup>236</sup> Using his estimated replacement cost of \$105.73 per square foot, Mr. Browen calculated the replacement cost of the portion of the building housing paper machines 1 and 2 to be \$13,149,860. Mr. Browen reduced that figure by 80% (his estimate of the amount of physical depreciation already taken with respect to the space),<sup>237</sup> to arrive at the remaining undepreciated cost of the building (\$2,629,972).<sup>238</sup> To that, Mr. Browen added demolition costs, estimated at \$8.00 per square foot or a total of \$994,952.<sup>239</sup> Mr. Browen therefore arrived at total estimated functional obsolescence of \$3,624,924.<sup>240</sup>

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<sup>235</sup> Ex. 1, at 142.

<sup>236</sup> Ex. 1, at 142.

<sup>237</sup> See Ex. 1, at 145.

<sup>238</sup> Ex. 1, at 142.

<sup>239</sup> Ex. 1, at 142.

<sup>240</sup> Ex. 1, at 142.

**(b) Mr. Dodd's approach**

Mr. Dodd assumed "the majority of the improvements," and specifically including the structures associated with paper machine 3, suffered no functional obsolescence.<sup>241</sup> But Mr. Dodd applied a rate of 10% to the property's original buildings "to recognize that those improvements likely had functional deficiencies" totaling \$236,175.<sup>242</sup>

**(c) Discussion**

In its discovery responses, AIM apparently reported it was aware of no functional obsolescence as of January 2, 2012.<sup>243</sup> But AIM neither owned nor operated the subject property as of January 2, 2012, and its interest in acquiring the property in 2013 was not for continued paper production. We therefore discount AIM's report. We credit instead Mr. Dodd's approach and find functional obsolescence equal to 10% of the physically depreciated cost of the original paper

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<sup>241</sup> Ex. 1, at 148.

<sup>242</sup> Ex. 1, at 148, 150. The buildings considered to have functional obsolescence were the original paper plant buildings associated with paper machines 1 and 2 (including the storage and finishing building, the supercalender room, the maintenance shop and storeroom, and the saveall and beater room buildings), the older plant buildings "common to all" (including the bleach plant, clay prep area, and engine room), the north power plant, the common maintenance shops (including the old log storage building), and the main offices. Ex. 1, at 150; *see* Ex. 1, at 95 (listing and enumerating structures).

<sup>243</sup> *See* Ex. A, at 148 (Mr. Dodd indicating that "[t]he petitioner reports in its responses to interrogatories that it was not aware of the subject's functional shortcomings as of January 2, 2012," and noting that "the vast majority of the subject improvements are not available for inspection"). *But see* Tr. 47 (Mr. McGlin testifying that the mill "was very piecemeal constructed"), 49-50 (Mr. McGlin testifying that a number of the components of the number 3 paper machine "were older technology"), 66-67 (Mr. McGlin testifying that coating heads are commonly replaced every six or seven years, but the coating heads on the number 3 paper machine were likely 15 years old).

plant buildings, the older plant buildings serving the entire property, the north power plant, the maintenance shops, and main offices totaling \$236,175.<sup>244</sup>

### (3) External Obsolescence

Finally, “[e]xternal obsolescence is a loss in value caused by negative externalities, i.e., factors outside a property.” *Appraisal of Real Estate* 632. Such negative externalities can reflect the location of the subject property (for example, “proximity to some detrimental influence on value such as heavy traffic, a landfill, or other undesirable land use outside the property being appraised”). *Id.* at 633. They can also reflect “the natural expansion and contraction of the real estate market”—so-called market obsolescence. *Id.* In addition, when the subject property is a special-purpose property, external obsolescence may reflect a change in conditions in the industry in which the business enterprise at the subject property operates. *Guardian Energy, LLC v. Cty. of Waseca*, 868 N.W.2d 253, 263 (Minn. 2015) (citing Robert F. Reilly, *Functional and Economic Obsolescence Procedures in Valuing Industrial Property*, J. Multistate Tax’n & Incentives, Sept. 2012, at 20, 27). In this case, each appraiser determined that conditions prevailing in the paper industry were the primary cause of external obsolescence affecting the subject property as of January 2012.<sup>245</sup>

“[T]he most persuasive measurement of the effect of negative externalities on value” is the direct comparison of similar properties with and without external obsolescence. *Appraisal of Real Estate* 634-35. But there must be sufficient data for such an analysis, that is, data on “similar

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<sup>244</sup> See Ex. A, at 150. Although we arrived at slightly different replacement cost (new) figures for the pulp and paper warehouses and main office building, Mr. Dodd did not consider any of those buildings to be affected by functional obsolescence.

<sup>245</sup> Ex. 1, at 142; Ex. A, at 149.

properties with and without external obsolescence.” *Id.* at 634. In the absence of such similar properties, external obsolescence can also be estimated by capitalizing “income lost to the effect of the eternality” and, if necessary, “allocating that estimate of loss in total property value between the land and building components.” *Id.* at 635.

**(a) Mr. Browen’s approach**

Mr. Browen estimated economic obsolescence to be 13% of the subject property’s replacement cost.<sup>246</sup> To reach this figure, Mr. Browen used neither approach outlined in the Fourteenth Edition. Rather, Mr. Browen made a subjective determination of external obsolescence.

Mr. Browen first concluded that although the subject property had a remaining *physical* life expectancy as of January 2, 2012, of 10 years, its remaining *economic* life expectancy was only 3.5 years.<sup>247</sup> At a depreciation rate of 2% per year (based on a physical life expectancy of 50 years), that meant having to depreciate another 13% of replacement cost (new) (2% per year x 6.5 years, or \$12,377,300) in order to fully depreciate the property by the end of that economic life.<sup>248</sup>

Mr. Browen found a relatively short remaining economic life “appropriate in light of the deteriorating market conditions for coated paper.”<sup>249</sup> In particular, Mr. Browen noted:

Given paper is a commodity that is produced in high volumes (sometimes whether it is needed or not due to the high cost associated with idling and restarting a paper machine) and prices are set by a global market, the primary focus of

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<sup>246</sup> Ex. 1, at 142.

<sup>247</sup> Ex. 1, at 142; 144.

<sup>248</sup> See Ex. 1, at 144.

