REPORT

ON

SPECIAL FRANCHISE ASSESSMENT ADMINISTRATION

STATE OF NEW YORK

STATE BOARD OF EQUALIZATION AND ASSESSMENT

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INTRODUCTION

In 1982, the State Board of Equalization and Assessment determined that 305 companies in New York State owned special franchise property valued at $15,410,101,475. The Board certified to 1,545 units of local government, 7,503 special franchise assessments with a total assessed value of $6,481,002,198.

The administrative program by which these assessments are made and certified began in 1900 amid great political and legal controversy. That controversy has ebbed and flowed almost continuously during the ensuing 83 years; today we are again at floodtide. In 1983, special franchise owners filed more than 2,500 requests for administrative review of tentative special franchise assessments, and the State Board of Equalization and Assessment had been named respondent in more than 1,000 petitions for judicial review of special franchise assessments seeking tax refunds estimated to be in excess of $2,000,000,000.

On April 6, 1983, the State Board of Equalization and Assessment proposed rules to formally establish the standards, procedures and valuation methodology of its special franchise assessment responsibility. Notice was published in the State Register on April 27, 1983, and during the month of June, five public hearings were conducted at various locations throughout the State.

On September 8, 1983, the Board's hearing-officers issued a Report on the written and oral comments which had been submitted at the hearings and during the comment period on the proposed rules. The Report of the hearing officers was mailed to interested parties, and a Notice of Continuation was published in the State Register on September 14, 1983. In order to allow for additional comment by interested parties, the Board extended the comment period through October 15, 1983. At its September 21, 1983 meeting, held in Albany, the Board received oral and written comment on the Report from industry and local government representatives.

At its November 9, 1983 meeting, held in Hempstead, the Board determined that the proposed amendments were not environmentally significant and issued a Negative Declaration pursuant to the State Environmental Quality Review Act.

This rule-making process produced voluminous material, including more than 700 pages of written comment and 22 oral statements by representatives of more than 30 public utilities and local governments. In promulgating the final Rules, as Part 197 of Title 9 of the Official Compilation of Codes, Rules and Regulations of the State of New York, the Board is acutely aware of the magnitude of the program and the complexity of the issues. In the context of this rule-making, the Board has conducted an extensive review of its administration of the special franchise assessment program and the issues involved. The State Board of Equalization and Assessment has prepared this report as a public record of the results of that review.

SUMMARY

The imposition of real property taxation upon special franchises in 1899 was a dramatic legal innovation. Since that time, the Courts have consistently acknowledged the unique nature of this property and upheld the concept by which it is taxed.

The special franchise law subjects to taxation not only the tangible property in the public way but also the right to occupy the public way. In fact, since the tangible property had previously been subject to local assessment, the tax on the franchise itself — the so-called "intangible property" — was the primary purpose of the act. Its validity was established in 1909 and has never been in doubt since.

The law clearly establishes that the tangible special franchise property must be valued using a reproduction cost approach. First, this property is a "specialty" because of its unique nature and the reproduction cost approach is the only approach which the Courts have accepted to value specialties. Second, in the special franchise cases, the tangible property has been repeatedly valued using reproduction cost. Finally, no other approach is valid for this purpose.

Original cost is not an appropriate valuation methodology for purposes of taxation. Although it is used by the Public Service Commission to value utility property for rate-making purposes, it has no bearing on the value of the property for purposes of taxation.

Capitalization of income is appropriate to value property which has no other attribute or function than the production of income. However, the income approach is inapplicable to tangible special franchise property because for tax valuation purposes, (1) only rental income, not sales or other business income, may be capitalized; (2) the property, not merely the owner's business interest therein, must be valued; (3) the income of the company cannot be allocated to the tangible property within the tax district; and (4) this theory assumes that the taxpayer is both at risk and free to attempt to maximize income, neither being the case with a regulated monopoly.

The reproduction cost approach includes the use of certain adjustments to reproduction cost new if circumstances exist which impair the value of the property. An allowance for physical depreciation determined by the "straight-line" approach has long been recognized as valid. However, the industry claims other allowances which have never been recognized and are unsupported in law.

Although the law recognizes "economic obsolescence" under certain circumstances, there is no support for an allowance to account for the effects of regulation upon the value of property for purposes of taxation. An allowance might be authorized for a company which cannot meet its taxes and other fixed charges, but not for a company which is returning a profit.

An allowance for "functional obsolescence" has never been judicially recognized where the operation of the property currently in place is neither impaired nor inadequate, even if the labor and materials used in the original construction would be replaced with less expensive and more efficient labor and materials if the plant were built today. The only circumstances under which the courts have recognized an allowance for functional obsolescence is where there is a loss in the value of tangible property due to either "inadequacy" or "superfluity".

Finally, it has been argued that there should be an allowance for piecemeal construction to account for purported inefficiencies in the installation of special franchise properties. Such an allowance is without foundation in law or accepted appraisal theory.

I. NATURE OF SPECIAL FRANCHISE

The imposition of real property taxation upon special franchises in 1899 was a dramatic legal innovation. Since that time, the Courts have consistently acknowledged the unique nature of this property and upheld the concept by which it is taxed.

Analysis:

No reasonable discussion of the issues can proceed without an appreciation of why the New York State Legislature, in 1899, enacted the special franchise tax where none existed before. During the 1890's, New York was undergoing a profound transition into a new age.

> Everybody realized that a new era had opened, an era of illimitable progress. Science and invention were producing fresh miracles almost daily. Each morning the newspapers seemed to be announcing some dazzling project, incredible in its magnitude, extravagance and promised grandeur. Only a few years remained before the twentieth century would arrive. You didn't need the gift of prophecy to know that, before its advent, life was going to be radically different. No matter where you looked, you saw that New York was being startlingly transformed. By the time the century ran out, it was certain to become an almost unrecognizable city.[1]

New Yorkers took pride in their technological achievements, such as the magnificent bridge linking Manhattan to Brooklyn and skyscrapers exceeding twenty stories high. On the thoroughfares, trollies were replacing horse-drawn carriages as the backbone of the transportation systems of the day. But perhaps in no way was life affected more dramatically than by the services becoming available to the public as a result of the new technologies.

> New Yorkers were becoming accustomed to the new marvels of electricity. The city's telephone system was already the largest and most efficient in the world. By 1896, it had fifteen thousand subscribers, as compared with a mere twenty-eight hundred sixteen years earlier. There were twelve central offices, or "exchanges," which handled an average total of one hundred and fifty thousand calls a day, establishing connections in about forty seconds. All subscribers were able to have "long-distance" connections, and so make calls to Boston

> or Washington or even Chicago, and in an effort to popularize telephone service the company had introduced "message rates," with charges rising from a minimum base of six hundred calls yearly, in accordance with actual use of the telephone. But installation of a telephone in one's home was considered a luxury, and most people, wishing to use one "uptown," went either to the nearest hotel, or to some neighborhood store whose enterprising proprietor had put in an instrument for the use, mainly, of his customers. The device was affixed to a wall — the mouthpiece on a protruding metal neck, the earpiece to be taken from a metal cradle on the side of the box. You turned a crank lustily, lifted the earpiece, and the agreeable young woman at "central" who responded soon made your connection. Whether you spoke from a hotel or a store, anyone standing nearby could eavesdrop on your conversation, so you were likely to be very careful about discussing intimate personal affairs.
>
> The expansion of electric lighting was scarcely less remarkable. Three companies were furnishing this service to different parts of the city. Of these, the Edison system was the largest. It supplied six thousand customers with two hundred and twenty-five thousand incandescent lamps, three thousand arc lamps, and some thirteen thousand horsepower for motors. The city had a total of three hundred and twenty-five thousand incandescent lamps and sixty-two hundred arc lights. Most of the brownstone houses were still illuminated by gas, but wealthy people who had introduced electricity for lighting purposes were able to enjoy such other conveniences as revolving electric fans to keep rooms cool in sultry weather. Already predictions were being made that cooking would be done, and houses heated, by electricity, and New Yorkers had been assured that very soon they would be "able to remain at home and enjoy the lightest note of the prima donna at the opera."[2]

It was during this period of fundamental change that the New York State Legislature approved a radical departure from the existing method of corporate taxation — a tax on "special franchises."

In the late nineteenth century, the State taxed corporations, not only on real property, but also on personal property, both tangible and intangible. However, a

problem arose for assessment officials concerning the franchises to use the public way held by corporations which would come to be known as "utilities." Clearly, these franchises were valuable; what was not as clear was the part their value was to play in the taxation of the corporation.

The assessors were burdened by a statute which predated the nascent, yet burgeoning, utility industry and allowed a corporation to deduct from its personal property its debt payments (L. 1857, c. 456). Furthermore, in 1891, the State's highest court, the Court of Appeals, held that only the capital stock of a corporation was subject to taxation and that the franchise which conferred the privilege to carry on its business, although undeniably property, constituted no part of its capital and, therefore, was not taxable (People ex rel. Union Trust Co. v. Coleman, 126 N.Y. 433, 27 N.E. 818 [1891]).

More important in terms of the taxation of the franchise to use the public way was People ex rel. Manhattan Railway Co. v. Barker, 146 N.Y. 304, 40 N.E. 996, decided in 1895. The Court of Appeals held that not only was the franchise to do business excluded in assessing the corporation's personalty, but so, too, was the franchise to use the streets. The result: a loss of 100 million dollars — turn of the century dollars — in tax revenues for New York City alone.[3] Only legislative action could subject this property to taxation.

A simple legislative overruling of the Union Trust and Manhattan Railway cases would have made the value of the corporate franchises taxable personal property. However, the dichotomous treatment of debt in New York tax law (deductable from personalty, but not from realty) would mean that corporations whose bonded indebtedness exceeded the capital stock (including franchises) would be taxable only on their real property. The value of the franchise would have gone untaxed. The more effective solution was to define in law the value of the franchise to use the public way as real property, thereby making that value immune to debt deductions.

This solution, however, could not become a reality without concerted political support. The leader who was able to create and sustain that political support came to the fore in 1898, when Theodore Roosevelt was elected Governor of New York State.

> On taking office, Roosevelt had no special goal in legislation affecting corporations. What he did have was an attitude, an approach, a stance toward controversial issues of corporate privileges and regulation. His role, as he conceived it, was that of an honest broker among contending factions; his aim, a just yet acceptable compromise.[4]

Early in his administration, Roosevelt played the role of "honest broker" regarding legislation which awarded to certain corporations franchises to use the public way. "In the long run, however, the most significant effect of the tunnel, rapid-transit, and Astoria Gas bills was that they directed Roosevelt's attention to the taxation of franchises as public policy."[5] Another whose attention was directed to this issue was State Senator John Ford, who, along with the Governor, believed that the

real property taxes paid by private individuals were excessive, while corporations owning valuable yet untaxed franchises escaped their fair share.

As a result, Senator Ford introduced legislation to tax the franchise to use the public way. The Governor publicly stated that he "favor[ed] the adoption of a system whereby corporations in this State shall be taxed on the public franchises which they control."[6] The bill created immediate controversy, and the issue developed into perhaps the most important and visible political (and policy) action of Governor Theodore Roosevelt's first year in office.[7]

The significance of this legislation at the time of its enactment cannot be overstated. Immediate opposition developed from the affected corporations, as well as from political leaders who described the bill as "radical legislation * * * bound to strike the conservative business community * * * as an extreme concession to Bryanism."[8] The editors of the Brooklyn Eagle wrote that passage "would make New York State quotable with Kansas, Nebraska and Missouri in the scale of communistic and social legislation, as a state for capital to shun, for investments to abandon and for enterprise and confidence to desert."[9]

Nevertheless, the bill, in its original form, easily passed both houses of the State Legislature. The importance of the Governor's active support in this was ruefully recognized by his own party organization's leadership: there had been "nothing behind this frantic Ford bill until you sprang forward as its champion except the clamor of two yellow newspapers."[10] But when the bill reached his desk, the party leaders renewed their efforts in the hope that Roosevelt would exercise that "very rare and difficult quality of moral courage not to sign it after the part [he] took in its enactment."[11]

But the pressure was to no avail. The Governor asserted that he had not "gone off half-cocked in this matter," that he had "the most profound indifference to the clamor of the yellow papers" and that franchise taxation was "by no means a revolutionary measure."[12]

Recognizing Roosevelt's determination, the opposition offered amendments: (1) substitute a gross receipts tax; or (2) vest the assessment power in a State official rather than the local authorities; and (3) provide for the deduction from the franchise tax any taxes already payable for public rights.

The first amendment, really a substitute measure, was rejected "because it would not produce as large a revenue and would discriminate in favor of the larger metropolitan companies with their relatively low operating costs as compared to income."[13] The other offerings were, however, accepted: State assessment to avoid "the utter corruption of Tammany in laying these taxes"[14] and thereby correcting "the serious defect in the bill";[15] and deduction of franchise fees to avoid double taxation.[16] Following the amendment at a Roosevelt-called special legislative session, the Ford franchise tax bill was signed into law on May 25, 1899.

Chapter 712 of the Laws of 1899 was deceptively simple in its language, profoundly broad in its scope. For purposes of taxation, it included within the

definition of real property the privilege conferred upon certain corporations to make use of the public way. In describing his purpose, Senator Ford stated:

> The [prior] law enumerated the kinds of tangible property which were to be assessed and taxed as real property but said nothing about the property in the land — the easements in, under and over the public highways and places — which the corporations owned in addition to their material structures.
>
> In an amending law which I drew up — the Ford franchise tax bill of 1899 — wherever the material structure appeared in the enumeration, I inserted the words "including the value of the right, privilege or franchise."[17]

While some questioned the classification of this franchise as real property, Edwin R.A. Seligman, Professor of Political Economy and Finance at Columbia University, advising Governor Roosevelt on this issue, deemed the objection

> * * * purely theoretical. From the abstract point of view it is immaterial whether we class such a franchise as personalty or as real estate. It is both, and it is neither. The real estate of a corporation is made valuable by the existence of the franchise in the same way that the personalty of the same corporation is made valuable by the existence of the franchise. The franchise might therefore be classed as either real or as personal property * * *. The classification of special franchises as real estate * * * is a peculiarity referable to that feature in the New York tax system which permits deduction of debt from personalty but not from realty.[18]

As a result, Professor Seligman suggested the term "special franchise" to describe the newly-created class of taxable real property.[19]

No sooner had the State Board of Tax Commissioners issued the first special franchise assessments than the corporations challenged the constitutionality of the very provision of the new law for which they themselves had lobbied: State, rather than local assessment. The Court of Appeals, however, swept aside the claimed violation of the principle of home rule by emphasizing the unique quality of the property to be assessed. In its opinion in People ex rel. Metropolitan Street Ry. v. State Board of Tax Com'rs, 174 N.Y. 417, 67 N.E. 69 (1903), aff'd 199 U.S. 1, 25 S.Ct. 705, 50 L.Ed. 65 (1905), the Court noted that the general franchises of a corporation — to exist and to operate — had always been taxed by the State. The Court's opinion also provided an excellent description of special franchise:

> Special franchises [to use the public way], however, had never been lawfully assessed either by local or state authority, but were made taxable property by the act before us for the first time in the history of the state (174 N.Y. at 436; emphasis supplied).

Thus, special franchises were a singular class of property requiring singular treatment:

> * * * the Legislature * * * created a new system of taxation, brought within its range a new character of property * * *.
>
> The statute should be considered in the light of the circumstances existing when it was passed, which were extraordinary and unprecedented. The system thus created had never been known before, and, as its main subject, the act dealt with special franchises, which had never been taxed before (174 N.Y. at 438-439).

This very uniqueness became the cornerstone of the new law's constitutionality. The principle of home rule could not be violated where property which had never before been assessed was now to be so by a State, rather than a local, officer.

> [The Legislature] found that the valuation of this new kind of property, intangible, invisible, and elusive, but of great value, would be attended with peculiar difficulties, which would require a degree of knowledge and skill not possessed by local assessors, but belonging only to experts, who had long and carefully studied the subject of taxation in all its varied aspects. The problem was to place a just and adequate value upon a right capable of valuation, but which was unseen, without form or substance, and, as it were, the mere breath of the Legislature. It was a new problem that had never arisen before during the history of the state, and it was to be solved, not to meet local needs, but an exigency of state (174 N.Y. at 437-438).

Thus, the imposition of real property taxation upon special franchises in 1899 was a dramatic legal innovation. Since that time, the Courts have consistently acknowledged the unique nature of this property and upheld the concept by which it is taxed.

II. VALUATION OF THE INTANGIBLE COMPONENT

The special franchise law subjects to taxation not only the tangible property in the public way but also the right to occupy the public way. In fact, since the tangible property had previously been subject to local assessment, the tax on the franchise itself — the so-called "intangible property" — was the primary purpose of the act. Its validity was established in 1909 and has never been in doubt since.

Analysis:

Subdivision (17) of section 102 of the Real Property Tax Law defines the term "special franchise." It establishes a dual nature of this property consisting of: (1) an intangible component, comprising the value of the right to use the public way; and (2) a tangible component, comprising the value of the physical property actually placed in the public way under the exercise of the franchise.

The Ford franchise tax bill was a model of simplicity: "wherever the material structure appeared in the enumeration [of tangible real property subject to assessment and taxation], I inserted the words 'including the value of the right, privilege or franchise.' "[20] The resulting law, with the amending matter emphasized, graphically details Senator Ford's purpose:

> Section 1. Subdivision 3 of §2 of the tax law is hereby amended to read as follows:
>
> "3. The terms 'land,' 'real estate,' and 'real property,' as used in this chapter, include the land itself above and under water, all buildings and other articles and structures, erected upon, under, or above, or affixed to the same; all wharves and piers, including the value of the right to collect wharfage, cranage, or dockage thereon; all bridges, all telegraph lines, wires, poles, and appurtenances; all supports and inclosures for electrical conductors and other appurtenances upon, above, and under ground; all surface, underground, or elevated railroads, <u>including the value of all franchises, rights, or permission to construct, maintain, or operate the same in, under, above, on, or through streets, highways, or public places;</u> all railroad structures, substructures and superstructures, tracks and the iron thereon; branches, switches, and other fixtures permitted or authorized to be made, laid, or placed in, upon, above, or under any public or private road, street, or ground; all mains, pipes, and tanks laid or placed in, upon, above, or under any public or private street or place for conducting steam, heat, water, oil, electricity, or any property, substance, or product capable of transportation or conveyance therein or that is protected thereby, <u>including the value of all franchises.</u>

> rights, authority, or permission to construct, maintain, or operate, in, under, above, upon, or through any streets, highways, or public places, any mains, pipes, tanks, conduits, or wires, with their appurtenances, for conducting water, steam, heat, light, power, gas, oil, or other, substance, or electricity for telegraphic, telephonic, or other purposes; all trees and underwood growing upon land, and all mines, minerals, quarries, and fossils in and under the same, except mines belonging to the state. A franchise, right, authority, or permission specified in this subdivision shall, for the purpose of taxation, be known as a "special franchise." A special franchise shall be deemed to include the value of the tangible property of a person, copartnership, association, or corporation situated in, upon, under, or above any street, highway, public place, or public waters in connection with the special franchise. The tangible property so included shall be taxed as a part of the special franchise. No property of a municipal corporation shall be subject to a special franchise tax. (L.1899, c.712).

Today, the whole of the property, both tangible and intangible, is generally referred to as the special franchise. However, in the early years of the program, when interested parties spoke of the "special" franchise, they spoke of the right to use the public way; what the Court of Appeals, in Metropolitan Street Railway, described as a "new kind of property, intangible, invisible, and elusive, but of great value" (174 N.Y. at 437). The taxation of the tangible property was not new; the act's innovation was the taxation of the intangible component. It is essential to understand this when reviewing the early special franchise cases.

The Net Earnings Rule

In the Metropolitan Street Railway case, the Court of Appeals upheld the constitutionality of the special franchise law. Four years later, with People ex rel. Jamaica Water Supply Co. v. State Board of Tax Com'rs, 196 N.Y. 39, 89 N.E. 581 (1909), mod'g 128 App.Div. 13, 112 N.Y.S. 392 (3d Dept. 1908), the courts began the process of reviewing the methods by which the tangible and intangible components of the taxable special franchise were to be valued.

Jamaica Water had complained of its assessment of $800,000, and the trial court directed a hearing before a Referee. Only the utility introduced evidence, the nature of which is not stated in the opinions. The Referee valued the tangible property in the streets at its reproduction cost new less depreciation (RCNLD). He valued the intangible element of the special franchise by computing net earnings for the preceding year, by deducting from the net earnings a five per cent return on the

aggregate value of the company's tangible property in and out of the streets (based on the RCNLD of structures and original cost of land), and by capitalizing the remainder at seven percent. The addition of the value for the tangible property in the streets to the value for the intangible gave a total special franchise value of $906,053, and the Referee therefore upheld the assessment.

On appeal from the order of the lower court confirming the Referee's report, the utility did not contest the valuation of its tangible property in the streets at RCNLD. However, it did contend that the Referee's method of valuing the special franchise (that is, the intangible component) was "arbitrary and misleading, and necessarily includes in the assessment intangible elements contributing to such earnings not constituting a part of the special franchise" (196 N.Y. at 46-47). The Referee's method for valuing the intangible would be subsequently referred to as the "net earnings rule". What method Jamaica Water proposed to substitute does not appear.

Counsel for the State Board argued that the assessment was presumptively correct and should not be overturned, even if shown to be in excess of the result reached by the net earnings rule or by "any other one theory or rule" (196 N.Y. at 44). However, just as had the company, the Board offered no methodology in place of the net earnings rule. Only the City of New York, also a party to the action, was willing to accept the net earnings test as final.

The Court of Appeals stated that the State Board was by no means bound by any single rule. However, it then proceeded to give the following qualified endorsement of the net earnings rule:

> While, as we have already pointed out, the legislature has not prescribed any exclusive or hard and fast rule for assessing the value of special franchises, we think that in the case of this relator and many other corporations similarly circumstanced the adoption and application of the net earnings rule would result in a fair and just valuation. There are obviously many cases, however, to which it would not be applicable at all. Take, for example, the case of a corporation enjoying a special franchise which by reason of mismanagement or other causes had yielded no earnings perhaps for many years; there it might be wholly contrary to the truth to hold that the special franchise of such corporation had no value simply because there happened to have been no earnings by which that value could be measured. Since, however, the net earnings rule may often be employed with convenience and justice and doubtless could justly be adopted in the case at bar, it is proper for us to make some observations in regard to the manner of applying it and the ascertainment of the elements necessary for its application (196 N.Y. at 55).

In effect, the Court's decision was that valuation of the special franchise would be by RCNLD for the tangible and capitalized net earnings for the intangible, unless the State Board introduced and proved an alternative methodology for valuation of the intangible component. As adopted by the Court, the method for valuation of the intangible was as follows:

> (1) Ascertain the gross earnings.
>
> (2) Deduct the operating expenses.
>
> (3) Deduct a fair and reasonable return on that portion of the capital of the corporation which is invested in the tangible property.
>
> The resulting balance gives the earnings attributable to the special franchise. If this balance be capitalized at a fair rate we have the value of the special franchise (196 N.Y. at 56).

It cannot be overemphasized that the net earnings rule applied only to the intangible property; the tangible property was valued by the RCNLD method.

The issue in Jamaica Water Supply was the valuation of the special franchise — "this new kind of property, intangible, invisible, and elusive" — made taxable by the legislature only ten years earlier. In the twenty years following Jamaica Water Supply, use of the net earnings rule to value the intangible component was confirmed and further refined by many courts (see, e.g., People ex rel. Third Ave. R.R. Co. v. State Board of Tax Com'rs, 136 App. Div. 155, 120 N.Y.S. 528 [3d Dept. 1909], aff'd 198 N.Y. 608, 92 N.E. 1098 [1910]; People ex rel. Hudson & Manhattan R.R. Co. v. State Board of Tax Com'rs, 203 N.Y. 119, 96 N.E. 435 [1911]; People ex rel. Manhattan Ry. Co. v. Woodbury, 203 N.Y. 231, 96 N.E. 420 [1911]; People ex rel. Third Ave. R.R. Co. v. State Board of Tax Com'rs, 157 App. Div. 731, 142 N.Y.S. 986 [1st Dept. 1913], aff'd 212 N.Y. 472, 106 N.E. 325 [1914]; People ex rel. Central Hudson Gas & Electric Co. v. State Tax Com'n, 218 App. Div. 44 and 60, 217 N.Y.S. 707 and 722 [3d Dept. 1926], aff'd 247 N.Y. 281, 160 N.E. 371 [1928]). The rule thus came to be described by Bonbright:

> As a result of subsequent decisions, the formula of the Jamaica Water case has come close to being rigidified into hard-and-fast law. Indeed, it is the most striking approach to a rigid valuation formula that has come to our attention in our entire study of legal appraisal. To be sure, the opinions have continued to repeat the doctrine that no one method of valuation is final. So far, however, this doctrine has been given little effect in practice.[21]

Rate Regulation

In the early years, the value of the intangible was the predominant component of special franchise assessments. However, between 1916 and 1947, the value of the intangible relative to the tangible dropped precipitously:[22]

YEAR	INTANGIBLE VALUE		TANGIBLE VALUE		FULL VALUE
	Dollar amount	Percentage of full value	Dollar amount	Percentage of full value	
1916	$330,996,264	50.9%	$ 318,309,673	49.1%	$ 649,305,937
1930	$162,961,828	16.1%	$ 844,141,691	83.9%	$1,007,105,519
1947	$ 86,943,847	7.4%	$1,073,179,188	92.6%	$1,160,123,045

The reason for this is unmistakable: the effective regulation of utilities by the New York State Public Service Commission (PSC) was yielding smaller and smaller earnings to capitalize under the net earnings rule.

Administrative regulation of public utilities in New York was established in 1855 with the first Railroad Commission (L. 1855, c. 526). However, while these first Commissioners were given limited powers to uncover and report violations of law (§13), rates were originally fixed by the State Legislature. The first delegation of actual rate-making authority to an administrative agency occurred in 1905, when the Commission of Gas and Electric was created to fix the maximum prices for gas and electric light service (L.1905, c. 737). Shortly thereafter, in 1907, the Public Service Commissions Law was enacted (L. 1907, c. 429).

By the late 1920s, rate regulation had broken down (see, Section IV, "Valuation of the Tangible Component by Original Cost [pp. 30-36]. In 1930, a Legislative Commission to revise the Public Service Commissions Law made recommendations (see, Report of Commission on Revision of the Public Service Commissions Law 1930, Vols. I-IV) which, following enactment (L.1930, cc. 760, 761, 773-793), generally strengthened the hand of the PSC in matters such as capitalization, holding and affiliated companies, utility accounts and records, and financial transactions. However, no practicable solution of the rate-making difficulties was found.[23]

Ultimately, the PSC would assert its power over utility rates, and, when it did, the net earnings, which in the early part of this century formed so significant a portion

of the total special franchise assessment, declined under that regulation. Clearly, however, the franchise to use the public way remained a valuable commodity; witness the present economic health of utilities whose origins reach back into the last century, even before the enactment of the special franchise tax law.

The Five Percent Rule

Regulation had a significant effect upon the operation of the net earnings rule. In an age of virtually unbridled income, "the adoption and application of the net earnings rule would result in a fair and just valuation" (People ex rel. Jamaica Water Supply Co v. State Board of Tax Com'rs, 196 N.Y. at 55). However, even then, the Court of Appeals noted that:

> There are obviously many cases, however, to which it would not be applicable at all. Take, for example, the case of a corporation enjoying a special franchise which by reason of mismanagement or other causes had yielded no earnings perhaps for many years; there it might be wholly contrary to the truth to hold that the special franchise of such corporation had no value simply because there happened to be no earnings by which that value could be measured (196 N.Y. at 55).
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> * * *
>
> If, as is suggested might occur in some supposed cases, this would result in giving a special franchise no taxable value at all, that would be a conclusive reason for rejecting the net earnings rule in such cases and would demand the adoption of some other method of valuation (196 N.Y. at 59; emphasis supplied).

The cumulative effects of rate regulation and economics eventually produced just such a situation, reviewed in People ex rel. New York Telephone Co. v. Browne, n.o.r. (Sup. Ct., Albany Co. 1953).[24] There, the corporation's witness testified that in "applying the net earnings rule as laid down in the aforesaid Jamaica case there was a deficit rather than net earnings subject to capitalization" (slip op. at 24-25; emphasis supplied). As a result, the State Tax Commission calculated the value of the intangible component on the basis of 5% of the tangible valuation (RCNLD).

The corporation argued that this figure was "arbitrary" (slip op. at 13) and represented a double taxation of the franchise. As the Referee stated

> The position of the relator is that that physical property would have mere junk value, and no more, were it not for the rights and privileges granted to it by the State and that in computing reproduction cost new [of the tangible property] and depreciating the same the State Tax Commission has already taken into consideration the value of the franchise (slip op. at 15).

These positions were entirely rejected by Referee Lounsberry, who, in construing the statute, found that the inclusion of the specific reference to the tangible property "indicates the separability for tax purposes of the value of the physical property and the value of the grant from the State" (slip op. at 14). Accordingly, the Referee found that "[t]he relator's argument that the valuation of the tangible part of its special franchise, if more than junk value, includes the value of the intangible element can not be sustained as a matter of law" (slip op. at 16; emphasis supplied).

As to the State Tax Commission's manner of valuing the intangible component in the absence of net earnings, the Referee dismissed the charge of arbitrariness upon the testimony of the Commission's witness. Having qualified as an expert on public utility matters, "[h]e stated that in his opinion the figure of 5 percent of the value of the physical property of the relator located in the City of Buffalo was fair and reasonable" (slip op. at 16). Quoting and following the authority of the Jamaica Water Supply case, the Referee found that "[u]nder the law and the fact of the particular nature of the taxpayer's operation and special franchise the State Tax Commission was justified in refusing to apply the net earnings rule" (slip op. at 25).

Within a short period of time, this new method of valuing the intangible component received a full judicial review in Matter of Staten Island Edison Corp. v. Moore, 6 A.D.2d 369, 177 N.Y.S.2d 129 (3d Dept. 1958), rev'g 6 Misc.2d 1031, 164 N.Y.S.2d 772 (Sup. Ct., Albany Co. 1955), aff'd after remand 15 A.D.2d 983, 225 N.Y.S.2d 520 (1962), aff'd 12 N.Y.2d 846, 187 N.E.2d 475, 236 N.Y.S.2d 624 (1962). The Referee in Staten Island Edison, unable to distinguish the Browne case, simply disagreed with that opinion, adopting all that had there been rejected. He cited Jamaica Water Supply for its holding that "in most cases 'the adoption and application of the net earnings rule would result in a fair and just valuation' (164 N.Y.S.2d at 789), but he failed to continue the quotation to include the language regarding the "obviously many cases, however, to which it would not be applicable" (People ex rel. Jamaica Water Supply Co. v. State Board of Tax Com'rs, 196 N.Y. at 55), as had Referee Lounsberry in Browne. Thus, in marked contrast to the only other case which reviewed the issue, Referee McNulty found that "[i]f an independent value is to be placed on the franchise right in a case where there are no excess earnings, double taxation is bound to result" (164 N.Y.S.2d at 790). Accordingly, the value of the intangible property here was deemed to have "necessarily merged into and becomes an integral part of the value ascribed to the tangible component of the franchise" (164 N.Y.S.2d at 788-789).

The Appellate Division reversed the decision of the Referee. The finding that the intangible had merged with the tangible with the result that the former was not subject to an independent assessment was rejected:

> We do not believe this argument to be tenable. The State Board has no control over the various items which are used in arriving at the earning ratio in accordance with accounting methods and practices prescribed by the Public Service Commission. The State Board employed a 5 percent figure for determining the value of the intangibles which seemed warranted on the record (177 N.Y.S.2d at 134).

The Appellate Division accepted "as a proper component of value the intangible property in the amount found by the Board as justified and reasonable" (177 N.Y.S.2d at 136), and the Court of Appeals affirmed: "It is sufficient simply to note that the record before us supports the result reached below" (12 N.Y.2d at 848).

The special franchise law subjects to taxation not only the tangible property in the public way but also the right to occupy the public way. In fact, since the tangible property had previously been subject to local assessment, the tax on the franchise itself - the so-called "intangible property" - was the primary purpose of the act. Its validity was established in 1909 and has never been in doubt since.

Sections 197-3.7 and 197-3.8 of our Rules are promulgated in recognition of these legal developments. The net earnings rule has been modified and is now called the excess earnings rule due to the substitution of rate base (valued primarily on an original cost less depreciation basis [OCLD]) for the RCNLD of the tangible property to arrive at excess earnings. The reason for this modification is that since (1) the value of the intangible component has been held to be, in the circumstances described above, a function of the property's earning capacity, and (2) a utility's earnings are strictly regulated on the basis of OCLD, the only equitable means of measuring the intangible value in those circumstances is upon the same basis as that on which the PSC regulates the property's income.

III. VALUATION OF THE TANGIBLE COMPONENT BY REPRODUCTION COST

Tangible special franchise property must be valued by a reproduction cost approach, especially since it is "specialty" property.

Analysis:

An examination of the case law leads to the inescapable conclusion that reproduction cost new less depreciation (RCNLD) is the only appropriate method by which tangible special franchise property may be valued.

This is not to say that the courts have refused to recognize a dimunition of the value of real property as a result of the economic circumstances of the company; however, this recognition has taken the form of an adjustment to RCNLD rather than the use of the income approach. This allowance will be considered in Section VII, "Economic Obsolescence" (pp. 43-45).

The Specialty Doctrine

The courts have repeatedly concluded that "specialty" property must be valued using RCNLD. Recently, the Court of Appeals in Matter of Great Atlantic & Pacific Tea Co., Inc. v. Kiernan, 42 N.Y.2d 236, 366 N.E.2d 808, 397 N.Y.S.2d 718 (1977) stated that "a specialty may perhaps be best defined as a structure which is uniquely adapted to the business conducted upon it and cannot be converted to other uses without the expenditure of large sums of money [citations omitted]" (42 N.Y.2d at 240; emphasis in original).

These criteria were reaffirmed and refined in Matter of County of Suffolk (Van Bourgondien), 47 N.Y.2d 507, 392 N.E.2d 1236, 419 N.Y.S.2d 52 (1979):

> (a) The improvement must be unique and must be specially built for the specific purpose for which it is designed; (b) There must be a special use for which the improvement must be so specially used; (c) There must be no market for the type of property * * * and no sales of property for such use; and (d) The improvement must be an appropriate improvement at the time of the taking and its use must be economically feasible and reasonably expected to be replaced * * *. In Matter of Great Atlantic & Pacific Tea Co. v. Kiernan (42 N.Y.2d 236, 240), in the context of a tax certiorari proceeding, we added a further refinement to the element of uniqueness: "a specialty may perhaps be best defined as a structure which is uniquely

> adapted to the business conducted upon it or use made of it and cannot be converted to other uses without the expenditure of substantial sums of money" (47 N.Y.2d at 512; emphasis in original).

An analysis of these standards makes clear that tangible special franchise property is specialty property:

a. The "mains, pipes, tanks, conduits, wires or transformers, with their appurtenances, for conducting water, steam, light, power, electricity, gas or other substance" (RPTL, §102[17]), which make up tangible property are "unique" and "specially built" for the specific purpose for which they are designed. "The requirement of uniqueness goes to the function of the building, not to the availability of its components" (47 N.Y.2d at 512; emphasis in original).

b. The installation of this property is clearly "a special use for which they were originally designed." As stated in Metropolitan Street Railway, "[a]ll the mains and pipes, poles and wires, rails and ties of the relators, when separated from their special franchises, have no value except as firewood or old iron" (174 N.Y. at 441).

c. As the cases have clearly held, there is no market for this type of property and no sales of similar property for this use.

d. Tangible special franchise property is "an appropriate use of the property; it is economically feasible and reasonably expected to be replaced." It requires no citation of authority to suggest that should this property be destroyed, it necessarily would be replaced. Our society is so heavily dependent upon most forms of special franchise that non-replacement is unthinkable.

More recently, in Matter of Consolidated Edison Co. of N.Y. v. State Board of Equalization and Assessment, 101 Misc. 2d 910, 422 N.Y.S.2d 584 (Sup.Ct., Albany Co. 1979), mod. on other grds. 83 A.D. 2d 355, 445 N.Y.S.2d 243 (3d Dept. 1981), aff'd 58 N.Y.2d 710, 444 N.E.2d 1326, 458 N.Y.S.2d 907 (1982), the Court analyzed the assessment methods applicable to tangible special franchise property:

> The legislature has not mandated nor prescribed any exclusive method for the valuation of special franchises. However, where property is designed for "unique" purposes or is "uniquely adapted" to the business conducted upon it or use made of it, for which there is no market, and which cannot be converted to other uses without the expenditure of substantial sums of money, such property has been classified as a "specialty" and regarded as such in determining its sound value. Applying these criteria to petitioner's special franchises impels the conclusion that we are dealing

> here with the valuation of "specialty" property (Matter of County of Suffolk [C. J. Van Bourgondien, Inc.], 47 N.Y.2d 507, 419 N.Y.S.2d 718, 366 N.E.2d 1236; Matter of A & P Tea Co. v. Kiernan, 42 N.Y.2d 236, 397 N.Y.S.2d 718, 366 N.E.2d 808). It has consistently been held that the proper and accepted method for the valuation of a "specialty" is reproduction cost new less depreciation, except in a case where, because of the newness of the property, actual construction cost may adequately and fairly reflect its value (Matter of County of Suffolk [C. J. Van Bourgondien, Inc.], supra; Matter of Onondaga County Water Dist. v. Board of Assessors, 39 N.Y.2d 601, 605, 385 N.Y.S.2d 13, 15, 350 N.E.2d 390, 391; Matter of Semple School for Girls v. Boyland, 308 N.Y. 382, 389, 126 N.E.2d 294, 296; People ex rel. Hotel Paramount Corp. v. Chambers, 298 N.Y. 372, 83 N.E.2d 839; Westbury Drive-In v. Board of Assessors of County of Nassau, 70 Misc.2d 1077, 1081, 335 N.Y.S.2d 361, 365, aff'd. 45 A.D.2d 821, 356 N.Y.S.2d 1017; Long Is. Light. Co. v. State of New York, 28 A.D.2d 1014, 1015, 283 N.Y.S.2d 806, 808; cf. Orgel, Valuation Under Eminent Domain, sec. 211, p.95) (422 N.Y.S.2d at 586-587).

