

Minnesota Attorney General: Administrative Rules Proceedings

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Version 3
August 20, 2018

MINNESOTA STATE REGULATIONS

Notice of filing by the Commissioner of Administration

We have received on this date, stamped and filed 2 copies of Rules and Regulations pertaining to the Department of Revenue (Agency or Board)

Regulation No. Chapter One

Subject: ad Valorem Tax regulations Valuation and assessment of Electric Gas Distributor and pipeline Companies (Utility companies)

Department of Administration
Publication, Central Services Division
Documents Section
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St. Paul, Minnesota 55155
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FILED
RICHARD L. BRUBACHER
Commissioner of Administration

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BY Edna Klundenmann R.S.
AUTH. SIGNATURE

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ADMIN. 1000

STATE OF MINNESOTA

DEPARTMENT of Revenue

Office Memorandum

TO : MICHAEL B. MILLER
Department of Administration

DATE: Dec. 8, 1975

FROM : ARTHUR C. ROEMER
Commissioner of Revenue

SUBJECT:

I was greatly disappointed at your striking of the TaxAdVal 3, Clause (g) and (h). As I expressed to you at the time of the meeting, I was also very disappointed at the time it took to consider these regulations. I am advised that we did explain to you the necessity of prompt action on the regulations. Despite this, you took over six weeks to act. You avoided the twenty (20) day period stated in the statute allowing the Attorney General to act on a technicality. The delay has resulted in a statewide problem in completing the 1975 assessment.

In holding TaxAdVal 3(g) invalid, you have apparently chosen to ignore our justification. I, as well as members of our staff who were present at the meeting with you, felt that the decision had already been made and nothing that we presented would matter. I strongly feel that in the case of integrated companies the differing economic characteristics result in substantial additional profit and that under our classification statute treating them as a separate class is valid. It was not denied from Briggs and Morgan, who represented Northern States Power, that using the higher rate of capitalizing income was justified. Yet, you held invalid the entire method. We are not dealing with money to be collected by the State of Minnesota. It results in a reduction of property taxes that Northern States Power and other integrated companies will be paying to St. Paul, Ramsey County or the other areas in which they operate; and will result in a shift of tax obligation to the homeowners and local businesses who will be forced to pay a higher property tax.

In 1974, the market value on Northern States Power property in Ramsey County was $43,790,000, which as a result of your ruling will be reduced to $40,025,000. This action denies us the opportunity to have the validity litigated in any court action. In the case of at least one of the other two integrated companies, our staff indicated that records were not kept on each separate operation. This action leaves us with a real dilemma since this integrated company cannot furnish the information to compute values of the separate portions.

You have chosen to hold invalid TaxAdVal 3, Clause (h). This was not discussed at the time of the hearing and no serious objection was raised to me concerning this proposed regulation. It was intended to permit the Commissioner to determine a fair and realistic valuation

of the property of those companies that do not fit into regular categories of cooperatives or invester owned companies. Since some of these companies have no net income (such as the wholly owned Standard Oil Pipeline) or report a loss (such as Blandin Paper Company's electrical service to a portion of Grand Rapids occupied by its offices), the use of our regular formula in some instances would practically exempt the property from taxation. The 1974 valuation of Standard Oil Pipeline was $4,694,488. I will not permit this property to be valued at a very low valuation merely because you feel our sentence was vague. I cannot acquiesce in the use of the regular formula on hybrid cases or in cases where income can be controlled (such as a wholly owned subsidiary). Despite your action, we intend to place a realistic value on these properties and I will discuss with Warren Spannaus some method of handling any court challenge that may arise by hiring a mutually acceptable counsel if he will not represent this Department.

It is the taxing districts that stand to lose the taxes which the local citizens and businesses will have to pay. I cannot permit this to happen without a fight.

A regulation of this type is not unusual in tax matters because no formula can be adopted to apply to all existing or future circumstances. For example, I refer you to Income Tax Regulation 2018(1) where the Commissioner of Revenue is authorized to employ any other formula that properly reflects income assignable to Minnesota where the statutory formula does not do so. Any such formula can be litigated if the taxpayer feels it to be unjust.

You apparently struck Regulation 3(h) not on any legal basis but simply on the question of vagueness. I submit there is no way we can spell out a formula in a regulation that will meet all of the circumstances that might arise concerning hybrid companies. You have acted in a very complex field, which is the valuation of utility property. I submit that, despite the time that you took in acting upon the regulations, you have utterly failed to conduct a proper analysis of the situation and have cost the homeowners of this state hundreds of thousands of dollars and have created chaos in our administration this year without affording the citizens or the Department an opportunity to litigate the matter in court.