<sup>249</sup> Ex. 1, at 142.

companies in this industry has been reducing their cost as the price has fallen in an attempt to remain profitable. As such, the mills that present more cost saving opportunities are the ones [that] will survive as of the valuation date of January 2nd, 2012 and also going forward.<sup>250</sup>

Mr. Browen listed four characteristics he believed “would lead a mill to have a higher cost structure which will increase the likelihood it is closed.”<sup>251</sup> Those characteristics were: (1) lack of a co-generation plant capable of producing 100% of the mill’s electricity needs; (2) lack of an on-site pulp mill; (3) older paper machines (i.e. machines installed prior to the boom in the early 1980’s); and (4) a non-linear flow of raw materials to finished product.<sup>252</sup> Of those, however, Mr. Browen conceded that the subject property lacked only a co-generation plant capable of producing all of the mill’s required electricity.<sup>253</sup>

Mr. Browen then turned to the mill’s financial prospects. Noting that Verso had not provided financial results for the mill for 2010 or 2011, Mr. Browen first cited press releases issued by Verso after the May 2012 explosion suggesting that the mill’s cost structure was higher than other Verso properties:

If this cost structure for producing paper as of January 2nd, 2012 actually resulted in a negative profit margin that is not curable it could be the improvements no longer contribute to the business of making coated paper. When the machine

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<sup>250</sup> Ex. 1, at 143.

<sup>251</sup> Ex. 1, at 143.

<sup>252</sup> Ex. 1, at 143.

<sup>253</sup> Ex. 1, at 143. Mr. Browen indicated that the subject property includes an on-site pulp mill, “but still purchased pulp from outside sources.” Ex. 1, at 143.

becomes obsolete, so does the real estate for a special-purpose property. A paper mill property is not very economically adaptable to another use.<sup>254</sup>

Mr. Browen also cited a report of business interruption losses prepared by rwhMyers after the May 2012 explosion, which included Verso's budget for operation of the Sartell facility in 2012.<sup>255</sup> Relying on the rwhMyers report, Mr. Browen calculated that Verso did not expect the Sartell facility to be profitable in 2012.<sup>256</sup>

As a final step, Mr. Browen estimated the rate of annual depreciation implied in the sales of the five other mills considered in his sales comparison approach, as well as the post-explosion sale of the subject facility to AIM in 2013.<sup>257</sup> For each property, Mr. Browen reduced the sale price by his estimate of the value of the land included in the sale to yield an estimate of the depreciated value of the improvements.<sup>258</sup> Mr. Browen then estimated the replacement cost (new) of each mill by multiplying its usable square footage by his estimate of the replacement cost (new) of the subject property (adjusted for time).<sup>259</sup> Comparing the respective value of the improvements to their respective replacement costs resulted in an estimate of the total depreciation implied in the

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<sup>254</sup> Ex. 1, at 143; *see id.* at 144 (quoting the president and CEO of Verso as saying "The mill has not been competitive for a number of years and . . . it is impossible for the mill to achieve a competitive position in today's marketplace").

<sup>255</sup> Ex. 17 (rwhMyers report (dated Aug. 10, 2012)).

<sup>256</sup> Ex. 1, at 143-44.

<sup>257</sup> Ex. 1, at 147.

<sup>258</sup> Ex. 1, at 147.

<sup>259</sup> Ex. 1, at 147.

purchase price. By Mr. Browen's calculations, each of the six mills was 98% or 99% depreciated at the time of sale.<sup>260</sup>

"Based on all this information," Mr. Browen concluded that the subject property's remaining economic life was only 3.5 years and its total depreciation from all causes as of January 2, 2012, was 97%.<sup>261</sup>

**(b) Mr. Dodd's approach**

Mr. Dodd took a different approach to estimating economic obsolescence, doing so through an income analysis.<sup>262</sup> *See Appraisal of Real Estate* 635. Mr. Dodd began with Verso's estimate of 2012 earnings before income tax, depreciation, and amortization (EBITDA) of \$5,108,963.<sup>263</sup> Mr. Dodd added to that figure \$4.3 million, reflecting the additional revenues to be generated by an expected increase in paper prices beginning in the third quarter of 2012, for a total adjusted EBITDA of \$9.4 million.<sup>264</sup> To that figure, Mr. Dodd applied a multiplier of 8.0 to reach an "indicated going concern value" of \$75,271,704.<sup>265</sup> Mr. Dodd estimated that \$59,088,288 of that value was plant, property, and equipment, of which \$11,817,658 was land.<sup>266</sup> To the land value, Mr. Dodd added his estimate of the value of the hydroelectric dam (\$1,719,060) to reach an

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<sup>260</sup> Ex. 1, at 147.

<sup>261</sup> Ex. 1, at 144.

<sup>262</sup> Ex. A, at 149.

<sup>263</sup> Ex. A, at 168; *see id.* at 149 (explaining the source of the estimate of 2012 earnings).

<sup>264</sup> Ex. A, at 168.

<sup>265</sup> Ex. A, at 168.

<sup>266</sup> Ex. A, at 168.

indicated value for the subject property of \$13,536,718.<sup>267</sup> Mr. Dodd then compared that figure to his estimate of total replacement cost (\$63,598,974) to arrive at external obsolescence of \$50,062,256, or 85.4% of the estimated replacement cost of the improvements.<sup>268</sup>

Mr. Dodd then applied the rate of obsolescence to the replacement cost of individual improvements, in some cases adjusting the obsolescence rate upward or downward. For example, Mr. Dodd used an obsolescence rate of 95% for the buildings associated with paper machines 1 and 2, reasoning that a higher rate was needed “to reflect the fact that those machines were shut down.”<sup>269</sup> But Mr. Dodd used an obsolescence rate of only 50% for the training center and capital stores buildings across the BNSF tracks from the main mill property, reasoning that “those building[s] could be used, and sold, independently from the rest of the plant.”<sup>270</sup> In all, Mr. Dodd estimated external obsolescence to total \$49,014,285.<sup>271</sup>

### (c) Discussion

We begin by examining the assumptions underlying Mr. Browen’s subjective determination of external obsolescence.

*Closure of the subject mill.* Mr. Browen assumed the subject property’s remaining economic life was only 3.5 years as of January 2, 2012. To support this assumption, Mr. Browen

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<sup>267</sup> Ex. A, at 168.

<sup>268</sup> Ex. A, at 168.

<sup>269</sup> Ex. A, at 149. Mr. Dodd declined, however, to consider those buildings 100% depreciated, “as there was some potential to repurpose them.” *Id.*

<sup>270</sup> Ex. A, at 149.

<sup>271</sup> Ex. A, at 150.

cited “the deteriorating market conditions for coated paper,” resulting in “declining demand/falling prices for coated paper and an industry that is dealing with excess capacity (supply) by closing mills.”<sup>272</sup> We agree with Mr. Browen: the undisputed evidence in this case establishes that demand for coated paper was indeed declining nationwide (and perhaps worldwide) around the valuation date at issue here. We also agree that the paper industry dealt with excess production capacity by closing paper mills. But the condition of the paper industry as a whole does not establish the Sartell mill’s remaining economic life—particularly considering the fact that it was only one of several mills operating under Verso ownership.