Thus, the specialty doctrine requires the use of RCNLD to establish the value of the tangible special franchise. Moreover, in the numerous instances in which courts have reviewed the valuation of this type of property, RCNLD has always been applied.

Railroad Cases

When the special franchise tax was enacted in 1899, a methodology for valuing tangible utility property had already been approved by the courts with regard to railroad real property. The case law is notable for two reasons: (1) valuation by income capitalization was thoroughly rejected; and (2) RCNLD was accepted as and has remained the only means of valuing this type of property.

Prior to 1897, railroads were assessed primarily on the basis of capitalization of earnings. The Court of Appeals stated in People ex. rel. Buffalo and State Line R. Co. v. Bailey, 48 N.Y. 70 (1871) that:

> A railroad through the town of Hamburgh only, having no connection at either end, would be of no value. The erections and superstructure would

> destroy its value for family purposes. As a railroad, it would have no passengers and no business, and would be worthless. The attempt to use it as such would involve debt and embarrassment, but no profit * * *. Each piece of property is to be estimated in connection with its position, and the business and profit to be derived therefrom. The road in question is part of a whole, and is to be valued as such. This is independent of the taxation of the capital. It is an estimate of the value of the real estate for railroad purposes * * * (48 N.Y. at 77; emphasis supplied).

From this point until 1897, the courts routinely reduced reproduction cost based railroad assessments (People ex rel. New York Elevated R. Co. v. Comr's., 19 Hun. 460 [1st Dept. 1879]; People ex rel. Ogdensburgh & C.C. R.R. Co. v. Pond, 13 Abb. N.Cas. [3rd Dept. 1882]; People ex rel. Albany & Greenbush Bridge Co. v. Weaver, 34 Hun. 321 [3rd Dept. 1884], app. dism. 99 N.Y. 659; People ex rel. Walkill Valley R.P.C. v. Keator, 17 Abb. N.Cas. 369 [3rd Dept. 1885]; People ex rel. Delaware & Hudson Canal Co. v. Roosa, 2 How.Pr. (n.s.) 454 [Sup.Ct., Ulster Co. 1885]; People ex rel. Rome, W. O. & R.R. Co. v. Hicks, 40 Hun. 598, aff'd 105 N.Y. 198 , 11 N.E. 653 [1887]; but see, People ex rel. Panama R.R. Co. v. Com'rs of Taxes, 104 N.Y. 240, 10 N.E. 437 [1887]).

However, in 1897, in People ex rel. Delaware, Lackawanna & Western R.R. Co. v. Clapp, 152 N.Y. 490, 46 N.E. 842 (1897), the Court of Appeals dramatically altered the law. At issue in Clapp was the assessment of seven miles of railroad track belonging to a profitable railroad company. After considering the earnings of the railroad, the assessors had valued the property in excess of RCNLD, the rationale being that if diminished earnings require a lower assessment than RCNLD, then enhanced earnings justify a greater assessment.

The Court of Appeals rejected this income approach in favor of the reproduction cost approach on the grounds that capitalization of income involves insurmountable difficulties, whereas the reproduction cost approach is straightforward, accurate and fair when applied to a "paying railroad". The Court compared the relative merits of the two approaches as applied to utility property:

> The earnings of a railroad include the earnings of the personal property as well as the real estate. It includes the use of its franchises, and the profits of operation may, in many cases, be attributed to the skill or ability of the management. The rentals grow out of all real and personal estate and franchises. It is simply impossible to apportion the rentals or earnings and credit the just proportion to real estate, to personal property and to franchises.

To ascertain the rental per mile, and then capitalize that sum at six per cent in order to ascertain the value per mile, as seems to have been done in this case, would include the use of real and personal property and corporate franchises, and such a rule for the assessment of real estate alone is misleading and wholly unreliable.

The cost of reproducing these seven miles of railroad seems to us to be the just and reasonable rule of valuation. There is no reason that we can perceive for assessing this property at a greater sum than the cost of replacement. It may not in every case be worth what it would cost to reproduce it. That would depend upon the income or earning capacity of the road after it is built. But this is the case of a paying railroad, and, when valued at what it would cost to procure the land, construct the roadbed, put down the ties and rails and erect the buildings and other structures, all new, it is difficult to see any ground for assessing it at a larger sum* * *. Such a rule of valuation is reasonable and possible. But to ascertain the value of a few miles of railroad in a country town upon a complex theory based upon the income or rentals of two hundred miles in this state of an intricate railroad system extending into other states, is impracticable, and, if permitted, would, in many cases, result in injustice. An assessment based upon the cost of reproduction eliminates from the question all extraneous elements, and at the same time subjects railroad property to its just share of the public burdens* * *.

The assessment of the real estate upon a basis of profits of income of the whole railroad must necessarily attribute to the real estate a value which should be shared with the personal property and franchises. This objection is obviated when the real estate is assessed as such, and at a valuation not to exceed the sum at which it could then be produced in its existing conditions. Of course, the valuation will vary in each locality according to circumstances, as the cost will vary. In some localities the property may have increased in value from natural causes, and in others it may have depreciated, but these inequalities are practically eliminated when in each locality the real estate is valued according to the cost of reproduction (152 N.Y. at 493-497; emphasis supplied).

This analysis is relevant both to the issue of RCNLD versus the income approach and to the issue of the unit approach versus the summation approach, discussed in Section V, "Valuation of the Tangible Component by the Income Approach" (pp. 37-38). For now, it is enough to say that the Clapp case stands for the proposition that RCNLD, rather than capitalization of income, is the proper method of valuing tangible utility property.

In Clapp, the Court did acknowledge that in the case of a non-paying railroad the proper assessment could be less than reproduction cost, depending upon income and earnings capacity. In cases since Clapp primarily involving non-paying railroads, the courts recognize an impairment in the value of real property as a result of the economic distress, but, as noted earlier, this recognition has taken the form of an adjustment to RCNLD, rather than the rejection of the cost approach (see, Section VII, "Economic Obsolescence" [pp. 43-45]).

Special Franchise Cases

As we have throughout, we again stress the historical context within which the law on special franchise assessment developed. Unlike today, when the tangible component of a special franchise may exceed 95% of the entire full value, in the age when most of the leading cases were decided, the value of the intangible component was far greater.

As a result, it was to the advantage of the corporation to receive as high a tangible property valuation as possible. The net earnings rule required a deduction from gross earnings of "a fair and reasonable return on that portion of the capital of the corporation which is invested in the tangible property" (People ex rel. Jamaica Water Supply v. State Board of Tax Com'rs, 196 N.Y. at 56). Thus, the higher the value of the corporate tangible property,[25] the higher the earnings attributable to it after applying the rate of return. The higher the return on the tangible property, the lower the earnings attributable to the intangible component which, when capitalized, represent its value under the net earnings rule. Accordingly, despite the fact that the valuation of the intangible was at issue in Jamaica Water Supply and the cases which follow, discussion there of the valuation of the tangible property is not only germane, but crucial. Without a determination of the value of the tangible, the courts could not apply the net earnings rule in valuing the intangible.

The Referee in Jamaica Water Supply valued the tangible property by "what it would cost to reproduce the property new, less 5% depreciation" (196 N.Y. at 43). Since the corporation preferred RCNLD to original cost less depreciation (for the reasons stated above), this finding went unchallenged by the corporation. However, the corporation did object when, for purposes of allowing a return on the tangible property under the net earnings rule, the Referee included the original cost of the land instead of its present value. That the corporation sought the highest possible valuation of the tangible property is clear from its argument: "The referee erred in allowing a return upon only the original cost, instead of the much greater present

value of the relator's land [citing Willcox v. Consolidated Gas Co., 212 U.S. 19, 29 S.Ct. 192, 53 L.Ed. 382 (1909)]" (196 N.Y. at 48).

In agreeing with the corporation, the Appellate Division found it

> * * * difficult to understand upon what ground they refuse to give to the relator the actual value of its real estate * * *. The question is: What is the relator's property, tangible and intangible, actually worth? Actual value, and not cost, is the true basis for taxation. It was, therefore, clearly error to refuse to recognize the actual value of the real estate owned by the relator (112 N.Y.S. at 394; emphasis supplied).

The Court of Appeals affirmed, citing the same authority relied upon by the corporation: "The taxes upon this land are based upon the present value, not upon its cost to the corporation when originally acquired. So we think its present value must be taken into account in applying the net earnings rule to the valuation of the special franchise" (196 N.Y. at 59). Original cost, then, was clearly discredited and rejected as a valid method for valuing tangible property for tax purposes in favor of present value (RCNLD).

At virtually the same time that the courts were reviewing the issues in the Jamaica Water Supply case, similar, if not identical, arguments were being heard in another special franchise assessment review proceeding. In People ex rel. Third Ave. R.R. Co. v. State Board of Tax Com'rs, 136 App. Div. 155, 120 N.Y.S. 528 (3d Dept. 1909) aff'd 198 N.Y. 608, 92 N.E. 1098 (1910), the utility requested a reduced special franchise assessment based upon the use of reproduction cost new in the valuation of its tangible property. Significantly, the corporation argued against a reduction in reproduction cost new due to depreciation. Again, the higher value (without depreciation) as a factor in the net earnings rule would produce a lower overall value and, therefore, a reduced assessment.

The State Board and the City of New York maintained that present or actual value (RCNLD) was the proper measure, and the lower court agreed. The railroad appealed, and while neither the opinion nor the Record on Appeal explicitly defines the terms, "actual value" and "reproduction cost," it is clear from both that actual value refers to reproduction cost less depreciation.

> It is urged that the actual value of the tangible property should have been considered rather than its reproduction cost. Some of the property was practically indestructible by use, and much of it was nearly new. As to such properties, the reproduction cost would fairly

> indicate its value. The record does not give facts sufficient to warrant a determination how much the other property had depreciated (120 N.Y.S. at 529; emphasis supplied).

Unless the parties were differentiating between actual value and reproduction cost on the basis of depreciation, the comments of the Court that the property was "practically indestructible by use" and "nearly new" have no meaning; of similar import is the reference to the lack of evidence in the record as to "how much the other property had depreciated."

In the Brief on behalf of the State Board of Tax Commissioners and The City of New York, the use of reproduction cost was explained:

> * * * in the Jamaica case we contended that the relator was only entitled to a return upon the original cost of the land and not upon its present value. To be consistent therefore in our theory, we made the same contention before the Referee in the case at bar. As we asked the Referee and the courts to allow a return upon the original cost of the land, we were consistent when it came to the other tangible portions of the relator's plant, and as there was no testimony as to the original cost of these portions of the plant we took the cost to reproduce it new as being the best evidence (Brief at 24-25; emphasis supplied).

The State Board also noted that at the time of the Referee's report, the Referee's decision in Jamaica Water Supply had not yet been reversed by the Appellate Division and then affirmed by the Court of Appeals. Thus, "at the time the Referee's second report in the case at bar was made, it was the law in this State that a return could only be had upon the original cost of tangible property" (Brief at 25).

With the opinions of the Appellate Division and the Court of Appeals in Jamaica Water Supply, that a return was to be computed on the present value of land, not its original cost, the State Board merely asked the Court "to apply the law of the State to the case at bar" (Brief at 25). It also noted the "inconsistent position" (Brief at 26) of the corporation seeking to obtain a return on the greatly appreciated present value of its land while claiming entitlement to a return on the other tangible property valued by its original cost or, in the absence of proof as to what that was, its reproduction cost new without any adjustment for depreciation:

> There is no reason for any such distinction. If the relator is entitled to the benefit of appreciation

> in the value of some of its property, there is no reason why depreciation should be ignored, especially when the test laid down by all the authorities is that the return must be based upon the present value of the property employed in the production of the earnings (Brief at 27).

Despite this argument, the Court affirmed the valuation at reproduction cost new. However, this should not be taken as rejecting, as a matter of law, an allowance for depreciation where appropriate, since that portion of the appeal was dismissed on procedural grounds: "The trial having proceeded entirely on that theory [reproduction cost new], I think neither party is in a position to be heard against it" (People ex rel. Third Ave. R.R. Co. v. State Board of Tax Com'rs, 120 N.Y.S. at 529).

The timing of the decisions in Jamaica Water Supply and Third Avenue Railroad shows the extent to which the utilities understood the net earnings rule and sought to make it work to their advantage. This understanding is most clearly shown in People ex rel. Hudson and Manhattan Ry. Co. v. State Board of Tax Com'rs, 203 N.Y. 119, 96 N.E. 435 (1911), rev'g 142 App. Div. 220, 126 N.Y.S. 1063 (3d Dept. 1911) and 143 App. Div. 26, 127 N.Y.S. 918 (1st Dept. 1911). To begin, the utility argued, and the court agreed, that since the subject property was a partly constructed and presently non-operating railroad, "at this time no assessed value should be attributed to such privilege [the intangible component]" (203 N.Y. at 130).

With the valuation of the intangible component of this special franchise eliminated, the assessment would rest only upon the valuation of the tangible property. Accordingly, with the net earnings rule inapplicable in these circumstances, the corporation argued against a tangible value based upon reproduction cost new on the ground that this would be "greatly in excess of any fair value of such tangible property" (203 N.Y. at 121). Instead, "only its scrap value, which is merely nominal, should be considered" (126 N.Y.S. at 1065).

The Court of Appeals rejected this contention, finding instead that

> That there is evidence to sustain the determination of the state board is reasonably clear. The expert evidence shows that the assessed valuation of the tangible property does not exceed the cost of reproduction. The relator, however, contends that the cost of reproduction does not necessarily determine the value of the property. That proposition may be conceded, but nevertheless it is some evidence of value. In 1908 no part of the railroad's tunnel, structures and roadway was so far completed as to enable it to put any part of its railroad in operation * * *. [However, t]he promoters evidently had faith in it, for they

> continued its prosecution. There is no claim that there has been any mistake in the plans or construction of the work which necessitates the abandonment or replacing of any part of the structure and the substitution of a new structure. Under these circumstances, we think until it is shown by actual experience that the structure is worth less than the cost of reproduction, such cost is the best evidence of value (203 N.Y. at 123-124; emphasis supplied).

(In our view, the lack of a depreciation allowance is explained by the obvious newness of the construction).

With the Jamaica Water Supply (1909), Third Avenue Railroad (1910), and Hudson and Manhattan Railway (1911) cases, the courts unequivocably established RCNLD as the appropriate methodology to use in the valuation of the tangible component of the special franchise assessment. Despite this, the utilities, in subsequent litigation, continued to argue otherwise.

In People ex rel. Third Ave. R.R. Co. v. State Board of Tax Com'rs, 212 N.Y. 472, 106 N.E. 325 (1914), aff'g 157 App. Div. 731, 142 N.Y.S. 986 (1st Dept. 1913), the corporation, in seeking to prove a higher value of its tangible component, sought to preclude the introduction of depreciation as a reduction of reproduction cost new.

> The court found the value of the tangible property of the relators in the streets in its condition on the tax day [that is, RCNLD] to be $3,591,302.40, and that it would have cost $5,707,780 to reproduce it new at that time [RCN]. We are not asked to review these findings of fact; but the appellants contend that they were entitled to have included in the value of the tangible property upon which a return is to be allowed, the reproduction value of the tangible property in the streets, as distinguished from the depreciated or present value thereof, upon which the order of the court was predicated. We are of the opinion that the court adopted the proper rule established by the authorities and recently declared by this court [citations omitted] (142 N.Y.S. at 1001).

Furthermore, error was claimed for the exclusion "from the value of the tangible property [of] an item for 'development expenses' of $3,094,752.44" (142 N.Y.S. at 1002), a sum nearly equal to the RCNLD.

The Appellate Division rejection of both these additions to tangible value was affirmed by the Court of Appeals:

> In the present case, the value of the tangible property was proven at the Special Term by evidence of the witnesses of the relators of the cost of reproduction and of accrued depreciation. Such evidence was not disputed (212 N.Y. at 486-487).

As to the development expenses or overhead charges, the Court "approve[d] of the decision of the Appellate Division concerning this matter" (212 N.Y. at 487), which affirmed the "trial court [which], by a finding of fact held such testimony inadequate to increase the reproduction value as proven" (212 N.Y. at 487).

If any doubt remained as to the propriety of RCNLD as a means of valuing tangible special franchise property, it was laid to rest in People ex rel. New York Central & Hudson R.R. Co. v. Woodbury, 167 App. Div. 428, 153 N.Y.S. 537 (3d Dept. 1915), aff'd 218 N.Y. 635, 112 N.E. 1070 (1916), a case involving a steel trestle over a street. The State Board admitted that the RCN was $16,487 and conceded that "the present value of this structure in 1907, allowing for depreciation [RCNLD] , was only $10,327" (153 N.Y.S. at 538). The Court confirmed the assessment based upon RCNLD, putting the entire valuation process into perspective:

> The matter of determining the value of a special franchise [that is, the intangible component] is admittedly one of considerable difficulty and as to which experts might well differ. But the valuation of the tangible property included in a special franchise presents no such difficulties. As to such tangible property we think the usual rules as to value should apply and that it should accordingly be valued at the cost of reproduction less depreciation (153 N.Y.S. at 538; emphasis supplied).

Modern Cases

Court-sanctioned application of RCNLD did not end with the age of net earnings. The introduction of the five percent rule for valuation of the intangible component saw no comparable conversion in the methodology for valuation of the tangible, though not for the lack of advocacy. In People ex rel. New York Telephone Co. v. Browne, Referee Lounsberry, in his unreported opinion, upheld the State Tax Commission's valuation in the face of several diverse methodologies presented by the corporation as

alternatives to the well-settled RCNLD; valuation by the reproduction cost approach was similarly upheld in the Staten Island Edison case (see, Section IV, "Valuation of the Tangible Component by Original Cost" [pp. 34-35]).

Furthermore, the reproduction cost approach has been universally accepted in the context of taxation of public utility properties which are not special franchises. For example, In Matter of Onondaga County Water Dist. v. Board of Assessors, 39 N.Y.2d 601, 350 N.E.2d 390, 385 N.Y.S.2d 13 (1976), the Court of Appeals stated with regard to a water pipeline:

> Where property is regarded as a 'specialty', that is, property designed for 'unique' purposes and for which there is no market, the proper method of valuation is ordinarily reproduction cost less depreciation (see Matter of Semple School for Girls v. Boyland, 308 N.Y. 382, 389; cf. 2 Orgel, Valuation Under Eminent Domain, §211, at p 95) (39 N.Y. 2d at 605).

In sum, tangible special franchise property must be valued by a reproduction cost approach, especially since it is "specialty" property.

IV. VALUATION OF THE TANGIBLE COMPONENT BY ORIGINAL COST

Although original cost is used by the Public Service Commission as the primary indicator of value for rate-making purposes, it may not be so used for purposes of taxation.

Analysis:

During this rule-making process, representatives of the utility industry have argued that the value of tangible property for purposes of taxation should be no greater than the value upon which the PSC permits a utility to earn a fair rate of return. Since this rate base is basically original cost less depreciation (OCLD), the argument goes, then OCLD, not RCNLD, is the proper method of valuing tangible special franchise property. The law, however, leads to the opposite conclusion.

Until 1944, valuation for purposes of rate-making required consideration of constitutional principles set out in Smyth v. Ames, 169 U.S. 466, 18 S.Ct. 418, 42 L. Ed. 819 (1898), which concerned maximum railroad rates fixed by the Nebraska Legislature. There, the Supreme Court held that in determining reasonable rates upon the fair value of a utility's property used in the public service, regulatory bodies must take into consideration various factors, including both original costs and reproduction value:

> We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stocks, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth (169 U.S. at 546-547).

In 1944, in Federal Power Com'n v. Hope Natural Gas Co., 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333, the Supreme Court determined that the Constitution does not mandate consideration of reproduction cost or any other specific factor in fixing rates, provided that the end result be just and reasonable:

> The Commission was not bound to the use of any single formula or combination of formulae in determining rates * * *. [I]t is the result reached not the method employed which is controlling * * *. It is not theory but the impact of the rate order which counts (320 U.S. at 602).

With this decision, the New York State Public Service Commission, which had been very active in reforming the reporting of utility accounts based upon original cost, moved to calculating rates based solely upon its recently installed Uniform System of Accounts. Over the protests of the utilities, the PSC refused to receive evidence of reproduction cost, despite statutes such as section 97 of the Public Service Law, which governed telephone rate proceedings and provided that

> * * * the commission shall, with due regard, among other things, to a reasonable average return upon the value of the property actually used in the public service and to the necessity of making reservation out of income for surplus and contingencies, determine the just and reasonable rates (emphasis supplied).

As discussed in Section III, "Valuation of the Tangible Component by Reproduction Cost" (pp. 23-28), in litigation relating to special franchise assessments, the utilities regularly took inconsistent positions regarding valuation methodology. Any method which suited their purpose of reduced assessments, however contradictory, was offered as proper.

This practice continues today with the argument that property has only one value to be used for all purposes. Yet, notwithstanding the appearance of logic, even this position has not always been maintained by the utilities. For example, in the Browne case, New York Telephone Company argued against the State Tax Commission's valuation of its tangible special franchise property by RCNLD, and for a valuation based upon OCLD. At virtually the same time, however, this same utility maintained the opposite position in rate-making litigation against the PSC (i.e., valuation based on RCNLD, not OCLD).

The New York State Court of Appeals, in Matter of New York Telephone Co. v. Public Service Com'n, 309 N.Y. 569, 132 N.E.2d 847 (1956), held that despite the removal of the constitutional barrier by the Supreme Court in the Hope Natural Gas

case, "public utility rate making in this State remained nonetheless subject to our statutory mandate" (309 N.Y. at 576; emphasis in original). Thus, "the proffered evidence of reproduction cost was improperly refused" (309 N.Y. at 576). The Court continued:

> The concept of value, of course, is quite different from that of cost, and the expression "actually used" connotes a present use. Thus, the commission is required to receive proof of reproduction cost less depreciation as some evidence of present value in the case of utility property which, due to the unique restrictions placed upon it by law, cannot readily be valued by other usual methods, such as so-called "market", "sales" or "exchange" value (309 N.Y. at 578-579).

However, the Court's definition of what constituted "due regard" may be summarized thus: "What consideration is to be given to 'value' 'among other things' is for the commission to decide, having in mind that the overriding principle governing its primary duty is that it shall determine 'just and reasonable rates' " (309 N.Y. at 579). The result has been the acceptance of evidence of RCNLD where offered but, in exercising its court-sanctioned discretion, the PSC calculates rates based essentially upon OCLD.

Although original cost has become accepted as a basis for determining rates of return on public utility property, the applicability of this valuation method for tax purposes has been roundly renounced by the courts beginning in 1953 with People ex rel. New York Telephone Co. v. Browne, n.o.r. (Sup.Ct., Albany Co. 1953). In Browne, the telephone company offered OCLD as the proper method of valuing the tangible property. The Referee dismissed this contention on four grounds: (1) though similar, the elements of value in rate-making cases are not the same as in special franchise assessment cases; (2) the State Tax Commission was not legally bound by the value computed by the PSC, especially since it is never a party to a rate-making case; (3) no showing was made, nor could be made without making the PSC a party, that the value set by the PSC for rate-making purposes was correct ("[i]t may just as well be true that the State Tax Commission's estimate of full and actual value is correct and that of the Public Service Commission erroneous" [slip op. at 23]); and (4) the purposes of valuing property for regulation differ from those of taxation.

The Browne case, decided in 1953, concerned a 1943 special franchise assessment. In 1949, a temporary State Board of Equalization and Assessment was established by State legislation (L. 1949, c.356) in order "to provide for prompt, effective and overall review and revision of state equalization rates." The enabling legislation found "that unusual and abnormal increases have occurred in the value of real estate by reason of lack of housing, inflation and other economic dislocations resulting from the recent war; [and] that such increase in value necessitates an immediate and full review and revision throughout the state of rates of equalization."

Challenge to the constitutional validity of the statute was rejected in Matter of Consolidated Edison Co. v. Moore, 197 Misc. 628 (Sup. Ct., Albany Co. 1950), and the life of the Board was subsequently extended (L. 1952, c. 293; L. 1954, c. 150; L. 1956, c. 189). Ultimately, the Board's duties were expanded to include a reexamination of the efficacy of the special franchise tax and to make appropriate recommendations to the Legislature (L. 1956, c. 189,§ 3-a, subd. [3]).

The newly created temporary State Board, following its legislative mandate, conducted Statewide market value surveys and revised the State equalization rates accordingly. However, the Board also recognized a problem in applying these new rates to the special franchise property values, which were not as current as those used to compute the new rates. In order to avoid the need "to revalue on a current basis" all such special franchise property, the State Board sought and obtained legislative approval for the practice of applying equalization rates "established on the old basis" to the undervalued special franchise property. Thus, in its memorandum to the Governor written by the State Board's Chief Local Assessment Consultant and dated April 17, 1953, the Board urged executive approval for enactment of its bill, already approved by the Legislature (L. 1953, c. 874, amending Tax Law, §45):

> Under existing law the State Board of Equalization and Assessment must first determine the full valuation of special franchise property and then apply to it the latest state equalization rate. The rates now being used are roughly on a prewar basis, and in recent years special franchise properties, to which the rates have been applied, have been assessed at either depreciated original cost or 1941 depreciated reproduction cost. In the case of many special franchises the property was installed when costs were low.
>
> The Legislature has directed the State Board of Equalization and Assessment to review and revise the state equalization rates (Chapter 346, Laws of 1949, as amended by Chapter 293, Laws of 1952). In carrying out that program current values are being used by the Board in the appraisal of typical properties in the various localities. Such appraisals, as well as other factors, will be considered in fixing and determining the revised state equalization rates. If possible, the Board will establish the revised equalization rates throughout the State in 1954.
>
> It would not be equitable or realistic to apply the revised equalization rates to the special franchise valuations as presently determined.

> This bill requires continued use of the 1953 state equalization rates (which have been established on the old basis) with special franchise property assessed in 1953 and the application of later equalization rates only to the special franchise property installed thereafter. Thus, it will not be necessary to revalue on a current basis the special franchise property which was assessed in 1953.
>
> By applying the 1953 state equalization rates to special franchise property assessed for the year 1953 and by applying the latest state equalization rates to special franchise property installed thereafter, assessments generally comparable to the assessment of other real property will be substantially achieved (emphasis supplied).

In contrast to former section 45 of Tax Law, (L. 1916, c. 334, §4), requiring the equalization of special franchise values at the same percentage of full value at which other real property in the locality was being assessed, section 45, as amended by Chapter 874 of the Laws of 1953, required such equalization only as to new property assessed after 1953. As to special franchise property assessed in or prior to 1953, the equalization rates "established on the old basis" continued to be applied. To preclude the possibility that special franchise assessments equalized "on the old basis" might be tried together with later assessments effected on the basis of more current market levels, and therefore might be equalized at the latest equalization rates for the tax district, the Legislature barred consolidation of tax review proceedings embracing special franchise assessments prior to 1954 with proceedings involving assessments made after 1953 (Tax Law, §290-d).

Thus, it is clear that with respect to special franchise property, neither the State Board nor the Legislature believed that "depreciated original cost or 1941 depreciated reproduction cost" represented the full value of such property or could be used to produce "assessments generally comparable to the assessment of other real property." To the contrary, it is apparent that the view adopted by the Legislature was that the assessment of special franchise property on a present value basis, more closely indicating current value levels, was essential, and that assessment on a depreciated original cost basis would be tantamount to the extension of more favorable treatment to public service corporations as a class.

The first litigation commenced against the new State Board's assessments was the Staten Island Edison case. The Board, aware of the valuation problems described above, had requested reproduction cost new information from the utilities. In its Annual Report to the State Board for the tax year under review, Staten Island Edison struck out the words "cost of reproduction new" and inserted the words "original cost, new."[26] As a result, the State Board was without the essential data for determining a present value of the tangible property. The Board concluded that application of the newly-computed equalization rates based upon current market surveys to special

franchise property valued solely upon a fixed, historical cost basis would not result in an equal distribution of the tax burden. Thus, the Board applied the "old" rate to the corporation's "old" cost.

At trial, however, the State Board defended its assessment upon the proper method of valuing tangible property: RCNLD. Unable to compute reproduction costs itself, an engineering firm was engaged.[27] The resulting valuation was then equalized using the then current equalization rate.

The Referee, however, rejected the State Board's defense based upon reproduction cost, relying instead upon the original cost figures reported by the corporation. Having accepted this rate base valuation, he further rejected the Board's depreciation allowance, substituting in its stead that of the Public Service Commission determined for rate purposes. Finally, in the face of the legislative history set out above concerning the creation and duties of the temporary State Board, the Referee applied the then current equalization rate to the original cost valuation.

The Appellate Division reversed the decision of the Referee, citing numerous cases to the effect that RCNLD was the proper basis of valuation. Perhaps most telling in this case, where the issue was clearly reproduction versus original cost, was the quotation from the Hudson and Manhattan Railroad case: " 'Under these circumstances, we think until it is shown by actual experience that the structure is worth less than the cost of reproduction such cost is the best evidence of value' [203 N.Y. at 124]" (177 N.Y.S.2d at 133). Accordingly, the Appellate Division and the Court of Appeals "accept[ed] the valuation of the tangible property as found by the State Board * * * as justified and reasonable" (177 N.Y.S.2d at 136).

The Appellate Division further rejected the applicability of Public Service Commission's depreciation allowance in tax valuation matters:

> If the method used by the Referee is to be accepted, it means in substance that so far as the State Board is concerned, it must accept a depreciation rate fixed by a different agency for a different purpose and based upon a different definition of "depreciation" [citation omitted].
>
> This, we think, was not and is not the intent of the law and the State Board has the authority as it did in this case to arrive independently at a "reasonable" rate of depreciation (177 N.Y.S.2d at 134).

Two cases not involving special franchise assessment remain to be discussed. In Onondaga County Water Authority v. New York Water Service Corp., 285 App. Div. 655, 139 N.Y.S.2d 755 (4th Dept. 1955), the valuation of utility properties for

condemnation purposes was at issue. Original cost, the Court said, is nearly always accorded great, if not dominant, weight in rate-making. "However, by virtue of the vast distinction between the value of property for purchase or condemnation, this measure of value should not, and seldom does, carry much weight in the determination of just compensation. In short, 'original cost' and 'present value' are not equivalent terms" (139 N.Y.S.2d at 763; emphasis supplied). Present value, of course, is just what is sought in assessing real property (Matter of Hellerstein v. Assessor of Town of Islip, 37 N.Y.2d 1, 332 N.E.2d 279, 371 N.Y.S.2d 388 [1975]; Matter of Bauer v. Bd. of Assessment Review, 114 Misc.2d 640, 452 N.Y.S.2d 186 [Sup.Ct., Columbia Co. 1982], aff'd 91 A.D.2d 1097, 458 N.Y.S.2d 296 [3d Dept. 1983], appeal dismissed 60 N.Y.2d 585, ____ N.E.2d ____, 467 N.Y.S.2d ____ [1983]; Stemmer v. Bd. of Assessors of Town of Pompey, n.o.r., Index No. 81-4558 [Sup.Ct., Onondaga Co. December 28, 1982], aff'd ____ A.D.2d ____, ____ N.Y.S.2d ____ [4th Dept. 1983]); original cost, except when the property is new, is not a valid approximation of present value.

Finally, in the case of Brooklyn Union Gas Co. v. Chambers, 7 Misc.2d 601, 164 N.Y.S.2d 768 (Sup. Ct., Queens Co. 1952), which involved utility property not in the public way, the Court stated:

> The relator also contends that as the Public Service Commission in fixing the rate which the relator may charge has used the original cost of the improvements in making its computations, the assessors should use the original cost rather than the reproductive cost for the purpose of assessment. The determination of the Public Service Commission is not binding upon the respondents. The latter have been directed by statute to perform a certain duty. Merely adopting the Commission's valuations would be neglect of that duty. It may be as stated in Atchison, T. & S.F. Ry. Co. v. Collins, D.C., 294 F. 742, 749 " * * * in the long run valuation for rate-making purposes and valuation for taxation purposes should closely approximate each other" but that is a matter to be settled by the Legislature, not by this court (164 N.Y.S.2d at 771; emphasis supplied).

Accordingly, although original cost is used by the Public Service Commission as the primary indicator of value for rate-making purposes, it may not be so used for purposes of real property taxation.

V. VALUATION OF THE TANGIBLE COMPONENT BY THE INCOME APPROACH

Capitalization of income is appropriate to value property which has no other attribute or function than the production of income. However, the income approach is inapplicable to tangible special franchise property because for tax valuation purposes, (1) only rental income, not sales or other business income, may be capitalized; (2) the property, not merely the owner's business interest therein, must be valued; (3) the income of the company cannot be allocated to the tangible property within the tax district; and (4) this theory assumes that the taxpayer is both at risk and free to attempt to maximize income, neither being the case with a regulated monopoly.

Analysis:

Impropriety of the Income Approach

During the rule-making process, the utility industry representatives have argued that the effects of regulation upon the income potential of tangible special franchise property warrant the use of the income approach in valuing that property. Besides the clear, consistent line of authority requiring the use of RCNLD, there is a fundamental objection to this argument. It is well-settled in New York State that in using "income capitalization as the basis for computation of full value[, w]hat is capitalized in such a computation is, of course, the rental income of the property, not the sales resulting from business conducted on the property [citing] (People ex rel. Hotel Paramount Corp. v. Chambers, 298 N.Y. 372, 375, 83 N.E.2d 839 [1914])" (Matter of Barnum v. Srogi, 54 N.Y.2d 896, 898, 429 N.E.2d 421, 444 N.Y.S.2d 914 [1981]; emphasis supplied). These decisions are clear: it would not be correct to capitalize the earnings from the sales of "water, steam, light, power, electricity, gas or other substance" (RPTL, §102 [17]) in order to value the special franchise property for purposes of taxation.

If the subject of assessment were the company's interest in the property, it might be appropriate to consider regulation, since it is true that the price an investor would be willing to pay for the property might be affected by the regulation. However, for purposes of real property taxation, the property, not merely the owner's interest, must be valued. An interest in utility property was reserved by the public when the utilities were granted the right to operate without competition. This public interest is protected by the regulation of utility rates. Thus, to the extent that the value of the company's interest in the property (determined through capitalization of actual income) is less than the full value of the property (determined using RCNLD), the difference represents the value of the public's interest in the property. The assessment, however, must relate to the entire fee interest.

The landlord-tenant relationship can be analogized to this concept. Although the landlord's interest in rental property is diminished by the tenants' interests, those various interests are not assessed separately. Rather, the entire property is assessed according to the full value of the entire fee interest (Matter of Merrick Holding Corp. v. Bd. of Assessors, 45 N.Y.2d 538, 382 N.E.2d 1341, 410 N.Y.S.2d 565 [1978]; see, also, Matter of Barnum v. Srogi, 54 N.Y.2d 896, 429 N.E.2d 421, 444 N.Y.S.2d 914 [1981]; Matter of Onondaga Savings Bank v. Srogi, __ A.D.2d __, 467 N.Y.S.2d 441 [4th Dept. 1983]; Henry Distributing Corp. v. Srogi, 91 A.D.2d 818, 458 N.Y.S.2d 98 [4th Dept.

1982]). The landlord pays the taxes upon this assessment but recovers the portion attributable to the tenants' interests through the rents. Similarly, public utility property must be assessed according to its value without regard to regulation, but the owner may recover the taxes attributable to the public's interest through its rates.

Summation versus Unit Approach

As discussed in Section III, "Valuation of the Tangible Component by Reproduction Cost" (p. 23), the Clapp case stands for, among other things, the proposition that the summation approach is favored over the unit approach to value property located in two or more assessing units.

The unit approach requires the valuation of the system as a whole and the allocation of that value to the real property within the assessing unit. The summation approach values the property within the assessing unit without regard to the remainder of the system. The Court in Clapp recognized that "[t]he property in question would be worth practically nothing except for its position as part of a railroad system. It has a value as part of the whole property and practically no value when detached or severed from it" (152 N.Y. at 496). However, the Court also rejected the notion that the value of the system could be allocated as would be required under the unit approach; rather, it approved of the valuation of the specific segment within the assessing unit.

Further, with regard to the propriety of the summation approach, Referee Lounsberry, in People ex rel. New York Telephone v. Browne, held the following:

> The relator, New York Telephone Company, conducts its business throughout the State of New York and is part of a telephone system which operates throughout the world. The services it provides and from which it yields revenue in the City of Buffalo are so intertwined and intermingled with its state wide operation that it would be exceedingly difficult and in the opinion of the referee improper to attempt to allocate the correct net earnings figure to the City of Buffalo alone (slip op. at 24).