ACR:kjz

cc: Warren Spannaus
John Haynes

DEPARTMENT OF REVENUE

AD VALOREM TAX REGULATIONS

CHAPTER ONE: VALUATION AND ASSESSMENT OF ELECTRIC, GAS DISTRIBUTION, AND PIPELINE COMPANIES (UTILITY COMPANIES)

TaxAdVal 1 INTRODUCTION. On October 19, 1973, the Minnesota Supreme Court in Independent School District No. 99, et al. v. Commissioner of Taxation, 297 Minn. 378, ruled that in estimating the market value of utility properties for ad valorem tax purposes, the assessing authorities must consider every element and factor affecting market value. The assessment formula used to value operating utility property since 1962, based solely on the original cost less limited depreciation and commonly known as the "Hatfield Formula," was thus invalidated as a rule of general application.

These regulations are promulgated to fill that void and reflects the manner in which the value of utility property will be estimated by utilizing data relating to the cost of the property and the earnings of the company owning or utilizing the property.

Since the Commissioner of Revenue is by statute the assessor of some of the utility property in the State of Minnesota and has supervisory powers of all assessments of property, and may raise or lower values pursuant to Minnesota Statutes, Section 270.11, he will estimate the valuation of the entire system of a utility company operating within the state. The entire system will be valued as a unit instead of valuing the component parts and the

resulting valuation will be "allocated" or assigned to each state in which the utility company operates. Finally, by the process of apportionment, the portion allocated to Minnesota will be distributed to the various taxing districts within the state. All data used in the valuation, allocation, and apportionment process will be drawn from reports submitted to the Department of Revenue by the utility companies. These reports will include Minnesota Department of Revenue Annual Utility Reports (UTL Forms), Annual Reports to the Federal Power Commission and Annual Reports to the Interstate Commerce Commission. Periodic examinations of the supporting data for these reports will be made by the Department of Revenue.

The methods, procedures, indicators of value, capitalization rates, weighting percents, and allocation factors will be used as described in TaxAdVal 3 through 7 for 1975 and subsequent years, or until, in the opinion of the Commissioner of Revenue, different conditions justify a change.

As in all property valuations the Commissioner of Revenue reserves the right to exercise his judgment whenever the circumstances of a valuation estimate dictate the need for it.

TaxAdVal 2 DEFINITIONS: As used in this chapter, the following words, terms and phrases shall have the meanings given to them by this regulation, except where the context clearly indicates a different meaning.

Allocation - the process of dividing the unit value of a utility company among the states in which the utility operates.

Apportionment - the process of distributing that portion of the utility company's unit value which has been allocated to Minnesota to the various taxing districts in which the utility company operates.

Book depreciation - the depreciation shown by a utility company on its corporate books, and allowed the company by various regulatory agencies.

Capitalization rate - the relationship of income to capital investment or value, expressed as a percentage.

Electric company - any company engaged in the generation, transmission or distribution of electric power, excluding cooperatives and municipal corporations.

Gas distribution company - any company engaged in the distribution of natural or synthetic gas excluding cooperatives and municipal corporations.

Installed capacity - the number of kilowatts a power plant is capable of producing as shown by the nameplates affixed to the generators by the manufacturer.

Integrated company - any company engaged in two or more utility operations within Minnesota, such as electric distribution and gas distribution, within the framework of one corporate structure.

Major generating plant - any steam electric power plant capable of generating 25,000 KW (kilowatts) or more; or any

hydroelectric, internal combustion, or gas turbine power plant capable of generating 10,000 KW or more.

Net operating earnings - earnings from system plant of the utility after the deduction of operating expenses, depreciation, and taxes but before any deduction for interest.

Non-formula assessed property - property of a utility which is valued by the local or county assessor rather than by the Commissioner of Revenue.

Operating property - any property, owned or leased, except land that is directly associated with the generation, transmission, or distribution of electricity, natural gas, gasoline, petroleum products, or crude oil. Examples of operating property include, but are not limited to substations, transmission and distribution lines, generating plants, and pipelines. Land, garages, warehouses, office buildings, pole yards, radio communication towers, and parking lots are examples of non-operating property.

Pipeline company - any company engaged in the transmission of natural gas, gasoline, petroleum products or crude oil via a fixed line of pipes.