As we have noted, to support his assumption that prevailing market conditions would soon cause Verso to close *this mill*, Mr. Browen listed (without attribution) four “characteristics that would lead a mill to have a higher cost structure which will increase the likelihood it is closed.”<sup>273</sup> Mr. Browen acknowledged, however, that the Sartell mill lacked most of those characteristics. To the contrary, the Sartell mill had a co-generation plant that produced some of the mill’s power; a pulp mill that produced some of the mill’s raw material; and a linear flow of raw materials to finished product.<sup>274</sup> As for the age of the mill’s machines, its older machines had been permanently shut down, and the number 3 machine was less than 30 years old. The County contends that at 53 and 45 years old respectively, the Biron and Rumford mills were older.<sup>275</sup> Mr. Browen could not

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<sup>272</sup> Ex. 1, at 142.

<sup>273</sup> Ex. 1, at 143.

<sup>274</sup> Ex. 1, at 143.

<sup>275</sup> Resp’t’s Post-Trial Br. 2 (filed Sept. 1, 2016) (pointing out that the Sartell mill “was the newest mill in the universe of Verso mills”), 3 (stating that when paper machine 3 was installed in the Sartell mill in 1982, “the Biron mill was 23 years old, and the Rumford Mill 12 years old”).

have concluded (and did not conclude) on the basis of these factors alone that the Sartell mill was about to be closed.

*Profitability of the subject mill.* Mr. Browen therefore turned to the financial prospects for the subject property. According to Mr. Browen's appraisal report, the Sartell mill was not expected to generate a gross profit in 2012.<sup>276</sup> Indeed, Mr. Browen cited an August 2012 press release announcing the permanent closure of the mill as confirmation that the Sartell facility was not profitable.<sup>277</sup> At trial, however, Mr. Browen corrected his calculation of the mill's expected 2012 results from a loss of \$571,705 to a gross profit of \$14,393,227, or 7.7% of gross sales.<sup>278</sup> But Mr. Browen did not change his estimate of economic obsolescence based on this correction. To the contrary, Mr. Browen cited the expected 2012 gross *profit* as evidence "that this mill is very weak from a standpoint of being able to compete in the future."<sup>279</sup>

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AIM cites Mr. Browen's report for the fact that the most recent construction at the Biron mill was in 2004 and at the Rumford mill in the 1990s. Pet'r's Post-Trial Reply Br. 11 (filed Sept. 15, 2016). But Mr. Browen's appraisal gives the actual age of the Biron mill as 53 years old and the actual age of the Rumford mill as 45 years old. Ex. 1, at 147.

<sup>276</sup> Ex. 1, at 144.

<sup>277</sup> Ex. 1, at 144 (Verso's president stating "The mill has not been competitive for a number of years and, despite our employees' dedicated efforts since the December 2011 shutdown of two of the facility's three paper machines, our assessment indicates that it is impossible for the mill to achieve a competitive position in today's marketplace, especially after a setback of this magnitude and duration.").

<sup>278</sup> Ex. 14 (Browen's corrected cash flow calculations).

<sup>279</sup> Tr. 175. Mr. Browen had other evidence of the Sartell mill's financial prospects in the form of the report of business interruption losses due to the May 2012 explosion and fire (Ex. 17) but, unable to reconcile his calculation of gross profit (a small operating loss) with that in the report (a positive 19.3%), Mr. Browen simply discounted its content. Ex. 1, at 144 ("There is insufficient information in this report for the appraiser to understand how such a different gross profit margin

Moreover, there was other evidence in the record, not cited by Mr. Browen, that as of January 2012 Verso intended to continue operations at the Sartell mill for some time to come. For example, it appears that Verso had recently spent more than \$1.1 million to overhaul a large electrical generator and turbine at the facility, and that “a new turbine was on site and being readied for installation at the time of the fire and explosion” in May 2012.<sup>280</sup>

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could be arrived at. It is presumed there were other variables specifically related to how the insurance claim process works that factored into this.”).

Based on our review of the rwhMyers report, we conclude that it calculates the *marginal* profit to have been earned by the Sartell mill on a ton of paper produced in 2012, that is, assuming fixed costs were otherwise covered.

<sup>280</sup> Ex. A, at 18 (citing a Scope of Work document provided by Verso during discovery).

The County contends that the closure of the Sartell mill was not inevitable, but rather was part of a considered effort by its then-owner, Verso, to resolve litigation seeking to block Verso’s acquisition of competitor Newpage. More specifically, according to the County, Verso closed the Sartell mill “to reduce its inventory of mills to the point where its NewPage-Verso merger would pass Justice Department anti-trust guidelines.” Resp’t’s Post-Trial Br. 1; *see also id.* at 4 (stating that the shutdown “reduced the number of plants in [Verso’s] inventory, facilitating the anti-trust settlement with the Justice Department and hence helping to clear the way for the New Page Merger.”). AIM derides the County’s claim as “the stuff of conspiracy novels.” Pet’r’s Post-Trial Reply Br. 1.

Although we decline to agree with AIM’s characterization of the County’s claim, we conclude that the record does not support the County’s theory of the reasons for the closure of the Sartell mill. Verso announced the closure of the Sartell facility in August 2012 and sold the property to petitioner AIM in January 2013. The merger between Verso and Newpage was not announced until January 3, 2014, *a year after* the Sartell mill was sold to AIM. *See Newpage Holdings, Inc.*, 2015 WL 9982691, at \*1 (noting that “On January 3, 2014, Verso agreed to acquire NewPage in a transaction valued at approximately \$1.4 billion.”). The Justice Department did not file its antitrust action until December 2014, nearly *two years after* the sale to AIM. *See id.* at \*1 (stating that “[o]n December 31, 2014, the United States filed suit to enjoin Verso’s acquisition of NewPage”). There is no indication in the factual record before us that Verso and Newpage were negotiating the merger in 2012.