In sum, the income approach is inapplicable to tangible special franchise property because for tax valuation purposes, (1) only rental income, not sales income or other business income, may be capitalized; (2) the property, not merely the owner's business interest therein, must be valued; (3) the income of the company cannot be allocated to the tangible property within the tax district; and (4) this theory assumes that the taxpayer is both at risk and free to attempt to maximize income, neither being the case with a regulated monopoly.

VI. PHYSICAL DEPRECIATION

Although the courts have not mandated any particular method for determining physical depreciation for real property tax purposes, invariably the "straight-line" method has been upheld.

Analysis:

It is beyond cavil that an adjustment must be made to reproduction cost new for physical depreciation in order to calculate the present value of aged tangible property. The case law concerning the efficacy of the RCNLD valuation methodology fully settles this issue. The manner of computing this depreciation, however, has raised some questions.

The case law is silent on the question of calculating depreciation when valuing the tangible property. There are, however, clear holdings on the subject of depreciation in valuing the intangible.

In applying the net earnings rule, a deduction of operating expenses from gross earnings is a preliminary step. In Jamaica Water Supply it was argued that in addition to current operating expenses, it was necessary to consider "any depreciation allowances that it might be necessary to set aside in order to provide a renewal fund to replace the tangible property of the plant when it shall wear out" (196 N.Y. at 47). The Court of Appeals upheld this notion, recognizing that

> [n]o corporation would be regarded as well conducted which did not make some provision for the necessity of ultimately replacing the property thus suffering deterioration; and we cannot see why an allowance for this purpose should not be made out of the gross earnings in order to ascertain the true earning capacity (196 N.Y. at 57-58).

Clearly, this allowance was apart from that used in computing the RCNLD of the tangible property since, if newly constructed, this property would be entitled to little, if any, depreciation. On the other hand, since it would ultimately have to be replaced, prudence would require setting aside an allowance annually for this purpose (see, e.g., People ex rel. Third Ave. R.R. Co. v. State Board of Tax Com'rs, 136 App. Div. 155, 120 N.Y.S. 528 [3d Dept 1909], aff'd 198 N.Y. 608, 92 N.E. 1098 [1910]).

In People ex rel. Manhattan Ry. Co. v. Woodbury, 203 N.Y. 231, 96 N.E. 420 (1911), the Court of Appeals settled upon the proper method of determining the annual depreciation allowance: "[it] should be computed by dividing the values of the various kinds of tangible property by the number of years of their respective estimated physical lives" (203 N.Y. at 236): the so-called straight-line method.[28] In so doing, the Court rejected the sinking fund method which, through amortization over a period

equal to the life of the tangible property, would produce a sum equal to the cost of replacing the property:

> The difficulty with such holding is that railroad corporations do not reconstruct their railroads and rolling stock in that way. In order to afford proper protection to the public they are required to maintain a high state of efficiency both in roadbed and rolling stock * * *. Old ties have to be removed and replaced with new ones; old rails that have become worn and battered have to be removed and their places supplied with new rails and so the work of reconstruction progresses from year to year. It is not the waiting forty or sixty years to reconstruct, during which time the amount set apart as a sinking fund may be doubled many times over by compounding the interest, but it is the annual expenditure for reconstruction which is to be paid for at the time that the construction is made (203 N.Y. at 239).

It is not discoverable from the case law whether calculation by straight-line versus sinking fund was ever at issue in determining depreciation for RCNLD purposes. However, even though the sinking fund method may theoretically be applicable,[29] the straight-line method, in general, is not so fraught with shortcomings as to be without a rational basis.[30] While not precisely on point, the Manhattan Railway Company case tends to support this conclusion.

The straight-line method is based upon the "service life" of the property being depreciated and assumes that the average service life, ascertained from studies of historical data, is the life, or period of years, over which an item or group of items of real property should be depreciated. That is, an annual depreciation rate is computed by dividing the maximum depreciation by the service life. Therefore, if the maximum depreciation is 80% and the service life of a given category of property is 40 years, the annual rate of depreciation would be 80% divided by 40 years, or 2% per year. A ten-year old item of property in such a category would have 10 years times 2% per year, or 20% depreciation. This method is applied with a full awareness that some items will last longer than the average service life and some items will wear out sooner than they have attained their service life. This method will result in accurate depreciation only if the average service lives have been developed from exhaustive studies and truly represent the average number of years the items in a given category of property will last.

The service lives and net salvage percentages, included in Subpart 197-6 of the Rules which we promulgate today, are based primarily on studies conducted by State and Federal regulatory agencies. Since these agencies allow for the recouping of investment in tangible property in the respective rate bases over the life of the property, accurate factors are extremely important. Consequently, the regulatory bodies make extensive service life and salvage value studies using the voluminous data

made available to them in the carrying out of their rate-making responsibilities. Moreover, we are not inflexible in this regard; in the Rules we promulgate today, we establish a procedure for interested parties to demonstrate alternative or modified service lives or net salvage percentages.

A third means of calculating physical depreciation (in addition to the straight-line and sinking-fund formulae) is that based on "remaining useful life" or the observation method. Through actual inspection of the property, the appraiser estimates the remaining useful life of the property being valued and bases the depreciation on the relationship of the remaining life to the service life. For example, if an appraiser estimates the remaining useful life of a building is 40 years, and if the building has a service life of 50 years, the depreciation would be computed by dividing the difference of 10 years (50 - 40) by the service life (50 years), resulting in 20% depreciation. This is done regardless of the actual age of the building. In the example above, the building could be actually 30 years old, but the effect of the appraiser's judgment that it has a 40 year remaining useful life gives it an effective age of 10 years for depreciation purposes.

Appraisal experts have long noted what Bonbright calls the "fatal limitations"[31] of the observation method.

> In the first place, it ignores any deterioration not perceptible to the eye of the appraiser. Underground and concealed assets must go almost uninspected. Deterioration that is not manifest, such as that of an electric-light bulb which has already lived half of its useful life [footnote omitted], is not included at all.
>
> In the second place, observation itself gives no basis for an inference as to how long an asset which is still giving good service will continue to render that service, or as to how the rent value of the asset may fall between the present date and the retirement date. These forecasts are essential to an estimate of depreciation, and a declaration that they cannot be made is tantamount to a declaration that depreciation cannot be determined. The appraiser has no basis for such a forecast except for the accumulated experience of the profession as summarized by useful-life tables. This means that observation, so far from being an independent method of appraisal, is merely a complementary method. It does not avoid the necessity of resorting to formulas based on speculative predictions as to length of service life and as to future trends of rent values.
>
> The fact that, almost invariably, appraisers who purport to use the observation method arrrive

> at lower estimates of depreciation than do appraisers who lay stress on the more theoretical formulas [i.e., straight-line], gives ground for serious suspicion that the former method, as currently employed, is chronically biased. Indeed, this very bias is what leads the expert witnesses to favor the method in litigations in which their clients desire to establish the highest possible value. From the standpoint of a litigant, a further charm of "judgment" estimates based on observation is that their errors are extremely difficult to attack by cross-examination. Unlike a specific formula, the assumptions of which can be exposed to searching criticism, an expert judgment is fortified from attack by the assertion that the appraiser has arrived at it by intuition gained from years of experience. Of course no appraiser lives who has any such clairvoyance. But counsel for the opposing side may have a hard time in disproving the claim, especially when it is made by an engineer who parades an impressive list of distinctions, including offices in engineering societies and honorary degrees from universities (emphasis supplied).[32]

The nature and location of special franchise property (for example, buried cable and pipe, high voltage lines, etc.) make the observation or "remaining useful life" method of estimating physical depreciation difficult if not impossible to apply. These same facts are the reason the straight-line or "service life" method is ideally suited to determining the physical depreciation of special franchise property.

Furthermore, during the hearings on these Rules, the industry accepted, with only one caveat, the application of the straight-line method. The exception taken was to the use of a simple (for lack of a better term) straight-line calculation instead of one based upon the "Iowa State curves". The industry claims that using these mortality curves more closely approximates the actual physical deterioration of an asset by allowing for greater depreciation in its earlier life and less as it grows older.

The "Iowa State curves" are estimates of future service life of tangible property; so, too, are the service lives contained within Subpart 197-6 of the Rules. The latter were calculated for the Board by independent appraisal consultants and based upon depreciation accrual rates used by the major utility companies operating in the State and approved by the Public Service Commission and, where applicable, the Federal Energy Regulatory Commission.

Accordingly, physical depreciation shall be estimated using the straight-line method.

VII. ECONOMIC OBSOLESCENCE

Although the law recognizes "economic obsolescence" under certain circumstances, there is no support for an allowance to account for the effects of regulation upon the value of property for purposes of taxation. An allowance might be authorized for a company which cannot meet its taxes and other fixed charges, but not for a company which is returning a profit.

Analysis:

The concept of economic obsolescence or economic depreciation has been recognized by the courts as a loss in value brought about by conditions extrinsic to the property, such as declining location, downgrading or abandoning of a neighborhood, or changing behavior patterns, all of which result in reduced business volume (see, Matter of City of New York [Coogan], 20 N.Y.2d 618, 233 N.E.2d 113, 286 N.Y.S.2d 16 [1967]; Matter of Piazza v. Town Assessor of Town of Porter, 16 A.D.2d 863, 228 N.Y.S.2d 397 [4th Dept. 1962]; Application of Putnam Theatrical Corp., 16 A.D.2d 413, 228 N.Y.S.2d 93 [4th Dept. 1962]).

The primary case in New York which recognized the possibility of a limitation on RCNLD due to earnings is People ex rel. Delaware, Lackawanna & Western R.R. v. Clapp, 152 N.Y. 490, 46 N.E. 842 (1897), discussed in Section III, "Valuation of the Tangible Component by Reproduction Cost (pp. 21-23). In holding that reproduction cost new is the upper limit on value of a "paying railroad," the Court stated:

> It may not in every case be worth what it would cost to reproduce it. That would depend on the income or earnings capacity of the road after it is built (152 N.Y. at 494).

Thus, in the case of a railroad which is not a paying railroad, the value may be less than reproduction cost new. However, the Court did not define "paying railroad," nor did it specify how the assessment of a non-paying railroad should be determined.

People ex rel. New York, Ontario and Western Ry. Co. v. Rosenshein, 300 N.Y. 74, 89 N.E.2d 233 (1949), was the only non-paying railroad case to result in an opinion by the Court of Appeals. The net operating income of the railroad in question had been insufficient to meet taxes and other fixed charges from 1936 through 1942. The Court stated that "[r]eduction of the value employed for assessment by a factor derived from the average annual deficit was not arbitrary" (300 N.Y. at 78). The Court then determined the factor for "economic depreciation" by dividing the average operating loss by the net income that had been earned in 1935, the last year in which there had been a profit.

People ex rel. Lyford v. Allen, 286 App. Div. 621, 146 N.Y.S.2d 186 (3d Dept. 1955), involved the same property, but for the years 1944 to 1950. The railroad was by then in reorganization under the Bankruptcy Act, and the formula applied in the

Rosenshein case would have resulted in an assessment that was lower than the value of the land alone. The Third Department found that "the financial situation of the railroad has steadily deteriorated and as a railroad entity it is at the point of extinction" (146 N.Y.S.2d at 189). The Court concluded that under the circumstances, the value of the land plus the scrap value of the improvements would be the proper basis of valuation.

Other cases involving non-paying railroads have permitted an allowance based upon earnings capacity.[33] These cases, however, did not identify the manner in which such allowances were to be determined.

People ex rel. Mid-Crosstown Ry. v. State Tax Com'n, 192 N.Y.S. 388 (Sup. Ct., New York Co. 1921) has been the only special franchise case to date concerning economic obsolescence. The corporation claimed an allowance for its special franchise assessment based upon the substantial deficits it had incurred in each of the previous four years. Its claim was that the replacement cost should be depreciated by 50% rather than the 25% the Tax Commission had authorized. The Court's response to this argument was that although the repeated losses might mean that the intangible component had no value, these losses did not mean that the tangible property was worth only 50% of its reproduction cost. The Court based this conclusion upon the enactment of the special franchise law and the distinction created thereby between the tangible and intangible components. Earnings, it stated, were relevant only to the valuation of the latter.

In two recent cases involving non-special franchise utility property (in the private right-of-way), trial courts considered the argument that there should be an allowance for economic obsolescence because of regulation of earnings by the PSC.

The Court in Tenneco, Inc. v. Town of Cazenovia, n.o.r. (Sup. Ct., Madison Co. March 24, 1983)[34] rejected this contention:

> Government regulation is undoubtedly a factor external to the property which affects the earning power of the petitioner, however, it is not necessarily to be equated with economic obsolescence. Government regulation may affect the earnings of the Petitioner but it does not follow ipso facto there is a loss in value of the property in question * * *. We reject the economic obsolescence as defined and applied by the Petitioner (slip op. at 25).

In Orange and Rockland Utilities, Inc. v. Williams, n.o.r., Index No. 6041/80 (Sup. Ct., Rockland Co. June 24, 1983),[35] two different types of economic obsolescence were presented to the court, one by the company and the other by the Town. The Court rejected the allowance demanded by the company:

> [T]his novel approach lacks both legitimacy and reliability and is little more than an attempt to do indirectly what cannot be done directly ie. [sic] imposing an upper limit of value by capitalizing the income allowed to the utility by the Public Service Commission, thereby conversely arriving at net book cost * * *. In sum, what petitioner calls "economic obsolescence" is modified and is in realty a means of utilizing an income approach and calling it a cost approach (slip op. at 18, 20).

The Court accepted the allowance that had been granted by the Town.

The Rules which we promulgate today provide the conditions under which an allowance for economic obsolescence when a company demonstrates that it cannot meet its taxes and other fixed charges.

VIII. SUBSTITUTE MATERIALS

An allowance has never been judicially recognized where the operation of the property currently in place is neither impaired nor inadequate, even if the labor and materials used in the original construction would be replaced with less expensive and more efficient labor and materials if the plant were built today.

Analysis:

Adjusting RCNLD to account for the cost of an identical plant versus the cost of the most efficient substitute is suggested by the industry as a constituent of "functional obsolescence". Since that term embraces several disparate concepts (see, Matter of Onondaga County Water Dist. v. Bd. of Assessors, 39 N.Y.2d 601, 350 N.E.2d 390, 385 N.Y.S.2d 13 [1976]; Bonbright, 1 Valuation of Property 187-188) variously recognized by the case law, we eschew this umbrella term in this context, preferring to discuss the issue under the heading, "substitute materials."

From an appraisal theory viewpoint, consideration of substitute materials is an argument well-articulated. Written in 1937, Bonbright's remarks on this subject, though in a rate-making context, would appear to be as relevant today:

> In this age of rapid technological development, few public-utility plants would be replaced with virtual replicas. More adaptable sites would be chosen; more modern structures and equipment would be set up; the capacity of the plant would be made either larger or smaller according to the present and prospective demand for service.[36]

However, while the concept is recognized, the means for doing so is not so simply derived:

> * * * if reproduction cost is used as a basis of valuation, the only significant cost is that of constructing a modern substitute plant. The cost of producing a substantial replica would then be ignored except as an indirect means of estimating the former figure. Even the cost of the substitute plant could not be used as the basis of valuation; for its greater efficiency would mean savings in operating expenses. The operating disadvantage of the present plant as compared to the hypothetical new plant should be estimated by a capitalization of the difference in annual expenses, which should be deducted from the cost of the new plant in arriving at the value of the old one.[37]

Surely we are to be educated by the acknowledged experts in appraisal theory; we are, however, bound to follow the law of this State as it is construed by the courts. Where that law differs from theory, there can be little disagreement over which course we are to follow. Bonbright himself recognizes the dilemma (if, in fact, it is one at all) when reviewing a decision of the United States Supreme Court in McCardle v. Indianapolis Water Co., 272 U.S. 400, 47 S.Ct. 144, 71 L. Ed. 316 (1926), where it was argued that, as far as reproduction cost was relevant, that cost should be one of a different type of plant, contended to be both less expensive and more efficient. In rejecting this contention, the Court held:

> There is to be ascertained the value of the plant used to give the service and not the estimated cost of a different plant. Save under exceptional circumstances, the court is not required to enter upon a comparison of the merits of different systems. Such an inquiry would lead to collateral issues and investigations having only remote bearing on the fact to be found, viz. the value of the property devoted to the service of the public (217 U.S. at 417-418).

Bonbright notes two different reasons for the Court's conclusion: (1) the value of the property is to be that of the instant plant, not a different one; and (2) the difficulty of deciding which type of plant would have the greatest merit. On appraisal theory alone does he place himself at odds with the Court:

> The fallacy of the first point has frequently been noted by appraisal experts [footnote omitted]. Any reproduction cost, even the cost of a duplicate plant, is the cost of a different plant and is neither the cost nor the value of the instant plant. The practical difficulty suggested by the second point is conceded by everyone. But it is a difficulty inherent in the appraisal of a complex and nonmarketable property. The attempt to avoid it by accepting the estimated cost of a substantially identical plant constitutes an admission that value is unascertainable for practical purposes — a very sane admission, but one that would not have conformed to the accepted legal doctrine (emphasis in original).[38]

What, then, is the state of that "accepted legal doctrine" in New York? In our discussion of physical depreciation (see, Section VI, "Physical Depreciation" [pp. 39-40]), we noted that in the early cases on the special franchise law, reference is made to an annual depreciation allowance separate and apart from that used in computing

the RCNLD of the tangible property. This annual allowance was an operating expense to be deducted from gross earnings in valuing the intangible under the net earnings rule. In this context, the Court of Appeals, in People ex rel. Manhattan Ry. Co. v. Woodbury, 203 N.Y. 231, 96 N.E. 420 (1911), referred to the concept of substitute materials:

> I am aware that some corporations have in the past met with heavy losses by reason of their machinery becoming obsolete. This is especially true with reference to those corporations using electricity for power and other purposes. Such use is the result of modern inventions which have been improved from year to year, thus rendering obsolete and practically useless expensive dynamos and machinery, but there is a difficulty in making any estimate as to the amount of depreciation in the assessable value of tangible property which may result from future invention, and, therefore, this species of property should be left to be considered when such depreciation actually occurs (203 N.Y. at 240; emphasis supplied).

This depreciation actually occurred in People ex rel. Central Hudson Gas & Electric Co. v. State Tax Com'n, 218 App. Div. 44, 217 N.Y.S. 707 (3d Dept. 1926), aff'd 247 N.Y. 281, 160 N.E. 371 (1928) where the Court, in the context of determining deductable operating expenses, allowed

> * * * the sum of $27,887 for obsolescence in addition to depreciation as claimed by the relator and objected to by the respondent. The objection of the respondent is that this was included in the sum set up on the relator's books for depreciation and obsolescence reserve * * *. The obsolescence claimed by the relator was for two electric generating units which were removed from the plant during the year in question on account of their obsolescence, which were replaced by more modern type of machinery. The amount allowed for this loss was the value of the unexpired physical life of these units. This element was not covered by the item of depreciation which contemplates the use of property to the end of its physical life. "This species of property should be left to be considered when such depreciation actually occurs." People ex rel Manhattan Railway Co. v. Woodbury, 203 N.Y. 231, 240, 96 N.E. 420, 424. Our interpretation of the rule, as laid down by the Court of Appeals in that case, is that such depreciation actually occurs when

> the property is removed from service. These two electric generating units were removed from the plant during the year in question (217 N.Y.S. at 713; emphasis supplied).

It is clear from both of these cases that the property deserving consideration for substitute materials is that which has not yet reached the end of its physical life but is nonetheless functionally useless, thereby resulting in financial loss to the corporation. In the context of rate-making, Bonbright observes that "if the physical assets have become so obsolete or inadaptable that they are recognized as utterly useless for the purposes of the business, they have generally been disregarded on the theory that they are not 'used and useful in the public service' ".[39]

This perception of the issue is repeated in circumstances other than special franchise. In Barber & Bennett, Inc. v. State of New York, 34 A.D.2d 303, 311 N.Y.S.2d 203 (3d Dept. 1970), the Appellate Division, in a condemnation case, held that the mere fact that the present building and equipment were "to some extent obsolete and/or inadequate" so that "a claimant would not faithfully reproduce them upon moving his site of business" (311 N.Y.S.2d at 206), is not a sufficient basis for reducing RCNLD by a factor for substitute materials. Rather, the test is two-fold, one financial and the other technological. As a financial consideration, "the question of functional obsolescence is dependent upon the extent to which the existing improvements are adapted to the needs of the business being carried on at the premises and the extent to which the business itself is adapted to profitably serving a public need" (311 N.Y.S.2d at 206). The other test concerns "technological and inventive advances which lessen the value of older machines and equipment" (311 N.Y.S.2d at 206).

Under this test, the Court denied the adjustment to RCNLD:

> * * * the record clearly establishes a profitable operation at the subject premises, with no indication that the business could not so continue to operate in the foreseeable future, and that as a practical matter the premises were well adapted to the claimant's business. The facts that the building as designed and the premises as situated precluded certain innovative production economies do not appear to be conclusive on the primarily factual question of functional obsolescence.
>
> * * * it does not appear that * * * the incorporation of mechanical devices to save on labor costs * * * require[s] a finding of obsolescence as a matter of law. The facts of increased production capacity and perhaps a greater market or marketability of the claimant's product are new elements which might well not have had any bearing

> that would have reduced the value of the facilities at the subject premises beyond ordinary physical depreciation (311 N.Y.S.2d at 207; emphasis in original).

(See, also, In re Ruppert Brewery Urban Renewal Project, 67 Misc.2d 863, 325 N.Y.S.2d 438 [Sup. Ct. New York Co. 1971], where the Court adopted the approach set out in Barber & Bennett).

In Matter of Onondaga County Water Dist. v. Bd. of Assessors, 39 N.Y.2d 601, 350 N.E.2d 390, 385 N.Y.S.2d 13 (1976), the issue of functional obsolescence was discussed in its broadest terms. The Court of Appeals noted:

> More sophisticated analysis has recognized various subclasses, based upon causal distinctions, of the class "functional depreciation" * * *.
>
> The common thread running through each subclass of functional depreciation [of which substitute materials or " 'physical obsolescence', the out of datedness of an asset" is one] is that each is an "undesireable feature", an "adverse influence", or a "deterioration"; in short, a disutility diminishing in some way the value of the property [citations omitted] (39 N.Y.2d at 605-606; emphasis supplied).

Again, the Courts are concerned with an impairment or inadequacy of some kind of the operation of the property.

Finally, in another condemnation case, Congregation of Sons of Israel v. State of New York, 54 A.D.2d 794, 387 N.Y.S.2d 738 (3d Dept. 1976), a deduction from RCNLD for functional obsolescence was sought on a substitute materials theory. The Court denied the allowance, citing its decision in the Barber & Bennett case and the definition of this aspect of functional obsolescence set out there and attributed to Nichols' treatise, Eminent Domain:

> Functional depreciation is caused by the inadequacy or obsolescence of the facility due to developments which have made it incompetent to perform its function properly or economically even before its natural life has run. While physical depreciation is inevitable, functional depreciation may or may not happen (387 N.Y.S.2d at 740).

Since the proof firmly established that the property was completely adequate for the purposes for which it was constructed and would continue to be so indefinitely, no adjustment for substitute materials was necessary.

Thus, an allowance has never been judicially recognized where the operation of the property currently in place is neither impaired nor inadequate, even if the labor and materials used in the original construction would be replaced with less expensive and more efficient labor and materials if the plant were built today.

IX. FUNCTIONAL OBSOLESCENCE

The courts have recognized the propriety of deducting an amount from reproduction cost which represents a loss in the value of tangible property due to either "inadequacy" or "superfluity".

Analysis:

Functional obsolescence is often used as an all-encompassing term. For example, during this rule-making process, representatives of the utility industry included within the term the concept of substitute materials (see, Section VIII, "Substitute Materials" [p. 46]). Based upon our understanding of New York law, however, we believe that functional obsolescence is better defined as:

(a) "inadequacy", or the failure of the property to meet present or projected needs; or

(b) "superfluity" or "overbuilding", or a capacity of the property in excess of reasonable anticipated demands.

Clearly, functional obsolescence in either of these forms is causally distinct from the concept of substitute materials. Accordingly, separate treatment is required.

The case upon which we principally rely is Matter of Onondaga County Water Dist. v. Bd. of Assessors, 39 N.Y.2d 601, 350 N.E.2d 390, 385 N.Y.S.2d 13 (1976), where the Court of Appeals reviewed the assessments of water district pipeline facilities. But for the proviso in subdivision (17) of section 102 of the Real Property Tax Law, which exempts from the definition of special franchise the property of a special district, the Water District property, if located in the public way, would have been tangible special franchise property. Accordingly, the Onondaga Water District case is particularly instructive.

The District had claimed a deduction for functional obsolescence based on the fact that the system was operating at only 25% capacity. Since the remaining 75% of capacity represented an "overbuilding", the District claimed entitlement to a 75% deduction for functional obsolescence.

The Court found that the system had been "[d]eliberately planned and constructed to meet the future needs of Onondaga County and parts of Otsego County" (39 N.Y.2d at 604). Following an unraveling of the various strands which make up the all-inclusive (and therefore issue-blurring) term "functional obsolescence", the Court isolated the concept of "superfluity". Relying upon property valuation treatises, Chief Judge Breitel wrote, "functional obsolescence in the form of superfluity occurs when there is a capacity for service in excess of reasonable anticipated needs and thus is functionally useless, now and in the future" (39 N.Y.2d at 606).

Since the Court found that "there was no superfluity or improvident overbuilding in this instance, but deliberate and wise construction in reasonable anticipation of future needs" (39 N.Y.2d at 606), the deduction claimed by the Water District was

denied. The Court concluded that the District was effectively claiming an exemption for thrifty advance planning, a claim better addressed by the Legislature.

We believe that the following statement by the Chief Judge concerning the "judicial function" is similarly applicable (and, perhaps, more so) to that of an administrative board such as our own:

> What is certain is that it would be a distortion of the judicial function to provide that exemption by fiat to the effect that what is valuable is not valuable because the return in value from the investment is deferred from the present to the future, when in truth an asset with future benefit deferred is valuable indeed. Nor is it appropriate to discount for deferral of utility just because either market value or voluntary investment of capital will take into account the deferral of utility (39 N.Y.2d at 607).

Accordingly, the Rules which we promulgate today authorize an allowance for functional obsolescence only when the company demonstrates a loss in the value of tangible property due to either inadequacy or superfluity.

X. PIECEMEAL CONSTRUCTION

An allowance for piecemeal construction to account for purported inefficiencies in the installation of special franchise properties is without foundation in law or accepted appraisal theory.

This issue concerns another industry-requested adjustment to reproduction cost new. The position of the industry was summarized in the Report of our hearing officers:

> Reproduction cost new assumes the most efficient construction of property in a single impulse rather than the actual practice of small increments of construction over time. This piecemeal placement of plant leads to an excessive labor cost in the original cost which, when trended, results in an excessive reproduction cost. The SBEA's failure to adjust its trended costs for piecemeal construction is a serious deficiency in its valuation methodology [citations to record omitted].

However, in their written and oral submissions to the record, the industry provided citation to neither law nor treatise.

The municipal position was summarized as follows:

> The decision by the SBEA not to provide cost modifications for construction inefficiencies is entirely sound. The concept itself is speculative and is more than offset by the increased cost of financing unitary, rather than piecemeal construction; and the cost of having this system off-line until completion, viz, lack of revenue [citations to record omitted].

We have found no support for the allowance claimed and so, given the dearth of authority, there is little we can add to the debate. On the basis of this record, we are constrained to reject the claim.

CONCLUSION

As stated in the Introduction, we are acutely aware of the magnitude and complexity of special franchise assessment administration, referred to in its earliest years by Professor Seligman:

> It is evident that the success or failure of the law depends upon the action of the State Board. It was considered best not to provide in the bill for hard and fast rules in the method of assessment. This was done in order to give the Board ample opportunity to learn by experience what would be the most practicable and the most equitable plan to pursue. There is every reason to hope that with the exercise of intelligence and prudence the State Board will be able to lay down uniform rules of assessment * * *.[40]

The Rules which we promulgate today codify both the concept of assessing the franchise to use the public way enacted in 1899 and the program developed under the administration of the State Board of Tax Commissioners, State Tax Commission and State Board of Equalization and Assessment over the past 83 years. As a result of this long experience, we are now able to take the step which Professor Seligman had first proposed. We believe this action will further our responsibility to provide fair and equitable assessments of special franchises in this State.

NOTES

1. Lloyd Morris, Incredible New York at 198 (1951).

2. Id. at 208-210.

3. John Ford, Theodore Roosevelt's Feet of Clay, 34 Current History 678, 680 (1931).

4. G. Wallace Chessman, Governor Theodore Roosevelt - The Albany Apprenticeship. 1896-1900 at 112 (1899).

5. Id. at 131.

6. Id. at 133.

7. Id. generally at 133-157.

8. Id. at 183 quoting correspondence from Sen. Thomas C. Platt to Governor Roosevelt, May 6, 1899.

9. Id. at 147-148 quoting the Brooklyn Eagle, May 9, 1899.

10. Id. at 149 quoting correspondence from Platt to Roosevelt, May 6, 1899.

11. Id.

12. Id. quoting correspondence from Roosevelt to Platt, May 8, 1899.

13. Id. at 152.

14. Id. at 150 quoting correspondence from Roosevelt to Platt, May 8, 1899.

15. Id. at 150.

16. Edwin R.A. Seligman, The Franchise Tax Law in New York, 13 Quarterly Journal of Economics 445, 449 (1899).

17. Ford, Theodore Roosevelt's Feet of Clay at 680.

18. Seligman, The Franchise Tax Law in New York at 448-449.

19. Chessmen, Governor Theodore Roosevelt - The Albany Apprenticeship 1896-1900 at 152.

20. Ford, Theodore Roosevelt's Feet of Clay at 680

21. James C. Bonbright, 1 Valuation of Property 601 (1937).

22. State Board of Tax Commissioners, 1916 Report at 93; State Tax Commission, 1930 Report at 94; 1947-48 Report at 153.

23. This history of utility regulation is drawn largely from Kent H. Brown, Introduction to the Public Service Law, McKinney's Consolidated Laws of New York, Book 47, vii-xii (1955).

24. A copy of this opinion is appended to this report as Appendix A.

25. Corporate tangible property represents all the tangible property of a utility, both in and out of the public way, upon which it earns income.

26. Relator's Exhibit 9 at 701, 703-705; also, Record on Appeal to Appellate Division, Third Department at 305 (fol. 913).

27. Record on Appeal to Appellate Division, Third Department at 340-342 (fols. 1020-1026).

28. See, Bonbright, 1 Valuation of Property 604.

29. Id. at 192-193.

30. Id. at 192, 203-204.

31. Id. at 204.

32. Id. at 205-206.

33. People ex rel. N.Y.C.R.R. v. Thompson, 156 Misc. 536, 282 N.Y.S. 269 (Sup.Ct., Wayne Co. 1935); People ex rel. Lehigh Valley R.R. Co. v. Harris, 168 Misc. 685, 6 N.Y.S.2d 794 (Sup. Ct., Seneca Co. 1938) aff'd 257 App.Div. 912, 12 N.Y.S.2d 1011 (4th Dept. 1939), aff'd 281 N.Y. 786, 24 N.E.2d 476 (1939); People ex rel. N.Y.C.R.R. Co. v. Griffin 174 Misc. 28, 19 N.Y.S.2d 914 (Sup. Ct., Monroe Co. 1939); People ex rel. N.Y.C.R.R. Co. v. Vincent, 68 N.Y.S.2d 202 (Sup. Ct., Ontario Co. 1947); People ex rel. Delaware, Lackawanna & Western R.R. Co. v. Sims, 219 N.Y.S.2d 889 (Sup.Ct., Steuben Co. 1961); see also, People ex rel. New York, Ontario & Western R.R. Co. v. Shaw, 143 App. Div. 811, 128 N.Y.S. 177 (3d Dept. 1911), aff'd 202 N.Y. 556, 95 N.E. 1129 (1911).

34. A copy of this opinion is appended to this report as Appendix B.

35. A copy of this opinion is appended to this report as Appendix C.

36. Bonbright, 2 Valuation of Property 1124.

37. Id.

38. Id. at 1126.

39. Id. at 1125.

40. Seligman, The Franchise Tax Law in New York at 450.

APPENDICES

A - People ex rel. New York Telephone Co. v. Browne, n.o.r. (Sup.Ct., Albany Co. 1953)

B - Tenneco, Inc. v. Town of Cazenovia, n.o.r. (Sup.Ct., Madison Co. March 24, 1983)

C - Orange and Rockland Utilities, Inc. v. Williams, n.o.r., Index No. 6041/80 (Sup.Ct., Rockland Co. June 24, 1983)

Appendix A

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NEW YORK SUPREME COURT
COUNTY OF ALBANY

- -X

THE PEOPLE OF THE STATE OF NEW YORK ex rel. NEW YORK TELEPHONE COMPANY,

Relator,

-:- against -:-

ROLLIN BROWNE, GLEN R. BEDENKAPP and JOSEPH M. MESNIG, together constituting the State Tax Commission of the State of New York,

Respondents,

CITY OF BUFFALO,

Intervenor.

- -X

City of Buffalo
Special Franchise
Assessment

Year 1943

RALPH W. BROWN, ESQ.,
Attorney for Relator,
By: MESSRS. LEBANLEY, PLATT, GILCHRIST & WALKER, FRANK A. FRITZ, ESQ., of counsel; JOHN M. BARRELL, ESQ., Tax Attorney, New York Telephone Company; and MESSRS. ALBERTSON, COCK, MITCHELL, DASS & LETCHWORTH, THOMAS F. FANNING, ESQ., of counsel.

HON. NATHANIEL L. GOLDSTEIN,
Attorney General of the State of New York,
By: EDWARD J. GROGAN, JR., Esq., and GEORGE RADZ, ESQ., of counsel, for Respondents.

FRED C. MALONEY, ESQ.,
Corporation Counsel of the City of Buffalo,
By: ABRAM M. I. CHUN, ESQ., Assistant Corporation Counsel, for Intervenor City of Buffalo.

LOUNSBERRY, Referee.

New York Telephone Company brought this proceeding in certiorari against the State Tax Commission of the State of New York, in order to review the assessment by the State

Tax Commission of the New York Telephone Company's special franchise in the City of Buffalo for the year 1943. The City of Buffalo was permitted to intervene in this proceeding by order of the Supreme Court.

The State Tax Commission had determined the full value of the relator's special franchise in the City of Buffalo for the year 1943 to be the sum of $9,102,800.00. The Commission further found the equalization rate to be applied thereto in determining the full equalized value to be 90 per cent. The final full equalized value of relator's property in the City of Buffalo for the year 1943 was thereby determined by respondent to be the sum of $8,192,520.00.

In arriving at the full value figure of $9,102,800.00, the State Tax Commission used as a basis thereof the estimate of reproduction cost new figure supplied to them by the relator in an annual report to the State Tax Commission, which report was for the year ending December 31st, 1941. This report submitted by the Telephone Company on blank forms furnished by the Commission, showed the Telephone Company's estimate of the reproduction cost new of its tangible property in the City of Buffalo to be $12,040,738.00. It appears from the evidence that the Commission adjusted said figure by reducing it by 20 per cent. The Commission, seeking to place a then present value on the tangible property which it considered to be in 80 per cent condition, multiplied this figure by 80 per cent and arrived at a then present value of $8,669,331.00 for the value

of the Telephone Company's special franchise property in the City of Buffalo.

To that figure, the commision added 5 per cent, or $433,469.00, as the intangible value of the relator's special franchise as represented by its franchise rights to use the streets, highways and other public ways in the City of Buffalo.

A recapitulation of the figures propounded by the Commission is:

Net full value of tangible property	$8,669,331.00
Intangible value	433,469.00
Total full value	$9,102,800.00
Total full value	$9,102,800.00
Equalization rate 90%	
Full equalized value	$8,192,520.00

The contention of the relator is essentially threefold. Firstly, relator strongly objects to the use by the Commission of the reproduction cost new less depreciation figure as a basis for determining full value in the face of their being what the relator considers more just and proper criteria for the determination thereof. Secondly, that the computation of 5 per cent of the full value of the relator's tangible property in order to determine the intangible value is arbitrary, without basis in law and fact, and is already included in the figure representing the full and actual value of the tangible property in that the tangible property would only have junk value unless

it were used in connection with the franchise. Thirdly, that the equalization figure of 90 per cent used by the State Tax Commission is excessive, erroneous and should have been 70 per cent.

The relator insists, therefore, that by the use of methods other than reproduction cost new, less depreciation, such as methods of accounting alleged to be prescribed by the Public Service Commission in rate making cases, the Federal Communications Commission, its own book value, the "net earnings rule," and other methods, the full and actual value would be in the neighborhood of $6,000,000.00 and applying thereto the equalization rate of 70 per cent urged by it that the full and equalized value would be approximately $3,000,000.00 less than that established by the State Tax Commission.