System plant - the total tangible property, real and personal, of a company which is used in its utility operations in all states in which it operates.

Unit value - the value of the system plant of a utility company taken as a whole without any regard to the value of its component parts.

Weighted pipe line miles - the product obtained by multiplying the number of miles of each size of a pipeline by the diameter in inches of each size.

Example: a 6 mile pipeline having 3 miles with a 10 inch diameter and 3 miles with a 30 inch diameter would have a weighted miles product of 120.

TaxAdVal 3 VALUATION. (a) GENERAL. Because of the unique character of public utility companies, such as being subject to stringent government regulation over operations and earnings, the traditional approaches to valuation estimates of property (cost, capitalized income and market) must be modified when utility property is valued. Consequently, for the 1975 and subsequent assessment years, until economic and technological factors dictate a change, the value of utility company property will be estimated in the manner provided in this chapter.

(b) MARKET APPROACH. Market value implies a price for which an entire public utility enterprise might reasonably change hands between willing and informed buyers and sellers. The term presupposes a market of normal activity, no urgency to buy or sell on the part of either buyer or seller, and continued operation of the utility as a single entity. Public utility property is seldom transferred as a whole unit under these circumstances. Consequently, after consideration of this approach, it has been decided that valuation of utility properties by this approach is speculative and unrealiable and will not be employed as a method of valuation for utility property at this time.

(c) COST APPROACH. The cost factor that will be considered in the utility valuation formula is the original cost less depreciation

of the system plant, and improvements, plus the original cost of construction work in progress on the assessment date. Depreciation will be allowed as a deduction from cost in the amount allowed on the accounting records of the utility company, as such records are required to be maintained by the appropriate regulatory agency. Depreciation, however, shall not exceed the prescribed percentage of cost: for electric companies, 15 percent; for gas distribution companies, 45 percent; pipeline companies, 45 percent.

When valuing electric company property the "average cost per kilowatt of installed capacity" will also be considered. Any excess of average cost per kilowatt of installed capacity over the actual cost of production plant (except land) multiplied by the kilowatts of installed capacity will be added to the original cost of the plant, and reduced by the same rate of depreciation applicable to the original cost. The average cost per kilowatt of installed capacity is computed by averaging the construction costs of production plant (except land) for major generating plants in the Continental U.S. for the five most recent years available, by type of plant, as shown in the latest issues of the Federal Power Commission publications, Hydroelectric Plant Construction Cost and Annual Production Expenses and Steam-Electric Plant Construction Cost and Annual Production Expenses and Gas Turbine Electric Plant Construction Cost and Annual Production Expenses. Average cost per kilowatt of installed capacity will be determined after excluding, (a) federally constructed, multi-purpose projects, and (b) nuclear electric generating plants.

The following examples illustrate this procedure. In both examples assume that the five year study of the most recent construction data available from Federal Power Commission publications indicates that the average cost per kilowatt of installed capacity in a fossil fuel steam plant is $150 per kilowatt. Each of the two plants is of this type.

1.	Plant	#1	#2
2.	Installed capacity	100,000 KW	50,000 KW
3.	Year in Service	1960	1940
4.	Cost of Plant	$15,200,000	$3,500,000
5.	Cost per KW	$152	$70
6.	Average cost per KW	$150	$150
7.	Excess (line 6 - 5)	--	$80
8.	Additional value (line 7 x 2)	--	$4,000,000

The cost indicator of value computed in accordance with this regulation will be weighted for each class of utility company as follows: electric companies, 85 percent; gas distribution companies, 75 percent; pipeline companies, 75 percent.

(d) INCOME APPROACH TO VALUATION. The income indicator of value will be estimated by averaging the net operating earnings of the utility company for the most recent three years. After considering, as far as possible, all conditions that may exist in the future that may affect the present annual return, including risk, life expectancy of the property, and cost of money, the capitalization rates used to compute value for the 1975 assessment will be: electric companies, 7.75 percent; gas distribution companies, 8 percent; pipeline companies, 8.25 percent. The

income indicator of value computed in accordance with this regulation will be weighted for each class of utility company as follows: electric companies, 15 percent; gas distribution companies, 25 percent; pipeline companies, 25 percent.

(e) UNIT VALUE COMPUTATION. The unit value of the utility company will be the total of the weighted indicators of value.