The County may have extrapolated from Exhibit 15, a January 2014 presentation to lenders by Newpage in conjunction with certain credit facilities. *See* Ex. 15. Exhibit 15 mentions that on January 6, 2013, Newpage Holdings “announced a definitive agreement to be acquired by Verso

*Availability of comparable sales.* Finally, as we have noted, Mr. Browen estimated the total depreciation implied in the prices for which other paper mills sold at or near the valuation date. This “market extraction” method of estimating total depreciation “relies on the availability of comparable sales from which depreciation can be extracted.” *Appraisal of Real Estate* 605. “[I]deally,” according to the Fourteenth Edition, “the comparable properties should [] have physical, functional, and external characteristics similar to the subject property.” *Id.* at 610. If they do not, the Fourteenth Edition cautions, “appraisers can find it difficult to judge whether differences in value are attributable to these characteristics or to a difference in age, and thus depreciation.” *Id.* Indeed, as the Fourteenth Edition notes, “external conditions may affect building values as well, which is why it is important to select sales that are subject to the same (or similar) market influences.” *Id.*

Here, four of the properties from which Mr. Browen extracted estimates of total depreciation (Kimberly, Brainerd, Sartell, and Port Edwards) were sold for their salvage or scrap value, not as operating paper mills.<sup>281</sup> It is therefore unsurprising that their sale prices reflect near-total depreciation of their improvements. The remaining two properties (Biron and Rumford) were sold, as we have discussed, as part of a portfolio and to resolve the litigation challenging the Verso-Newpage merger on antitrust grounds.<sup>282</sup> The Fourteenth Edition warns: “If the sales analyzed

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Paper Holdings LLC.” *Id.*, at 5. But there is no mention of the acquisition in Verso’s March 7, 2013 Form 10-K (Ex. 18), even as Verso disclosed three other events subsequent to December 31, 2012, occurring in January and February 2013. Ex. 18, at 90. We credit the date given in the federal district court’s memorandum opinion (January 2014) and consider the date in the lender presentation (January 2013) a typographical error.

<sup>281</sup> Ex. 1, at 177.

<sup>282</sup> Ex. 1, at 171-72, 175-76.

are affected by special financing or unusual motivation, the problem is further complicated.” *Id.* We declined to consider the Biron and Rumford sale prices reliable indicators of market value, and we similarly decline to consider them reliable indicators of depreciation.

We turn to a discussion of Mr. Dodd’s approach to estimating economic obsolescence.

***Projected 2012 price increase.*** As we have discussed, Mr. Dodd estimated external obsolescence by means of an income analysis. More specifically, Mr. Dodd estimated the going-concern value of the Sartell mill based on an assumption of the Sartell mill’s 2012 earnings before taxes in continued operation, and compared that to his estimate of the replacement cost of the mill.<sup>283</sup> AIM challenges Mr. Dodd’s assumption of a projected price increase in 2012.<sup>284</sup>

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<sup>283</sup> Ex. A, at 168.

<sup>284</sup> Pet’r’s Post-Trial Br. 2. AIM also challenges Mr. Dodd’s decision not to attempt to extract depreciation from the marketplace. Pet’r’s Post-Trial Br. 2. At trial, Mr. Dodd explained that sales of closed facilities and sales for salvage or scrap “are not relevant to appraising a paper mill whose highest and best use is to continue functioning as a paper mill.” Tr. 224.

AIM argues to the contrary, calling “sales of paper mills for alternative uses . . . extremely relevant to the value of the subject.” Pet’r’s Post-Trial Br. 15-16. We disagree. Based in no small part on Mr. Browen’s expert appraisal, we value the subject property here for its continued use as a paper mill. Properties sold for other uses are of no relevance, even in the calculation of depreciation. *See Appraisal of Real Estate* 423 (“To qualify as comparables, the highest and best use of the properties should be very similar, if not the same, as that of the subject property.”).

AIM further argues that Mr. Dodd should have heeded an appraisal (Exhibit 16) of a different paper mill (the Sappi mill in Cloquet, Minnesota) as of a different valuation date (January 1, 2015) because its appraiser determined that two of the paper mills considered by Mr. Browen as sales comparables (Biron and Rumford) had depreciated by 98% and 96% respectively. Pet’r’s Post-Trial Br. 16; Ex. 16, at 57, 59. Gary Battuello, MAI, the appraiser who wrote Exhibit 16, did not attempt to value the subject property, did not testify at trial in this matter, and was not subject to cross-examination on his calculations. For all of these reasons, we give Mr. Battuello’s opinion no consideration.

In estimating the Sartell mill's 2012 earnings, Mr. Dodd began with its 2012 budgeted earnings (\$5,108,963) and added \$4.3 million, reflecting an anticipated increase of \$20 per ton in the price of paper during 2012.<sup>285</sup> AIM criticizes Mr. Dodd for doing so, pointing out that such price increases "never materialized."<sup>286</sup>

The question is not whether paper prices actually increased in 2012, but whether a buyer of the subject property on January 2, 2012, would have reasonably have expected them to. On that point, AIM claims that "[i]ndustry forecasts of price increases were and are commonplace" in paper markets but "rarely are realized."<sup>287</sup> The record suggests otherwise. For example, the record indicates that prices for coated ground-wood paper—the type of paper produced at the subject property—increased by \$30 per ton in 2011.<sup>288</sup> According to rwhMyers, a 2012 price increase was more than a mere forecast. Verso actually announced such a price increase in April 2012 for new orders shipped in May and, although "the market did not accept the increase" initially, Verso still expected prices to increase by August.<sup>289</sup> The record indicates that there was a price increase of \$20 per ton in July 2012 on coated ground-wood paper, and a second round of price increases

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<sup>285</sup> Ex. A, at 168. According to rwhMyers, the anticipated price increase was \$60 per ton. See Ex. 17, at 3. Mr. Dodd's calculations use a figure of \$20.00 per ton. Ex. A, at 168.

<sup>286</sup> Pet'r's Post-Trial Br. 4.

<sup>287</sup> Pet'r's Post-Trial Br. 5.

<sup>288</sup> Ex. 2, at 15 (Harold M. Cody, *Weak Demand, Rising Input Costs Keep Pressure on Groundwood Mills Despite Improvements in Pricing*, PaperAge, Sept.-Oct. 2011.)

<sup>289</sup> Ex. 17, at 3. The expected August price increase *did* materialize. See Ex. 3 (Harold M. Cody, *Groundwood Paper Capacity a Key Wild Card as Producers Battle Sluggish Demand*, PaperAge, Sept.-Oct. 2012) (indicating there was a \$20 per ton increase in coated ground-wood prices in July 2012 and that "major producers announced a \$60/ton price increase[] on coated ground-wood grades and \$40 on supercalendered grades effective in October.").

in October 2012.<sup>290</sup> Acknowledging the nature of this industry, however, a figure of \$20 per ton (averaged across all 2012 production) overstates a buyer's reasonable expectation as of January 2012 both as to the amount and timing of such an increase. We conclude that a figure of \$15 per ton (again, averaged across all 2012 production) reflects a buyer's reasonable expectations as of January 2, 2012, concerning a 2012 price increase.