In determining assessed valuation for the taxation of special franchises the tax commission must first determine the full and actual value of the property to be assessed. It is then necessary for the Commission to determine the percentage of full value at which the property in the City of Buffalo is being assessed and thereby obtain a rate of equalization which to apply to the aforesaid full and actual value; thereby determining the equalized valuation of the special franchise in this case. Section 45 of the Tax Law is as follows:

> Special franchise; full valuation and equalization by tax commission
>
> The tax commission shall annually fix and determine the full and actual valuation of each special franchise

> subject to assessment in each city, town or village; shall inquire into and ascertain as near as may be the percentage of the full and actual value at which other real property in the city, town or village for which such full valuation has been made, is being assessed, and by the rate of equalization so established fix and determine the equalized valuation of each special franchise subject to assessment. Added L. 1916, c. 334, Section 4, eff. Jan. 1, 1917.

Both the State Tax Commission and the City of Buffalo on the one side and the New York Telephone Company on the other introduced evidence respecting the propriety of the 90 per cent equalization rate fixed by the State Tax Commission applied to special franchises in the City of Buffalo. During the trial of this proceeding it was urged by the respondents and intervenor that both parties were bound by the method of proof outlined in Article 13, Section 293 of the Tax Law, that the method of proof was exclusively the "comparable parcel" method. That portion of the section in question to so limit the type of proof is set forth as follows:

> "Upon a hearing the parties to the proceeding may mutually agree on parcels of real estate to be valued and the number of witnesses to be sworn. But in case the parties fail to agree on a selection of parcels to be valued and the number of witnesses to be sworn, then upon application of either party the Court or Referee shall determine the number of witnesses to be sworn, select the parcels that shall be valued without reference to their assessed values and both parties shall be limited in their proof on the trial to such witnesses and the parcels so selected, except that evidence as to actual sales of real property within the tax district that occurred during the year in which the assessment under review was made may be given by either party."

The Referee was requested at the trial to so limit the mode of proof. It was then decided by the Referee that this

Section could not be practicably followed in a case involving the equalization rate as applied to a special franchise in that it would be impossible, firstly, to select comparable parcels and, secondly, that Section 293 was permissive and not mandatory in cases concerning special franchises.

The question was decided in favor of relator, i.e., that Section 293 could not practicably be used in a proceeding to determine the validity of the equalization rate as applied to a special franchise. Section 46 of the Tax Law, in discussing the certiorari proceeding brought to review the assessment, states in part:

> "An assessment of a special franchise by the tax commission may be reviewed in the manner prescribed by article thirteen of this chapter, and that article applies so far as practicable to such an assessment. in the same manner and with the same force and effect as if the assessment had been made by local assessors;"

Both sides have discussed in their respective briefs at some length the case of People ex rel, Yaras vs. Kinnaw, etc., 303 N.Y. 224, 101 N.E. (2d) 474, dealing with the mode of proof outlined in Section 293. This case was decided subsequent to the referee's ruling and it is urged by respondents that the referee should have refused any evidence other than that type outlined in said section.

Suffice it to say that in the case above cited, the position taken by the referee is justified. This case did not deal with the question of equalization, but rather with the question of inequality, where several properties on the same tax roll are assessed at different percentages of their full

value. The Court clearly distinguished "inequality" from "equalization" and also stated on page 228 thereof:

> "The pertinent statutory provisions limit the proof that may be adduced in a proceeding where the assessment is attacked as being "unequal," - - - - - -."

The Yaras case was an "inequality" case and therein the court several times repeated that the question of equalization rates was not involved.

The referee has heard in this case voluminous testimony. He has carefully examined the petition, return and exhibits. Subsequent to the close of the testimony, voluminous proposed findings of fact and law were submitted by both sides. Extensive briefs and supplemental briefs were submitted, containing citations therein of more than one hundred cases of various courts in this state and others, in support and refutation of the arguments of both sides on the varied questions of law involved herein. The referee, being mindful of the far reaching effects of the rulings of law required here, has studied the cited cases and others to arrive at those conclusions set forth herein below.

The question raised of the propriety and correctness of this 90 per cent equalization rate for the City of Buffalo used by the State Tax Commission is less difficult to determine and will be considered first.

The rate of equalization referred to in the statute (Tax Law, Section 45, supra) is the "percentage of the full

and actual value at which other real property in the city . . . for which such full valuation has been made, is being assessed, ..."

As mentioned earlier, the referee did not limit the proof to Section 293 of the Tax Law, and in fact, neither side submitted proof strictly in accord therewith. Neither respondents nor intervenor on the one side, nor relator on the other, submitted a list of selected parcels to be valued. Both sides, however, submitted the type of evidence precluded by Section 293 such as reports of the Erie County Board of Equalization offered by respondent and testimony of city wide total value, assessment, and improvement submitted by relator.

The substance of the evidence submitted by the relator to substantiate its contention that the equalization rate of 90 per cent was excessive and erroneous was the testimony of its witness, one Horace Carpenter, Jr. His testimony, when reduced to its bare essence is as follows:

That the total assessed valuation of all the taxable real property in the City of Buffalo for the year 1928 was $1,020,347,980.00, and in that year the equalization rate was 78 per cent. He testified further that the value of real property in the City of Buffalo increased from 1928 to 1942, using various methods in arriving at his conclusion of this fact which will be briefly mentioned later. Then by showing that the assessed valuation of all the taxable real property in the City of Buffalo for the year 1942 was only $873,835,1[illegible].00,

a decrease of $146,512,880.00, that the equalization rate of 90 per cent was too high. In other words if the total valuation increased and the assessment decreased, the equalization should of course be lower to arrive at the lower assessment figure.

The relator's witness Carpenter, explained how he arrived at his conclusions that the total value of all the taxable real property increased from 1928 to 1942.

He investigated and considered the total amount of improved real property in the City of Buffalo in 1928 and its physical condition, the extent to which new improvements were made and others demolished from 1928 to 1942, the surrounding economic factors at work in Buffalo and their effect on full and actual value of realty in Buffalo, the state of the real estate market during those years, reproduction cost new of improvements made and depreciation.

The witness further stated that he studied various statistical reports, such as the record of permits issued by the Division of Buildings of the City of Buffalo showing construction, alteration and repair of buildings, and the dollar values thereof given by applicants; a report by the Taxation Committee of the Buffalo Chamber of Commerce published in January, 1940; data from the Department of Assessment of the City of Buffalo of the amount of assessed value demolished, a study covering the years 1935 through 1938 inclusive, a report by the Bureau of Labor Statistics of the U. S. Depart-

ment of Labor, based on permits issued; a document known as "Real Property Survey and Low Income Housing Area Survey, Buffalo, New York, 1939" which was a WPA project; and other data and sources including his own experience.

The witness concluded that there was a net gain of approximately $105,000,000.00 in the value of improved real property in the City of Buffalo for year 1942 as it applied to the figure for the year 1928.

It appears from the testimony that the witness considered to a substantial extent the aforementioned WPA report in that regard. It is interesting to note the testimony of the witness Cohn for the respondent, who stated in effect that said WPA report was prepared primarily for the purpose of providing work for the enemployed and was not considered an authoratative study of the matters therein contained.

Although Carpenter's testimony was based to a large extent on the reports, data and information mentioned above, it appears that his conclusion is likewise predicated in a large measure upon his own experience and observation.

The referee feels constrained to state that this type of testimony offerred by Carpenter on this vast, broad, technical, nebulous and complicated matter which must take into consideration a multitude of general economic factors, a multitude of data in the minutest detail, to be exceedingly difficult for one man to conclude with any degree of accuracy or certainty. Had the respondent sought to contradict this

testimony by a witness of its own choice and if this proceeding would have had to be decided by testimony of this nature, a determination would, of necessity, be based entirely upon opinion rather than logically documented fact.

The brief of the respondent sets forth the argument that Carpenter's conclusion has as one of its major premises that the equalization rate of 78 per cent fixed by the State Tax Commission in 1928 is correct.

Carpenter admitted on cross examination that if he assumed that the equalization rate for 1943 of 90 per cent was correct and he applied the results of his study in reverse to determine whether the equalization rate of 78 per cent in 1928 was correct, he would, by the very same reasoning, find that the equalization rate of 78 per cent in 1928 was likewise incorrect and erroneous.

On the other hand, the State Tax Commission and the City of Buffalo introduced evidence showing that the 90 per cent equalization rate was reasonable. The witnesses who so testified were Walter Cohn and Forrest G. Read, who were both licensed real estate brokers with substantial experience and active in the real estate market in the City of Buffalo. They were likewise appraisers of real property. These witnesses testified at great length regarding parcels of real property sold through them as brokers in the City of Buffalo during the years 1941, 1942 and 1943. The parcels of property sold through these witnesses were comprised of dwellings, vacant lots, and commercial

properties. These properties were located in all of the City of Buffalo's fourteen tax districts. It appeared beyond question that the sales prices of these respective parcels of real property were, in most instances, substantially lower than the respective assessed valuations thereof. The overall picture as shown by these witnesses was that the assessed valuation of real property in the City of Buffalo for the years 1942 and 1943 was higher than the sale prices thereof. These witnesses further testified that appraisals made by them of the values of certain parcels of real property in the City of Buffalo in 1941, 1942 and 1943, were substantially lower, in the aggregate, than the assessed values thereon.

Return Item Number 5 was a table of sales prepared by one Arthur Tyng which showed that of 2,852 sales of real property in Buffalo between July, 1941, and June, 1942, the ratio of assessed values to sales prices of said parcels was 103.8 per cent. This table was submitted by the relator to the respondents.

In view of this evidence offerred by the respondents and intervenor through the witnesses Cohn and Read, men with extensive experience in the active real estate field, showing clearly that generally assessments were higher than the sales prices of the respective parcels, the Referee can not find that the equalization rate of 90 per cent was too high.

Great weight and consideration has been given to the fact that sales prices alone may not necessarily represent full value. However, the appraisals of parcels of real property made

by the witnesses Cohn and Read, as opposed to sales, which appraisals they testified were made with consideration given to the condition of the real estate market, reproduction cost new less depreciation, general economic conditions, income yield to the owner, and other factors, likewise clearly showed that the assessed valuation on said parcels were higher than the appraised values thereof.

Relator's witness, Dexter P. Rumsey, president of the Erie County Savings Bank, testified that in his opinion the sales prices of real estate approximated two-thirds of the amount of the assessments on such properties.

The evidence appears to be that the equalization rate for 1943 of 90 per cent was reasonable.

The next question decided is that of the fixing by the State Tax Commission of the figure of $433,469.00 as the intangible value of the relator's special franchise in the City of Buffalo for the year 1943. This figure was derived by taking 5 per cent of the full value of the relator's special franchise property, tangible property, in the City of Buffalo for the year 1943. Relator contends that this figure is arbitrary and was already included in determining the full value.

Section 2 of Sub-division 6 of the Tax Law sets forth:

> "A franchise, right, authority or permission specified in this subdivision shall for the purpose of taxation be known as a "special franchise." A special franchise shall be deemed to include the value of the tangible property of a person, co-partnership, association or corporation situated in, upon, under or above

any street, highway, public place or public waters in connection with the special franchise. The tangible property so included shall be taxed as a part of the special franchise."

To constitute a special franchise two elements must be present, the element of physical property, in, upon or above the street, public place or public waters, and a grant from the State of the right to construct, maintain or operate the same. If either the tangible or intangible element is missing, there can be no special franchise within the meaning of the Tax Law.

People, ex rel New York Central Railroad Company vs. State Tax Commission
264 App. Div. 80
35 N.Y.S. 2d 77

People, ex rel Barron vs. Knapp
208 App. Div. 127
203 N.Y.S. 76
Aff'd 239 N.Y. 581
147 N.E. 204

Both of the above cases referred to Section 2, Subdivision 6 of the Tax Law.

The wording of the statute, "The tangible property so included shall be taxed as a part of the special franchise," indicates the separability for tax purposes of the value of the physical property and the value of the grant from the State.

It appears that the parties in this proceeding are in agreement basically that the value of the physical property and the value of the right, authority or permission to construct, maintain or operate in, under, above, upon or through the streets highways or public places are both elements to be included in the assessment. The disagreement lies in the fact that where the State Tax Commission determined the reproduction cost new, of

the relator's physical property, adjusted and depreciated said figure and then added 5 per cent, which 5 per cent is supposed to represent the intangible element, relator contends that said 5 per cent was thereby included twice. The position of the relator is that the physical property would have mere junk value, and no more, were it not for the rights and privileges granted to it by the State and that in computing reproduction cost new and depreciating the same the State Tax Commission has already taken into consideration the value of the franchise.

The Referee, after hearing the evidence and studying the cases cited with respect to this question, does not find himself in accord with this view. Aside from that portion of Section 2, Sub-division 6, quoted above, the Tax Law does not prescribe a definite formula by which the State Tax Commission can determine the full and actual value of the relator's property in the City of Buffalo. Section 45 mentioned earlier herein states that "the tax commission shall annually fix and determine the full and actual valuation of each special franchise subject to assessment in each city, town or village;. . . . ." The statute evidently was not intended to limit or delineate the manner in which the State Tax Commission should determine full and actual valuation. It is quite evident from the testimony and the return to the writ that the State Tax Commission established full and actual value of relator's physical plant and then separately added to this value what, in its opinion, was the

reasonable value of the grant. The propriety of its determination of the full and actual value will be discussed later. Assuming, however, for the moment that it was proper, the addition thereto of 5 per cent thereof was substantiated as to its reasonableness by the witness Bauer.

Dr. Bauer qualified as an expert on public utility matters, having been employed by the Public Service Commission of the State of New York, being engaged therewith in public utility matters. He was the author of a number of books concerning regulation of public utilities and he was a consultant on a number of occasions to municipalities granting franchises to public utilities and was consulted in connection therewith. Dr. Bauer had examined the reports submitted by the relator to the State Tax Commission. He stated that in his opinion the figure of 5 per cent of the value of the physical property of the relator located in the City of Buffalo was fair and reasonable.

Indeed, the relator's witnesses, Moynahan and Ullrich, stated, and it is the position of the relator, that even their book value and the value of their physical property as represented by the methods of accounting used by relator in accordance with the uniform systems of accounts already included the value of the grant. The Referee is of the opinion that the State Tax Commission is not bound to so agree. The relator's argument that the valuation of the tangible part of its special franchise, if more than junk value, includes the value of the intangible element can not be sustained as a matter of law.

It would lend to confusing the issue to state that the Commission separately assessed the value of the tangible property and separately assessed the intangible value. In its judgment, the Commission determined the full and actual value to consist in part of the value of the property plus the value of the grant. The combined figure comprises the full and actual value of relator's special franchise. To consider the value of the "real property" alone using the reproduction cost new less depreciation method, would be to place relator in the position of an owner of real property without a special franchise who is similarly circumstanced in that his property has no ready market value. In such a case the full and actual value of such real property which is not used in conjunction with a special franchise, reproduction cost new less depreciation is a proper criteria for determining value.

Peo. ex rel New York Stock
Exchange Supply Co. vs. Cantor
221 App. Div. 193
223 N.Y.S. 64
Aff'd 248 N.Y. 533
162 N.E. 514

Peo. ex rel New York Dock Co.
vs. Cantor
208 App. Div. 52
203 N.Y.S. 424

Peo. ex rel Union Bag and Paper
Corp. vs. Fitzgerald
166 Misc. 237
2 N.Y.S. 2d 290

Peo. ex rel Hotel Astor vs. Sexton
159 Misc. 208
287 N.Y.S. 746

In re: St. Lawrence Transmission
Co. vs. McAvoy
137 Misc. 603
244 N.Y.S. 508

We now come to what the referee considers the most perplexing question raised herein, namely, the question of over-valuation.

Section 44 of the Tax Law provides that every corporation subject to taxation on a special franchise shall file reports with the State Tax Commission and further that "the tax commission may require an annual report and from time to time a further or supplemental report from any such . . . . . corporation containing information and data upon such matters as it may specify . . . . . Such commission may prepare blanks to be used in making the reports required by this section."

During 1941 the State Tax Commission furnished to relator blank forms requesting that the relator furnish certain information requested thereon. The information requested was the relator's estimate of the reproduction cost new of all its physical plant and property located in the City of Buffalo as of December 31st, 1941.

Relator furnished this information giving a detailed account thereon of its different types of property and the estimated reproduction cost thereof. The total estimated reproduction cost new was $12,040,738.00. The State Tax Commission used this information during the year 1942 in order to make a determination of full and actual valuation of relator's property

in the City of Buffalo for the year 1943 as it was the latest report available for that purpose.

The State Tax Commission adjusted this figure by reducing it by 10 per cent, thereby arriving at the figure of $10,836,664.00. The Commission thereafter determined that the property was in 80 per cent condition and further reduced the amount to $8,669,331.00.

The net result of reducing the reproduction cost new figure by 10 per cent and further reducing it by 20 per cent was the same as reducing said reproduction cost new figure by approximately 28 per cent.

The relator in the aforementioned report stated that the present value of its property was $8,577,812.00. This is also stated in relator's petition, the relator having deducted approximately 28.8 per cent from its reproduction cost new figure. The difference between the respondent's present value and the relator's present value is $91,519.00.

At the hearings, however, the relator attempted to prove that the value of its property when computed by other methods was in the neighborhood of $6,000,000.00 and subsequently moved to conform its pleading to its proof. Relator maintains that it is not bound by its figures furnished to the State Tax Commission, not having placed a value on its property of its own volition, but simply that since the State Tax Commission requested certain information on State Tax Commission

and the law requiring such information to be furnished, that it did so, and that this does not preclude or estop it from proving the correct figure of full and actual valuation in this proceeding.

The relator furnished evidence that according to other methods of determining value which are outlined below the full and actual value of its plant would be substantially less than that set by the State Tax Commission. The various methods provided by the relator are as follows:

1. That the relator was required by the Federal Communications Commission and the Public Service Commission of the State of New York to keep accounts of the cost, depreciation, etc., in accordance with the Uniform System of Accounts. That the value of relator's property, as computed by said method of accounting, was used by the Public Service Commission in rate making cases and that under said system of accounting the value of relator's property in the City of Buffalo as of December 31st, 1941, was $6,150,000.00.

2. That under the net earnings rule as laid down in the case of Peo., ex rel Jamaica Water Supply Co. vs State Board of Tax Commissioners, 196 N.Y. 39, the full and actual value of relator's property in the City of Buffalo as of December 31st, 1941, upon the basis of capitalization at the rate of 6 per cent of relator's net earnings allocated to the City of Buffalo was $6,592,000.00

3. That the book cost less depreciation of the relator's property was the basis of purchases and sales between relator and independent telephone companies as well as other telephone companies within the Bell system, and that said basis of sales and purchases would strongly indicate the proper basis of full and actual value.

Evidence of the above was presented by the relator through the testimony of relator's witnesses Carl O. Ullrich and Philip O. Moynahan. The referee does not discount or in anywise treat lightly the testimony given by these witnesses. These witnesses appeared as being men who had a clear and complete understanding of the facts and matters about which they testified and the referee also felt that they were eminently qualified to so testify. However, in the determination of the full and actual value of a taxpayer's property, the assessors are not bound by the books and records kept by the taxpayer in determining the amount of its assessment as there is no provision in the law to that effect.

This should not be altered by the fact that the taxpayer keeps his books and records in accordance with the requirements of regulatory authority

As stated earlier, Section 45 of the Tax Law requiring the Tax Commission to fix and determine the full and actual value of the special franchise did not prescribe the modus operandi. The statute appears to leave it within the fair

judgment and discretion of the State Tax Commission to make such determination. It is not within the province of the Court to delve into the mental processes of the assessing officers to determine all the factors considered by them and whether they used the very same judgment that the Court would have used had it performed the function. If the assessors avail themselves of all the information they are able to obtain regarding value and then fixed value according to their best judgment, they have properly performed their duties.

Peo. ex rel N.Y. Cent. and H.R.R.
Co. vs. Priest
206 N.Y. 274
99 N.E. 547

Peo. ex rel Jamaica Water Supply
Co. vs. State Board of Tax Commissioners
196 N.Y. 39
89 N.E. 581

Peo. ex rel R.W. & O. R.R. Co.
vs. Haupt
104 N.Y. 377
10 N.E. 871

Peo. ex rel Willey vs. Carmichael
256 App. Div. 421

Peo. ex rel Lehigh Valley Ry. Co.
vs. Burke
221 App. Div. 248
223 N.Y.S. 168

Peo. ex rel Haile vs. Brundage
195 App. Div. 745
187 N.Y.S. 460

Peo. ex rel Union Bag and Paper
Corp. vs. Fitzgerald
Supra

Peo. ex rel N.Y.O. & W.R. Co.
vs. Woodbury
71 Misc. 474
128 N.Y.S. 939

It does not appear that value for rate making purposes under the Public Service Law is necessarily the same as full and actual value for the purposes of taxation for the following reasons:

Firstly, matters considered in determining value in rate making cases, although similar, are not the same as in special franchise assessment cases.

See Yonkers R. Co. vs Maltbie
251 App. Div. 204
296 N.Y.S. 411

Yonkers R. Co. vs. Maltbie
242 App. Div. 319
274 N.Y.S. 535
Appeal dismissed
266 N.Y. 542
195 N.E. 191

Secondly, there is nothing in the law requiring the State Tax Commission to be bound by the findings regarding value made by the Public Service Commission nor is the State Tax Commission a party to a rate making case.

Thirdly, the relator has not shown, nor can it show without the Public Service Commission being a party here, that the value set by the Public Service Commission for rate making purposes is correct. It may just as well be true that the State Tax Commission's estimate of full and actual value is correct and that of the Public Service Commission erroneous.

Finally, the purposes for determining value by regulatory authority are not the same as those for taxation.

The net earnings rule is far from a mandatory method of determining valuation in special franchise taxes. As a matter of fact, the Jamaica case mentioned herein and cited prolifically by both relator and respondent contains the following statement on Page 55 therein:

> "While, as we have already pointed out, the Legislature has not prescribed any exclusive or hard and fast rule for assessing the value of special franchises, we think that in the case of this relator and many other corporations similarly circumstanced the adoption and application of the net earnings rule would result in a fair and just valuation. There are obviously many cases, however, to which it would not be applicable at all."

The relator, New York Telephone Company, conducts its business throughout the State of New York and is part of a telephone system which operates throughout the world. The services it provides and from which it yields revenue in the City of Buffalo are so intertwined and intermingled with its state wide operation that it would be exceedingly difficult and in the opinion of the referee improper to attempt to allocate the correct net earnings figure to the City of Buffalo alone.

Furthermore, the testimony of relator's witness Ullrich was that applying the net earnings rule as laid down in the aforesaid Jamaica case there was a deficit rather than net

earnings subject to capitalization in the City of Buffalo for the year 1943. In this regard it is interesting to note another exerpt from the aforesaid Jamaica case at Page 59 which states:

> "If, as is suggested might occur in some supposed cases, this would result in giving a special franchise no taxable value at all, that would be a conclusive reason for rejecting the net earnings rule in such cases and would demand the adoption of some other rule or method."

Under the law and the fact of the particular nature of the taxpayer's operation and special franchise the State Tax Commission was justified in refusing to apply the net earnings rule.

Relator has placed a substantial emphasis upon its evidence that the New York Telephone Company, independent telephone companies and telephone companies within the Bell system have used book cost less depreciation as the basis of sales and purchases of telephone property amongst themselves. Suffice it to say that here, too, the assessing officers are not bound by the book value placed on its property by the taxpayer. The State Tax Commission is not bound to inquire into the arrangements between the telephone companies mentioned and as to agreements which exist amongst them. The figures so found are not an adequate basis for determining full and accurate value for the purposes of assessment. The fact that in this case such figures coincide with the method of accounting prescribed by the Federal Communications and the Public Service

Commission would not seem to alter this principle.

It has been conceded by all parties herein that there is a presumption of the correctness of the assessment and that consequently the burden of proving the assessment to be illegal, erroneous or incorrect in any manner is upon the one seeking review of said assessment. The referee does not seek, as he does not deem it necessary, to discuss at length the shades of legal meaning properly applied to this statement of law. The statute provided in Section 45 for the obtaining by the State Tax Commission from the taxpayer any information it may require. It further provided in the last paragraph of Section 44 that "the public service commission shall furnish to the state tax commission the estimates of reproduction cost new, depreciation and present value presented to the public service commission by any utility company in any valuation matter . . . . . as the state tax commission shall request." The reproduction cost new figures were prepared and submitted by relator. Relator can not complain that this figure is not correct and relator does not so complain. The State Tax Commission has used this reproduction cost new figure as the basis for its determination of full value under the statute. This is reasonable, proper and sound in law.

Peo. ex rel New York Stock Exchange
Supply Co. vs. Cantor
Supra

Peo. ex rel New York Dock Co. vs.
Cantor
Supra

Peo. ex rel Union Bag and Paper
Corp. vs. Fitzgerald
Supra

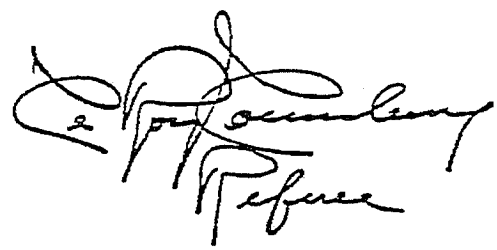
Peo. ex rel Hotel Astor vs. Sexton
Supra

In re: St. Lawrence Transmission
Co. vs. McAvoy
Supra

The Commission had adjusted and reduced said figure which resulted in a full and actual value figure less than 1 per cent, to wit, .8 per cent different from what relator would have found had relator itself depreciated this figure as a result of its own studies regarding depreciation rates. This difference of .8 per cent is reasonable and represents a fair difference of opinion as relator's own witness testified. The assessment can, therefore, not be said to be arbitrary, erroneous or excessive in any manner whatsoever.

Therefore, the writ of certiorari herein is quashed, the proceeding dismissed and the valuation confirmed with costs and disbursements against the relator.

Submit order.



Appendix B

SUPREME COURT: STATE OF NEW YORK
MADISON COUNTY: SIXTH JUDICIAL DISTRICT

IN THE MATTER OF THE APPLICATION UNDER
ARTICLE 7 OF THE REAL PROPERTY TAX LAW

by

TENNECO INC. - TENNESSEE GAS PIPELINE DIVISION
Petitioner

-against- DECISION

TOWN OF CAZENOVIA, NEW YORK
HARVEY STEVENS, HAROLD FIEDLER and
ARTHUR STRATTON, BOARD OF ASSESSORS, and
THE BOARD OF ASSESSMENT REVIEW OF THE
TOWN OF CAZENOVIA
COUNTY OF MADISON
STATE OF NEW YORK
Respondents

FOR REVIEW OF THE 1981-82 TAX ASSESSMENT OF CERTAIN
REAL PROPERTY IN THE SAID TOWN OF CAZENOVIA, NEW YORK

The above entitled matter having come before this court at a Special Term held in and for the county of Madison. The court having heard the testimony of Harvey Stevens, Robert H. McSwain, John F. Havemeyer and Robert V. Jelinek. The court further having examined the exhibits introduce and received into evidence, the briefs of the respective parties and the proposed factual findings of the parties. The court then having reserved.

This is a review pursuant to Art.7, Real Property Tax Law of the 1981-82 assessment of the pipeline located in the Town of Cazenovia, New York, belonging to the petitioner. During the course of the trial and at the conclusion of the petitioner's

case, the respondents moved to strike the appraisal of the petitioners, on the grounds that it was hearsay. The court reserved and at this time denies the respondent's motion.

Also, during the course of the trial, the petitioner moved to strike that part of the respondent's appraisal, that concerned a value for the land on which the right of way exists. The basis for this motion was that the respondent's appraisal attempted to value this land even though the original assessment didn't include a land value. The assessor agreed in his testimony, that the land was assessed to the landowners and not to the petitioner, in view of this fact, the motion of the petitioner is granted.

At the conclusion of the evidence and testimony, the court requested findings of fact from the parties. At the onset, this court commends the respective attorneys for the excellent findings submitted. The court will now make findings of fact; any findings submitted that are not found by the court are specifically denied:

1. That petitioner is a foreign corporation and was duly authorized to do business under the name Tennessee Gas Transmission Company in the State of New York on August 22, 1949 by a filing of a Statement and Designation pursuant to §210 of the General Corporation Law with the New York State Department of State (Petitioner's Exhibit 1).

2. That petitioner's business purpose within the State

of New York was and is: "To transport and sell natural gas in interstate commerce and to own, lease, maintain and operate pipe lines therefore" (Petitioner's Exhibit 1).

3. That effective April 20, 1966, by a filing pursuant to §1309 of the Business Corporation Law with the New York State Department of State the name Tennessee Gas Transmission Company as an authorized foreign corporation was amended to read Tenneco, Inc. (Petitioner's Exhibit 1).

4. On, prior and subsequent to June 1, 1981, the Petitioner was the owner of a section of gas transmission pipeline assessed as real property situate in the Town of Cazenovia, County of Madison and State of New York and described on the assessment roll of the Town of Cazenovia as Parcel No. 6-252289-600-81 [Petitioner's Exhibit 4 (assessment roll); Par. 1 of answer admitting paragraphs Second (2) and Fourth (4) of petition; testimony of Assessor Harvey Stevens]

5. That the Respondent Assessors tentatively assessed the Petitioner's property for the year 1981-1982 as follows: Land $0; Improvements $715,800; total $715,800 (Par. 1 of answer admitting par. Fifth (5) of petition).

6. That Petitioner duly filed a real property assessment complaint for the year 1981-82 with the Town of Cazenovia and its Board of Assessment Review wherein the $715,800 assessed value was protested as being unequal and

overvalued based on a 100% full market ratio; said complaint further alleged that the assessment should be reduced to $38,390 and claimed that the overvaluation and overassessment was $677,410 (Petitioner's Exhibit 3; Par. 1 of answer admitting Par. Sixth (6) of petition).

7. That Respondents Board of Assessment Review denied Petitioner's complaint and the assessment for Petitioner's property was finally fixed and determined as follows: Land $0; Improvements $715,800; Total $715,800 (Par. 1 of answer admitting Par. Eighth (8) of petition).

8. That Petitioner thereafter duly served upon Respondents a petition to the Supreme Court, State of New York, Madison County pursuant to Article 7 of the Real Property Tax Law praying that Petitioner's 1981-82 assessment be reduced to $38,390 and Respondents served an answer thereto asking for dismissal of said petition.

9. That Petitioner duly served a copy of its petition on the Clerk of the Cazenovia Central School District pursuant to §708 (3) of the Real Property Tax Law (Petitioner's Exhibit 2).

10. That the real property owned by Petitioner and assessed herein by the Town of Cazenovia consists of 4.62 miles (24,394 lineal feet) of 24 inch diameter pipeline.

11. That said pipeline was used exclusively for the transmission of natural gas.

12. That said pipeline in the Town of Cazenovia was and is an integral and integrated part of Petitioner's interstate pipeline which transmits natural gas from the Gulf of Mexico and its bordering states in a generally northeasterly direction through intervening states to the New England area(Map, Petitioner's appraisal, Exhibit 6; FERC "Form No.2"-Exhibit 7, page 101).

13. That said pipeline was installed in the Town of Cazenovia in the year 1951.

14. That the portion of the pipeline installed in the Town of Cazenovia was approximately thirty (30) years of age at the time of the assessment at issue herein.

15. That said pipeline was installed in right-of-way easements previously acquired by Petitioner from owners of the underlying fee title of the land.

16. That Assessor Harvey Stevens testified that the value of such land through which the Petitioner's pipeline passed was assessed to the underlying fee owners and not to the Petitioner.

17. That Petitioner as an interstate transmitter of natural gas comes under the jurisdiction and control of the Federal Energy Regulatory Commission (FERC).

18. That FERC as successor to the Federal Power Commission approves the price at which interstate pipeline companies may sell gas to public utilities for resale to final consumers

(Natural Gas Act).

19. That such approved sale prices for gas delivered to utilities for resale includes the cost at which the gas was purchased from the gas producers plus a regulated and approved charge for the transmission of such gas.

20. That after recovery of gas purchase costs the residual income of an interstate gas pipeline company consists of the payment of charges made for the transmission of gas, all of which charges are regulated by FERC.

21. That FERC Form No. 2 provides as follows: "This report is mandatory under the Natural Gas Act, Section 10 (a) and 16 and 18 CFR 260.2. Failure to report may result in criminal fines, civil penalties and other sanctions as provided by law. The Federal Energy Regulatory Commission does not consider this report to be of a confidential nature." (Petitioner's Exhibit 7).

22. That FERC Form No. 2 further provides under heading of "General Information" as follows: "I. Purpose. This form is a regulatory support requirement (18 CFR 260.1). It is designed to collect financial and operational information from natural gas companies subject to the jurisdiction of the Federal Energy Regulatory Commission. This report is also secondarily considered to be a nonconfidential public use form supporting a statistical publication (Statistics of Interstate Natural Gas Pipeline Companies), published by the

Energy Information Administration." (Petitioner's Exhibit 7 page 1).

23. That FERC Form No. 2 for December 31, 1980 (Petitioner's Exhibit 7 at page 110 thereof) sets forth a breakdown of Petitioner's assets by "Utility Plant", "Other Property and Investments", "Current and Accrued Assets" and "Deferred Debits."

24. That "Utility Plant" is the basic operating unit of the aforesaid interstate pipeline system operated by the Tennessee Gas Pipeline Company Division of Tenneco Inc. (Petitioner's Exhibit 7, pages 110 and 200).

25. That Petitioner's interstate pipeline system of which the Town of Cazenovia portion was a part, was built over a period of years beginning in 1944 and continuing to the present time. (Petitioner's Exhibit 6, page 15).

26. That FERC allows Petitioner and other interstate gas pipelines to earn a rate of return which is based on original cost less accumulated "depreciation", "amortization" and "depletion."

27. That the basis for earnings by an interstate gas pipeline utility is also referred to as the net book value or net utility plant investment.

28. That Robert H. McSwain (hereinafter McSwain) made a written appraisal which was introduced into evidence as Petitioner's Exhibit 6, subject to opposing counsel's right

to cross-examine and make motions to strike.

29. That respective counsel for the Petitioner and the Respondents, after the commencement of appraisal testimony, stipulated in open court as follows:

> "If any matter is referred to in an appraisal, the appraiser may elaborate on that matter during his testimony."

30. That the purpose of Petitioner's appraisal was stated to be "to estimate the market value of the operating properties of Tenneco Inc., Tennessee Gas Pipeline Company Division in the Town of Cazenovia, New York". The valuation date is May 1, 1981. (Petitioner's Exhibit 6,page2).

31. That appraiser McSwain estimated the fair market value of the pipeline within the Town of Cazenovia to be the sum of $95,100 as of May 1, 1981. (Petitioner's Exhibit 6,page 37).

32. That Petitioner's appraiser McSwain, based on his computations and analysis contained on his appraisal pages 25 through 28, estimated that the future net utility operating income, including income from construction work in progress, was $127,000,000. (Petitioner's Exhibit 6, page 26)

33. That McSwain's conclusion of value by the income approach was $976,923,077 which was reached by capitalizing the estimated future net utility operating income of $127,000,000 at a capitalization rate of 13% ($127,000,000 ÷ .13) which was then rounded to a value of $977,000,000 for the

system-wide operating properties of Tennessee Gas Pipeline Company Division of Tenneco Inc. (Petitioner's Exhibit 6, page 27).

34. That appraiser McSwain also considered the availability of market data sales between a seller and buyer but the appraiser stated he found no sales of comparable pipeline properties. (Petitioner's Exhibit 6, pages 29,34 and 36).

35. That appraiser McSwain considered the Stock and Debt Approach in appraising utility properties normally the leastreliable of the three approaches to value. (Petitioner's Exhibit 6, page 34).

36. That in considering the Cost Approach to value, appraiser McSwain employed three methods as follows:

a) original cost system-wide with an allocation of value to the Town of Cazenovia (Petitioner's Exhibit 6, pages 12, 35 and 37).

b) reproduction cost system-wide with an allocation of value to the Town of Cazenovia (Petitioner's Exhibit 6 pages 9, 35 & 37).

c) reproduction cost within the Town of Cazenovia. (Petitioner's Exhibit 6, pages 15-16).

37. That McSwain applied to his cost approaches depreciation which he defines as a loss in value from cost new and included in this category of depreciation were three types identified as "physical deterioration","functional

obsolescence" and "economic obsolescence". (Petitioner's Exhibit 6, page 6).

38. That appraiser McSwain also calculated a reproduction cost approach using values localized to the Town of Cazenovia; that respective counsel stipulated that the reproduction cost new of the 4.62 miles of pipeline within the Town of Cazenovia was $1,800,000 but by express language this stipulation did not restrict or regulate the amount of depreciation and/or obsolescence to be applied thereby by either party.

39. That appraiser McSwain stated that in reaching his values as of May 1, 1981, he based his opinions of value on the most recent data which was as of December 31, 1980 and he found that no material change had occurred in the property in Cazenovia between December 31, 1980 and May 1, 1981 and its market value would remain the same on each said dates (Petitioner's Exhibit 6, page 38).

40. That appraiser McSwain stated that " the property is serving the purpose for which it was created"; that the use of the pipeline in the Town of Cazenovia as part of an interstate gas pipeline system is its highest and best use. (Petitioner's Exhibit 6, page 36).

41. That the appraisal of John F. Havemeyer III, (hereinafter Havemeyer) was entered into evidence as Respondent's Exhibit B, subject to the right of opposing counsel to

$1,800,000.(Exhibit B, page 33).

47. That Havemeyer was of the opinion that "there can be no question that underground facilities remain the most economically feasible and perhaps the only practical method of transporting large volumes of natural gas over long distances". (Exhibit b, page 34).

