79-95

RICHARD S. COHEN
ATTORNEY GENERAL

STEPHEN L. DIAMOND
JOHN S. GLEASON
JOHN M. R. PATERSON
ROBERT J. STOLT
DEPUTY ATTORNEYS GENERAL

STATE OF MAINE
DEPARTMENT OF THE ATTORNEY GENERAL
AUGUSTA, MAINE 04333

May 22, 1979

Honorable Judy Kany
House of Representatives
State House
Augusta, Maine 04333

Re: Applicability of Maine Administrative Procedure Act to Bureau of Taxation Property Tax Valuation Procedures.

Dear Representative Kany:

On April 23, 1979, you asked orally for advice as to whether the appraisal procedures employed by the Bureau of Taxation Property Tax Division with respect to public utility property constituted rules within the meaning of Title 5, § 8002 of the Maine Administrative Procedure Act. Since receiving your request, we have conferred with the Bureau and have examined certain materials provided by it. We have also reviewed the relevant statutory provisions under which the Bureau operates.

As we understand it, the valuation procedure operates as follows. Individual municipalities are responsible for valuing and taxing real and personal property in their respective municipalities, 36 M.R.S.A. § 701, et seq. The Bureau of Property Taxation, under 36 M.R.S.A. § 208, is responsible for establishing a state valuation for each municipality, which state valuation is used for numerous state-related purposes. Valuations established by the State Tax Assessor may be appealed by municipalities to the Municipal Valuation Appeals Board, 36 M.R.S.A. § 291, et seq. The State Bureau of Taxation also provides advice to municipalities for the purpose of assisting municipalities in their local valuation procedures. 36 M.R.S.A. § 201. The valuation process is required by statute to be undertaken in a manner so that the assessment of each parcel of property represents just value for that property. 36 M.R.S.A. § 701-A. Finally, the State Tax Assessor is authorized to adopt regulations necessary to carry into effect any of his duties and responsibilities. 36 M.R.S.A. § 305(5).

The Bureau of Taxation has traditionally provided advice to municipalities on valuation methods, including specifically the valuation of electrical transmission systems, distribution systems and substations. The Bureau has also established for state equalization purposes a state value on such facilities. However, the Bureau has not established a separate state valuation on generation facilities, but has customarily used valuations established by local assessors. In 1978, the Property Tax Division of the Bureau of Taxation implemented for the first time a separate state valuation of electrical generating facilities. The state valuation was apparently undertaken because the Bureau became concerned that the value set on generating facilities by various municipalities varied so widely that the Bureau believed that it could not simply accept the value established by local assessors. On May 1, 1978, the Property Tax Division of the Bureau of Taxation prepared a report analyzing the application of assessing procedures to utility generating facilities. A copy of that report is attached hereto. We assume that it is this report which is the document about which you requested our opinion. We understand from the Bureau that no other documents or policies have been issued. After the report, the Bureau began to separately value generating facilities. In some instances the state valuation has differed markedly from local valuations and has caused concern with some municipalities.

Title 5 § 8002(9)(A) of the Maine Administrative Procedure Act defines a rule as

> "the whole or any part of every regulation, standard, code, statement of policy or other agency statement of general applicability, including the amendment, suspension or repeal of any prior rule, that is or is intended to be judicially enforceable and implements, interprets or makes specific the law administered by the agency, or describes the procedures or practices of the agency."

It is our opinion that the attached document is not a rule as defined in the Act.

The definition of rule in the Administrative Procedure Act encompasses any written document, regardless of whether it is called a rule on its face, which regualtes the conduct of citizens, defines with specificity the relationship of the agency to persons with whom it deals (e.g., rules of procedure for the agency), or establishes other substantive or procedural rights, liabilities or legal standards which have the same force

and effect as a statutory provision. In our view the attached document does not have any of those characteristics. A review of the property tax division memorandum indicates that it was intended to be an explanatory document for local property tax assessors to explain to them how the division would interpret the statutes under which it operated. We do not believe it can be characterized as being "judicially enforceable" particularly since its character is more that of a report analyzing valuation procedures than a regulation-like document having the characteristics of a statute. We read the Administrative Procedure Act's definition of rule as contemplating written documents which would prescribe mandatory legal standards and not the analytical type of document that is attached.

Not every analytical discussion of a statute by an agency constitutes a rule. In fact, the Act appears to contemplate documents such as this by excepting from its definition of rule "explanatory statements of policy" which are "intended solely as advice to assist persons in determining, exercising or complying with their legal rights, duties or privileges." 5 M.R.S.A § 8002(9)(B)(4). In our judgment, the attached memorandum falls within the scope of this exception and is therefore not a rule under the Act.

Alternatively, the memorandum could well be characterized as an internal management policy exempt from the definition of "rule" under § 8002(9)(B)(1). In dealing with a similar issue, the Washington Supreme Court held that assessment practices of a state agency that were interpretive of the statute did not constitute "rules" under that state's APA, but rather were internal management practices. Island County Committee on Assessment Ratios v. Department of Revenue, 500 P.2d 756 (Wash., 1972).