The following is an example of the computation of the unit value:

Cost indicator of value	$5,000,000 x	75% =	$3,750,000
Income indicator of value	$4,800,000 x	25% =	$1,200,000
Unit Value of Pipeline Company		100%	$4,950,000

(f) VALUATION OF UTILITY PROPERTY OF COOPERATIVES. Cooperative associations shall have their utility property valued on the basis of historical cost only since they do not operate on the traditional profit-making basis. Depreciation will be allowed as a deduction from cost at increments of 2.5 percent per year but the maximum shall not exceed 25 percent for property used in the generation, transmission or distribution of electric power.

TaxAdVal 4 ALLOCATION. (a) GENERAL. After the unit value of the utility property has been estimated, the portion of value which is attributable to Minnesota must be determined. This process of dividing the unit value of a utility company among the states in which the utility operates is called allocation. Each of the factors in the allocation formula is assigned a weighted percentage to denote the relative importance assigned to that factor. The resulting sum of the weighted factors multiplied by the unit value yields the valuation of the utility property which will, after the adjustments described in TaxAdVal 5, be subject to ad valorem tax in the State of Minnesota.

The factors to be considered in making allocations of unit value to Minnesota for the utility companies and the weight assigned to each factor for each class are specified in this regulation.

(b) ELECTRIC COMPANIES. The original cost of the utility property located in Minnesota divided by the total original cost of the property in all states of operation is weighted at 90 percent. Gross revenue derived from operations in Minnesota divided by gross operations revenue from all states is weighted at 10 percent.

The following example illustrates this formula, assuming a unit value of $20,000,000.

Example 1.

Minnesota plant cost / System plant cost	($115,000,000) / ($205,000,000)	x .90	=	50.49%
Minnesota gross revenue / Systems gross revenue	($ 40,000,000) / ($105,000,000)	x .10	=	3.8%
Total percentage allocable to Minnesota				54.29%
Unit value of system plant				$ 20,000,000
Amount of value allocable to Minnesota				$ 10,858,000

(c) GAS DISTRIBUTION COMPANIES. The allocation of value of gas distribution companies shall be made considering the same factors as are used to determine the allocation of value of electric companies. The weight given to the original cost factor will be 75 percent, and gross revenue shall be weighted 25 percent.

(d) PIPELINE COMPANIES. In addition to the cost factor and the gross revenue factor, the factor of weighted pipe line miles shall be considered in allocating the value of pipeline companies. Weighted pipe line miles means the number of miles of pipeline multiplied by the diameter of the pipe, measured in inches. To illustrate, a pipeline line 6 miles long has 3 miles of pipe with a diameter of 10 inches and 3 miles of pipe with a diameter of 30 inches. The weighted pipe line miles is 120.

3 miles x 10" diameter	=	30
3 miles x 30" diameter	=	90
Weighted pipe line miles		120

The following example illustrates the allocation of value of property of a pipeline company and the weights given to each factor.

Example 2.

Minnesota plant cost / System plant cost	($13,500,000) / ($39,300,000)	x .75	=	25.76%
Minnesota gross revenue / System gross revenue	($2,980,000) / ($9,300,000)	x .05	=	1.60%
Minnesota weighted pipe line miles / System weighted pipe line miles	($ 9,500) / ($27,100)	x .20	=	7.01%
Total percentage allocable to Minnesota				34.37%

TaxAdVal 5 ADJUSTMENTS FOR NON-FORMULA ASSESSED OR EXEMPT PROPERTY. After the Minnesota portion of the unit value of the utility

company is determined, any property which is non-formula assessed or which is exempt from ad valorem tax, will be deducted from the Minnesota portion of the unit value. Only that qualifying property located within the State of Minnesota may be excluded.

The following properties will be valued by the local or county assessor and, therefore, the formula provided herein for the valuation of utility property will not be applicable for such property.

1. Land
2. Non-operating property
3. Rights of way

The Minnesota portion of the unit value will be reduced by the original cost of these items except that in the case of non-operating property, the deduction shall be original cost, less the rate of depreciation applicable in the valuation process pursuant to TaxAdVal 3.

A deduction from the Minnesota portion of the unit value shall also be made for property, real or personal, which is exempt from ad valorem tax. For instance, pollution control equipment for which an exemption has been granted is exempt. A deduction from the Minnesota portion of the unit value shall be made at original cost, less the applicable rate of depreciation used in the valuation process pursuant to TaxAdVal 3. The value of personal property, such as office machinery and vehicles, which is not taxed, shall also be excluded from the Minnesota portion of the unit value. The deduction shall be at original cost less the applicable rate of depreciation utilized in the valuation process.