48. That Havemeyer attributed no economic obsolescence to the effect of FERC regulations upon income and return on capital and return of capital.

49. That the highest and best use of Petitioner's property within the Town of Cazenovia is its past and present use as a pipeline which is part of an interstate gas transmission system

50. Tenneco Inc. -Tennessee Gas Pipeline Division, owner of the subject premises is an aggrieved party within the definition of Section 704 of the Real Property Tax Law, and as such is a proper party to bring the proceedings before the court.

51. That the appraisors John F.Havemeyer, III and Robert H. McSwain are found to be duly qualified to testify and their qualifications are in evidence and part of the record of this matter.

52. The pipeline is cathodically protected with sacrificial anodes.

53. There are approximately eight test leads in the Town of Cazenovia for the taking of electrical readings to indicate

cross-examine and make motions to strike.

42. That appraiser Havemeyer stated that the highest and best use of the property is "substantially as improved, for a pipeline transmitting gas interstate." (Respondent's Exhibit B, page 22)

43. That Havemeyer stated that the pipeline was assessed in 1981 at full value at assessment of $175,800. (Respondent's Exhibit B,page 2)

44. That Havemeyer used a 4.62 mile length for the pipeline characterizing the neighborhood as rural for its entire length, having agricultural and recreational usages. (Exhibit B, page 6; see also photographs pages 7 to 15 inclusive).

45. That Havemeyer added to his depreciated reproduction cost of $1,620,000 a pipeline right-of-way value of $65,000 which he ascertained by analyzing option agreements to purchase rights-of-way for a brewery pipeline; that Havemeyer conceded in his trial testimony that the Town of Cazenovia had made only a pipeline assessment and no assessment for land or rights-of-way. (Exhibit B, pages 25-31).

46. That Havemeyer adopted the findings of Robert V. Jelinek, P.E. in that the pipeline should be depreciated 10% on only a physical deterioration basis constituting a deduction of $180,000 from reproduction cost new of

the need for replacement of the anodes.

54. The depreciation to be afforded to the pipeline, if any, is catagorized in three parts, namely: physical deterioration, functional obsolescence and economic obsolescence.

55. Physical deterioration is the reduction in utility resulting from an impairment of physical condition. Physical deterioration may be curable or incurable in nature based on whether it is economically feasible and/or cost effective to remedy the condition.

56. Functional obsolescence is the reduction in utility which occurs when a facility or a part thereof is incapable of performing the function for which it was designed or for which it was being used.

57. As with physical deterioration, functional obsolescence can be curable or incurable depending on whether the cost to cure the disfunctional element would be offset by the resulting increase in utility.

58. Economic Obsolescence is the impairment of desirability or useful life arising from factors external to the property such as economic forces or environmental changes which effect supply demand relationships in the market.

59. Dr. Jelinek studied the Type of Soil, Resistivity of the Soil, the pH of the Soil, and obtained data from Empire Soils Investigations Inc. in connection with the

Corrosion Potential of the petitioner's pipeline in the Town of Cazenovia.

60. Dr. Jelinek's determination of the physical life of bare pipe of the type used by petitioner in the Town of Cazenovia in the soils found in the Town of Cazenovia was over 200 years.

61. Dr. Jelinek testified that pipe protected as is petitioner's in the Town of Cazenovia could last indefinitely and there would be very little, if any, physical deterioration.

62. Repondents' appraiser, Mr. Havemeyer, used a 10% physical depreciation in his cost evaluation of petitioner's pipeline in the Town of Cazenovia.

63. The 10% physical depreciation adequately accounts for physical depreciation in his cost evaluation of petitioner's pipeline in the Town of Cazenovia.

64. With regard to pipelines in general, and the Town of Cazenovia in particular, there can be no question that underground facilities remain the most economically feasible and perhaps the only practical method for transporting large volumes of natural gas over long distances.

65. There were no rented pipelines of types comparable to the subject that were found by either petitioner or respondent.

66. Therewere no sales of pipelines comparable to the subject found by either petitioner or respondent.

67. The Federal Energy Regulatory Commission (F.E.R.C.) imposes restrictions on the economic earnings of interstate pipelines.

68. The business investment return of the petitioner's entire 13,500+ miles line is not a proper method of calculating the value of petitioner's real property located in the Town of Cazenovia.

69. The value of petitioner's real property in the Town of Cazenovia for assessment purposes must be the full value of the property.

70. Full value may be defined as , " The highest price estimated in terms of money which a property would bring if exposed for sale in the open market by a seller who is willing but not obligated to sell allowing a reasonable time to find a buyer who is willing but not obligated to buy both parties having full knowledge of all the uses to which it is adapted and for which it is capable of being used; and assumes that the properties taxed to market value ratio is similar to all other properties in the taxing jurisdiction".

71. Petitioner's have attempted to prove assessment value by taking the reproduction cost basis of the entire Tennessee Gas Pipeline Company Division in the amount of $9,366,201,962 less depreciation and then allocating a portion of the

system value to the property under appraisement.

72. Petitioner's expert subtracted from the reproduction cost of the entire line the F.E.R.C. allowance for Accumulated Depreciation Amortization and Depletion.

73. Petitioner's expert arrived at a reproduction cost of the utility plant, construction work in progress, materials ans supplies, and stored gas of $4,124,648,492 which was estimated should have a market rate of return of 13%.

74. There is no substantiation of the market rate of return of 13% as used by petitioner's expert.

75. Petitioner's expert subtracted the actual return obtained by petitioner from the theoretical return to be obtained from the reproduction cost of utility plant, construction work in progress, materials and supplies and from stored gas, and arrived at a indicated deficiency income of $409,204,304 which was capitalized at 13% to allegedly determine the economic obsolescence to be applied to the reproduction cost in order to arrive at an indicated value by the cost approach.

76. Value of work in progress and gas stored underground throughout the entire system has no bearing on the taxable value of the real property in the Town of Cazenovia.

77. The property of petitioner in the Town of Cazenovia is unique and specially built for the specific purposes for which it was designed.

With these findings of fact, the court determines as follows:

Both parties agree the issue is one of "full valuation" and whether the fair market value of the pipeline is less than the assessment. There is no issue of equalization rates.

The Petitioner Tenneco Inc.-Tennessee Gas Pipeline Company Division (hereinafter "Tenneco") is a corporation organized under the laws of Delaware engaged in the purchase, transmission and sale of natural gas through an intergrated system extending from Texas to the New England States.

The subject pipeline is located in the 50' wide permanent easement extending 4.62 miles from east to west in the Town of Cazenovia.

This section of pipeline was constructed in September 1951. All of the pipeline in the Town of Cazenovia is buried at a uniform depth of 30" with the exception of the three obstacles being road crossings, railroad crossings and creek crossings which are at a different depth.

The pipeline is cathodically protected with sacrifical anodes which in time disintergrate. When electrical readings indicate the need, the anodes are replaced.

The highest and best use of the property is substantially as improved, for a pipeline transmitting gas interstate.

Both appraisers considered the three approaches to value; the market data, cost and income approaches.

The Town of Cazenovia's appraiser, Mr. Havemeyer, concluded

that the cost approach is the only applicable approach to this type of property; his appraisal did not contain an income approach nor a market approach on the improvements.

Tenneco's appraiser, Mr. McSwain, adopted a unit approach wherein he first valued the Petitioner's pipeline system in its entirety and then allocated a portion of the system value to the property under appraisement in the taxing jurisdiction.

Appraiser McSwain stated that the market approach is not possible in appraising a utility property because these properties are not sold as operating units, and he used a stock and debt approach to find market value. However, he was of the opinion that this approach has many shortcomings, and on that point the court concurs and disregards that approach. Mr. McSwain also included a cost approach (using three methods: original cost system-wide with an allocation of value to the Town of Cazenovia; reproduction cost within the Town of Cazenovia; each less depreciation) but he chiefly relied upon and gave most weight to the income approach.

The issue raised by the proof before this court, is whether the Respondent erroneously overvalued the subject property by using the cost approach. In addition, whether the Respondent overvalued the subject property because of its application or lack of application of depreciation, and whether the income approach as put forth by the Petitioner arrives at the full value of the property.

In tax review proceedings, there is a presumption in favor of the validity of the assessment and the burden necessarily rests upon the one who attacks it to show that it is invalid (People ex rel Jamaica Water Supply Co. vs. State Board of Tax Commissioners, 196, NY 39) this presumption disappears once the realtors have made out a prima facie case by substantial evidence to the contrary... the case must them be determined by weighing only the evidence in the case. (People ex rel Beardsley vs. Barber 43 NYS 2nd 588, affid 293 NY 706; Property Portfolio 182 Corp. vs. Tax Commission of the City of New York 396 NYS 2nd 72).

The court must determine whether the assessment method employed by the taxing authority was corrected in form and application.(Consolidated Edison Company of New York Inc. vs. State Board of Equalization and Assessment, 445 NYS 2nd 243,246).

The ultimate goal of an assessment is the determination of "full value" of the property assessed, and the "full value" has been defined by the courts as equal to fair market value. (Hellerstein vs. Assessor of the Town of Islip, 371 NYS 2nd 388).

The aim of valuation is to assure that the share reasonably to be borne by a particular owner is based on the equitable proportioning of the fair market value of his property vis-a-vis the "fair market value of all other taxable properties in the same taxing jurisdiction.(Merrick vs. Board of

Assessors, 410 NYS 2nd 565,568).

In arriving at fair market value, there are three approaches commonly used: the market, the cost and the income approachs. Normally, all three approaches to value should be used to indicate and cross check a property's value. However, for certain types of property some approaches are more suitable than others.

The Petitioner is one of over 200 subsidiary companies which comprise the Tenneco Inc. Corporation, a large, diversified conglomerate of great financial complexity and sophistication. The property which is the subject of this proceeding, is but 4.62 miles of a much larger, integrated system of over 13,500 miles of pipeline stretching from Texas to New England. The Petitioner argues that the true value of the segment lies in consideration of the whole system and that a unit approach to value is preferable. Mindful, of the nature and extent of Petitioner's holdings, and having considered the extrapolation indulged in by appraiser McSwain, the court finds that the unit approach does not adequately and truly reflect the value of the segment in question.

The income approach, which considers expected monetary returns from a property in the light of return on investment currently being demanded by investors, is a valid consideration in some income producing properties. Indeed,

it has been approved as a factor to be considered in railway properties where there has been a sudden, enormous and progressive decline in the value of its securities (Lehigh Valley Railway Co. vs. Harris 6 NYS 2nd 794, aff'd 12 NYS 2nd 1011); where net operating income was insufficient to meet fixed expenses during years for which assessment was made (People ex rel New York, Ontario & Western Railway Co. vs. Rosenshein, 84 NYS 2nd 251, mod in part 300 NY 74); where the railway was not a paying property (People ex rel New York Central Railraod Co. vs. Thompson 292 NYS 269); or where there was financial deterioration, and revenues were not sufficient to meet tax accruals (People ex rel Delaware Lackawanna and Western Railraod Co. vs. Sims, 291 NYS 2nd 689). These cases are not analgous to the case at bar. The Petitioner is not claiming that it is economically distressed (in fact, although income stream over five years fluctuated there was as much as a 19.95% increase in 1979-1980) but that it could be more profitable were it not for government regulation.

The application of the income approach by the Petitioner wherein it capitalized the estimated utility operating income to arrive at a value of the system wide operating properties of Tenneco and then applied an allocation factor to find the Cazenovia portion of the system value, is too speculative to have any real probative value in this instance.

While appraisal is not an exact science (Delaware , Lackawanna and Western Railroad Co., supra 694) and the informed estimates of qualified appraisers are given due weight, those opinions must be tethered by common sense and grounded more in fact than conjecture if we are to arrive at a realistic estimate of value.

The unique characteristics of this property clearly call for the cost approach to value. The court holds that this is the only method "which will yield a legally and economically realistic value of the property". (Great Atlantic & Pacific Tea Co., Inc. vs. Kiernan, 397, NYS 2nd 718,723). This portion of the pipeline was constructed in 1951 specifically for the purpose of transmitting natural gas. Both parties agree that the highest and best use of the pipeline is as it is now being used, and that there is no market as such for this type of property. (See Matter of County of Nassau, 43 AD 2nd 45,49). A speciality for tax evaluation purposes is a structure which is uniquely adopted to business conducted upon it or use made of it and which cannot be converted to other uses without expenditure of substantial sums of money.(Great Atlantic & Pacific Tea Co., Inc).

The Respondent has relied upon cost approach and selected the reproduction cost as the type of cost to be used, the Petitioner has included the reproduction cost less

depreciation as one of its considered approaches to value. The court finds the reproduction cost to be a more appropriate type of cost to apply than original cost.

Even in using the same approach, and the same stipulated reproduction cost, the appraisers have arrived at widely disparate fair market values:

	Petitioner	Respondent
Stipulated Reproduction Cost	1,800,000	1,800,000
Physical Depreciation (80%)	1,440,000 360,000	(10%)-800,000 1,620,000
Economic Obsoles. (76.35) Improv.	274,752	(0)1,620,000
Land	0 85,248	+ 65,000 1,620,000

The appraisers disagree on the amount of physical depreciation (the amount of loss in value from cost new due to normal deterioration of the property) the pipeline has incurred.

The 24 inch pipeline was manually electric-arc welded, coated and wrapped, and cathodically protected with sacrificial anodes. Practically speaking, if properly maintained, the pipeline is virtually immune to corrosion; there was no testimony to show any special factors in the soil giving rise

to corrosion, nor was there any view to show the actual physical condition of the pipe. There was however abundant creditable testimony by Dr. Jelinek on the physical life of the pipeline. The Petitioner relied upon FERC, allowances for depreciation, amortization and depletion. Depreciation is defined and used differently in various disciplines. For purposes of regulating public utilities, depreciation refers to (1) a valuation account to establish a rate base, which is the investment upon which a utility may earn a fair return, and (2) an expense account for estimating the annual net income for fair return. (William M. Shenkel, Modern Real Estate Appraisal). The FERC depreciation rates were combined and there was no testimony as to how they were apportioned or arrived at. The court finds that the depreciation rates so relied upon by the Petitioner do not accurately reflect the physical life of the pipe, and gives weight to the testimony of the Respondent. The physical depreciation was properly placed at 10%.

The Petitioner alleges the method used by the Respondent was improper also because of the failure to consider economic obsolescence. Tenneco argues that there is economic obsolescence to the pipeline because of government regulation on earnings. To calculate this factor, the Petitioner took the difference between the estimated net utility operating income, and the net utility operation income which should have been

earned were it not for government regulation, and arrived at an indicated "deficiency income" which was then capitalized at a chosen figure to reach an obsolescence figure to be applied to the reproduction cost.

Government regulation is undoubtedly a factor external to the property under valuation which affects the earning power of the petitioner, however, it is not necessarily to be equated with economic obsolescence. Government regulation may affect the earnings of the Petitioner but it does not follow ipso facto there is a loss in value of the property, in question. To adopt that view would tie the value of the subject pipeline to the profits of the corporation as regulated by the government. We reject the economic obsolescence as defined and applied by the Petitioner.

The Respondent at trial placed a $65,000 value on the subject land, although the land was assessed at 0 value on the final assessment roll. The 0 value placed on the land will not be changed by the court. Testimony at the trial indicated that the underlying owners were assessed for the land.

One other point calls for consideration. The Respondent's final assessment on the improvements was $715,800, the value found by Respondent's appraiser at trial was $1,620,000, some $914,200 higher than the assessed value challenged. A court is without power in a proceeding to review tax assessments

to increase valuation fixed by the assessors for the function of assessment is distinct from the function of review. (Application of Board of Education Central School District #1 etc., 306 NYS 2nd 833). The act of the taxpayer in taking the proceeding into court does not imply a consent to have the assessment or an element thereof increased or a willingness to litigate that question, nor can the action of the taxing authorities in resisting his application for a reduction be construed to be notice they will ask for an increase. (24 Carmody-Wait 2nd 146:113).

The application of the Petitioner to have the assessed evaluation corrected and reduced is denied and the petition is dismissed.

Dated; March 24, 1983

Hon. George S. Kepner, Jr.,
Acting Supreme Court Justice

Appendix C

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF ROCKLAND
----------X

In the Matter of the Petition of	:	
ORANGE & ROCKLAND UTILITIES, INC.,	:	
Petitioner,	:	
-against-	:	D E C I S I O N
CLARA M. WILLIAMS, Assessor for the Town of Ramapo and HERMAN GOLDMAN, ARTHUR HEALEY, JOHN KEEGAN and ARTHUR PAIKIN, constituting and sitting as a Board to hear grievances with respect to real property taxes in and for the Town of Ramapo,	:	Index No. 6041/80
Respondents,	:	
for Review under Article 7 of the Real Property Tax Law of the Assessment of Certain Real Property in the said Town of Ramapo, New York.	:	

----------X

BURCHELL, J.

In this proceeding pursuant to Article 7 of the Real Property Tax Law petitioner seeks reduction of assessments on certain real property owned by it in the Town of Ramapo and various included villages on which there are constructed certain electrical substations and transmission lines. As part of its conduct of this trial the Court made field inspections to a number of installations in the presence of counsel and their respective experts.

The subject property is part of a transmission system which runs through parts of the states of New York,

New Jersey and Pennsylvania and is used for the delivery of electric power for wholesale, commercial, industrial and residential customers. Under review are five transmission substations, one switching station and various numbers of transmission lines depending on the particular year under review.

The substations are as follows:

1. The Hillburn substation:

This is a combination transmission and distribution substation containing five transformers with a combined capacity of 185,000 KVA; eight 69,000 v oil circuit breakers; nine 34,000 v oil circuit breakers; three 15,000 v oil circuit breakers; various switches, controls and related equipment.

2. New Hempstead substation:

This is a distribution substation containing two transformers with a combined capacity of 70,000 KVA; three 138,000 v oil circuit breakers; twelve units of 15,000 v metal clad switch gear; various switches, controls and associated equipment.

3. Ramapo substation:

This is a transmission substation containing six transformers with a combined capacity of 600,000 KVA; eight 138,000 v oil circuit breakers; various switches, controls and associated equipment.

4. Sloatsburg substation:

This is a distribution substation containing one

transformer with a capacity of 500,000 KVA; three units of 4,160 v metal clad switch gear; various switches, controls and associated equipment.

5. Tallman substation:

This is a distribution substation containing two transformers with a combined capacity of 50,000 KVA; nine units of 13,200 v metal clad switch gear; various switches, controls and associated equipment.

6. Ladentown switching station:

This is a transmission substation containing four 365,000 v air circuit breakers, various other switches, controls and associated equipment.

TRANSMISSION LINES

Line No. 23 - Hillburn to Sugarloaf, 69,000 v, approximately 3.6 pole miles, consisting of steel towers, poles, crossarms, conductors, insulators and appurtenances.

Line No. 26 - Ramapo to Sugarloaf, 138,000 v, approximately 5.5 pole miles, consisting of steel towers, poles, crossarms, conductors, insulators and appurtenances.

Line No. 31 - Hillburn to Sloatsburg, 69,000 v, approximately 2.8 pole miles, consisting of steel towers, poles, crossarms, conductors, insulators and appurtenances.

Line No. 35 - Hillburn to Ford, 34,500 v, approximately 1.1 pole miles, consisting of steel towers, poles, crossarms, conductors, insulators and appurtenances.

Line No. 52 - Ramapo to Hillburn, 138,000 v, approximately 2.0 pole miles, consisting of steel towers,

poles, crossarms, conductors, insulators and appurtenances.

Line No. 53 - Lovett to New Hempstead, 138,000 v, approximately .9 pole miles, consisting of steel towers, poles, crossarms, conductors, insulators and appurtenances.

Line No. 59 - Hillburn to Tallman, 69,000 v, approximately 3.2 pole miles, consisting of steel towers, poles, cross arms, conductors, insulators and appurtenances.

Line No. 60 - Ramapo to Burns, 138,000 v, approximately 9.3 pole miles, consisting of steel towers, poles, crossarms, conductors, insulators and appurtenances.

Line No. 65 - Hillburn to South Mahwah, 69,000 v, approximately 1.1 pole miles consisting of steel towers, poles, crossarms, insulators and appurtenances.

Line No. 67/68 - Ladentown to Bowline, 345,000 v, approximately 1.5 pole miles consisting of steel poles, conductors, insulators and appurtenances.

Line No. 72 - Ramapo to Ladentown, 345,000 v, approximately 5.1 pole miles consisting of steel towers, poles, conductors, insulators and appurtenances.

Line No. 73/74 - Ford to Burns, 34,500 v, approximately 5.2 pole miles, consisting of steel towers, poles, crossarms, insulators and appurtenances.

Line No. 88 - Ladentown to Con. Ed., 345,000 v, approximately .3 pole miles consisting of steel poles, conductors, insulators and appurtenances.

Line No. 89 - Hillburn to Ringwood, 138,000 v, approximately 4.3 pole miles, consisting of steel towers, poles, crossarms, insulators and appurtenances.

Line No. 94 - Ramapo to Buchanan - 345,000 v, approximately 5.5 pole miles, consisting of steel towers, poles, crossarms, conductors, insulators and appurtenances.

Line No. 311 - Harriman to Sloatsburgh, 138,000 v, approximately 2.2 pole miles, consisting of steel towers, poles, crossarms, conductors, insulators and appurtenances.

Line No. 531 - New Hempstead to Sloatsburg, 138,000 v, approximately 2.6 pole miles, consisting of steel towers, poles, crossarms, conductors, insulators and appurtenances.

Line No. 541 - West Haverstraw to Burns, 138,000 v, approximately 3.5 pole miles, consisting of steel towers, poles, crossarms, conductors, insulators and appurtenances.

Line No. 591 - Tallman to Burns, 138,000 v, approximately 5.0 pole miles, consisting of steel towers, poles, crossarms, conductors and appurtenances.

The assessment years in issue are 1978, 1979, 1980 and 1981. The proceedings for the year 1978 involve only six tax lots used as four substations and one switching station (the Hillburn substation consisting of two tax lots). In the subsequent years the proceeding involved these six lots plus various other transmission facilities. The same parcels are involved in the years 1979 and 1980. In 1981 the Town redesignated some of the tax lots and created some new tax lots.

For this reason the 1981 proceeding involves more tax lots than the 1979 and 1980 proceedings although the same property is involved. Only four of the parcels, those on which substations are located, include land. All the other parcels include only machinery and equipment which although they include no land are nonetheless to be treated as taxable real estate.

The parties have stipulated the land value of these four parcels for each of the four years in question as follows:

PLATE	DESCRIPTION	LAND VALUE
111	Sloatsburg substation	$ 19,800
118	Hillburn substation	$267,800
126 A	Tallman substation	$ 60,400
134 E	New Hempstead substation	$ 93,500

The parties have further stipulated that the Town of Ramapo assesses at full fair market value. Accordingly, the issue of inequality is not present in these proceedings. Additionally, the parties have stipulated that all jurisdictional requirements such as filing of protests, service of petition and ownership of the property have been satisfied.

Both parties made motions to strike their adversaries' appraisals for failure to comply with Section 678.1 of the Rules of the Appellate Division Second Department. The subject motions are in each case denied, the Court in each instance finding that the appraisals are in substantial

compliance with the Appellate Division Rules.

Additionally, respondents have moved to strike so much of petitioner's appraisals which set forth economic approaches to value on the ground that the subject property is a specialty and therefore can be valued only by the cost approach. This motion is also denied, it being the express finding of the Court that while primary consideration should be given to the cost approach, the Court should also consider the alternate approaches to value that have been presented.

For the years under review, the contested assessments are as follows:

1978 ROLL

Plate Number	Owner	Description	1978 Assessment Land	Total
111	Orange & Rockland Util. Inc.	Sloatsburg Sub.	$ 19,800	$ 242,700
118	Orange & Rockland Util. Inc.	Hillburn Sub.	257,800	3,166,600
119A	Orange & Rockland Util. Inc.	Hillburn Sub.	-	577,200
124J	Orange & Rockland Util. Inc.	Ramapo Sub.	-	6,323,600
126A	Orange & Rockland Util. Inc.	Tallman Sub.	60,400	695,600
134E	Orange & Rockland Util. Inc.	New Hempstead	93,500	1,688,900

1979 ROLL

Plate Number	Owner	Description	1979 Assessment Land	1979 Assessment Total
115B	Orange & Rockland Util. Inc.	Transmission	-	$ 36,500
115E	Orange & Rockland Util. Inc.	Transmission	-	82,500
115C	Orange & Rockland Util. Inc.	Transmission	-	211,700
112C	Orange & Rockland Util. Inc.	Transmission	-	195,900
112B	Orange & Rockland Util. Inc.	Transmission	-	694,500
120G	Orange & Rockland Util. Inc.	Transmission	-	179,500
120F	Orange & Rockland Util. Inc.	Transmission	-	262,900
120E	Orange & Rockland Util. Inc.	Transmission	-	630,800
120D	Orange & Rockland Util. Inc.	Transmission	-	130,300
120B	Orange & Rockland Util. Inc.	Transmission	-	122,800
124G	Orange & Rockland Util. Inc.	Transmission	-	303,600
124F	Orange & Rockland Util. Inc.	Transmission	-	1,103,400
127D	Orange & Rockland Util. Inc.	Transmission	-	82,600
127C	Orange & Rockland Util. Inc.	Transmission	-	803,000
246	Orange & Rockland Util. Inc.	Transmission	-	302,600
136H	Orange & Rockland Util. Inc.	Transmission	-	257,000
136G	Orange & Rockland Util. Inc.	Transmission	-	145,900
136F	Orange & Rockland Util. Inc.	Transmission	-	704,100
127F	Orange & Rockland Util. Inc.	Transmission	-	210,000
127E	Orange & Rockland Util. Inc.	Transmission	-	278,300
134A1	Orange & Rockland Util. Inc.	Ladentown Sw Sta.	-	1,724,700
136D	Orange & Rockland Util. Inc.	Transmission	-	1,230,100
136C	Orange & Rockland Util. Inc.	Transmission	-	480,500
133C	Orange & Rockland Util. Inc.	Transmission	-	285,600
245	Orange & Rockland Util. Inc.	Transmission	-	447,500

1979 ROLL

Plate Number	Owner	Description	1979 Assessment Land	1979 Assessment Total
244	Orange & Rockland Util. Inc.	Transmission	-	58,700
124D	Orange & Rockland Util. Inc.	Transmission	-	1,521,300
119A	Orange & Rockland Util. Inc.	Hillburn Sub.	-	552,700
118	Orange & Rockland Util. Inc.	Hillburn Sub	$257,800	3,590,900
134E	Orange & Rockland Util. Inc.	New Hempstead	93,500	1,682,900
111	Orange & Rockland Util. Inc.	Sloatsburg Sub.	19,800	250,500
126A	Orange & Rockland Util. Inc.	Tallman Sub.	60,400	707,300
124J	Orange & Rockland Util. Inc.	Ramapo Sub.	-	7,013,000

1980 ROLL

Plate Number	Owner	Description	1980 Assessment Land	1980 Assessment Total
115B	Orange & Rockland Util. Inc.	Transmission	-	$ 37,900
115E	Orange & Rockland Util. Inc.	Transmission	-	85,500
115C	Orange & Rockland Util. Inc.	Transmission	-	219,400
112C	Orange & Rockland Util. Inc.	Transmission	-	206,700
112B	Orange & Rockland Util. Inc.	Transmission	-	732,800
120G	Orange & Rockland Util. Inc.	Transmission	-	182,300
120F	Orange & Rockland Util. Inc.	Transmission	-	278,400
120E	Orange & Rockland Util. Inc.	Transmission	-	661,500
120D	Orange & Rockland Util. Inc.	Transmission	-	142,100
120B	Orange & Rockland Util. Inc.	Transmission	-	128,800
124G	Orange & Rockland Util. Inc.	Transmission	-	318,400
124F	Orange & Rockland Util. Inc.	Transmission	-	1,194,100
127D	Orange & Rockland Util. Inc.	Transmission	-	89,400
127C	Orange & Rockland Util. Inc.	Transmission	-	869,000

1980 ROLL

Plate Number	Owner	Description	1980 Assessment Land	1980 Assessment Total
136H	Orange & Rockland Util. Inc.	Transmission	-	278,100
136G	Orange & Rockland Util. Inc.	Transmission	-	157,900
136F	Orange & Rockland Util. Inc.	Transmission	-	761,900
127F	Orange & Rockland Util. Inc.	Transmission	-	227,300
127E	Orange & Rockland Util. Inc.	Transmission	-	301,200
134A1	Orange & Rockland Util. Inc.	Ladentown Sw Sta	-	1,807,300
136D	Orange & Rockland Util. Inc.	Transmission	-	1,331,200
246	Orange & Rockland Util. Inc.	Transmission	-	327,400
136C	Orange & Rockland Util. Inc.	Transmission	-	520,000
133C	Orange & Rockland Util. Inc.	Transmission	-	301,300
245	Orange & Rockland Util. Inc.	Transmission	-	469,300
244	Orange & Rockland Util. Inc.	Transmission	-	60,800
124D	Orange & Rockland Util. Inc.	Transmission	-	1,646,300
119A	Orange & Rockland Util. Inc.	Hillburn Sub.	-	573,800
118	Orange & Rockland Util. Inc.	Hillburn Sub.	$257,800	3,724,100
134E	Orange & Rockland Util. Inc.	New Hempstead	93,500	1,742,000
111	Orange & Rockland Util. Inc.	Sloatsburg Sub.	19,800	256,700
126A	Orange & Rockland Util. Inc.	Tallman Sub.	60,400	739,700
124J	Orange & Rockland Util. Inc.	Ramapo Sub.	-	7,303,900

1981 ROLL

Plate Number	Owner	Description	1981 Assessment Land	1981 Assessment Total
127D1	Orange & Rockland Util. Inc.	Transmission	-	$ 51,300
127D2	Orange & Rockland Util. Inc.	Transmission	-	707,200

1981 ROLL

Plate Number	Owner	Description	1981 Assessment Land	Total
127C1	Orange & Rockland Util. Inc.	Transmission	-	$ 44,200
127D3	Orange & Rockland Util. Inc.	Transmission	-	539,300
136F1	Orange & Rockland Util. Inc.	Transmission	-	111,800
127E1	Orange & Rockland Util. Inc.	Transmission	-	134,500
136H1	Orange & Rockland Util. Inc.	Transmission	-	124,400
127E2	Orange & Rockland Util. Inc.	Transmission	-	725,100
136H2	Orange & Rockland Util. Inc.	Transmission	-	669,300
136D1	Orange & Rockland Util. Inc.	Transmission	-	769,500
127F	Orange & Rockland Util. Inc.	Transmission	-	86,400
136G	Orange & Rockland Util. Inc.	Transmission	-	60,100
124F	Orange & Rockland Util. Inc.	Transmission	-	1,023,600
136C	Orange & Rockland Util. Inc.	Transmission	-	180,700
124D	Orange & Rockland Util. Inc.	Transmission	-	572,100
127C2	Orange & Rockland Util. Inc.	Transmission	-	78,400
136F2	Orange & Rockland Util. Inc.	Transmission	-	187,900
136F3	Orange & Rockland Util. Inc.	Transmission	-	241,500
127E3	Orange & Rockland Util. Inc.	Transmission	-	250,700
136H3	Orange & Rockland Util. Inc.	Transmission	-	231,400
136D2	Orange & Rockland Util. Inc.	Transmission	-	671,300
136D3	Orange & Rockland Util. Inc.	Transmission	-	118,900
133C	Orange & Rockland Util. Inc.	Transmission	-	334,200
132B1	Orange & Rockland Util. Inc.	Transmission	-	700
132B2	Orange & Rockland Util. Inc.	Transmission	-	28,600
132B3	Orange & Rockland Util. Inc.	Transmission	-	29,200
115E1	Orange & Rockland Util. Inc.	Transmission	-	1,200

1981 ROLL

Plate Number	Owner	Description	1981 Assessment Land	1981 Assessment Total
115C1	Orange & Rockland Util. Inc.	Transmission	-	$ 83,200
115C2	Orange & Rockland Util. Inc.	Transmission	-	166,300
115E2	Orange & Rockland Util. Inc.	Transmission	-	167,900
115B	Orange & Rockland Util. Inc.	Transmission	-	18,000
112C1	Orange & Rockland Util. Inc.	Transmission	-	37,200
112C2	Orange & Rockland Util. Inc.	Transmission	-	169,300
112B1	Orange & Rockland Util. Inc.	Transmission	-	185,200
112B2	Orange & Rockland Util. Inc.	Transmission	-	577,200
120G1	Orange & Rockland Util. Inc.	Transmission	-	13,400
120G2	Orange & Rockland Util. Inc.	Transmission	-	124,600
120F	Orange & Rockland Util. Inc.	Transmission	-	119,000
120D	Orange & Rockland Util. Inc.	Transmission	-	5,900
120B1	Orange & Rockland Util. Inc.	Transmission	-	711,200
120B2	Orange & Rockland Util. Inc.	Transmission	-	99,100
120B3	Orange & Rockland Util. Inc.	Transmission	-	151,100
120E	Orange & Rockland Util. Inc.	Transmission	-	761,900
124G	Orange & Rockland Util. Inc.	Transmission	-	179,400
134A1	Orange & Rockland Util. Inc.	Ladentown Sw	-	1,876,000
119A	Orange & Rockland Util. Inc.	Hillburn Sta	-	258,400
118	Orange & Rockland Util. Inc.	Hillburn Sta	$257,800	3,750,300
134E	Orange & Rockland Util. Inc.	New Hempstead	93,500	1,803,500
111	Orange & Rockland Util. Inc.	Sloatsburg	18,900	262,400
126A	Orange & Rockland Util. Inc.	Tallman Sub.	60,800	762,700
124J	Orange & Rockland Util. Inc.	Ramapo Sub.	-	9,042,400

On the trial the following appraisals were introduced into evidence:

1) Petitioner's "cost" and "earnings" appraisals prepared by Stone & Webster Appraisal Co. under the supervision of its Senior Vice President, John E. Daly.

2) Petitioner's "Market Data" appraisal prepared by Thomas Martin.

3) The appraisal of the State Board of Equalization and Assessment, on the basis of which respondents made their assessments and on which they relied to sustain said assessments.

Additionally, the Court heard the testimony on direct and cross examination of the respective appraisers who prepared the subject appraisals. John J. Patenaude and J. Leo Dugan, Assistant Directors of the Industrial and Utility Valuation Bureau of the State Board of Equalization on Assessment testified on behalf of the respondents.

Daly's findings as to value for the years under review are as follows:

1978	1979	1980	1981
$8,352,000	$15,695,800	$15,339,100	$14,984,100

While the expert Daly submitted his appraisal to petitioner by application of the cost approach and earnings ap-

proach, a secondary appraisal was also submitted prepared by Thomas G. Martin, which appraised the subject property by application of a market data approach. Martin's findings are as follows:

1978	1979	1980	1981
$8,940,683	$16,738,691	$16,367,850	$15,980,806

For each of the years under review the State Board of Equalization and Assessment found the full value of the property as follows:

May 1, 1978	May 1, 1979	May 1, 1980	May 1, 1981
$13,512,400	$26,652,300	$26,968,500	$28,602,700

THE COST APPROACH

The respective findings by petitioner's and respondents' experts as to original cost is as follows:

	PETITIONER	RESPONDENTS
1978	$10,423,876	$ 9,664,446
1979	$19,539,802	$19,126,946
1980	$19,559,654	$18,444,963
1981	$19,559,654	$18,975,923

The respective findings by petitioner's and respondents' experts as to reproduction cost new is as follows:

	PETITIONER	RESPONDENTS
1978	$20,446,000	$19,629,649
1979	$39,188,000	$38,237,982
1980	$43,096,000	$40,095,422

For each of the years under review, petitioner's expert, Daly, found physical and functional obsolescence to be as follows:

1978	-	$3,296,000
1979	-	$6,097,600
1980	-	$6,803,000
1981	-	$7,503,000

He thus arrived at the following figures for reproduction cost new less physical depreciation and functional obsolescence:

1978	-	$17,150,000
1979	-	$33,090,000
1980	-	$36,293,000
1981	-	$39,382,000

He then reduced these net figures by the following percentages to account for "economic obsolescence", and to arrive at his findings of "fair market value".

	Reproduction Cost New Less Depreciation and Functional Obsolescence	Reduction for "economic obsolescence"	Percentage of Reduction for Economic Obsolescence	Claimed Fair Market Value
1978	$17,150,000	$ 8,578,000	50.02%	$ 8,352,000
1979	$33,090,000	$16,982,600	51.32%	$15,695,800
1980	$36,293,000	$20,566,300	56.67%	$15,339,100
1981	$39,293,000	$24,010,500	60.97%	$14,984,100

The computations by the State Board, on the other hand reduced reproduction cost new by the following percentages to arrive at Reproduction Cost New Less Depreciation, which it treats as the "fair market value".