*Destruction of paper machine 3.* During trial, AIM's Vice President, Mr. McGlin, testified that various paper manufacturers and equipment brokers were interested in buying the subject property after Verso offered it for sale, but Verso determined it would "prevent these machines or portions of these machines from competing against themselves."<sup>291</sup> Verso therefore required that the number 3 paper machine be made inoperable.<sup>292</sup> In post-trial briefing, the County and its expert, Mr. Dodd, asserted that this testimony was their first notice of the destruction of the number 3 machine—the only paper machine still functioning as of the January 2, 2012 valuation date.<sup>293</sup> AIM responded that the County had actual notice of (or should have realized) the condition of the number 3 machine as of the date of sale to AIM.<sup>294</sup> The County replied that the destruction

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<sup>290</sup> Ex. 2.

<sup>291</sup> Tr. 60.

<sup>292</sup> Tr. 60 (Mr. McGlin testifying that Verso hired a contractor "to put a hole in the headbox in the coating heads, which are very, very critical and expensive sections of a paper machine").

<sup>293</sup> Resp't's Post-Trial Br. 8 ("AIM did not disclose to the parties that a condition of the Verso Sale was that AIM destroy critical components of Paper Machine #3, rendering it inoperable as a paper mill."); Decl. Clay Dodd ¶ 3 (filed Sept. 30, 2016).

<sup>294</sup> See Affidavit of Jeffery J. McNaught ¶ 12 (filed Sept. 23, 2016) (attesting that among the documents provided to the County in discovery was one specifically indicating that "[t]he headbox on S3 will be inoperable").

of the number 3 machine was disclosed only in passing among voluminous documents produced by Verso just days before the deadline for completion of the County's expert's report.<sup>295</sup>

Rather than engage in a trial-within-a-trial on the question of when the destruction of the number 3 machine was disclosed, we instead reopened the record to allow each expert to amend his expert report.<sup>296</sup> Mr. Browen indicated that the destruction of the number 3 machine had no impact on his analysis because he was aware of the destruction before finalizing his report.<sup>297</sup> Mr. Dodd, however, indicated that knowing the number 3 paper machine would be disabled would have changed his expert opinion. More specifically, Mr. Dodd indicated that the subsequent sale of the mill to AIM—rather than to another paper manufacturer—for only \$12,500,000 led him to “the implied understanding that AIM could not find a market for paper machine No. 3, and had to scrap a very costly machine due strictly to adverse industry conditions.”<sup>298</sup> That in turn, according to Mr. Dodd, “caused [him] to gravitate towards the high end of the obsolescence range.”<sup>299</sup> Mr.

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<sup>295</sup> Resp't's Post-Trial Br. 8.

<sup>296</sup> The County contends that the only appropriate remedy for AIM's alleged concealment of the condition of the number 3 paper machine is essentially dismissal of the petition. Resp't's Post-Trial Br. 12 (“The proper course, the fair course, here is to uphold the assessor's valuation . . .”). Although we take discovery violations seriously, particularly a party's refusal to comply with reasonable and timely served discovery requests, we decline for several reasons to adopt the County's proposed remedy. First, as we have explained, the record does not unequivocally establish that the information was concealed from the County. Second, as the comment to Minn. R. Evid. 403 explains, “a continuance rather than the exclusion of evidence is deemed to be the better method” of handling the introduction of “surprise” evidence.

<sup>297</sup> Letter from Darren L. Browen to Nicholas A. Furia and Jeffery J. McNaught (Nov. 15, 2016) (on file with the Minnesota Tax Court).

<sup>298</sup> Letter from Clay Dodd to Jerry Von Korff 10 (Nov. 14, 2016) (on file with the Minnesota Tax Court).

<sup>299</sup> *Id.*

Dodd further contends that the apparent fact that the number 3 paper machine could not be sold led him to “temper management’s forecasted price increase from \$60.00 per ton to \$20.00 per ton.”<sup>300</sup> Had he been aware that AIM was required to destroy the number 3 paper machine, Mr. Dodd claims, he would have applied an external obsolescence rate between 67% and 75%, rather than 85%.<sup>301</sup>

Although we find Mr. Dodd’s explanation credible, we place little weight on it, for several reasons. First, as we have explained, we are determining the extent of economic obsolescence of the subject property as an operating paper mill as of January 2, 2012. The events described in Mr. Dodd’s letter occurred well after that valuation date. Second, we are valuing the subject property assuming its highest and best use as of January 2, 2012, was as improved, rather than as vacant. The resale value of the number 3 machine may be relevant for a different highest and best use, but not for continued operation of the subject property as a paper mill; indeed, as the only operable paper machine in the facility, its value for resale or scrap seems particularly *irrelevant* to our decision. Third, and consistent with that point, there is no indication in Mr. Dodd’s original report that his estimate of economic obsolescence was a function of the resale market for paper machines. Rather, Mr. Dodd’s estimate of economic obsolescence was derived from the income expected to be generated from the sale of the paper produced by the number 3 machine.

*Conclusions regarding economic obsolescence.* Without minimizing in any way the financial challenges facing the paper industry, facing Verso, or facing the subject facility itself

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<sup>300</sup> *Id.* at 11.

<sup>301</sup> *Id.*

in 2012, we conclude that Mr. Browen underestimated, and Mr. Dodd overestimated, the remaining economic life of the Sartell mill.

Mr. Browen concluded that the subject facility had a remaining physical life of 10 years but a remaining economic life of only 3.5 years.<sup>302</sup> Mr. Browen's calculation of economic obsolescence is a function of that conclusion. We have previously rejected Mr. Browen's approach to physical deterioration and, as a result, do not adopt his approach to economic obsolescence.

Moreover, Mr. Browen's estimate of remaining economic life was based on his assumption that the facility was not profitable in 2012. In reality, as Mr. Browen acknowledged during trial, the subject facility was expected to generate a gross profit of more than \$14 million, or 7.7% of gross sales.<sup>303</sup> We have no information from which to more definitively assess the profitability of the Sartell mill relative to other mills. But, as we have discussed, the record indicates that the closure of the subject facility was not imminent as of January 2012, and that Verso was continuing to modernize and otherwise invest in the facility. Based on this record alone, we conclude that Mr. Browen underestimated the remaining economic life of the subject property and overestimated the economic obsolescence associated with it.

As we have explained, Mr. Dodd estimated economic obsolescence using the income approach, estimating the market value of the subject property as a multiple of its earnings before

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<sup>302</sup> Ex. 1, at 144.