The utility company shall have the burden of proof to establish that the value of any property should be excluded from the Minnesota portion of the unit value. Accordingly, the utility company shall have the responsibility to submit in the form required by the Commissioner of Revenue, such schedules of exempt or non-formula assessed property as he may require.

TaxAdVal 6 APPORTIONMENT. After the unit valuation of the utility company has been allocated to the State of Minnesota and has been adjusted pursuant to TaxAdVal 5, the determined amount shall be apportioned or distributed to the taxing districts in Minnesota in which the company operates. This apportionment will be made by the Commissioner of Revenue on the basis of information submitted by the utility companies in annual reports filed with the Commissioner.

The following information must be submitted for each taxing district:

1. The market value of the company's operating property by classification, as reflected in the last assessment, including the cost of leased taxable property.

2. The original cost of any new additions since the last assessment, including work in progress on the assessment date.

3. The market value of any retirements made after the last assessment, as reflected in that assessment.

The last market value of each company's operating utility property in each taxing district, plus original cost of new construction, reduced by last market value of property retired

since the last assessment, shall be divided by its total market value in Minnesota. For this purpose, the last market value and the last assessment shall mean the latest assessment immediately prior to the current assessment. The portion of unit value to be assigned to each taxing district will be the resulting percentage multiplied by the Minnesota portion of unit value, as adjusted pursuant to TaxAdVal 5.

If the market value of any parcel of property assessed pursuant to this chapter is increased, the increase entered on the assessment books shall be subject to the limitation provided in Minnesota Statutes, Section 273.11, Subdivision 2. The amount of decrease in market value of such property, exclusive of property retired or destroyed since the last assessment, shall not exceed ten percent of the value in the preceding assessment.

TaxAdVal 7 COMPREHENSIVE EXAMPLE. An illustration of the methods and procedures described in TaxAdVal 3, 4, 5 and 6 is as follows:

Example 1. COMPUTATION OF UNIT VALUATION OF AN ELECTRIC COMPANY.

		Amount	Reference
1.	Utility Plant (Cost)	$200,000,000	F.P.C. Report
2.	Construction in Progress	5,000,000	F.P.C. Report
3.	Additional Value From Average Cost per K.W. Computation	4,000,000	Example 2, Line 8
4.	Total Plant	209,000,000	1 + 2 + 3
5.	Non-Depreciable Plant (Land, Intangibles, Etc.)	15,000,000	F.P.C. Report
6.	Depreciable Plant	194,000,000	4 - 5
7.	Depreciation (Maximum 15%)	29,100,000	6 x 15%
8.	Total Depreciated Plant Plus Non-Depreciable Plant	179,900,000	4 - 7

		Reference	1971	1972	1973
9.	Net Operating Income	F.P.C. Report	8,000,000	8,500,000	9,000,000
10.	Capitalized Income @ 7.75%		103,225,806	109,677,419	116,129,032
11.	3 Year Total Capitalized Income			329,032,257	
12.	3 Year Average Capitalized Income (line 11 ÷ 3			109,677,419	

13.	Total Depreciated Plant	179,900,000	Weighted @ 85%	152,915,000
14.	3 Year Average Capitalized Income	109,677,417	Weighted @ 15%	16,451,613
15.	Market		Weighted @ 0%	---
16.	Unit Value			169,366,613

Example 2. COMPUTATION OF AVERAGE COST PER KILOWATT OF INSTALLED CAPACITY.

ASSUME THAT A 5 YEAR STUDY OF MOST RECENT CONSTRUCTION DATA AVAILABLE FROM THE F.P.C. SHOWS THAT THE AVERAGE COST PER KILOWATT OF INSTALLED CAPACITY IN A FOSSIL FUEL STEAM PLANT IS $150.00 PER KILOWATT.

1.	Plant	#1	#2
2.	Installed Capacity	100,000 K.W.	50,000 K.W.
3.	Date in Service	1960	1940
4.	Cost of Plant	$15,200,000	$3,500,000
5.	Cost Per K.W.	$152.00	$ 70.00
6.	Average Cost Per K.W.	$150.00	$150.00
7.	Difference (if any)	---	$ 80.00
8.	Additional Value	---	$4,000,000

Example 3. ALLOCATION OF UNIT VALUATION OF ELECTRIC COMPANY TO MINNESOTA.