	Reproduction Cost New	Reproduction For All Forms Of Depreciation	Percentage of Reduction For All Forms Of Depreciation	Claimed Fair Market Value
1978	$19,629,649	$ 6,117,165	31.16% (rounded to 4 digits)	$13,512,484
1979	$38,237,982	$11,373,049	29.74%	$26,864,933
1980	$40,095,422	$12,868,484	32.09%	$27,226,938
1981	$44,145,575	$15,542,767	35.31%	$28,602,808

MARKET DATA VALUATION

In addition to the Stone & Webster appraisal, petitioner introduced a "market data" appraisal prepared by Thomas G. Martin, a realtor in Rockland County who concentrates on the appraisal of residential and commercial property in that geographic area. While this appraiser's expertise may have been of some value in finding the value of the unimproved land on which the utility installations are situated, his training, background and expertise fall short of qualifying him as an expert in the valuation of public utility property. Martin assembled seven sales of electric distribution or transmission systems that took place in New York State between 1961 and 1979 and arrived at a multiplier between the net book cost and the sale price. He then ar-

rived at a multiplier for the subject property of 1.04 for each of the years under review. No correlation was made between the sale price of the alleged comparables and the profit and loss statements of the selling utilities. In the absence of adequate proof that these were bona fide transactions, the Court must consider that the subject lines may have been sold off for their salvage value because their operation yielded either a marginal profit or a loss to the selling utility. On the whole, the Court finds this market data approach to lack probative value, and it will be given minimal consideration by the Court in making its determinations.

FACTORS TO BE CONSIDERED IN VALUATION

The prime thrust of petitioner's arguments for reduction is that it is being unfairly regulated by the Public Service Commission, which limits its earnings to a prescribed rate of return on original cost less depreciation. Accordingly, it is argued, the Court in fixing value for real property taxation purposes should similarly limit valuation to an amount approximating this rate base. Thus petitioner's "earnings approach" is nothing more than a valuation based upon net book cost less a further reduction for "regulatory lag", ie. the period of lost earnings between the time that a rate increase is warranted and the time that it is granted. Petitioner's "cost approach", while it is valid in its first two stages, Reproduction Cost New (RCN) and Reproduction Cost New Less Physical Depreciation and Functional Obsolescence

then attempts to further reduce RCNLD by positing a factor for "economic obsolescence" obtained by capitalizing a hypothetical loss of income due to regulation, thereby reducing RCNLD by factors varying from 50 to 61 per cent for the various years under review. In the Court's view, this novel approach lacks both legitimacy and reliability and is little more than an attempt to do indirectly what cannot be done directly i.e. imposing an upper limit of value by capitalizing the income allowed to the utility by the Public Service Commission, thereby conversely arriving at net book cost. On the trial respondents introduced into evidence an appraisal prepared by Stone & Webster in 1978 for Consolidated Edison Company. The appraisal was prepared in anticipation of condemnation by the County of Westchester of Con Edison's Westchester operations. In that appraisal, RCNLD was presented by Stone & Webster as the fair market value of the subject property. Noticeably absent was the additional 50 or 60% reduction from RCNLD put forth here for economic obsolescence. On cross-examination petitioner's expert Daly was markedly evasive when repeatedly asked to explain the difference in methodology between the two appraisals. At one point he was asked the following question and gave the following answer:

> "Q. I would ask you relative to the two different positions, the condemnation case statement that we just put on the record and this case, why do you leave out economic depreciation in the condemnation case?

A. Well, in the case you're referring to, that wasn't for court presentation. That was for discussion purposes."

It is well settled law that the principles governing ascertainment of value for the purposes of taxation are the same as those that control in condemnation cases, confiscation cases and generally in controversies involving the ascertainment of just compensation. Great Northern R. Co. v Weeks, 297 US 135, 139; West v Chesapeake & P. Teleph. Co., 295 US 662, 671.

There are a number of things wrong with petitioner's approach in making its quantum leap from depreciated reproduction cost to what it would have the Court believe is fair market value. For one thing, it would have the Court apply an economic distress factor without so much as putting its profit and loss statements before the Court. The Court has absolutely no reason to believe on the record before it that petitioner is anything other than a healthy going concern making a substantial profit on its operation under the regulatory protection provided by the State to both rate payers and the utility itself. This petitioning utility makes bold to assert that it had an "earning deficiency" of $802,000 in 1978; of $1,587,500 in 1979; of $1,919,920 in 1980 and of $1,587,500 in 1981, for which it should be given real property tax relief. But this is far from a proven fact and falls within the realm of conjecture. Indeed, it would be just as reasonable to assume, on the other hand, that if this utility were not regulated and provided with a virtually guaranteed

return on its original investment dollars, that it would be operating at a loss. Furthermore, it is not the function of this Court to indirectly sit in review upon the determination of the Public Service Commission. In sum, what petitioner calls "economic obsolescence" is misdefined and is in reality a means of utilizing an income approach and calling it a cost approach.

THE ECONOMIC OBSOLESCENCE FACTOR

A contract entered into between the State Board of Equalization and Assessment ("SBEA") and the American Appraisal Company ("American Appraisal") on July 29, 1977, recited that:

> "WHEREAS, the reproduction cost-less-depreciation approach to valuation may require modification by the application of an economic factor in order to measure the full value of such property for purposes of local real property taxation."

Accordingly, American Appraisal was commissioned, among other things, to:

> "Conduct economic studies directed toward the development of factors or other devices which would convert reproduction cost less depreciation of public utility property to a full value that would reflect the effect of earnings on such value."
> (Schedule C, Subparagraph A of Amendment)

The study was thereafter conducted and the report submitted thereon on December 15, 1978. The report enumerated three different indicators of return to be reviewed in the analysis of economic obsolescence.

"1. Achieved return relates the actual net operating income generated to the rate base.

2. Allowable return is that calculated by the regulatory body and includes the debt and preferred capital at their embedded costs and the cost of equity at its "current" cost.

3. Market return is the same as allowable return except when the allowed or "current" cost of equity capital is not the same as that required by prudent investors in the open market."

The report then goes on to indicate the following analysis and definition of economic obsolescence:

"The achieved return is generally less that the allowable market returns and these differentials are an indication of the existence of economic obsolescence. For the purposes of simplifying the data gathering requirements we have assumed that the "current" cost of equity capital as determined by the regulatory body is the same as that required by prudent investors in the open market. Allowable return and market return are identifical under this assumption.

The conceptual approach that we recommend in the development of an economic obsolescence factor considers the difference between the achieved return and the market return.

Specific Methodology

The method we recomment utilizes readily available financial data and can be easily mechanized for computer calculation.

The data inputs required for each utility under review are:

-Reported Net Utility Operating Income for the most recent years.

-Calculated average year rate base for the most recent three years. This rate base should include all those elements utilized by the regulatory body in calculating a rate base. A partial listing includes the net original cost of the plant in service materials and supplies, working capital requirements related to operating expenses, prepayments, stored gas and so forth. If construction work in progress is allowed in the rate base by the regulatory body, it should also be included in the calculated rate base.

-The end of year capital structure of the utility stating relative components of debt, preferred, equity and reserve for deferred taxes capital on a percentage basis.

-The embedded costs of debt and preferred stock. These data should be calculated directly from end of year income statement and balance sheet data.

-The return on equity capital most recently allowed by the regulatory body. Judgment must be used to ensure that the allowed return on equity reasonably represents the current market cost of equity capital for the specific utility. Adjustments should be made to the allowed return on equity if it does not represent the real market.

To ensure that short term fluctuations in earnings do not drastically affect the economic obsolescence factor we recommend that the achieved return be calculated on the basis of the average of the last three years reported net utility operating income and rate base data. The annual rate bases should be calculated on an average year and not on a year-end basis. This should result in an achieved return that will not fluctuate significantly from year to

year but which will gradually move as the economic situation of the utility changes.

The allowable or market return could also be calculated on a three-year average basis but we recommend its calculation as of year end for the most recent available year. The regulatory examination of the cost equity capital has already built into it a steadying effect which should dampen any wide moves. The cost of embedded debt and preferred capital will not fluctuate significantly from year to year. Since all of the elements of the allowable or market return is justified. This cost of capital will be referred to as "market return" for the remainder of this report section. The three year average achieved return and the market return can now be manipulated to develop a factor which reflects the extent of economic obsolescence existent in the property.

The difference between the required market return and the achieved return indicates an earnings deficiency. For example if the market return is 10 percent and the achieved return is 8 percent, the differential of 2 percent represents a 20 percent (2% ÷ 10%) deficiency in earnings or an economic obsolescence factor of 20 percent. The formula for the caluclation of the economic obsolescence factor is:

$$\frac{\text{Market Return} - \text{Achieved Return}}{\text{Market Return}} \times 100\%"$$

As set forth in Petitioner's Exhibit 3A, the Stone & Webster Appraisal as of May 1, 1980, the difference between allowed and actual return for the years under review is as follows:

RETURN ON AVERAGE
COMMON EQUITY

	Allowed (1)	Actual (2)	Ratio (3)=(2)÷(1)
1980	14.2%	12.62%	.89
1979	13.0%	11.69%	.90
1978	13.0%	12.65%	.97
1977	13.4%	10.05%	.75

Utilizing the American Appraisal Co. formula, the one-year retrospective economic obsolescence for each of the above years should be determined as follows:

1981 $\frac{14.2 - 12.62}{14.2}$ X 100% = 11.13%

1980 $\frac{13.0 - 11.69}{13.0}$ X 100% = 10.08%

1979 $\frac{13.0 - 12.65}{13.0}$ X 100% = 2.69%

1978 $\frac{13.4 - 10.05}{13.4}$ X 100% = 25%

This is a far cry from the 50 to 60% advocated by petitioner as the economic factor.

FINDINGS

The Court finds, as a matter of law, that the most reliable indicator of the upper limits of value for the subject property is reproduction cost new less depreciation.

Considering the inherent protection afforded to investors in such a state sanctioned monopoly, the Court holds that this is the only method "which will yield a legally and economically realistic value of the property." Great Atlantic and Pacific Tea Company, Inc. v Kiernan, 42 NY 2d 236, 397 NYS 2d 718 (1977). The Court is mandated by RPTL §306 to sustain assessments based upon "full value." Matter of Hellerstein v Town of Islip, 37 NY 2d 1. There is a fundamental difference between "full value" for assessment purposes and the rate base value used for regulatory purposes. Simply stated, the difference is that "full value" for tax assessment purposes includes inflation from the time of construction, whereas rate base valuation does not.

Petitioner contends in effect, that if it constructs a facility in 1973 for one million dollars which then has a Reconstruction Cost New Less Depreciation in 1983 of two million dollars, it is entitled to return in 1983 on the basis of two million dollars or, failing that, that the property suffers from one million dollars of "economic obsolescence". This is fallacious logic. The true meaning of economic obsolescence is that the original one million dollars invested is failing to produce a fair return prior to its full recapture. No showing has been made by petitioner that such is the case. It is not the mandate of this Court, or indeed, of the Public Service Commission to make investors in a public utility inflation-proof.

Economic obsolescence, to the extent it is properly to be considered by this Court in valuing utility

property, is intended to be an estimate of the chronic slippage between allowed return and actual return, together with the loss of fair return occasioned by the lag in the regulatory process.

On the record herein, the Court finds that petitioner's figures for Reproduction Cost New Less Depreciation should be reduced by an average economic obsolescence factor of no more than 15% for each of the years under review, rather than the 50% to 60% posited by petitioner. This adjustment applied to petitioner's own figures for RCNLD would lead to the following indicated fair market values:

1978	$14,577,500
1979	$28,126,500
1980	$30,849,050
1981	$33,399,050

These adjusted figures are substantially higher than the figures found by the State Board of Equalization and Assessment and the assessments actually fixed by respondent Assessor.

The Court further finds that the SEBA assessment methodology was correct in form and application and that petitioner has failed to establish on the totality of this record that the subject assessments were other than fair and reasonable.

Accordingly, the within petitions are in all respects dismissed, with each side to bear its own costs.

Submit final order on notice.

Dated: White Plains, New York
June 24, 1983

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TOWN ATTORNEY
TOWN OF RAMAPO

Final Rules for Special Franchise Assessment

Approved December 14, 1983

Effective December 16, 1983

Pursuant to the provisions of the State Administrative Procedure Act and sections 202 and 600 through 620 of the Real Property Tax Law, the State Board of Equalization and Assessment hereby amends Title 9 of the Official Compilation of Codes, Rules and Regulations of the State of New York follows:

A new part 197 is adopted to read as follows:

Part 197

Special Franchise Assessment

(Statutory authority: Real Property Tax Law, §§202, 600)

Subpart 197-1 General

Subpart 197-2 Reports

Subpart 197-3 Valuation Methodology

Subpart 197-4 Determination of Special Franchise Assessments

Subpart 197-5 Miscellaneous Provisions

Subpart 197-6 Schedules

Subpart 197-1

General

(Statutory authority: Real Property Tax Law, §§202, 600)

Sec.

197-1.1 Definitions

Section 197-1.1 Definitions. (a) When used in this Part:

(1) Account means those accounts and sub-accounts which are prescribed by the New York State Public Service Commission, the New York State Commission on Cable Television or the Federal Energy Regulatory Commission in their uniform systems of accounts for electric, gas, pipeline, steam, telegraph, telephone and water corporations, and for cable television companies, and which include mass property.

(2) Adverse party means: (i) with respect to a complainant which is a special franchise owner, the assessing unit in which the subject special franchise is located;

(ii) with respect to a complainant which is an assessing unit, the owner of the subject special franchise.

(3) Assessing unit means a city, town, or village, or a county having a county department of assessment with the power to assess real property.

(4) Base property means that portion of special franchise property which was assessed for the year 1953 in an assessing unit which has not completed a revaluation and which is not expected to complete a revaluation.

(5) Base year means the year to which the cost of tangible property as of any year is compared in order to compute a cost index.

(6) Book cost means the amount at which property is recorded in accounts without deduction for provisions such as depletion, depreciation, or amortization

(7) Cable television company means any individual, trustee, partnership, association, corporation or other legal entity owning, controlling, operating, managing or leasing one or more cable television systems within the state.

(8) Cable television system means any system which operates for hire the service of receiving and amplifying programs broadcast by one or more television or radio stations or any other programs originated by a cable television company or by any other party, and distributing such programs by wire, cable, microwave or other means, whether such means are owned or leased, to persons in one or more municipalities who subscribe to such service. This definition does not include any master antenna television system.

(9) Change in the level of assessment means the percentage increase or decrease, expressed as a percentage, in the level of assessment of taxable real property on a given final assessment roll relative to the immediately preceeding final

assessment roll, as determined from the Assessor's Annual Report for equalization purposes prepared pursuant to Part 193 of this Chapter.

(10) Chief executive officer means, in the case of a city, the mayor or city manager, and the case of a town, the supervisor (if a town has more than one supervisor, the presiding supervisor).

(11) Complainant means a special franchise owner or an assessing unit which has filed a written complaint relative to a tentative special franchise assessment as provided in section 197-4.4 of Subpart 197-4 of this Part.

(12) Construction work in progress means taxable real property under construction but not finished or completed as of the close of the calendar year for special franchise owners which report to the Public Service Commission or the Federal Energy Regulatory Commission, and as of the close of the fiscal year for all other special franchise owners.

(13) Cost index means a number expressing the relationship of the cost of tangible property as of any year to its cost as of the base year.

(14) Cost of removal means the cost of abandoning in place, demolishing, dismantling, tearing down, or otherwise removing tangible property, including the cost of transportation, handling and disposal incidental thereto.

(15) Economic obsolescence means the loss of value of property due to the fact that it has not been a paying property, as defined in this Subpart, in any of the five fiscal years of the special franchise owner immediately preceding the valuation date.

(16) Electric corporation means every corporation, company, association, joint-stock association, partnership and person, their lessees, trustees or receivers appointed by any court whatsoever (other than a railroad or street railroad corporation generating electricity solely for railroad or street railroad purposes or for the use of its tenants and not for sale to others) owning, operating or managing any electric plant

except where electricity is generated or distributed by the producer solely on or through private property for railroad or street railroad purposes or for its own use or the use of its tenants and not for sale to others.

(17) Functional obsolescence means the impairment of operating capacity or efficiency resulting in a loss in value brought about by the failure of the tangible property to meet present or projected needs or where the capacity of the tangible property exceeds reasonable anticipated demands.

(18) Gas corporation means every corporation, company, association, joint-stock association, partnership and person, their lessees, trustees or receivers appointed by any court whatsoever, owning, operating or managing any gas plant (i) except where gas is made or produced and distributed by the maker on or through private property solely for its own use or the use of its tenants and not for sale to others, and (ii) except where manufactured gas is sold by the producer only for use or resale by a gas corporation and such gas of the producer and any affiliated producers does not exceed in any one year thirty per cent of the total gas sold by any purchaser thereof in the area in which such manufactured gas is resold either as manufactured gas or as a component of mixed gas.

(19) Handy-Whitman Index means the compilation of cost indices of public utility construction costs published by Whitman, Requardt and Associates, 2315 Saint Paul Street, Baltimore, Maryland 21218-5270.

(20) Intangible property means the franchise, right, authority or permission to construct, maintain or operate in, under, above, upon or through any public place mains, pipes, tanks, conduits, wires or transformers, with their appurtenances, for conducting water, steam, light, power, electricity, gas or other substance.

(21) Inventory date means the date as of which the condition and ownership of special franchise property is determined for purposes of valuing it pursuant to Subpart 197-3 of this Part.

(22) Mass property means items of tangible property that are sufficiently similar physically and functionally that they are commonly accounted for as uniform components of a group or class rather than as individual items.

(23) Master antenna television system means any system which serves only the residents of one or more apartment dwellings under common ownership, control or management and any commercial establishment located on the premises of such apartment house and which transmits only signals broadcast over the air by stations which may be normally viewed or heard locally without objectionable interference, and which does not provide any additional service over its facilities.

(24) MCF means one thousand cubic feet of gas.

(25) Net cable operating income means operating income less operating costs, including adjustments for income taxes and officers' salaries, as reported in financial statements submitted by a cable television company to the State Board or to the New York State Commission on Cable Television. The adjustments for income taxes and officers' salaries shall be obtained from a schedule to be adopted by the State Board.

(26) Net operating income means net utility operating income or net cable operating income.

(27) Net salvage percent means net salvage value expressed as a percentage of reproduction cost new.

(28) Net salvage value means the salvage value of property retired less the cost of removal.

(29) Net utility operating income means operating revenues less operating expenses as reported in financial statements submitted by a special franchise owner other than a cable television company or an unregulated special franchise owner to a regulatory agency other than the New York State Commission on Cable Television.

(30) Original cost means the cost of property to the corporation, company, association, joint-stock association, partnership and person, their lessees, trustees or receivers appointed by any court whatsoever, first devoting it to public service and the cost of contributed property.

(31) Paying property means property which produces a net operating income sufficient to meet taxes which were not included in the determination of net operating income, interest on indebtedness, and fixed charges.

(32) Person means individual, firm or co-partnership.

(33) Pipeline corporation means a corporation organized to construct and operate, wholly within or partly without this state, lines of pipe for conveying or transporting therein petroleum, liquids, gas or any products or property, or to maintain and operate for such purposes lines of pipe already constructed.

(34) Price level index means a cost index expressing the relationship of the cost of tangible property as of the date of valuation to its cost as of the base year.

(35) Property retired means property which has been removed, sold, abandoned, destroyed, or which for any cause has ceased to be used and useful in the service of the public.

(36) Regulatory agency means the New York State Public Service Commission, the New York State Commission on Cable Television, the New York State Department of Transportation, the Federal Energy Regulatory Commission or any other regulatory agency of the State or federal government.

(37) Revaluation means the process by which the uniform percentage of value of all real property is determined and entered on an assessment roll. For purposes of this Part, an assessing unit which has completed a revaluation is one which: (i) after January 1, 1954, completed an assessment roll for which the State Board established an equalization rate of 95 or more; (ii) after December 3, 1981, has been certified by the State Board as an "approved assessing unit," as defined in section 190-4.1(c) of Subpart 190-4 of Part 190 of this chapter; (iii) has filed an assessment roll with respect to which the State Board determined the coefficient of dispersion to be less than 15 percent; or (iv) has been certified by the State Board as eligible for the state assistance authorized by subdivision (b) of section 1572 of the RPTL.

(38) RPTL means Real Property Tax Law.

(39) Salvage value means the amount received for property retired, less any expenses incurred in connection with the sale or in preparing the property for sale; or, if retained, the amount at which the material recoverable is chargeable to materials and supplies, or other appropriate account.

(40) Service life means the anticipated duration of use of property for the purpose for which it was installed.

(41) Special franchise means the franchise, right, authority or permission to construct, maintain or operate in, under, above, upon or through any public street, highway, water or other public place mains, pipes, tanks, conduits, wires or transformers, with their appurtenances for conducting water, steam, light, power, electricity, gas or other substance. For purposes of assessment and taxation a special franchise shall include the tangible property situated in, under, above, upon or through any public street, highway, water or other public place in connection therewith. The term special franchise shall not include property of a municipal corporation or special

district, nor shall it include a crossing less than two hundred fifty feet in length of a public street, highway, water or other public place outside a city or village, unless such crossing be the continuation of an occupancy of another public street, highway, water or other public place.

(42) State Board or Board means the State Board of Equalization and Assessment.

(43) State Division or Division means the State Division of Equalization and Assessment.

(44) Steam corporation means every corporation, company, association, joint stock association, partnership and person, their lessees, trustees or receivers appointed by any court whatsoever owning, operating or managing any steam plant, except where steam is made or produced and distributed by the maker, on or through private property solely for the maker's own use or the use of the maker's tenant and not for sale to others.

(45) Subsequent property means that portion of special franchise property which was first assessed after the year 1953 in an assessing unit which has not completed a revaluation and which is not expected to complete a revaluation.

(46) Survey valuation date means the date as of which the value of taxable real property is estimated for purposes of a market value survey used in the computation of the equalization rate that will be applied in the determination of the special franchise assessment.

(47) Surviving original cost means the original cost by year of installation of property existing as of the inventory date.

(48) Tangible property means mains, pipes, tanks, conduits, wires or transformers, with their appurtenances, for conducting water, steam, light, power,

electricity, gas or other substance or any other tangible property situated in, under, above, upon or through any public street, highway, water or other public place.

(49) Tax district means a city, town or village.

(50) Tax district code means a seven digit number assigned by the State Board for each city, town and village.

(51) Telegraph corporation means every corporation, company, association, joint-stock association, partnership and person, their lessees, trustees or receivers, appointed by any court whatsoever, owning, operating or managing any telegraph line or part of telegraph line used in the conduct of the business of affording for hire communication by telegraph. This definition does not include a cable television company.

(52) Telephone corporation means every corporation, company, association, joint-stock association, partnership and person, their lessees, trustees or receivers appointed by any court whatsoever, owning, operating or managing any telephone line or part of telephone line used in the conduct of the business of affording telephonic communication for hire. This definition does not include a cable television company.

(53) Telephone index means the cost index introduced into evidence in New York State Public Service Commission Rate Case Nos. 27100 and 27469, as updated using the Handy-Whitman Index.

(54) Unit price means the cost per unit of measurement to install tangible property.

(55) Unregulated special franchise owner means a special franchise owner which is not subject to regulation.

(56) Valuation unit means that portion of tangible property which is within an account or accounts by year of installation.

(57) Water-works corporation means every corporation, association, joint stock association, partnership and person, their lessees, trustees or receivers, appointed by any court whatsoever, owning, operating or managing any water plant or water-works, except where water is distributed solely on or through private property solely for the use of the distributor or its tenants and not for sale to others.

(58) Year index means a cost index expressing the relationship of the cost of tangible property as of the year of installation to its cost as of the base year.

Subpart 197-2

Reports

(Statutory authority: Real Property Tax Law, §§202, 604)

Sec.

197-2.1 Reports to the State Board

197-2.2 Additional reports by telephone corporations and telegraph corporations

197-2.3 Additional reports by pipeline corporations

197-2.4 Additional reports within the City of New York

197-2.5 Exception for certain water-works corporations

197-2.6 Reports of cable television companies

197-2.7 Reports to regulatory agencies

197-2.8 Applications for allowances for functional or economic obsolescence

197-2.9 Method of reporting

197-2.10 Time of filing

197-2.11 Inspection

197-2.12 Failure to file

197-2.13 Municipal reports

Section 197-2.1 Reports to the State Board. (a) All gas corporations, electric corporations, pipeline corporations, steam corporations, telephone corporations, telegraph corporations, water works corporations other than water works corporations described in section 197-2.5 of this Subpart, and unregulated special franchise owners shall file with the State Board the following reports, at the time(s) specified in section 197-2.10 of this Subpart, which shall include the information as listed herein:

(1) Form EA 1 - Verification, including

(i) the types of Reports filed;

(ii) the number of pages in each;

(iii) in what form (e.g., magnetic tapes) the Reports are submitted; and

(iv) a statement of the Reporting period.

(2) Form EA 1.1 - Location and Description of Structural Items, including:

(i) identification of location, facility, or sub-facility, and whether jointly owned;

(ii) capacity or size, and unit of measure;

(iii) a description of the items which, in the case of buildings, shall include the height, width, length, type of construction and number of stories.

(3) Form EA 2.1 - Aged Surviving Original Cost Dollars of Structures and Equipment, including:

(i) identification of location, facility or sub-facility, account number and tax district;

(ii) the year built;

(iii) gross additions or surviving dollars;

(iv) retirements;

(v) improvements to leased property;

(vi) whether located in the highway or private right-of-way;

(vii) whether exempt and, if so, the exemption control number.

(4) Form EA 2.5 - Estimated Changes to Plant and Equipment, including:

(i) identification of location, facility, or sub-facility, account number and tax district code;

(ii) the year built;

(iii) capacity and unit of measure;

(iv) estimated cost of project and actual cost expended to the date of the filing of this Form;

(v) the taxable percentage completed as of the first day of the reporting period and as of the last day thereof;

(vi) the amount taxable, if known;

(vii) what percentage, if any, is jointly owned;

(viii) whether new or existing;

(ix) whether located in the highway or a private right-of-way; and

(x) a general description.

(5) Form EA 5.1 - Cost Summary, including:

(i) account number and account name, and corresponding company account code;

(ii) personal property;

(iii) real property, as segregated between highway and private right-of-way; and

(iv) total.

(6) Form EA 5.3 - Original Cost Balances by Tax District, including:

(i) tax district code;

(ii) personal property;

(iii) original cost balance (highway);

(iv) original cost balance (private right-of-way); and

(v) total.

(7) Form EA 7.1 - Leased Property (Supplemental), including:

(i) identification by location, facility or sub-facility, and tax district code;

(ii) whether structure, equipment or land;

(iii) year the lease expires;

(iv) to whom assessed;

(v) use; and

(vi) description or purpose.

(b) In addition to the Reports described in subdivision (a) of this section, corporations described in that subdivision, which maintain original cost information by tax district, shall file report form EA 4.1, to include the following information:

(1) Form EA 4.1 - Mass Property-Aged Surviving Original Cost Dollars by Tax District, including:

(i) account number;

(ii) year built;

(iii) identification of (a) gross additions or surviving dollars and (b) retirements, segregated between highway and private right-of-way;

(iv) tax districts.

(c) Corporations which do not file report form EA 4.1, shall file report forms EA 4.2 and EA 4.3, to include the information as listed herein:

(1) Form EA 4.2 - Mass Property-Aged Surviving Original Cost Dollars by Account, including:

(i) account number;

(ii) year built;

(iii) identification of (a) gross additions or surviving dollars and (b) retirements, segregated between highway and private right-of-way.

(2) Form EA 4.3 - Mass Property-Original Cost Balances by Tax Districts, including:

(i) account number;

(ii) tax district;

(iii) original cost balance of such property in the highway (divided between portion attributable to expenditures for base property and those for subsequent property);

(iv) original cost balance of such property in a private right-of-way.

(d) (1) A corporation described in subdivision (a) of this section may also submit a report documenting any basis for adjustments to be made in the determination of the original cost of its tangible property on form EA 6.1 (Cost Modifier).

(2) This report should contain a statement of the purpose of the information submitted and should include any data that is not included elsewhere in the report that the reporting company believes to be relevant to the original cost of its tangible property.

(3) If the data submitted modifies the value of specific inventory submitted elsewhere in a report, direct reference to the form number, page number, tax district, line number or numbers, should be made. The information submitted may include a description of the general project, extent of construction, overall percentage of completion at the date of report, and any other data that would assist the State Board in placing a fair value on the construction.

Section 197-2.2 Additional reports by telephone corporations and telegraph corporations. In addition to the reports described in section 197-2.1 of this Subpart, telephone corporations and telegraph corporations shall file:

(a) Form EA 4.4 - Station Apparatus, Station Connections, including:

(1) tax district code;

(2) quantity, divided between (i) small private branch exchanges and (ii) station apparatus (instruments and booths) in highway and private right-of-way;

(3) quantity of station connections;

(4) percent of station connections in highway.

(b) Form EA 4.5 - Station Apparatus, including:

(1) year purchased;

(2) division of (i) gross additions or surviving dollars, and (ii) retirement for:

(a) small private branch exchanges;

(b) station apparatus other than (a);

(3) the percent of station apparatus in highway.

Section 197-2.3 Additional reports by pipeline corporations. In addition to the reports described in subdivision (a) of section 197-2.1 of this Subpart, pipeline corporations shall file:

(a) Form EA 4.6 - Transmission and Distribution Pipe, including:

(1) account number, tax district code, and year installed;

(2) the diameter of the pipe;

(3) segregation of pipe in highway and in private right-of-way, in terms of:

(i) number of feet;

(ii) gross additions or surviving dollars; and

(iii) retirements.

(4) whether exempt and, if so, the exemption control number.

(b) The following information for the report year both for the entire system and for the portion of the system within New York State:

(1) Barrels or MCFs delivered;

(2) Pipeline mileage; and

(3) Investment in transmission plant (gas) and trunk lines (product).

Section 197-2.4 Additional reports within the City of New York.

Corporations owning special franchise property within the City of New York shall file reports of estimated changes to their special franchise property located within the City of New York on the forms prescribed in sections 197-2.1 through 197-2.3 and section 197-2.6 of this Subpart.

Section 197-2.5 Exception for certain water-works corporations. A water works corporation with annual operating revenues of less than $15,000 shall file with the State Board a copy of its Annual Report to the Public Service Commission (Form 347-E) and a "Supplemental Property Report Form", in lieu of all Forms otherwise required by section 197-2.1 and section 197-2.7 of this Subpart.

Section 197-2.6 Reports of cable television companies.

(a) Cable television companies with fewer than 1,000 subscribers, other than those described in subdivision (b) of this section, shall file with the State Board a certified annual financial report which shall include the following information:

(1) the name of the company and its principal officers;

(2) the name of the franchise or the area served;

(3) the number of subscribers (the total amount of first, or primary, outlets installed in each area served without reference to the number of additional outlets or services subscribed to by each customer);

(4) estimated percentage of the households being served;

(5) the miles of plant completed;

(6) the total route miles in the franchise area;

(7) total salaries of the corporate officers, or withdrawals by partners;

(8) an itemized statement of profit and loss;

(9) a balance sheet showing assets, liabilities and equity;

(10) schedule of plant, intangibles and deferrals;

(11) statement of long term debt.

(b) Cable television companies with less than 1,000 subscribers and an operating income for the immediately preceding fiscal year of less than $100,000 are not required to file the financial statement described in subdivision (a) of this section, provided that they file an application for exemption from that requirement.

(c) All cable television companies shall file an annual inventory report, on the following forms, to include the information as listed herein:

(1) Form EA 4.9 - Customer Connections, including:

(i) tax district code; and

(ii) quantity.

(2) Form EA 7.3 - Leased Property Report, including:

(i) the year the lease expires;

(ii) the type (structure, equipment, land or cable);

(iii) to whom assessed;

(iv) location; and

(v) use.

(3) Form EA 8.1 - Mass Property Report, including:

(i) tax district code and tax district name;

(ii) system classification codes of:

(a) aerial underground buried;

(b) capacity;

(c) owned poles;

(d) conduit.

(iii) quantity in highway and quantity in the private right-of-way; and

(iv) age.

(4) Form EA 8.2 - Mass Property Report - Average Cost/Mile (Aerial)

and

Form EA 8.3 - Mass Property Report - Average Cost/Mile (Underground), both Reports including:

(i) description;

(ii) quantity per mile;

(iii) material cost per unit at current year, based upon replacement cost (actual or estimated), or some other method (explained); and

(iv) the total value (quantity times unit cost).

(5) Form EA 8.4 - Mass Property Report - Construction Work in Progress, including:

(i) tax district code and tax district name;

(ii) system classification codes of

(a) aerial underground buried;

(b) capacity;

(c) owned poles;

(d) conduit.

(iii) quantity in highway and quantity in the private right-of-way; and

(iv) percent completed.

(6) Form EA 8.5 - Report of Poles Owned, including:

(i) tax district name and tax district code;

(ii) the year installed;

(iii) segregation of quantity of poles located in the highway and those located on private right-of-way.

(7) Form EA 8.6 - Report of Two Way and Dual Cable, including:

(i) tax district code and tax district name;

(ii) two way cable mileage;

(iii) dual cable mileage;

(iv) the percentage of dual cable operational and non-operational.

Section 197-2.7 Reports to regulatory agencies. In addition to the reports required by this Subpart, all special franchise owners other than unregulated special franchise

owners shall file with the State Board a copy of their annual financial statement as submitted to the appropriate regulatory agency and a completed Form EA 6.5, Addendum to Financial Report. Form EA 6.5 shall include the company name, the rate of return on common equity in effect, and a reconciliation of construction work in progress and allowance for funds used during construction. The statement of construction work in progress shall segregate the construction work in progress which is subject to the allowance for funds used during construction from that which is not subject thereto. The statement of allowance for funds used during construction shall include the amount and rate for borrowed funds and for utility funds.

Section 197-2.8 Applications for allowances for functional or economic obsolescence.

(a) A special franchise owner may apply for an allowance for functional or economic obsolescence by submitting information to demonstrate the existence of such functional or economic obsolescence, as defined in Subpart 197-1 of this Part.

(b) An application for an allowance for functional obsolescence shall contain information relating to present and projected needs, present and anticipated demands, and present and anticipated capacity, and shall also contain a suggestion of the manner by which the allowance should be calculated.

(c) An application for an allowance for economic obsolescence shall contain earnings history for the five fiscal years of the special franchise owner immediately preceding each valuation date, including the net operating income, taxes which were not included in the determination of net operating income, interest on indebtedness and other fixed charges, and shall also contain a suggestion of the manner by which the allowance should be calculated.

Section 197-2.9 Method of reporting. The information required by the preceding sections of this Subpart may be submitted on paper, on computer tape or in any other form mutually agreed upon by the special franchise owner and the Director of the Bureau of Industrial and Utility Valuation of the State Division.

Section 197-2.10 Time of filing.

(a) Reports required to be filed by sections 197-2.1 through 197-2.3 of this Subpart shall be filed by May 31 annually except as otherwise provided in this section.

(b) Reports of Estimated Changes to Plant and Equipment (Form EA 2.5), and the inventory reports required by section 197-2.6(c) of this Subpart, shall be filed by October 31 annually.

(c) Reports required by section 197-2.5 of this Subpart shall be filed annually by March 31, or within 3 months of the close of the fiscal year of the special franchise owner, whichever is later.

(d) Reports of Location and Description of Structural Items (Form EA 1.1) shall be filed quarterly as follows:

(1) by April 29, for the quarter ending March 31;

(2) by August 15, for the quarter ending June 30;

(3) by October 31, for the quarter ending September 30; and

(4) by May 31 for the quarter ending on the preceding December 31.

(e) Reports required by section 197-2.4 of this Subpart shall be filed by February 15 annually.

(f) Reports required by section 197-2.6(a) of this Subpart or the applications for exemption from such reports authorized by section 197-2.6(b) shall be filed within 90 days of the close of the fiscal year of the cable television company.

(g) The reports required by section 197-2.7 of this Subpart shall be filed within 15 days of the filing of the financial statement with the appropriate regulatory agency.

(h) An application for an allowance pursuant to section 197-2.8 of this Subpart shall be filed at the time of the filing of the report which provides information concerning the property for which the allowance is sought.

(i) For good cause shown upon written request, the Director of the Bureau of Industrial and Utility Valuation of the State Division may extend the time for the filing of any of these reports.

Section 197-2.11 Inspection. Reports submitted pursuant to this Subpart shall not be made available for public inspection or copying except for purposes of administrative or judicial review of assessments.

Section 197-2.12 Failure to file.

(a) Whenever it shall appear that a special franchise owner has failed to file a report or reports as of the date required by section 197-2.10 of this Subpart, an adjudicatory proceeding concerning the alleged failure will be held in the manner provided in Subpart 187 of this Chapter.

(b) If it is determined pursuant to such adjudicatory proceeding that the special franchise owner has failed to file a report or reports in the time and manner provided in this Subpart, the following penalties shall be imposed upon the special franchise owner:

(1) a penalty of $100 for each failure;

(2) an additional fine of $10 per day for each day the failure continues, beginning with the day on which the failure first occurred; and

(3) the loss of the right to review of the special franchise assessment, as otherwise provided in section 197-4.4 of Subpart 197-4 of this Part.

(c) If, following the issuance of such a determination, the failure to file such report or reports continues, counsel to the State Board may commence a special proceeding in Supreme Court, Albany County, to compel production of such report or reports.

Section 197-2.13 Municipal reports. (a) By December 31, the clerk of each city, town and village shall annually file a report on Form EA 194 identifying the name and address of any corporation to which the city, town or village has a granted franchise authorizing occupation and use of a public right of way. Such report shall include a statement of the amount of construction (1) in place and (2) anticipated in the next twelve months, for each such corporation.