<sup>303</sup> Tr. 171-76; *see* Ex. 14 (errata to Browen report, Ex. 1, showing projected earnings before income taxes, depreciation, and amortization (EBITDA) of \$5.1 million). By comparison, Verso itself generated EBITDA of 5.3% of gross sales during 2012. Ex 18, at 25.

income tax, depreciation, and amortization.<sup>304</sup> To do so, Mr. Dodd used a multiplier of 8.0.<sup>305</sup> Mr. Dodd justified the multiplier by comparing it to the price for which Verso purchased the mill from International Paper in 2006, which Mr. Dodd equated to a multiple of 6.34 times EBITDA.<sup>306</sup> Mr. Dodd reasoned that “interest rates and yield rates on competing investments were substantially lower at the start of 2012 compared to the second half of 2006, causing such earnings multipliers to increase.”<sup>307</sup> These considerations led Mr. Dodd to rely here on a multiplier of 8.0.<sup>308</sup> As a way to gauge Mr. Dodd’s choice of multipliers, we note that the acquisition of Newpage by Verso, announced in January 2013, represented a multiplier of only 5.2, based on Newpage’s expected EBITDA.<sup>309</sup> We conclude that a multiplier of 8.0 likely understates economic obsolescence.

Mr. Dodd considered the original paper plant buildings 95% obsolete, reasoning that “there was some potential to repurpose them” and because machines 1 and 2 could “be restarted as circumstances dictated.”<sup>310</sup> Machines 1 and 2 were removed from production (and physically disabled) in 2011 and therefore could not have been restarted without significant additional

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<sup>304</sup> Ex. A, at 168.

<sup>305</sup> Ex. A, at 168. The higher the multiplier, the larger the indicated value of the subject property and, all else being equal, the lower the indicated economic obsolescence. Conversely, the lower the multiplier, the smaller the indicated value of the subject property and, all else being equal, the higher the indicated economic obsolescence.

<sup>306</sup> Ex. A, at 169 (indicating that the purchase price “equated to an EBITDA multiplier of 6.34-to-1.00 (Purchase Price / Projected EBITDA)”).

<sup>307</sup> Ex. A, at 169.

<sup>308</sup> Ex. A, at 169.

<sup>309</sup> Ex. 15, at 6 (Newpage Lenders presentation).

<sup>310</sup> Ex. A, at 149.

expenditures. Moreover, we disagree with Mr. Dodd on the possibility of repurposing the buildings associated with those machines, both because of their age (more than a century old) and because of their configuration. This is special-purpose property, after all, and the buildings housing paper machines 1 and 2 were particularly unsuited to repurposing.<sup>311</sup> We consider machines 1 and 2 and the production facilities associated with them fully depreciated as of January 2, 2012. We find that economic obsolescence associated with buildings A11 through A16 (using Mr. Dodd’s labels) totaled \$1,498,185 as of January 2, 2012.

Mr. Dodd considered the training center and capital stores buildings only 50% obsolete, “reflect[ing] the fact that those buildings could be used, and sold, independently from the rest of the plant.”<sup>312</sup> We disagree. Although the buildings could theoretically be used independently of the rest of the mill, their location—hard by the BNSF high-speed rail line, with its associated noise, vibration, danger to pedestrians and motor vehicles, and risk to the buildings themselves from derailment—makes them particularly undesirable once separated from the mill itself. We assign those buildings no special level of obsolescence.

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<sup>311</sup> For example, as explained in Mr. Browen’s report:

Paper mills are designed around paper machines and thus have a ground level and an operating floor level to accommodate the machine that can have a height in excess of 40 feet. There is a cutout in the operating floor for the paper machine to extend upwards from the ground floor. . . . A portion of the ground floor is often below grade and sometimes entirely below grade.

Ex. 1, at 61.

<sup>312</sup> Ex. A, at 149.

Mr. Dodd considered the balance of the site 85% obsolete as of January 2, 2012.<sup>313</sup> Carefully considering all the evidence, including the improvements made and planned for the Sartell facility, the prospects for economic improvement in general and paper price increases in particular, the demonstrated financial viability of the mill, and the effect of Mr. Dodd's 8.0 EBITDA multiplier on his calculations, we find the remainder of the site 90% externally obsolete as of January 2, 2012. In all, we find external obsolescence totaling \$53,018,513. We therefore find the market value of the site improvements (excluding the hydroelectric dam) as of January 2, 2012, to be \$5,724,481.

#### **B. HYDROELECTRIC DAM VALUATION**

Both experts valued the hydroelectric dam on the subject property separately from the rest of the improvements,<sup>314</sup> and we do the same.

The subject property includes a hydroelectric dam spanning the Mississippi River between Benton and Stearns Counties.<sup>315</sup> The hydroelectric dam was constructed at or about the same time as the original paper mill. Extensive improvements and refurbishments were made to the subject dam in 1985, including modifications to the floodwall, replacement of four generators, refurbishing another seven generators, and rehabilitation of all eleven turbines.<sup>316</sup> Upon

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<sup>313</sup> Ex. A, at 168.

<sup>314</sup> Ex. 1, at 182; Ex. A, at 151.

<sup>315</sup> Ex. 1, at 182; Ex. A at 104.

<sup>316</sup> Ex. A, at 28-29.

completion of the improvements, the dam had a capacity of 9.5 MWh and a 40-year regulatory license expiring March 1, 2025.<sup>317</sup>

As of the date of the appraisal, the dam included “11 operable generating bays . . . seven of the bays each have a generating capacity of 925,000 kilowatts per hour (0.925 MWh) and four of the bays each have a generating capacity of 746,000 kilowatts per hour (0.746 MWh); resulting in a total capacity for the dam of 9.459 MWh per hour.”<sup>318</sup> The dam is “licensed as [a] nameplate 9.5 MW[h] facility.”<sup>319</sup> A majority of the physical improvements associated with the dam are located in Benton County.<sup>320</sup> At the date of the assessment, the subject property was averaging 3.3 MWh per year.<sup>321</sup> In February 2014, the dam was sold to Eagle Creek Renewable Energy for \$10,900,000.<sup>322</sup>

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<sup>317</sup> Ex. A, at 29.

<sup>318</sup> Ex. A, at 105.

<sup>319</sup> Ex. A, at 105. The dam “is licensed by the Federal Energy Regulatory Commission (FERC). The subject dam is licensed as a 9.5 MW facility.” *Id.*, at 106.

<sup>320</sup> Ex. A, at 39, 157-58.

<sup>321</sup> Ex. A, at 106.