Finally, it should be pointed out that whether or not the policy document is in fact a rule, its application may be challenged by individual municipalities by appeal to the Municipal Valuation Appeals Board and ultimately the Maine courts.

I hope this answers your question. If you have any further requests, please feel free to contact me.

Very truly yours,

RICHARD S. COHEN
Attorney General

RSC/ec
Enclosure

APPRAISAL OF ELECTRIC UTILITY PROPERTY

The State Tax Assessor has the responsibility of exercising general supervision over local assessors in the performance of their duties to the end that all property should be assessed at its just value in compliance with the laws of the state. He is also charged with the responsibility of equalizing and adjusting the assessment list of each town, by adding to or deducting from it such amount as will make it equal to its just value. The following statement is offered as the Property Tax Division's position with regard to the valuation of operating electric utility property.

Just value is a complex concept when considered in the context of regulated public utilities. There is no normal or free market in such properties. The operating property of a public utility cannot be sold except with prior authorization of the Public Utilities Commission. The appraisal of public utility property is generally restricted to economic factors which are clearly second best since, for all practical purposes, meaningful sales of public utility property do not occur.

For purposes of real estate appraisal, value is defined as the present worth of future benefits arising from ownership of real property.[1] Equally as important as recognizing what value is, is recognizing what value is not. It is not cost, although the two might be equal at the time cost is incurred. Nor is value for tax purposes the same as value for rate-making purposes.

However, the rate base, which is administratively determined by the Public Utilities Commission, tends to equal value for tax purposes if the utility can earn what the regulatory agency regards as a fair return and no more, and the agency's concept of a fair return is compatible with that of the investing public.

In the case of capital or income-producing goods or services, the value of property in fact is derived from the value of the product or income which it can produce. Under circumstances where the rate base yields net utility operating income at a rate equal to the fair or market rate of capitalization, the rate base and the income indicator of value for ad valorem tax purposes are essentially the same. To the extent that the actual rate of earnings falls below the fair rate of capitalization, the income indicator of the value of the utility property will be less than the allowed rate base. It is for this reason that, as a rule, the historical cost approach tends to set an upper limit of value for utilities regulated on that basis.[2]

Recognition of this regulatory treatment is important to clear up any misunderstanding that a property could be sold at a price in excess of net book value and that a utility could earn on the purchase price. This is generally not so. Any excess, not approved by the P.U.C. as a prudent acquisition cost, is not under regulatory edict an earning asset.

If an excess should be paid, it would be recorded as an acquisition adjustment and subsequently amortized out of the return allowed; i.e., a cost to be paid by the stockholders.

Since value is the capitalized expression of income, whatever determines income determines value. Replacement costs under current regulatory controls are devoid of significance or usefulness as an evidence of value for tax purposes. As long as land and improvements are an integral part of the utility operation and are dedicated to that purpose, it is their earning capacity as utility property that determines their just value---not their value in exchange in a free market. 35 MRSA §52 clearly states that current value must be excluded in determining reasonable value for rate-making:

> In fixing such reasonable value, the commission shall give due consideration to evidence of the cost of the property when first devoted to public use, prudent acquisition cost to the utility, less depreciation on each, and any other factors as evidence material and relevant therto, but such other factors shall not include current value.

Tax administrators, tax assessors and appraisers should keep in mind that public utilities are heavily regulated by Federal and/or State agencies and that by law the quantity and quality of service as well as the price of the product or service are regulated with the intent to set a limit on earnings in relation to invested capital.[3] This law in fact frames the utility and those who are called on to value regulated enterprises must recognize this framework within which economic factors; i.e., the factors of production are compelled to operate.

The degree of regulation by the P.U.C., therefore, plays a part in the selection of the valuation techniques to be used. Restrictions, whether they be zoning restrictions, building codes, or rate restrictions can affect value. A rate base restricted to original cost less depreciation certainly affects the value of a utility.[4]

In spite of the difficulties involved in the appraisal of public utility property, certain evidences of value are generally accepted. They are: (1) capitalized earnings, (2) market price of stock and debt, (3) original or historical cost less depreciation. The latter is generally given secondary significance by the courts in the appraisal of utility property. The earning capacity of a public utility has long been recognized by the U.S. Supreme Court as a primary indicator of value.[5]

A computation of system value based upon average market price of stocks and bonds or upon capitalization of net earnings reflects the effect upon actual value of obsolescence, of the competition, and of all other factors affecting earnings. Original cost and replacement cost do not reflect adverse economic conditions, whether temporary or permanent. Although replacement cost is a good evidence of value in a competitive or unregulated economy, it has generally been criticized as an index of value for ad valorem taxation of utility property.[6]

The bulk of utility operating property would have no practical usefulness except as an integrated part of the entire system, and its value upon discontinuance of the system would be insignificant. Utility property is generally adapted to a single use and its value depends entirely upon a continuance of that use. Consequently, an appraisal of its value without consideration of the use to which it is adapted would be a practical impossibility as its use as part of a system is the only element that gives it whatever real value it has.