(b) Such report shall also state whether any corporation or person has constructed or placed property in the public right-of-way, and whether this was pursuant to a special franchise.

(c) If there has been any change in the boundaries of the reporting city, town or village since the last Form EA 194 was filed, the clerk shall so indicate and submit a copy of a map showing that change.

Subpart 197-3

Valuation Methodology

(Statutory authority: Real Property Tax Law, §§202, 600)

Sec.

197-3.1 Inventory date; valuation dates

197-3.2 Valuation of tangible property

197-3.3 Calculation of reproduction cost new

197-3.4 Allowance for physical deterioration

197-3.5 Allowance for functional obsolescence

197-3.6 Allowance for economic obsolescence

197-3.7 Valuation of intangible property

197-3.8 Excess earnings rule

197-3.9 Valuation of special franchise property

197-3.10 Application of methodology and data

Section 197-3.1 Inventory date; valuation dates.

(a) The inventory date of special franchise property shall be December 31 of the year preceding the year in which the assessment roll on which the special franchise assessment will be entered is filed in the office of the city or town clerk, subject to the following:

(1) The value shall include an estimate of the anticipated net change in the inventory from the year preceding the inventory date to the year including the inventory date. This estimate shall be made by determining the average net change by account, as reported in the

annual financial reports required under section 197-2.7 of Subpart 197-2 of this Part, for the three years preceding the year which includes the inventory date and multiplying the average net change by the account balance reported for the year preceeding the year which includes the inventory date or, where available, on the basis of estimated changes reported by the special franchise owner for the year which includes the inventory date.

(2) The inventory date shall be December 31 of the second year preceding the date required by law for filing of the final assessment roll for purposes of city assessment rolls required to be filed between January 1 and June 1 inclusive and for all village assessment rolls.

(b) All property that is to be valued pursuant to this Subpart shall be valued as of each of the following dates:

(1) The survey valuation date or dates as of which the full value of taxable real property was estimated for purposes of computing the equalization rate to be applied in determining the special franchise assessment as set forth in Subpart 186-10 of Part 186 of this Chapter.

(2) The inventory date.

Section 197-3.2 Valuation of tangible property.

(a) In an assessing unit which has completed a revaluation or which is expected to complete a revaluation, the reproduction cost new less depreciation of the tangible property of a special franchise shall be determined as follows:

(1) The reproduction cost new less depreciation of each account of property reported under sections 197-2.1, 197-2.2(b) or 197-2.5 of this Part is determined as follows:

(i) Determine the reproduction cost new of each valuation unit by trending surviving original cost in the manner provided in section 197-3.3 of this Subpart.

(ii) Multiply the result for each valuation unit by factors for physical depreciation and functional obsolescence, respectively, if applicable.

(iii) Add the results for all of the valuation units and multiply the sum by a factor for economic obsolescence, if applicable.

(iv) If some of the property in the account is outside the assessing unit, multiply the result by the percentage that the surviving original cost of the property in the assessing unit bears to the surviving original cost of all of the property in the account.

(2) The reproduction cost new less depreciation of each account of property reported under sections 197-2.2(a) or 197-2.3 of this Part is determined as follows:

(i) Multiply the number of units of measurement in each valuation unit by the appropriate unit price, as set forth in a schedule to be adopted annually by the State Board.

(ii) Multiply the result for each valuation unit by factors for physical depreciation and functional obsolescence, respectively, if applicable.

(iii) Add the results for each of the valuation units and multiply the sum by a factor for economic obsolescence, respectively, if applicable.

(iv) If some of the property in the account is outside the assessing unit, multiply the result by the percentage that the surviving original cost of the property in the assessing unit bears to the surviving original cost of the property in the account.

(3) The reproduction cost new less depreciation of property reported under section 197-2.6 of this Part is determined as follows:

(i) Multiply the number of units of measurement in each valuation unit by the appropriate unit price, as set forth in a schedule to be adopted annually by the State Board.

(ii) Multiply the result for each valuation unit by factors for physical depreciation and functional obsolescence, respectively, if applicable.

(iii) Add the results for each of the valuation units and multiply the sum by a factor for economic obsolescence, if applicable.

(4) The reproduction cost new less depreciation of the tangible property of the special franchise equals the sum of the reproduction costs new less depreciation of all of the types of tangible property of the special franchise in the assessing unit.

(b) In an assessing unit which has not completed a revaluation and which is not expected to complete a revaluation, the value of the tangible base property and the reproduction cost new less depreciation of the tangible subsequent property of the special franchise owner shall be determined as follows:

(1) The value of the tangible base property is determined by multiplying the surviving original cost of the tangible base property in each account by the percent condition used to establish the 1953 assessment of the special franchise and adding the results for all of the accounts.

(2) The reproduction cost new less depreciation of the tangible subsequent property is determined in the manner provided in subdivision (a) of this section.

Section 197-3.3 Calculation of reproduction cost new. (a) Reproduction cost new for a valuation unit of an account of property other than telephone and telegraph property reported under sections 197-2.1 and 197-2.2(b) of Subpart 197-2 of this Part, equals the original cost divided by the year index, multiplied by the price level index, as set forth in the Handy-Whitman Index.

(b) Where the Handy-Whitman Index provides semi-annual cost indices, the year index equals the sum of the following:

(1) 50 percent of the cost index as of July 1 as of the year of installation;

(2) 25 percent of the cost index as of the January first immediately preceeding that used in (1); and

(3) 25 percent of the cost index as of the January first immediately succeeding that used in (1).

(c) Reproduction cost new for a valuation unit of an account of telephone and telegraph property reported under sections 197-2.1 and 197-2.2(b), equals the original cost divided by the year index, multiplied by the price level index, as set forth in the telephone index to be adopted annually by the State Board.

Section 197-3.4 Allowance for physical depreciation.

(a) Subject to the limitations in subdivisions (b) and (c) of this section, in determining the value of tangible property, there shall be an allowance for physical depreciation of surviving property in the account calculated as follows:

(1) Multiply 0.8 by the appropriate net salvage percent, as set forth in Sections 197-6.1, 197-6.2 or 197-6.3 of Subpart 197-6 of this Part.

(2) Subtract the result obtained in (1) from 0.8.

(3) Divide the age of the property by its service life, as set forth in Sections 197-6.1, 197-6.2 or 197-6.3 of Subpart 197-6 of this Part.

(4) Multiply the result obtained in (2) by the result obtained in (3).

(5) Subtract the result obtained in (4) from 1.0.

(b) In the calculation of physical depreciation, the result of age divided by service life may not exceed 1.0000.

(c) The allowance for physical deterioration may not be less than:

(1) 20 percent at zero percent salvage;

(2) 5 percent with negative salvage value.

Section 197-3.5 Allowance for functional obsolescence.

(a) There shall be an allowance for functional obsolescence where the application submitted by a special franchise owner pursuant to section 197-2.8 of this Part demonstrates the existence of functional obsolescence as defined in Subpart 197-1 of this Part. The allowance shall be expressed as a factor.

(b) Upon a demonstration that functional obsolescence exists, the State Board shall determine the manner in which the allowance will be calculated for the special franchise; provided, however, that once the allowance has been included in the final

assessment of a special franchise, the allowance shall be calculated in the same manner thereafter for that special franchise when the owner demonstrates that the same obsolescence continues to exist.

Section 197-3.6 Allowance for economic obsolescence.

(a) There shall be an allowance for economic obsolescence where the application submitted by a special franchise owner pursuant to section 197-2.8 of this Part demonstrates the existence of economic obsolescence as defined in Subpart 197-1 of this Part. The allowance shall be expressed as a factor.

(b) Upon a demonstration that economic obsolescence exists, the State Board shall determine the manner in which the allowance will be calculated for the special franchise; provided, however, that once the allowance has been included in the final assessment of a special franchise, the allowance shall be calculated in the same manner thereafter for that special franchise when the owner demonstrates that the same obsolescence continues to exist.

Section 197-3.7 Valuation of intangible property. (a) In an assessing unit which has completed a revaluation or which is expected to complete a revaluation, the value of the intangible property shall be the greater of:

(1) Five percent of the reproduction cost new less depreciation of the tangible property as determined pursuant to Section 197-3.2 of this Subpart, or

(2) The capitalized excess earnings attributable to the intangible property in the assessing unit, as determined pursuant to section 197-3.8 of this Part.

(b) In an assessing unit which has not completed a revaluation and which is not expected to complete a revaluation, the value of the intangible base property and the intangible subsequent property are determined as follows:

(1) The value of the intangible base property equals five percent of the value of the tangible base property.

(2) The value of the intangible subsequent property is the greater of:

(i) Five percent of the reproduction cost new less depreciation of the tangible subsequent property as determined pursuant to section 197-3.2 of this Subpart, or

(ii) The capitalized excess earnings attributable to the intangible subsequent property in the assessing unit, as determined pursuant to section 197-3.8 of this Part.

Section 197-3.8 Excess Earnings Rule.

(a) The capitalized excess earnings shall be determined as follows:

(1) Determine the rate base, the achieved rate of return and the market required rate of return, as defined in subdivision (e) of this section.

(2) Add one percent to the market required rate of return and subtract the sum from the achieved rate of return.

(3) If the result is greater than zero, multiply the result by the rate base and capitalize the product at a rate equal to the market required rate of return plus one percent.

(b) The capitalized excess earnings attributable to the intangible property or the intangible subsequent property in the assessing unit shall be determined by multiplying the capitalized excess earnings by the state allocation factor, if applicable, and the assessing unit allocation factor.

(c) The computations required by this section shall be based upon averages of the data for the five fiscal years immediately preceding the date as of which the property is to be valued; provided, however, that where less than five years of data are available, the computations shall be based upon the averages of the data that is available within that period.

(d) The computations required by this section shall not apply to a water works corporation with annual operating revenues of less than $15,000 or to a cable television company with less than 1,000 subscribers and an operating income for the immediately preceding fiscal year of less than $100,000.

(e) When used in this section:

(1) Achieved rate of return means net utility operating income or net cable operating income divided by the rate base.

(2) Amortization means that gradual extinguishment of an amount in an account by distributing the amount over a fixed period, such as the life of the asset or liability to which it applies, or the period during which it is anticipated the benefit will be realized.

(3) Assessing unit allocation factor means (i) in an assessing unit which has completed a revaluation or is expected to complete a revaluation, the ratio that the reproduction cost new less depreciation of the tangible property within the assessing unit bears to the reproduction cost new less depreciation of all of the tangible property of the special franchise owner within New York State; or (ii) in an assessing unit which has not completed a revaluation and is not expected to complete a revaluation, the ratio that the reproduction cost new less depreciation of the tangible subsequent property within the assessing unit bears to the reproduction cost new less depreciation of all of the tangible property of the special franchise owner within New York State.

(4) Capital structure means the sum of long term debt, preferred stock, common equity and deferred income taxes using year end book cost as of the close of the calendar year for special franchise owners which report to the Public Service Commission or the Federal Energy Regulatory Commission, and as of the close of the fiscal year for all other special franchise owners. For purposes of determining the capital structure of a special franchise owner which is a subsidiary of a parent company, the ratio of debt to equity of the special franchise owner shall be the same as the ratio of debt to equity approved for the special franchise owner by the appropriate regulatory agency in the most recent rate case or, if there has been no such rate case, the ratio of debt to equity of the parent.

(5) Common equity means the amount of common stock plus premium on common stock plus retained earnings less reacquired common stock less common stock expense plus any additional paid in capital associated with common stock, as reported on the financial statement submitted to the appropriate regulatory agency or the State Board.

(6) Debt discount means the excess of the face value of the debt securities plus interest accrued at the date of the sale over the cash value of the consideration received from their sale.

(7) Debt expense means all expenses in connection with the issuance and initial sale of evidences of debt, such as fees for drafting mortgages and trust deeds; fees and taxes for issuing or recording evidences of debt; cost of engraving and printing bonds and certificates of indebtedness; fees paid trustees; specific costs of obtaining governmental authority; fees for legal services; fees and commissions paid underwriters, brokers, and salesmen for marketing such evidences of debt; fees and expenses of listing on exchanges; and other like costs.

(8) Deferred income taxes means the amount of federal corporate income tax liability not presently payable resulting from the use of accelerated depreciation and amortization and investment tax credits.

(9) Embedded cost of debt means the annualized interest on long term debt, plus the annual amortization of debt discount and debt expense, less the annual amortization of a premium on long term debt, all divided by long term debt. For a special franchise owner which is subsidiary of a parent company, the embedded cost of debt shall be the same as the embedded cost of debt approved for the special franchise owner by the appropriate regulatory agency in the most recent rate case or, if there has been no such rate case, the embedded cost of debt of the parent.

(10) Embedded cost of preferred stock means preferred stock dividends annualized divided by preferred stock.

(11) Long term debt means the unpaid balance of notes, bonds and other evidences of debt payable after one year from the date issued plus any unamortized premium less unamortized debt discount and debt expense and any reacquired long term debt.

(12) Market required rate of return means:

(i) for a special franchise owner other than a pipeline corporation or a cable television company, the sum of the following calculations:

(a) $\frac{\text{long term debt}}{\text{capital structure}} \times$ embedded cost of debt

(b) $\frac{\text{preferred stock}}{\text{capital structure}} \times$ embedded cost of preferred stock

(c) $\frac{\text{common equity}}{\text{capital structure}} \times$ rate of return on common equity

(ii) for a pipeline corporation which is not subject to the jurisdiction of the Federal Energy Regulatory Commission pursuant to the Natural Gas Act (15 U.S.C. §§ 717 et. seq.), the market required rate of return equals the yield, as published in Moody's, on AA utility bonds as of the date of valuation.

(iii) for a cable television company, the market required rate of return equals the yield, as published in Moody's, on A utility bonds as of athe date of valuation.

(13) Preferred stock means the amount of the preferred stock plus any unamortized premium on preferred stock less reacquired preferred stock less preferred stock expense, plus any additional paid in capital associated with preferred stock.

(14) Premium means, as applied to securities issued or assumed by the special franchise owner, the excess of the cash value of the consideration received from their sale over the sum of their par (stated value of the stocks without par value) or face value and interest or dividends accrued at the date of sale.

(15) Prepayments means outlays for benefits or services which apply to or will directly benefit future operations.

(16) Rate base means the value of a special franchise owner's investment on which it is allowed to earn a return including but not limited to the net original cost of net utility plant or net telephone plant as reported to the appropriate regulatory agency, working capital requirements, and construction work in progress, except that (i) in the case of a pipeline corporation which is not subject to the jurisdiction of the Federal Energy Regulatory Commission pursuant to the Natural Gas Act (15 U.S.C. §§ 717 et. seq.), rate base means the reproduction cost new less depreciation of improvements and personal property, the value of land, the value of rights of way and

working capital, as published by the Federal Energy Regulatory Commission, and (ii) in the case of a cable television company, rate base means the replacement cost new less depreciation of improvements and personal property, the value of land and working capital.

(17) Rate of return on common equity means the rate of return on common equity most recently allowed by the appropriate regulatory agency. If there has been no such allowance within the last two calendar years, a rate of return on common equity is derived from the average of common equity rate of return from similar type corporations.

(18) State allocation factor means:

(i) For an interstate company other than a pipeline corporation, the revenues within New York divided by the gross revenues.

(ii) For an interstate pipeline corporation, the sum of:

(a) $\frac{\text{Barrels or MCFs Delivered in New York}}{\text{Total Barrels or MCFs Delivered}} \times 25\%$

(b) $\frac{\text{Investment in New York}}{\text{Total Investment}} \times 45\%$

(c) $\frac{\text{Mileage in New York}}{\text{Total Mileage}} \times 30\%$

(19) Working capital means an allowance for expenditures required to conduct business including, but not limited to, material and supplies, and prepayments. The working capital component of rate base shall be computed as follows:

(i) For purposes of electric, gas, and steam, the Maintenance Expenses are added to the Operation Expenses from which Purchased Electric and Gas are subtracted to arrive at net operating expenses. One-seventh (1/7) of the net operating expenses are then added to Materials and Supplies, Gas Stored Underground, Liquified Natural Gas and Prepayments.

(ii) For purposes of water, the Maintenance Expenses are added to the Operation Expenses from which Purchases Water is subtracted arriving at net operating expenses. One-seventh (1/7) of the net operating expenses is then added to Materials and Supplies and Prepayments.

(iii) For purposes of telephone, seven percent (.07) of the Operating Expenses less Depreciation is added to the Materials and Supplies and Prepayments.

(iv) For purposes of cable, five dollars per subscriber connection.

Section 197-3.9 Valuation of special franchise property.

(a) In an assessing unit which has completed a revaluation or which is expected to complete a revaluation, the value of the special franchise property equals the reproduction cost new less depreciation of the tangible property plus the value of the intangible property.

(b) In an assessing unit which has not completed a revaluation and which is not expected to complete a revaluation, the value of the base property and the value of the subsequent property are determined as follows:

(1) The value of the base property equals the value of the tangible base property plus the value of the intangible base property.

(2) The value of the subsequent property equals the reproduction cost new less depreciation of the tangible subsequent property plus the value of the intangible subsequent property.

Section 197-3.10 Application of methodology and data.

(a) The methodology provided in this Subpart shall apply whether computing a tentative or final special franchise assessment.

(b) The indices, unit prices, service lives, net salvage percentages and other data used to compute a tentative assessment shall be obtained as provided in this Subpart.

(c) If a special franchise owner or municipal corporation wishes to contest an index, unit price, service life, net salvage percentages or other figure used in the computation of the tentative special franchise assessment, it shall file a complaint as provided in Subpart 197-4 of this Part. If it does so and establishes that a different figure should have been used, that figure will be used to compute the final special franchise assessment. Otherwise, the final special franchise assessment shall be computed using the data used to compute the tentative assessment.

Subpart 197-4

Determination of Special Franchise Assessments

(Statutory authority: Real Property Tax Law, §§202, 600-620)

Sec.

197-4.1 Computation of tentative special franchise assessment

197-4.2 Determination of tentative special franchise assessment

197-4.3 Rescission of tentative special franchise assessment

197-4.4 Complaints

197-4.5 Hearings

197-4.6 Determination of final special franchise assessment

197-4.7 Rescission of final special franchise assessment

Section 197-4.1 Computation of tentative special franchise assessment.

(a) In an assessing unit which has completed a revaluation, other than an assessing unit described in subdivisions (b) or (d) of this section, the tentative special franchise assessment shall be computed as follows:

(1) The unequalized value of the special franchise property is determined as follows:

(i) If only one market value survey was used to compute the equalization rate that is to be applied, the unequalized value of the special franchise property equals the value of the special franchise property as of the survey valuation date.

(ii) If two market value surveys were used to compute the equalization rate to be applied, the unequalized value is

determined by averaging the values of the property as of the respective survey valuation dates in the same manner as is provided in section 186-10.2(d) of Subpart 186-10 of Part 186 of this Chapter for averaging the total market values of the assessing unit as of those dates to compute its equalization rate.

(2) The equalized value of the special franchise property is determined by multiplying the unequalized value of the special franchise property by the final state equalization rate for the latest final assessment roll; provided, however, that if the final equalization rate for that roll has not been established at the time the tentative special franchise assessment is to be determined, the tentative equalization rate for that roll shall be used in lieu thereof.

(3) The tentative special franchise assessment equals the lesser of the following:

(i) The equalized value of the special franchise property; or

(ii) The value of the special franchise property as of the inventory date.

(b) In an assessing unit which is expected to complete a revaluation, the tentative special franchise assessment shall be computed as follows:

(1) The unequalized value of the special franchise property is determined as follows:

(i) If only one market value survey was used to compute the equalization rate that is to be applied, the unequalized value of

the special franchise property equals the value of the special franchise property as of the survey valuation date.

(ii) If two market value surveys were used to compute the equalization rate to be applied, the unequalized value is determined by averaging the values of the property as of the respective survey valuation dates in the same manner as is provided in section 186-10.2(d) of Subpart 186-10 of Part 186 of this Chapter for averaging the total market values of the assessing unit as of those dates to compute its equalization rate.

(2) The tentative special franchise assessment equals the lesser of the following:

(i) The unequalized value of the special franchise property; or

(ii) The value of the special franchise property as of the inventory date.

(c) In an assessing unit which has not completed a revaluation and which is not expected to complete a revaluation, the tentative special franchise assessment shall be computed as follows:

(1) The equalized value of the base property is determined by multiplying the value thereof by the final state equalization rate for the 1953 assessment roll.

(2) The unequalized value of the subsequent property is determined as follows:

(i) If only one market value survey was used to compute the equalization rate that is to be applied, the unequalized value of the subsequent property equals the value of the subsequent property as of the survey valuation date.

(ii) If two market value surveys were used to compute the equalization rate to be applied, the unequalized value is determined by averaging the values of the subsequent property as of the respective survey valuation dates in the same manner as is provided in section 186-10.2(d) of Subpart 186-10 of Part 186 of this Chapter for averaging the total market values of the assessing unit as of those dates to compute its equalization rate.

(3) The equalized value of the subsequent property is determined by multiplying the unequalized value thereof by the final state equalization rate for the latest final assessment roll; provided, however, that if the final equalization rate for that roll has not been established at the time the tentative special franchise assessment is to be determined, the tentative equalization rate for that roll shall be used in lieu thereof.

(4) The tentative special franchise assessment equals the equalized value of the base property plus the equalized value of the subsequent property.

(d) In the village of Athens and all towns in Greene County, other than the town of Ashland, special franchise assessments shall be determined in the manner provided in section 197-5.3 of Subpart 197-5 of this Part.

Section 197-4.2 Determination of tentative special franchise assessment.

(a) The figure computed in section 197-4.1 of this Subpart shall be determined as the tentative special franchise assessment by resolution of the State Board; provided, however, that if a resolution of the State Board delegates the power to determine such tentative special franchise assessments to an officer or employee of the State Division, such officer or employee may determine the tentative special franchise assessment pursuant to such resolution.

(b) A Notice of Determination of Tentative Special Franchise Assessment shall be served upon the special franchise owner and the chief executive officer of the municipality in which the special franchise property is located. Such Notice shall include:

(1) a statement that the tentative special franchise assessment has been determined;

(2) the tentative special franchise assessment;

(3) an identification of the assessment roll for which the special franchise assessment was established;

(4) the time and place that a hearing will be held to hear any complaint concerning such special franchise assessment;

(5) if the assessing unit for which the assessment is established is a town, the amount of the special franchise assessment attributable to each village therein;

(6) if the assessing unit is one which is expected to complete a revaluation, a statement that the tentative assessment represents the unequalized value of the special franchise property

and that the final assessment will represent the equalized value of the property.

(c) If the special franchise owner is a partnership, association or corporation, service shall be made upon it by mailing or delivering a copy to its principal place of business. If the special franchise owner is a person, service shall be made upon him by mailing or delivering a copy to him at his place of business or last known place of residence.

(d) Such Notice shall be served at least thirty days before the date specified for the hearing.

(e) An affidavit shall be executed and retained showing when, where, to whom and to what address each Notice of Determination of Tentative Special Franchise Assessment was served.

Section 197-4.3 Rescission of tentative special franchise assessment.

(a) The tentative special franchise assessment shall be rescinded if and only if:

(1) it is ascertained prior to the establishment of the final special franchise assessment that procedures or data which were defective in a significant respect were relied upon in the determination of the tentative special franchise assessment and if a written complaint is not filed by the assessing unit or special franchise owner as provided by section 197-4.4 of this Subpart; or

(2) at the time that the tentative assessment was determined, the assessing unit had been expected to complete a revaluation, but it is no longer expected that the assessing unit will complete a revaluation; or

(3) at the time that the tentative assessment was determined, the assessing unit had not been expected to complete a revaluation, but it is now expected that the assessing unit will complete a revaluation.

(b) A new tentative special franchise assessment shall be simultaneously determined, according to this Subpart and the correct procedures or data.

(c) The rescission and reestablishment of a tentative special franchise assessment pursuant to this section shall be done by resolution of the State Board; provided, however, that where a resolution of the State Board delegates the power to rescind and reestablish such tentative special franchise assessments to an officer or employee of the State Division, such officer or employee may rescind and reestablish the tentative special franchise assessment pursuant to such resolution.

Section 197-4.4 Complaints.

(a) A special franchise owner or the assessing unit in which the special franchise is located may obtain administrative review of the tentative special franchise assessment by serving a written complaint specifying its objections as provided herein.

(b) The complaint shall be served upon the State Board at least ten days before the hearing date. In addition, a copy of the complaint shall be served upon the adverse party at least five days before the hearing date. At least five days before the hearing date, a complainant shall file an affidavit with the State Board demonstrating compliance with this section. A failure by a complainant to comply with the provisions of this paragraph may only be waived if the adverse party consents in writing thereto.

Section 197-4.5 Hearings; reports.

(a) The State Board or its duly authorized representative shall meet at the time and place specified in the Notice sent pursuant to section 608 of the RPTL and section 197-4.2 of this Part to hear complaints regarding the tentative special franchise assessments. A complainant need not attend the hearing in order to have its complaint considered.

(b) Unless the State Board directs otherwise, an attorney of the Bureau of Legal Services of the State Division shall be assigned by Counsel to the State Board to serve as hearing officer and preside over the hearing. The hearing shall not constitute an adjudicatory proceeding subject to article three of the State Administrative Procedure Act, but the provisions of section 525(2) of the RPTL shall apply as far as practicable to the hearing. The hearing officer shall rule on all procedural matters arising at the hearing.

(c) At least one representative of the Bureau of Industrial and Utility Valuation shall attend the hearing.

(d) The hearing officer may accept materials offered by a complainant at the hearing and may permit a complainant or an adverse party to submit additional materials until no later than ten days after the hearing. Upon good cause shown, the Deputy Executive Director for Equalization of the State Division may allow additional time for the submission of additional materials and shall notify the complainant and adverse party accordingly. All materials submitted after the hearing shall be accompanied by an affidavit of service upon the adverse party. The hearing officer shall forward any documentation relating to valuation submitted on or after the hearing to the Bureau of Industrial and Utility Valuation of the State Division.

(e) Following the conclusion of the hearing, the hearing officer shall prepare a report for the State Board reviewing the procedural and legal issues presented in the complaint or hearing and submit the report to Counsel to the State Board. The Director of the Bureau of Industrial and Utility Valuation of the State Division shall prepare a report to the State Board reviewing the valuation issues presented in the complaint or hearing and submit the report to the Deputy Executive Director for Equalization of the State Division.

Section 197-4.6 Determination of final special franchise assessment.

(a) If no written complaint has been filed as provided by section 197-4.4 of this Subpart, the final special franchise assessment shall be established by resolution of the State Board; provided, however, that if a resolution of the State Board delegates the power to establish such final special franchise assessments to an officer or employee of the State Division, such officer or employee may establish such final special franchise assessment pursuant to such resolution. The final special franchise assessment shall be equal to the tentative special franchise assessment, except that:

(1) if at the time the tentative special franchise assessment was determined, the final equalization rate for the latest final assessment roll had not been established, the final special franchise assessment shall be recomputed using the final equalization rate for that roll;

(2) if within 30 days after the last day provided by law for the filing of the final assessment roll, it shall be made to appear that there has been a change in the level of assessment of two percent or more, a special equalization rate shall be established and the final special franchise assessment shall be computed using the special equalization rate;

(3) if the assessing unit had been expected to complete a revaluation, and such a revaluation was completed, but there has not been a change in the level of assessment of two percent or more, the final special franchise assessment shall be recomputed using the latest final equalization rate.

(b) If a written complaint has been filed as provided by section 197-4.4 of this Subpart, the final special franchise assessment shall be determined by resolution of the State Board after consideration of the reports prepared by the hearing officer and by the Director of the Bureau of Industrial and Utility Valuation of the State Division pursuant to section 197-4.5 of this Subpart.

(c) A Certificate of Final Special Franchise Assessment shall be executed by the Secretary or Assistant Secretary of the State Board, setting forth such final special franchise assessment, and filed with the assessors of the assessing unit for which it was established. If the assessing unit is a town, the certificate shall also set forth the amount of the special franchise assessment attributable to each village therein.

(d) Upon filing the certificate, notice shall be sent to the special franchise owner, setting forth the amount of the final special franchise assessment and, if the assessing unit is a town, the amount of the special franchise assessment attributable to each village therein. Such notice shall be served in the same manner as is provided for the Notice of Determination of Tentative Special Franchise Assessment in section 197-4.2(c) of this Subpart. An affidavit shall be executed and retained showing when, where, to whom and to what address each copy of the notice was served.

Section 197-4.7 Rescission of final special franchise assessment.

If within 30 days after the last date provided by law for the filing of the final assessment roll it shall be made to appear that there has been a change in the level of assessment of two percent or more and a special equalization rate had not been established prior to the determination of the final assessment, a special equalization rate shall be established, the final special franchise assessment shall be rescinded and a new final special franchise assessment shall be determined using the special equalization rate. The rescission and reestablishment of a final special franchise assessment pursuant to this section shall be done by resolution of the State Board; provided, however, that where a resolution of the State Board delegates the power to rescind and reestablish such final special franchise assessments to an officer or employee of the State Board, such officer or employee may rescind and reestablish the final special franchise assessment pursuant to such resolution.

Subpart 197-5

Miscellaneous Provisions

(Statutory authority: Real Property Tax Law, §§202, 607, 616, 620)

Sec.

197-5.1 Apportionment of special franchise assessments

197-5.2 Adjustment upon change of fiscal year

197-5.3 Determination of special franchise assessments in certain assessing units in Greene County

Section 197-5.1 Apportionment of special franchise assessments. (a) School Districts. In a city or town the assessment of a special franchise located in more than one school district shall be apportioned by the assessor or assessors among each such school district prior to the delivery of that portion of the assessment roll applying to such district pursuant to section 1302 of the Real Property Tax Law; provided, however, that if the final special franchise assessment is received after the delivery of such portion, the assessment shall be apportioned by the assessor upon receipt, and notice of the apportionment shall be thereupon furnished by the assessor to each such district.

(b) Special districts. In towns the assessment of each special franchise located in one or more special districts shall be apportioned by the assessor or assessors among each special district at the time of the completion and filing of the final assessment roll; provided, however, that if the final special franchise assessment is received after the completion and filing of the final assessment roll, the assessment shall be apportioned by the assessor upon receipt, and notice of the apportionment shall be thereupon furnished by the assessor to each such district.

(c) Notice of methods. No later than the date for the filing of the tentative assessment roll, the assessor or assessors shall provide the county director of real property tax services with a written statement of the method or methods of apportioning special franchise assessments.

Section 197-5.2 Adjustment upon change of fiscal year. Adjustments in special franchise assessments as may be necessary in the event that the fiscal year of a city or village has been changed under law shall be made after hearing.

Section 197-5.3 Determination of special franchise assessment in certain assessing units in Greene County.

(a) Notwithstanding the provisions of subdivision (a) of section 197-4.1 of Subpart 197-4 of this Part, the tentative assessment of each special franchise in the village of Athens and in all towns in Greene County, other than the town of Ashland, shall be computed in the manner set forth in subdivision (b) of such section, except that the value of base property shall be multiplied by the adjusted base year equalization rate determined in the manner provided in this section.

(b) Subject to the provisions of subdivision (c) of this section, the adjusted base year equalization rate shall be the lesser of:

(1) the State equalization rate for the 1954 assessment roll of the assessing unit multiplied by two and adjusted to take into account the increase in the level of assessment on the 1961 assessment roll of the Village of Athens and the 1960 assessment roll of any town subject to the provisions of this section; or

(2) the State equalization rate for the 1953 assessment roll of the assessing, adjusted to take into account such increase in the level of assessment.

(c) The base year equalization rate shall be adjusted for any:

(1) decrease in the level of assessment of more than 5 percent on an assessment roll; or

(2) for any such decrease in excess of an aggregate of 5 percent on three consecutive assessment rolls.

Subpart 197-6

Schedules

(Statutory authority: Real Property Tax Law, §§202, 600)

Sec.

197-6.1 Schedule of service lives and net salvage percentages pertaining to Class A and Class B utilities as defined by the Public Service Commission

197-6.2 Schedule of service lives and net salvage percentages pertaining to Class C and Class D utilities as defined by the Public Service Commission

197-6.3 Schedule of service lives and net salvage percentages pertaining to cable television companies

Section 197-6.1 Schedule of service lives and net salvage percentages pertaining to Class A and Class B utilities as defined by the Public Service Commission.

ELECTRIC

Account		Service Life	Net Salvage Percentage
190	All Electric Property	50	0
312	Boiler Plant Equipment	32	0
353	Station Equipment	35	0
354	Towers and Fixtures	55	(5)
355	Poles and Fixtures	35	(10)
356	Overhead Conductors & Devices	40	10
357	Underground Conduit	60	0
358	Underground Conductors & Devices	40	10
362	Station Equipment	40	0
364	Poles, Towers & Fixtures	30	(20)
365	Overhead Conductors & Devices	35	12
366	Underground Conduit	60	(5)
367	Underground Conductors & Devices	40	5
368	Line Transformers	35	5
369	Services	35	(35)
369.1	Overhead Services	30	(25)
369.2	Underground Services	35	(25)
371	Installation on Customers Premises	28	6
373	Street Lighting	25	(15)
373.1	Street Lighting - Overhead	22	(3)
373.2	Street Lighting - Underground	25	(5)
390	Structures and Improvement	45	0
397	Communication Equipment	15	5

GAS

Account		Service Life	Net Salvage Percentage
290	All Gas Property	50	0
332	Field Lines	45	0
334	Field M & R Station Equipment	25	0
353	Lines	50	0
366	Transmission Structure & Improvements	45	(7)
367	Mains	50	0
369	M & R Station Equipment	30	0
375	Distribution Structure & Improvement	45	0
376	Mains	50	0
377	Compressor Station Equipment	35	0
378	M & R Station Equipment	30	0
380	Services	50	(30)
385	Industrial M & R Station Equipment	30	0
387	Other Equipment	30	0

STEAM

Account		Service Life	Net Salvage Percentage
353	Mains	50	0
359	Services	50	0

WATER

Account		Service Life	Net Salvage Percentage
314	Wells & Equipment	40	0
321	Pumping Structures & Improvements	45	0
325	Electric Pumping Equipment	30	0
328	Other Pumping Equipment	35	0
343	Transmission and Distribution Mains	50	0
345	Services	50	0
348	Hydrants	50	0
349	Other Transmission and Distribution Plants	30	0

TELEPHONE AND TELEGRAPH

Account		Service Life	Net Salvage Percentage
221	Central Office Equipment	24	(2)
231	Station Apparatus	11	1
232	Station Connections	7	(19)
241	Pole Lines	32	(43)
242.1	Aerial Cable	35	(5)
242.2	Underground Cable	50	30
242.3	Buried Cable	33	(3)
242.4	Submarine Cable	35	(1)
243	Aerial Wire	11	(19)
244	Underground Conduit	60	0
790	All Telephone Accounts	30	0

PIPELINE

Account		Service Life	Net Salvage Percentage
153	Line Pipe	50	0
332	Field Lines	35	0
367	Mains	50	0

Section 197-6.2 Schedule of service lives and net salvage percentages pertaining to Class C and Class D utilities as defined by the Public Service Commission.

ELECTRIC

Account		Service Life	Net Salvage Percentage
354.0	Overhead Lines	35	12
354.1	Poles, Towers & Fixtures	30	(20)
354.2	Overhead Conductors & Devices	35	12
354.3	Overhead Services	30	(25)
356.0	Underground Liner	40	5
356.1	Underground Conduit	60	(5)
356.2	Underground Conductors & Devices	40	5
356.3	Underground Services	35	(25)
358	Line Transformers	35	5
363	Street Lighting	25	(15)

GAS

Account		Service Life	Net Salvage Percentage
363.0	Transmission & Distribution Lines	50	0
363.1	Mains	50	0
363.3	Services	50	(30)

WATER

Account		Service Life	Net Salvage Percentage
321	Mains	50	0
323	Services	50	0
326	Fire Protection Plant	50	0

TELEPHONE AND TELEGRAPH

Account		Service Life	Net Salvage Percentage
032	Station Wiring	7	(19)
045	Poles, Conduit, Cable & Wire	30	0

Section 197-6.3 Schedule of service lives and net salvage percentages pertaining to cable television companies.

Account	Service Life	Net Salvage Percentage
Cable on Owned Poles	21	0
Cable on Leased Poles	15	0
Cable in Owned Conduit	21	0
Cable in Leased Conduit	15	0
Buried Cable	15	0

These amendments shall take effect immediately upon filing with the Secretary of State.

Memorandum

STATE OF NEW YORK
STATE BOARD OF
EQUALIZATION AND ASSESSMENT

September 8, 1983

TO: State Board of Equalization and Assessment

FROM Joseph K. Gerberg and Steven Stark-Riemer, Hearing Officers

SUBJECT: Proposed Rules on Special Franchise Assessments and Advisory Appraisals

At your meeting of April 6, 1983, you approved the proposal of rules governing Special Franchise Assessments (9 NYCRR 197) and an amendment to the rules concerning Advisory Appraisals (9 NYCRR 195). Notice of the Proposed Agency Action was published in the New York State Register on April 27, 1983. Although not required by law, hearings concerning the proposed rules were held at five locations throughout the State:

Batavia	-	June 2, 1983
Syracuse	-	June 3, 1983
Garden City	-	June 8, 1983
Newburgh	-	June 9, 1983
Albany	-	June 16, 1983

The hearings varied widely in participation. The Batavia hearing was attended by twenty-six persons. Samuel Lomando, Assessor of the Town of Evans, Erie County, and Alan S. Bader, Assessor of the Town of Sweden, Monroe County, each asked a question concerning the proposed rules. The remainder of the questions and comments did not relate to the proposed rules.