<sup>322</sup> Ex. A, at 151. At the time of its sale in February 2014, the dam had 11 years remaining on its FERC license. Ex. A, at 106.

To value the hydroelectric dam, Mr. Browen used the cost,<sup>323</sup> sales,<sup>324</sup> and income<sup>325</sup> approaches. Mr. Dodd relied primarily on the February 2014 sale to Eagle Creek.<sup>326</sup> We begin with Mr. Browen's approach.

**1. Mr. Browen's approaches**

**a. Cost approach**

To estimate the value of the hydroelectric dam under the cost approach, Mr. Browen relied on an appraisal conducted by Paul Williams, P.E., for eventual buyer Eagle Creek Renewable Energy.<sup>327</sup> Mr. Williams estimated the 2014 reproduction (not replacement) cost of the dam to be \$53,670,000.<sup>328</sup> From this, Mr. Williams subtracted physical depreciation of \$39,008,000 to arrive at a depreciated reproduction cost of \$14,662,000.<sup>329</sup> Mr. Williams determined that 72% (\$10,613,000) of the depreciated cost represented real property and 28% (\$4,049,000) represented personal property.<sup>330</sup> Although Eagle Creek purchased the dam for \$10,900,000, Mr.

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<sup>323</sup> Ex. 1, at 183-87.

<sup>324</sup> Ex. 1, at 188-90.

<sup>325</sup> Ex. 1, at 191-93. Although Mr. Browen considered the income approach in his appraisal, he gave it no weight in the reconciliation process. *Id.*, at 191.

<sup>326</sup> Ex. A, at 151-54. Mr. Dodd did not estimate the replacement cost (new) of the dam, given the sale to Eagle Creek Renewable Energy. *Id.*, at 20-21.

<sup>327</sup> Ex. 1, at 183-84. Mr. Williams' appraisal is not part of our record.

<sup>328</sup> Ex. 1, at 184. According to Mr. Browen, Mr. Williams's appraisal used reproduction cost (rather than replacement cost) because the appraisal was used to record the purchase on the books of the buyer, Eagle Creek Renewable Energy. *Id.*, at 184.

<sup>329</sup> Ex. 1, at 184.

<sup>330</sup> Ex. 1, at 184.

Williams concluded that the true purchase price of the dam alone was \$8,200,000.<sup>331</sup> Mr. Williams allocated 72% of that amount (\$5,935,520) to the real property associated with the dam and the balance (\$2,264,480) to the personal property.<sup>332</sup> In other words, Mr. Williams valued the real property associated with the dam at about \$5,900,000.<sup>333</sup>

Mr. Browen adjusted Mr. Williams' value for inflation to arrive at a reproduction cost as of January 2, 2012, of \$49,268,975.<sup>334</sup> Mr. Browen reduced this amount for physical depreciation (\$36,038,975) and for functional and economic obsolescence (\$6,069,180) to arrive at an indicated market value of \$7,160,820.<sup>335</sup> Of this amount, Mr. Browen allocated \$2,829,260 to furniture, fixtures and equipment.<sup>336</sup> Because the dam straddles the Mississippi River between Benton and Stearns Counties, Mr. Browen allocated half of the remainder to Benton County, arriving at an estimated value under the cost approach of \$2,170,000.<sup>337</sup>

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<sup>331</sup> Ex. 1, at 185. According to Mr. Browen, Eagle Creek overpaid for the dam because it misunderstood how the dam would be treated for property tax purposes. *Id.* Eagle Creek assumed that only the real property associated with the dam would be subject to property tax, according to Mr. Browen. *Id.* Under Minnesota law, however, once the dam is connected to the electric grid, both its real and personal property become taxable. *See* Minn. Stat. § 272.02, subd. 9(a) (2016) (making taxable “personal property which is part of an electric generating, transmission, or distribution system”).

<sup>332</sup> Ex. 1, at 184.

<sup>333</sup> Ex. 1, at 184.

<sup>334</sup> Ex. 1, at 186.

<sup>335</sup> Ex. 1, at 186.

<sup>336</sup> Ex. 1, at 187.

<sup>337</sup> Ex. 1, at 187.

**b. Sales comparison approach**

To reach an estimate of the value of the hydroelectric dam as of January 2, 2012, Mr. Browen compared the sale prices of four dams located in Minnesota and Wisconsin (including the Sartell dam): the Ford Dam in St. Paul (which sold in 2008); the Kimberly Dam (which sold in 2010); the Brainerd Dam (which sold in 2014); and the subject dam (which sold in 2014).<sup>338</sup> Mr. Browen adjusted each sale price for market conditions (time of sale) and, in the case of the Kimberly dam, for the higher retail price of electricity in Wisconsin in 2011.<sup>339</sup> To calculate the market conditions adjustment, Mr. Browen examined the average price per MWh and KWh for each of the years as provided by the U.S. Department of Energy.<sup>340</sup> He then averaged the MWh anticipated to be produced by each dam based on its efficiency nameplate capacity.<sup>341</sup>

Mr. Browen then calculated the adjusted sale price per megawatt of electricity both anticipated to be produced by each dam and per megawatt of nameplate capacity.<sup>342</sup> The adjusted sale prices ranged from \$1,126,828 to \$2,429,693 of nameplate capacity and from \$1,997,031

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<sup>338</sup> Ex. 1, at 189.

<sup>339</sup> Ex. 1, at 189. According to Mr. Browen, the average retail price of electricity in Wisconsin in 2011 was \$0.1021 per KWh, or 18% more than the average retail price in Minnesota. *Id.*

<sup>340</sup> Ex. 1, at 189.

<sup>341</sup> Ex. 1, at 189. For undisclosed reasons, Mr. Browen excluded the Kimberly dam from the average adjusted price. Ex. 1, at 190.

<sup>342</sup> Ex. 1, at 189. Nameplate capacity is the maximum production capacity. Ex. 1, at 188.

to \$3,912,778 of anticipated production.<sup>343</sup> Considering all, Mr. Browen arrived at an estimated value of \$2,000,000 per megawatt.<sup>344</sup>

To determine the capacity of the subject dam, Mr. Browen relied on Eagle Creek's expected power generation of 5.02 megawatts.<sup>345</sup> Mr. Browen therefore arrived at an estimated value of \$10,045,662.<sup>346</sup> From this, Mr. Browen subtracted \$2,200,000 (the estimated cost to connect the dam to the electric power grid) and \$2,829,260 (the estimated value of the personal property associated with the dam).<sup>347</sup> Mr. Browen also subtracted \$1,506,849, representing a 15% "buyer's entrepreneurial incentive."<sup>348</sup> Mr. Browen allocated 50% of the estimated value to Benton County, arriving at a market value under the income approach of \$1,750,000.<sup>349</sup>

**c. Income approach**

To preserve the independence of the three approaches to value, and because he used the income approach in estimating economic obsolescence as part of the cost approach, Mr. Browen gave the income approach no weight in his analysis.<sup>350</sup>

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<sup>343</sup> Ex. 1, at 189.