Central assessment under the unit rule offers the most accurate means of appraising public utility property. There are, however, problems associated with allocation of value to the taxing jurisdictions for state valuation purposes in view of the inventory records available from the utility companies as well as local preconceptions to utility value. Application of the market or income approach presumes a unit rule appraisal, i.e., assessing a utility company as an integrated system, but towns are required to assess only that property which has situs within their geographical boundaries.[7] This effectively precludes use of the unit rule by local assessors through market or income approaches. This results generally in an assessment based upon a replacement cost approach with no real consideration given to the primary and most appropriate indicators of value.

Therefore, it is reasonable that the state also appraise on a fractional basis; i.e., appraisals of only that portion of the utility which has situs in a town without reference to the value of the remainder or the whole system. At the very least, the state can assure that the accumulative total of all fractional state assessments will approximate a reasonable indication of value for the public utility taken as an operational unit.

Reliable cost data for the utilities is available since they are required by the Federal Power Commission and the P.U.C. to maintain a uniform system of accounts. Every dollar invested or spent must be recorded in a particular account. Unfortunately, these accounts do not record costs by taxing jurisdiction. However, in the allocation of transmission and distribution costs, reasonably accurate cost and depreciation amounts can be calculated using job orders and other data on file to allocate depreciated original costs by taxing jurisdiction. Generating plant cost data is readily available from company records according to plant situs.

This approach to valuation of electric utility property is appropriate for state valuation purposes. Although this procedure does not explicitly consider the income approach to value in the final correlation of value within a given town, it should be noted that the selection of the historical cost approach less depreciation implicitly considers the income stream generated by the utility since this serves as the principal criterion in the rate-making policy by the P.U.C.

The historical cost less depreciation, plus an allowance for construction work in progress within each taxing jurisdiction, offers the most reasonable indication of value for fractional assessment of utilities regulated on that basis. This procedure does not account for additional economic obsolescence which may derive from the failure of the utilities to actually earn the allowed return. Ultimately, the judgment of the appraiser in each individual case will adjust the procedure to achieve the goal of equalized assessments.

With regard to non-operating property, it is reasonable that current market values as reflected in actual market activity or replacement cost less depreciation serve as the appropriate basis for valuation.

The electric utility companies have considerable land holdings. Some of this land is operating property, some is not. Since the utilities periodically sell non-operating land at a market value, it is suggested that all land be assessed on a current market basis. With regard to hydro-electric sites, the principle of substitution seems most appropriate. The value of a hydro site is essentially a source of "free fuel" for electric generation. After making adjustments for transmission expenses due to remote locations, in some cases, a value for land and water rights can be determined based upon an analysis of current factors influencing the economic value of such property.

The question of maximum depreciation allowed in the cost approach deserves attention. It has been suggested that the amount of depreciation allowed public utilities be limited for purposes of valuation as long as the property is in use.[8] Although the company cannot earn on fully depreciated property, this property does serve a useful purpose in that it allows the company to serve its customers and generate revenue. It would seem reasonable that informed buyers and sellers of such property would be aware of the useful purpose served by fully depreciated property and that some consideration above net book value would be agreed upon for such property. A 40 percent residual value applied to original cost would seem the maximum which could be justified for this class of property. Retention of such a residual value tends to offset the objection of local assessors that the property can still be operative and yet be without value for property taxation.

It should be noted that this approach to valuing electric utility property is consistent with Maine Court decisions regarding the valuation for property tax purposes. In establishing this process of valuation all approaches to value were considered: cost, market, and income capitalization. It was determined that of the three cost approaches available: historical cost, reproduction cost and replacement cost, only historical cost provides an indication which is consistent with the approaches judged by the U.S. Supreme Court and the appraisal profession as deserving primary significance.

1. Property Assessment Valuation, I.A.A.O., 1977, Chicago, p. 16

2. Dr. Alfred Ring, "The Art and Application of the Cost Approach to Value". Address delivered at 1977 Public Utility Workshop, Wichita State University.

3. Ibid.

4. Tom Fleming, CAE. "Cost as an Evidence of Value". Seminar on Public Utility Valuation for Property Tax, Sacramento, California, 1971, p. 51

5. See, e.g., Cleveland, c.c. & St. L.R. Co. v. Backus (1893) 154 U.S. 439.

6. Appraisal of Railroad and other Public Utility Property for Ad Valorem Tax Purposes, National Association of Tax Administrators, 1954, Chicago, p.8.

7. 36 MRSA § 553; 36 MRSA § 601

8. John E. Green, "Appraisal Principles and Techniques for Valuation of Railroads and Utilities". Address presented at 42nd International Conference on Assessment Administration.