The Syracuse hearing on June 3 was attended by seven persons, none of whom had any questions or comments concerning the proposed rules.

The Garden City hearing on June 8 was attended by twelve persons, three of whom commented substantively upon the proposed rules:

Arthur W. Rosenblatt	-	Buckeye Pipe Line Company
John E. Green	-	National Fuel Gas Corporation
Charles H. King	-	Nassau County Department of Assessment

The presentations of Messrs. Rosenblatt and Green were supplemented with written statements. Additionally, a written transcript of the hearing was provided by the National Fuel Gas representatives.

The Newburgh hearing was attended by thirteen persons. Only R. Warren Frisina, Westchester County Director of Real Property Tax Services commented upon the proposed rules. No written statement was submitted.

The Albany hearing on June 16 generated the most participation by far. Of the twenty-four persons who attended, statements were made by the following:

Irwin Litman	-	New York Telephone Company
John Goodman and James Patterson	-	National Fuel Gas Corporation
Franklin J. Schwarzer	-	Town of Cazenovia
John H. Dieckelman	-	Niagara Mohawk Power Corporation
F. Peter O'Hara (reading a statement of Fred Gentile)	-	Brooklyn Union Gas Corporation
Frederick J. Hunziker, Jr.	-	Energy Association of New York State; New York Gas Group; and Consolidated Edison;
Alan K. Jamison	-	New York State Electric and Gas Corporation
Samuel H. Browne	-	Rochester Gas and Electric Corporation
William K. Block and John P. MacArthur	-	City of New York

Each of the parties provided written comments during or after the hearing.

In addition to the written statements submitted by the participants at the hearing, written statements were submitted by:

A. E. Withers	-	Rochester Telephone Company; Highland Telephone Company; and Sylvan Lake Telephone Company
Abe Seldin	-	New York State Association of County Directors of Real Property Tax Services
William J. Dibble, III	-	Niagara Mohawk Power Corporation
John F. Havemeyer, III	-	Town of Cazenovia
Michael F. Zihal	-	Long Island Water Corporation
George Rodgers	-	Continental Telephone Company
Michael Whiteman	-	20 cities, towns and villages in Westchester County
Marvin S. Fink	-	Village of Scarsdale
Henry J. Smith	-	City of Mount Vernon; and Towns of Eastchester, Mamaroneck, Mount Pleasant and Scarsdale
Joshua N. Koenig	-	New York State Cable Television Association

An index to all the comments is attached.

The comments tended to present one of two points of view: that of the special franchise owners or that of the municipalities. The comments of the special franchise owners, although varied in tenor and presentation, were quite similar in substance. The same was true, to a lesser extent, of the municipalities. A report which attempted to summarize each statement received would be extremely cumbersome and highly repetitive, and could not do justice to the many excellent arguments received. Furthermore, we understand that the participants in the hearings will have the opportunity to review this report and to address the Board directly. Acting on the

premise that our responsibility is to identify for the Board the issues raised by the proposed rules and to present the arguments that pertain to those issues, we have structured this report so as to present in consolidated form the basic positions of each side.

We have summarized each position where possible, but where an argument has been developed in the record at great length, the essence of the argument has been indented beneath a general description of the position. Citations to the record follow each point to facilitate reference to the respective sources if desired.

A. PROPOSED RULES

Special franchise property would be valued pursuant to proposed Subpart 197-3 in essentially the following manner:

1) Reproduction cost will be calculated by trending original cost to current levels. Where reproduction cost cannot be obtained, replacement cost will be calculated using a unit price methodology.

2) An allowance will be calculated for physical depreciation using the service lives and salvage values set forth in Subpart 197-6.

3) An allowance will be made for "functional obsolescence" where the property no longer serves the purpose for which it was designed.

4) The value of the "intangible" property, the right to operate in the public way, will be calculated and included in the assessment. This figure will be equal to 5% of the value of the "tangible," or physical, property, unless there are earnings more than one percent greater than those authorized by the Public Service Commission (PSC), in which case the excess earnings will be capitalized and, where greater than the 5% minimum, would be substituted as the intangible property value.

The State Board would make advisory appraisals of taxable public utility property which is not in the public way in the same manner pursuant to proposed section 197-3.5(c).

The proposed rules also set forth definitions of the terms used therein (Subpart 197-1), provisions relating to reports to be filed by special franchise owners and municipalities (Subpart 197-2) procedures to be followed in establishing special franchise assessments (Subpart 197-4) and miscellaneous provisions (Subpart 197-5).

B. POSITION OF SPECIAL FRANCHISE OWNERS

The arguments of the special franchise owners were quite consistent. Indeed, when asked at the Albany hearing to emphasize their differences, all were silent. The basic argument follows.

1. Three approaches to value must be considered

The first part of the argument is that the SBEA must recognize that there are three approaches to value, not just the cost approach.

> When assessing special franchise property under RPTL, §606, the SBEA must determine the value of the property. There are three recognized methods for arriving at full value: the market, income and cost approaches. In order to validly estimate the value of any property, all three indicators must be considered to determine (1) which method or methods are applicable to the particular property and, (2) where multiple methods are chosen, which method deserves greater weight. While it may not be possible to value the property by all three approaches, none should be automatically excluded.
>
> The market approach relies upon the sales of comparable properties between willing buyers and sellers. While this method is uniformly rejected for valuing special franchise property due to the lack of arms length sales, a stock and debt indicator has been developed as a substitute method for companies which have their securities actively traded on an open market. Under this approach, the value of the assets of the company are obtained by valuing its liabilities. The use or non-use of this approach is predicated on the appraiser's judgment.
>
> The income indicator is appropriate for valuing all income-producing property. By anticipating the return received on the investment, this method estimates how much the investor should be willing to pay for the property. Assuming a constant future income, capitalizing this stream results in an indicator of present value.
>
> The cost method is the current cost to reproduce the existing property less allowances for all forms of depreciation, i.e. physical, functional and economic. It is an approach of the last resort where an open market does not exist for the particular property because of its status as "specialty," or where an income stream is not determinable.
>
> The State Board's reliance on the cost approach, to the exclusion of all others, is erroneous. First, the recent Brooklyn Union Gas decision held that capitalization of income is an appropriate method of valuing special

franchise property. Second, special franchise property is not specialty property so unique as to require valuation by the cost method alone. Third, though valid comparable sales of special franchise property are nonexistent, the stock and debt approach is applicable to those companies listed on open stock exchanges. Fourth, since special franchise property is income-producing and that stream is constant by reason of governmental regulation, the income approach may be used.

The citations for the above discussion are: Green, index #1, pp. 14-15, 25; Goodman, index #3b, pp. 7-10; id., index # 3c, p. 18; Patterson, index #4a, pp. 2-3; Jamison, index #6, p. 3; Withers, index #9, p. 2; Zihal, index #15, p. 1; Litman, index #16a, pp. 2-3; id., index # 16b, pp. 2-3; Rodgers, index #18, p. 2.

2. The income approach is the most reliable

The special franchise owners further argued that the income approach is not merely another indicator of value to be considered, but is the most reliable indicator of the value of the property which generates an income and should be given primary, if not exclusive, consideration.

> Once the property has been valued using each of the relevant indicators, many appraisers assign weights to each to arrive at a numerically weighted average which best represents their judgment of value. Others believe relative weight cannot be quantified and reach a final value based upon the method believed to be most reliable, tempered by the other indicators.
>
> In the context of the valuation of public utility property for ad valorem tax purposes, the cost method is frequently ill-favored due to the extensive amount of economic obsolescence existing in such property. The market approach is not applicable due to lack of sales, and its surrogate, the stock and debt approach, suffers from the difficulty in allocating the stock and debt value to the property and the wide fluctuations in value inherent in temporary aberrations in the stock market.
>
> The income method, on the other hand, represents what a potential purchaser would pay for income-producing property and is therefore the real measure of value. It is especially applicable to special franchise property for the following reasons: (1) since special franchise property is permanently regulated, its earnings are limited to its rate of return and, more importantly, this income stream is constant; (2) due to governmental regulation, there is extensive and reliable data available; (3) the income approach can serve to identify functional and economic obsolescence not

readily apparent otherwise; and (4) this method brings into focus the difference between reproduction cost and replacement cost, viz, utility systems, if built today, would employ new and improved technology, materials, tools and installation efficiencies. Therefore, the income approach should be used as the primary indicator of value of special franchise property.

The references for the above discussion are: Goodman, index #3b, pp. 33-34; id., index #3c, pp. 35-36; Patterson, index #4a, p. 3; Jamison, index #6, pp. 3-4; Hunziker, index #7b, p. 1; Dieckelman, index #13, p. 2; Zihal, index #15, p. 4; Litman, index #16a, pp. 2-3; id., index #16b, p. 9; Rodgers, index #18, p. 2.

3. The SBEA cost methodology is incorrect

The SBEA cost approach as embodied in the proposed rules was criticized as contrary to proper cost methodology for two primary reasons: "trending," the application of indices to original cost dollars to arrive at a theoretical current reproduction cost, and the allowances used to adjust the current reproduction cost for certain factors.

a. Trending

The Handy-Whitman indices are prescribed for all trending purposes except for certain telephone and telegraph property. Regarding these properties, a composite index would be used based upon data filed by New York Telephone in connection with their rate cases, and updated by the SBEA using the Handy-Whitman telephone index. Rochester Telephone, New York Telephone, and Continental Telephone questioned whether this composite index was the "telephone index" defined in Subpart 197-1 and noted their lack of input into the development of this index (Withers, index #9, pp. 2-3; Litman, index #16b, appendix, pp. iii-ix; Rodgers, index #18, Ex. B, pp. 2-3).

Oil pipelines would not be valued according to the reproduction cost approach, since no Handy-Whitman Index is prepared for such property. Instead, a unit price methodology would be used to compute replacement, rather than reproduction cost. However, Buckeye Pipeline urged the SBEA to use an index that has been prepared by the Oil Pipeline Valuation Section of the Federal Energy Regulatory Commission's Bureau of Accounts since 1934, namely, Annual Pipeline Valuations (Rosenblatt, index #1, p. 4).

More generally, however, the use of the indices was criticized on the grounds that the instructions which come with the Handy-Whitman Index state that if used for valuation purposes, allowance must be made for all forms of depreciation and obsolescence (Green, index #2a, pp. 3-5; id., index #2b, pp. 11, 15-16; Goodman, index

#3b, pp. 8-25; Hunziker, index #7a, p. 3; Dibble, index #12, pp. 1-2). This brings us to the second objection to the proposed cost methodology.

b. Allowances

The special franchise owners argued that it is necessary when using the reproduction cost approach to adjust the trended original cost for each of the following factors: construction inefficiencies; physical deterioration; functional obsolescence; and economic obsolescence. They sharply criticized the SBEA methodology for failing to adequately provide such allowances.

> While reproduction cost is defined in the proposed rules as the estimated cost of reconstructing existing property using materials and methods employed in the original construction, the proposed rules fail to consider that much of the property would never be reproduced in its present form, since it is technologically, functionally, and economically obsolete.

(Gentile, index #5a, p. 2; Jamison, index #6, pp. 1-2; Hunziker, index #7b, p. 2; Withers, index #9, p. 2; Dibble, index #12, p. 2; Zihal, index #15, p. 2; Litman, index #16a, p. 3; Rodgers, index #18, pp. 3-4)

> Reproduction cost new assumes the most efficient construction of property in a single impulse rather than the actual practice of small increments of construction over time. This piecemeal placement of plant leads to an excessive labor cost in the original cost which, when trended, results in an excessive reproduction cost. The SBEA's failure to adjust its trended costs for piecemeal construction is a serious deficiency in its valuation methodology.

(Green, index #2b, p. 11; Goodman, index #3b, p. 26; Gentile, index #5a, p. 3; Hunziker, index #7a, p. 4; id., index #7b, p. 2; Withers, index #9, p. 2; Dibble, index #12, p. 2; Diekelman, index #13, p. 2; Zihal, index #15, pp. 3-5; Litman, index #16a, pp. 1, 3; id., index #16b, pp. 2, 11-12; Browne, index #17, pp. 2-3; Rodgers, index #18, pp. 5-7)

> The proposed rules recognize the existence of physical deterioration of the property. However, its method for calculating this depreciation is inadequate. First, rather than the straight line depreciation offered, an accelerated depreciation method, such as the Iowa State Curve, should be used since it would more accurately measure the greater deterioration of the property in its earlier life and the lesser amount later on.

(Rosenblatt, index #1, p. 5; Jamison, index #6, p. 4)

Furthermore, the limitation of depreciation to 80% is arbitrary and without basis in appraisal theory.

(Green, index #2a, p. 5; id., index #2b, pp. 23-24; Patterson, index #4a, pp. 13-14; Jamison, index #6, p. 4; Hunziker, index #7a, p. 5; id., index #7b, p. 2; Withers, index #9, p. 6; Dibble, index #12, p. 3; Zihal, index #15, p. 3, Ex. B, p. 2; Litman, index #16b, appendix, p. ix; Rodgers, index #18, pp. 5-6)

It is especially unfair in that long after the property has been depreciated as fully as the proposed rules will allow, under the trending methodology, it will continue to appreciate.

(Jamison, index #4, p. 5; Dibble, index #12, p. 3; Zihal, index #15, Ex. B, p. 2; Rodgers, index #18, Ex. B, p. 3)

Instead, the termination of depreciation should be followed by a similar termination of appreciation. In addition, the proposed service lives and net salvage percentages should be replaced with individual schedules per company based upon those recognized and allowed by the Public Service Commission.

(Jamison, index #6, pp. 4-5; Withers, index #9, p. 3; Dibble, index #12, p. 6; Litman, index #16b, appendix, p. x; Rodgers, index #18, Ex. B, pp. 3-4)

As with physical deterioration, the SBEA has recognized the need to allow for functional obsolescence. However, the allowance provided is restricted to the impairment of operating capacity or efficiency and to overadequacy. Not recognized is that form of functional obsolescence which arises from technical improvements in property which have significantly reduced the cost and increased the operating efficiency of that property. Various forms of property installed many years ago would never be replaced today with the same product. Plastic pipe would now be installed where iron or steel pipe had been installed and aluminum wire would be installed where copper wire had been installed. Indeed, it would be illegal to install iron pipe today. However, the proposed rules ignore this substitution of materials. Furthermore, for the allowance the SBEA does propose, it fails to provide any guidance as to what information will be required to trigger its application and how this factor will be computed.

(Rosenblatt, index #1, pp. 1-2, 5; Green, index #2b, pp. 14, 18-19; Goodman, index #3b, p. 27; Patterson, index #4a, pp. 14-17; Gentile, index #5a, p. 3; Jamison, index #6, p. 5; Hunziker, index #7a, p. 5; id., index #7b, p. 2; Dibble, index #12, pp. 1-4; Dieckelman, index #13, pp. 1-2; Zihal, index #15, Ex. B, pp. 2-3; Litman, index #16b, p. 11, appendix, p. i; Browne, index #17, p. 2; Rodgers, index #18, Ex. B, pp. 4-8; Koenig, index #22, p. 15)

Finally, the proposed rules ignore the fact that governmental regulation restricts the ability of utility property to earn income resulting in diminished value due to economic obsolescence. The SBEA's cost approach can only represent fair market value if the company is achieving the rate of return on investment allowed by the appropriate regulatory authority. An economic obsolescence factor would recognize the reduction in value inherent in a regulated environment where the achieved rate of return is consistently less than the allowed rate of return.

(Rosenblatt, index #1, pp. 1-3, 5-6; Green, index #2b, pp. 8-10, 12-13, 20-21; Goodman, index #3b, pp. 27-28; Patterson, index #4a, p. 17; Gentile, index #5a, p. 3; Hunziker, index #7a, p. 4; Withers, index #9, p. 3; Dibble, index #12, p. 2; Zihal, index #15, pp. 3, 5; Litman, index #16a, p. 3; id., index #16b, p. 11; Browne, index #17, pp. 2-3; Rodgers, index #18, pp. 6-7; Koenig, index #22, pp. 12-13)

The special franchise owners further argued that the SBEA itself has admitted that these allowances are proper and has made such allowances when performing advisory appraisals.

In 1977, the SBEA admitted in a memorandum to the Department of Audit and Control and in a Request for Proposal that it needed to make the above mentioned allowances in order to arrive at reproduction cost. It contracted with American Appraisal to provide it with a methodology for doing so. After American Appraisal completed its report, the SBEA made some, but not all, of the allowances in performing advisory appraisals. It still declined to make any of the allowances for special franchise assessments. The SBEA now acknowledges the inconsistency but proposes to resolve it by reverting to the incorrect methodology for both types of property. It should retain the present methodology for advisory appraisals, expand it by incorporating all of the allowances, and extend it to special franchise assessments.

(Rosenblatt, index #1, Ex. A; Goodman, index #3b, p. 29; id., index #3c, p. 33; Patterson, index #4a, pp. 5-10, 17; Jamison, index #6, pp. 5-6; Withers, index #9, pp. 2, 4; Zihal, index #15, exhibit A, pp. 2-3, 5, Rodgers, index #18, exhibit A, pp. 4-5)

4. Intangible Property

The proposed rules divide special franchise property into two components — tangible and intangible — and provide separate definitions and a separate valuation methodology for each. The special franchise owners maintained that the statute recognizes no such dichotomy and insisted that the SBEA has no right to assess intangible property.

As to the valuation methodology for the intangible property, under the proposed rules, the minimum value of the intangible property would be 5% of the value of the tangible property. However, when the company achieves a rate of return at least 1% higher than the so-called market required return, the resulting excess earnings would then be capitalized and, where greater than the 5% minimum, would be substituted as the intangible property value.

The five percent minimum was widely criticized as arbitrary and completely unjustified. The valuation methodology was attacked on numerous other grounds as well.

> The excess earnings methodology is completely erroneous. For example, the proposed definition of "capital structure" includes deferred income taxes, which is contrary to the generally accepted definition. Any advantage gained by a company by delaying the payment of its income taxes is reflected at every step of the appraisal process: if used to purchase new plant, it appears as increased cost; if used to maximize cash flow and minimize tax consequences, it is reflected in the amount of debt or debt rating, or stock price. Thus, to create an additional item as proposed is simply doublecounting.
>
> Also with respect to capital structure, the proposed definition provides that anytime the equity portion exceeds 70%, the excess portion will be transferred to the debt portion, and that a AAA utility bond rating will be used to value that debt. This is wrong for two reasons: first, the appraisal of the company must be based upon its actual capital structure, not an imaginary one. Additionally, valuation by AAA rated bonds is totally inappropriate. No utility has AAA rated debt; most are struggling to hold an A rating while some are down to BBB. The use of an AAA rating substantially understates the cost of the debt and results in an understated capitalization rate. This overstates the earnings achieved by the company. It would result in overvaluation of any intangible property and would also lead to overvaluation if used to estimate economic obsolescence or in an income approach.
>
> The proposed rules assume that the right to operate the tangible property always has a positive value. In fact, with the right to serve comes an obligation to serve whether economically feasible or not. The results in a negative franchise value which should be recognized in the proposed rules.
>
> The proposed rules also create a double standard. If an excess earnings formulais included then an intangible value should be adjusted downward if the company fails to achieve its allowed rate of return. The proposed rules fail to so provide. Furthermore, it is equally appropriate to

apply this business and commercial indicator to the valuation of the tangible property, for the excess earnings concept is simply one side of the income "coin", the other side being economic obsolescence.

Finally, adding a separate value for the right to operate may involve double taxation. Franchise fees are regularly paid by companies to local governments for the same right that the SBEA proposes to value and add to the assessment against which these same local governments will levy their taxes. Although RPTL, §626 authorizes the crediting of these fees against taxes paid, some governments force companies to contractually waive the deduction and these waivers have been upheld in the courts.

The references for the above discussion are: Rosenblatt, index #1, pp. 1-3, 5-6; Green, index #2b, pp. 8-11, 21-22; Goodman, index #3b, pp. 15-18; id., index #3c, pp. 26-27; Patterson, index #4a, pp. 10-11, 14-15; Gentile, index #5a, pp. 2-3; Jamison, index #6, p. 6; Hunziker, index #7a, p. 5; id., index #7b; Dibble, index #12, pp. 2, 4-5; Zihal, index #15, Ex. B-pp. 1, 3-4; Litman, index #16a, pp. 3-4; 16b, pp. 12, appendix, pp. i-ii; Browne, index #17, p. 2; Rodgers, index #18, Ex. B, pp. 1-2, 8-9; Koenig, index #22, pp. 4, 6, 15-18.

5. Unit v. Summation approaches

Where property consists of many segments it may theoretically be valued either by valuing each segment separately, the "summation" approach, or by valuing the entire property as a single entity, the "unit" approach. The special franchise owners maintained that the unit approach should be followed when assessing special franchise property.

The summation approach is inappropriate for the valuation of public utility property because it does not consider the contribution of each component to the value of the integrated whole. The value of the entire system may not equal the sum of the values of its components. The unit approach does reflect the value of the integrated system and should be used. The use of the unit approach requires the value of the unit to be allocated to the tax district in which it is located, as well as to special franchise and private property. This can be done by applying allocation factors which reflect the contribution of each component to the unit. For utility property, original cost less depreciation is the most logical allocation factor since it reflects the income generating capacity of the property.

(Goodman, index #3b, pp. 21-25 and 36, id., index #3c, pp. 11-13 and 34-36; Green, index #2b, p. 22.)

6. Reports

The utilities also raised numerous complaints about non-valuation issues. One such issue concerns the reports that would be required by Subpart 197-2 of the proposed rules. The reports were challenged on several grounds.

> The rules would require companies to provide information concerning its off-street property, central office equipment, station equipment and leased property, all of which is unrelated to its special franchise property. The State Board is overreaching its authority by requiring this information. If the State Board seeks this information for advisory appraisal purposes, it may only request it when a municipality has sought such an appraisal.

(Litman, index #16a, p. 4 and index #16b, appendix pp. iv-vi; Withers, index #9, p. 3, Gentile, index #5a, p. 4)

> The deadline of March 31 for the filing of regulatory reports is inappropriate because the report may not have been filed with the regulatory agency by that date. Some reports are not due until after March 31 and extensions are often granted by the regulatory agency. It would be more appropriate to require the reports to be filed on or after the filing with the regulatory agency.

(Litman, index #16b, appendix, p. vii; Rosenblatt, index #1, p. 3; Patterson, index #4a, p. 12)

> The requests for vintaged original cost of telephone massed property would be difficult, if not impossible to provide. The information has never been maintained in the form required by the State Board and the pertinent records no longer exist. Furthermore, the State Board has been assessing this property for decades without this information.

(Litman, index #16a, p. 4 and index #16b, appendix e, p. iii-vi; Withers, index #9, p. 3)

> The form provided by section 197-2.1(d)(1) for documenting the basis for exceptions to reported costs (EA 6-1) should be revised to provide a column for listing factors in addition to dollar amounts. There should also be instructions regarding allowable exceptions.

(Jamison, index #6, p. 2)

> The terms used in section 197-2.1 such as "Structural items," "Structures," "Equipment," "Plant" and "Cost Balances" are not defined.

(Zihal, index #15, Ex. B, p. 2; Rodgers, index #18, Ex. B, p. 2; Litman, #16b, appendix, p. iv)

Section 197-2.2(a) refers to "instruments," which is not defined. Section 197-2.2(b) is confusing as to the information required for "station apparatus".

(Rodgers, index #18, Ex. B, p. 2)

New York Telephone raised several additional complaints concerning the reports:

(1) There is no justification for additional information for New York City property, nor is a time period provided for such reports; (2) the rules appear to require reports to be submitted on computer tape, but written or printed form should also be acceptable; (3) quarterly filings of reports on structural items is unreasonable; (4) the reports should be open to inspection; (5) the enforcement procedures should be supplemented with interim procedures prior to the commencement of an adjudicatory proceeding; (6) penalties for failure to report should not be imposed automatically, especially for failure to file data which had not been required previously.

(Litman, index #16b, appendix, pp. iii-ix)

Buckeye Pipeline complained that it does not maintain the information required by section 197-2.3 broken down by tax district or by public or private right of way because FERC does not require it to do so. It urged that the section be revised to allow estimates of gross additions, surviving dollars and retirements (Rosenblatt, index #1, p. 3).

The Cable Television Association's comments concerned section 197-2.6, which relates to the reports from cable television companies.

Section 197-2.6(b) provides an exemption from the reporting requirement for cable companies with fewer than 1,000 subscribers and fewer than $100,000 in annual operating income. This exemption standard is defective for a number of reasons. First, the Executive Law exempts from regulation any cable company with fewer than 1,000 subscribers, regardless of income. Second, a cable company with 1,000 subscribers would be expected to generate $276,000 annual gross revenue. Third, the exemption fails to distinguish cable service revenues from non-cable revenues. Finally, there should be no deadline for applying for this exemption, but if there must be one, it should relate to the calendar year, rather than the fiscal year.

(Koenig, index #22, pp. 8-9)

The Cable Television Association also complained that:

> (1) The financial information sought is unrelated to special franchise assessment, and some of the information is not reported to any other agency; (2) it is not consistent to require cable systems with fewer than 50 subscribers to report while excluding Master Antenna television systems which use the public way for their wires from reporting; (3) the forms should treat cable criteria as consistently as possible; and (4) there should also be a single filing date for the reports, rather than multiple dates.

(Koenig, index #22, pp. 7, 9-11).

7. Procedures

Numerous objections were made to the procedures that the State Board would follow when establishing special franchise assessments:

> There may have been improper delegation of the State Board's responsibility to make final assessments and appears to be a lack of complete due process in the protest review mechanics.

(Gentile, index #5a, p. 4)

> Section 197-4.3, which provides for rescission of tentative special franchise assessments, erroneously provides for rescission where a complaint has not been filed. Further, the SBEA should correct any error whenever discovered, whether or not a complaint has been filed.

(Litman, index #16b, appendix, pp. ix-x.)

> The provision should also be expanded to authorize rescission where the tentative assessment had been calculated in anticipation of a revaluation but the level of assessment following the revaluation is not what had been anticipated.

(Dibble, index #12, p. 5)

> Sections 197-4.6 and 197-4.7 provide that special equalization rates shall be used "if it shall be made to appear" that there has been a change in level of assessment of 2% or more. It is not clear what the quoted language means or what authority there is to use 2% as the criteria.

(Zihal, index #15, Ex. B, p. 4; Rodgers, index #18, Ex. B, p. 9)

Section 197-5.1(b) appears to presume that special franchise property is always assessable in one or more special districts. This is not so in certain types of districts, and so the provision should be modified.

(Dibble, index #12, pp. 5-6)

Section 197-5.1(c), which requires the assessor to notify the County Director of the method of apportionment of special franchise, is redundant and unnecessary since the property must be assessed according to its location and condition.

(id., p. 6)

The special franchise owners should have the opportunity to review and comment upon the reports of the hearing officer and the Director of the Bureau of Industrial and Utility Valuation presented to the Deputy Executive Director.

(Litman, index #16b, appendix, p. x)

An SBEA officer or employee who receives reports and comments should not be able to make the determination of an assessment.

(id.)

8. Definitions

Numerous comments were made relative to the definitions set forth in Subpart 197-1 of the proposed rules. One common criticism was that the definition of special franchise property should repeat the statutory definition verbatim. Another was that the definition of "functional obsolescence" should be expanded and a definition for "economic obsolescence" added in accordance with the arguments made relative to allowances. "Capital structure" was criticized as noted under the discussion of intangible property. Some definitions were criticized on technical grounds and others were said to be unclear.

The comments on the definitions are found in the following references: Rosenblatt, index #1, pp. 1-3; Green, index #2a, pp. 3-4 and index #2b, pp. 8-13; Patterson, index #4a, pp. 10-11; Jamison, index #6, p. 2; Dibble, index #12, pp. 1-2; Zihal, index #15, Ex. B, p. 1; Litman, index #16b, appendix, pp. i-iii; Browne, index #17, pp. 1-2; Rodgers, index #18, pp. 1-2; Koenig, index #22, pp. 5-6.

9. Environmental impact

Brooklyn Union Gas maintained that the State Board is required to comply with the State Environmental Quality Review Act before it may adopt these rules.

> The overassessment that will result from the implementation of these rules willlead to increased costs of gas to consumers. The marketing of natural gas is price sensitive and so the competitive position of gas in the marketplace will be impaired. This will lead to a decrease in the use of gas and an increase in the use of less environmentally preferred sources such as oil and coal. This would in turn adversely impact the air quality, the use ofnatural resources and the economy. The SBEA is therefore required to conduct a review of the impact of these rules upon the environment pursuant to the State Environmental Quality Review Act at the earliest possible time.

(Gentile, index #3a, pp. 1, 3-4; id., index #5b, all)

C. POSITION OF MUNICIPALITIES

The City of New York submitted an extensive commentary on the proposed rules and several other municipal representatives submitted comments relating specifically to the valuation issues. Some other representatives expressly adopted the City's statement (Whiteman, index #19, p. 2; Fink, index #20, p. 1; Smith, index #21, p. 1). The municipal position which emerges is set forth herein.

I. The Cost approach is proper

The municipalities maintained that reproduction cost is the only appropriate method for valuing special franchise property.

> The cost approach is the only sound method available, avoiding as it does thesevere problems of attribution, allocation and unevenness over time associated with the cost and earnings based methodologies propounded by the utilities. Bearing in mind that the responsibility of the SBEA is to value property for tax purposes and not for setting utility rates or measuring rates of return on investments, values calculatedaccording to the income approach may vary widely from year to year with profit fluctuations. Profitability results more from external forces such as fuel costs or managerial prowess than from changes in property values. From the perspectives of tax equity and effective government, permitting assessments to vary on the basis of these externalities would be unsound.
>
> Specifically, the case law of this State supports the following: (1) special franchise property is specialty property which is best valued by the reproduction cost less depreciation method; and (2) the separate valuation of the intangible portion either by a capitalization of earnings method or an add-on of 5% of the value of the tangible property.
>
> Concerning the applicablilty of the income approach, the earnings to be capitalized are not those from the business, but those directly attributable to the property. Accordingly, real property income is expressed in terms of rentals. Since tangible special franchise property is not generally rented, the income approach is inapplicable. To capitalize corporate earnings is to value the business, not its real property.

The references for the above discussion are: Schwarzer, index #8b, pp. 23-25; Seldin, index #10, p. 2; MacArthur, index #11, pp. 25-26, 28-29; Havemeyer, index #14, pp. 2, 4; Whiteman, index #19, p. 2; Fink, index #20, p. 3; Smith, index #21, p. 2.

2. The SBEA methodology allows too much depreciation

The municipal commentators did not agree with the SBEA's allowance for physical deterioration, arguing that the service lives are too short and would allow special franchise property to be depreciated too quickly.

> The proposed rules would measure depreciation by resorting to accounting techniques which, while arguably relevant for income tax purposes and financial statements, are wholly unrelated to the physical condition of the property. This disparity is easily disclosed. The SBEA offers a 50 year service life for a gas main. However, if the pipe is wrapped and cathodically protected, it could have an almost infinite physical life. Furthermore, unprotected cast iron pipes over 75 years old have been reported in good to excellent condition. Thus, to depreciate property virtually to zero while it remains in useful service does not comport with reality and should be rejected. Similarly eliminated should be the notion that property depreciates 20% immediately upon installation.

(Schwarzer, index #8a, p. 1; Seldin, index #10, pp. 2-3; MacArthur, index #11, pp. 14-16; Havemeyer, index #14, p. 3; Whiteman, index #19, p. 3; Fink, index #20, p. 4; Smith, index #21, pp. 1-2)

3. The allowances demanded are unjustified

The municipalities maintained that there is no support for the allowances demanded by the special franchise owners.

> The decision by the SBEA not to provide cost modifications for construction inefficiencies is entirely sound. The concept itself is speculative and is more than offset by the increased cost of financing unitary, rather than piecemeal, construction; and the cost of having this system off-line until completion, viz, lack of revenue.

(Seldin, index #10, p. 3; MacArthur, index #11, p. 26; Havemeyer, index #14, p.3)

> The industry contends that functional obsolescence automatically arises upon the availability of newer materials even where older property performs just as well. At best, the determination of functional obsolescence, as so defined, can only be made by comparing the cost of the new technology with the inherent savings using the existing facilities. At worst, their notion is a perversion of the term. However, the SBEA's failure to provide any methodology whatsoever is a serious shortcoming.

(MacArthur, index #11, p. 26; Fink, index #20, p. 5)

> An allowance for economic obsolescence suffers from much of the same failings as the income approach, as both are based upon the earnings of the company. Thus, if the SBEA were charged with valuing the regulated business of providing electricity or natural gas, then perhaps this cost modifier should be allowed.

(Havemeyer, index #14, p. 4; but see, MacArthur, index #11, p. 26)

> However, the RPTL requires the valuation of real property, not the management skill of its owners. As with the income approach, an economic obsolescence factor would result in different values for the same kind of property, depending upon who owned it.

(Seldin, index #10, p. 2)

4. Unit v. Summation approach

The municipalities disputed the propriety of the unit approach, asserting that the summation approach must be used.

> The unit approach is not recognized by the courts of New York State and is not appropriate for valuing public utility property for ad valorem tax purposes. New York is not a central assessing state. The subject of assessment is the property within the assessing unit. An average of the entire system would not necessarily be representative of the property within the assessing unit. The Tenneco pipeline, for example, runs through solid rock, under highways, under rivers and over mountains, but in the Town of Cazenovia, it runs only through level farmland. In any event, allocation by original cost less depreciation has been discarded by the courts because it has nothing to do with value.

(MacArthur, index #11, p. 27; Havemeyer, index #14, pp. 2-3)

5. Intangible property

The municipalities maintained that the law clearly establishes that there is an intangible value of special franchise property, that it is subject to assessment by the State Board, and that the 5% floor on the intangible property is supported by law. However, they found no support for the 1% threshold in the calculation of excess earnings (MacArthur, index #11, pp. 26 and 28).

6. Treatment of off-street property

The municipalities interpreted the proposed amendment to the SBEA's rules on State advisory appraisals to require the cost approach to be used to value all taxable utility property located in the private way. That is, ordinary office buildings, garages, etc., as well as lines, pipes and mains would all be valued by the cost approach. They urged that non-specialty off-street property be valued by the method appropriate to the particular property (MacArthur, index #11, pp. 1-2; Whiteman, index #19, p. 2).

The issue of intangible property in the context of off-street property provides a split of opinion among the municipalities. On the one hand, it is suggested that there is no basis for an intangible component in the value of off-street property since no right to occupy the public way is involved (Whiteman, index #19, pp. 2-3). However, the view was expressed that while occupation of the public way is not involved, laying pipe or stringing telephone lines through or across private land does require obtaining private rights of way and these easements can represent up to 90% of the acquisition's fee value. Accordingly, the argument continues, these rights of way should be valued by the market approach to either sales of rights of way in the same geographical area if possible, or by sales of property since the companies do in fact own a significant portion of the bundle of rights of ownership (Havemeyer, index #14, pp. 4-5).

7. Procedures

Several comments were made regarding the procedures to be followed under the proposed rules.

> The practice of valuing property as of the survey valuation date has this year resulted in a four-and-one-half year lag from the taxable status date. Property installed after 1978 is reverse trended but not depreciated, which causes a very large disparity between actual and theoretical value. If this lag is used, it should be limited to one or two years and data for the last year should include the actual cost of new facilities.

(MacArthur, index #11, p. 12; Fink, index #20, p. 5)

> The procedure for assessing base property where there has been no revaluation is incorrect. The rules provide that the value of the 1953 property is its 1953 value, but RPTL, §606 and the Brooklyn Union Gas decision require that the 1953 assessment be continued as long as it does not exceed the current replacement cost less depreciation of the surviving tangible and intangible property.

(MacArthur, index #11, pp. 2-3, 13 and 17; see also, Whiteman, index #19, p. 4)

Section 197-4.4, which relates to complaints, is unclear as to what objections must be specified and the time periods are rather short. Otherwise, its provisions are acceptable. Section 197-4.7 should be amended by adding the phrase "and reestablishment" to clarify that rescission alone is not sufficient.

(MacArthur, index #11, p. 17)

8. Reports

With respect to the reports required by Subpart 197-2, it was argued that the municipalities should be able to participate in the determination of cost modifiers and that they should have access to the reports filed by the special franchise owners with the State Board. It was also suggested that the reference to particular employees of the Division may be improper delegation (MacArthur, index #11, p. 10-11).

9. Definitions

The City of New York provided an exhaustive critique of the definitions set forth in proposed Subpart 197-1. Many of the definitions, including the definition of tangible, intangible and special franchise property, were criticized as inconsistent with their statutory counterparts. Valuation terms, particularly those relating to depreciation, were criticized in accordance with the City's position on the valuation issues. Other definitions were criticized as incomplete, unclear, or technically inadequate. The industry's position on the definitions was disputed as well (MacArthur, index #11, pp. 2-10, 27).

D. CONCLUSION

Your hearing officers hope that this report will assist the Board in making its determination on the proposed rules.

Memorandum

STATE OF NEW YORK
EXECUTIVE DEPARTMENT
DIVISION OF EQUALIZATION AND ASSESSMENT

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