<sup>344</sup> Ex. 1, at 190.

<sup>345</sup> Ex. 1, at 190.

<sup>346</sup> Ex. 1, at 190.

<sup>347</sup> Ex. 1, at 190.

<sup>348</sup> Ex. 1, at 190.

<sup>349</sup> Ex. 1, at 190.

<sup>350</sup> Ex. 1, at 191.

Summarizing Mr. Browen's approach, he reached the following opinions of value of the hydroelectric dam:

|                           |             |
|---------------------------|-------------|
| Cost approach             | \$2,170,000 |
| Sales comparison approach | \$1,750,000 |
| Income approach           | \$2,100,000 |

Mr. Browen's final opinion of value of the hydroelectric dam as of January 2, 2012, was \$2,000,000.<sup>351</sup>

## **2. Mr. Dodd's approach**

In estimating the market value of the dam as of January 2, 2012, Mr. Dodd relied on the \$10,900,000 sale price to Eagle Creek in 2014 as "the best evidence of market value as of the date of value."<sup>352</sup> Mr. Dodd subtracted from that amount the cost to connect the dam to the electric grid (\$2,191,762), his estimate of the value of the land under the dam (\$724,536),<sup>353</sup> and \$2,112,681 for the value of the intangible assets included in the sale.<sup>354</sup> Mr. Dodd allocated 73.14% of the remainder to the machinery and equipment associated with the dam, and

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<sup>351</sup> Ex. 1, at 193.

<sup>352</sup> Ex. A, at 151.

<sup>353</sup> Ex. A, at 154. After the valuation date at issue here, and to facilitate the sale of the hydroelectric dam, parcel 1 was subdivided. Parcel 1a represents the land sold with the dam. To avoid double-counting its value, Mr. Dodd subtracted the value of parcel 1a from the sale price because it was already included in his estimate of the value of the entire subject property. *Id.*

<sup>354</sup> Ex. A, at 154.

allocated 65.45% of the resulting value to Benton County.<sup>355</sup> Mr. Dodd thus arrived at a value for the hydroelectric dam as of January 2, 2012, of \$2,810,000.<sup>356</sup>

### **3. Discussion**

#### **(a) Allocation between counties**

Making an extraordinary assumption, Mr. Browen divided the value of the dam equally between Benton and Stearns Counties.<sup>357</sup> Using Eagle Creek's allocation of the purchase price between the two counties, Mr. Dodd allocated 65.45% of the value to Benton County.<sup>358</sup> We adopt Mr. Dodd's allocation of 65.45% of the value to Benton County, and adjust Mr. Browen's calculations accordingly, to reach values of \$2,835,000 under the cost approach and \$2,297,000 under the sales comparison approach.

#### **(b) Conclusions regarding value**

Like Mr. Browen, Mr. Dodd determined that an active market existed for hydroelectric dams and used the subsequent sale of the subject property to Eagle Creek as best evidence of its value.<sup>359</sup> AIM criticizes Mr. Dodd for relying entirely on the 2014 sale in calculating his cost

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<sup>355</sup> Ex. A, at 154.

<sup>356</sup> Ex. A, at 154.

<sup>357</sup> Ex. 1, at 182.

<sup>358</sup> Ex. A, at 154. Had Mr. Dodd allocated the dam equally between Stearns and Benton counties, his allocation to Benton County would have been \$2,147,000. *See id.*

<sup>359</sup> Ex. 1, at 184-85; Ex. A, at 151.

approach.<sup>360</sup> However, Mr. Dodd verified his approach by looking at additional sales of hydroelectric dams. Ultimately, Mr. Dodd calculated the value of the dam to be \$2,810,465.<sup>361</sup>

Reviewing the values above, the appraisers' final valuations—especially under the cost approach—differ little. “[A] court confronted with conflicting appraisals may conclude that a compromise in valuation is required, provided it has evidentiary support.” *Nw. Racquet Swim & Health Clubs*, 557 N.W.2d at 588 (citing *Halla v. Cty. of Hennepin*, 306 Minn. 533, 534, 237 N.W.2d 348, 349-50 (1975)). We largely discount Mr. Browen’s value under the sales comparison approach, given the adjustments required. We give approximately equal weight to Mr. Dodd’s and Mr. Browen’s respective values under the cost approach (as adjusted) and find the value of the hydroelectric dam as of January 2, 2012, was \$2,800,000.

### C. RECONCILIATION OF VALUE

To recap, we arrived at the following market values for the subject property as of January 2, 2012:

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<sup>360</sup> Pet’r’s Post-Trial Br. 17-18.

<sup>361</sup> Ex. A, at 154.

| January 2, 2012   | Assessed Value | Browen's Value             | Dodd's Value                | Court Ordered Value |
|-------------------|----------------|----------------------------|-----------------------------|---------------------|
| Hydroelectric Dam |                | \$2,000,000 <sup>362</sup> | \$ 2,810,000 <sup>363</sup> | \$ 2,800,000        |
| Cost              |                | \$2,835,000                | \$ 2,810,000                |                     |
| Sales comparison  |                | \$2,297,000                |                             |                     |
| Paper Mill Land   |                | \$1,710,000                | \$ 2,150,000                | \$ 1,927,504        |
| Paper Mill RCN    |                | \$3,039,776                | \$ 9,726,462                | \$ 5,724,481        |
| TOTAL             | \$23,544,500   | \$6,749,776 <sup>364</sup> | \$14,686,462 <sup>365</sup> | \$10,451,985        |

We find a final market value (rounded to the nearest hundred) of \$10,452,000 as of January 2, 2012.

J.H.T.

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<sup>362</sup> See Ex. 1, at 193. Mr. Browen valued the hydroelectric dam at \$2,170,000 under the cost approach and \$1,750,000 under the sales comparison approach with the extraordinary assumption that value is divided equally between Stearns and Benton counties. *Id.* Our revised calculation appropriately allocating between counties results in values of \$2,835,000 under the cost approach and \$2,297,000 under the sales comparison approach.

<sup>363</sup> Ex. A, at 154.

<sup>364</sup> Ex. 1, at 146 (\$6,500,000 rounded).

<sup>365</sup> Ex. A, at 151.