		Amount	Reference
1.	Utility Plant System	$200,000,000	F.P.C. Report
2.	Construction Work in Progress	5,000,000	F.P.C. Report
3.	Total Utility Plant System	205,000,000	1 + 2
4.	Utility Plant Minnesota	110,000,000	UTL Report
5.	Construction Work in Progress Minnesota	5,000,000	UTL Report
6.	Total Utility Plant Minnesota	115,000,000	4 + 5
7.	Minnesota Plant to System Plant	56.10%	6 ÷ 3
8.	Weighting Factor	90%	
9.	Minnesota Weighted % Original Cost	50.49%	7 x 8
10.	Gross Revenue System	105,000,000	F.P.C. Report
11.	Gross Revenue Minnesota	40,000,000	UTL Report
12.	Minnesota Revenue to System Revenue	38.10%	11 ÷ 10
13.	Weighting Factor	10%	
14.	Minnesota Weighted % Revenue	3.81%	12 x 13
15.	Total Minnesota Percent	54.30%	9 + 14
16.	Unit Value	169,366,613	Example 1, line 16
17.	Minnesota Portion of Unit Value	$ 91,966,071	15 x 16

Example 4. COMPUTATION OF APPORTIONABLE VALUE OF UTILITY COMPANY.

			Amount	Reference
1.	Minnesota Portion of Unit Value		91,966,071	Example 3, line 17
2.	Excludable Items:			
	a. Land Assessed Locally		3,000,000	UTL Report
	b. Land Rights		---	
	c. General Plant Items	10,000,000		UTL Report
	d. Pollution Control Equipment	10,000,000		UTL Report
	e. Less Depreciation @ 15%	3,000,000		(c + d) x 15%
	f. Net General Plant & Pollution Control Items		17,000,000	(c + d) - e
	g. Total Excludable Items		20,000,000	a + f
3.	Minnesota Apportionable Value		71,966,071	1 - 2g

Example 5. APPORTIONMENT TO LOCAL TAXING DISTRICTS OF MINNESOTA PORTION OF UNIT VALUE AFTER ADJUSTMENTS.

ASSUME: TAX DISTRICTS 1 AND 2 HAVE POWER PLANTS AND DISTRIBUTION LINES.
TAX DISTRICTS 3 AND 4 HAVE DISTRIBUTION LINES ONLY.
MINNESOTA PORTION OF UNIT VALUE AFTER ADJUSTMENTS = $71,966,071.

TAX DISTRICT	1	2	3	4	Total
1. Last Market Value:					
a. Structures	$ 5,000,000	$10,000,000			$15,000,000
b. Machinery	10,000,000	20,000,000			30,000,000
c. Personal Property	1,000,000	3,000,000	$ 6,000,000	$ 5,000,000	15,000,000
d. Total	$16,000,000	$33,000,000	$ 6,000,000	$ 5,000,000	$60,000,000
2. Additions Including Construction in Progress at Original Cost			3,000,000	3,000,000	6,000,000
3. Retirements at Last Market Value (Machinery)		(1,000,000)			(1,000,000)
4. Additional Value Due to Average Cost per Kilowatt Computation ($4,000,000 Less 15% Depreciation Allowance)	3,400,000				3,400,000
5. Updated District Total	$19,400,000	$32,000,000	$ 9,000,000	$ 8,000,000	$68,400,000
6. Percent of Total (Line 5 by Tax District ÷ Line 5 Total)	28.36%	46.78%	13.16%	11.70%	100.0%
7. Portion of Minnesota Adjusted Unit Value (Line 6 x $71,966,071)	$20,409,578	$33,665,728	$ 9,470,735	$ 8,420,030	$71,966,071
8. New Market Value*					
a. Structures	$ 6,451,468	$10,520,540			$16,972,008
b. Machinery	12,904,976	19,990,709			32,895,685
c. Personal Property	1,053,134	3,154,479	9,470,735	8,420,030	22,098,378
d. Total	$20,409,578	$33,665,728	$ 9,470,735	$ 8,420,030	$71,966,071

*Computed by finding percentage of 1a, 1b, 1c plus any additions and minus any retirements in 2, 3, 4 ÷ line 5. This percentage x line 7 equals new market value by classification. Example: District 2, line 1b ($20,000,000) minus line 3 ($1,000,000) = $19,000,000 ÷ line 5 ($32,000,000)= 59.38% x line 7 ($33,665,728) = $19,990,709.

APPROVED AS TO FORM AND LEGALITY

DEC 1 1 1975 19

WARREN SPANNAUS, ATTORNEY GENERAL

BY /s/ Michael B. Miller

SPECIAL ASSISTANT ATTORNEY GENERAL

STATE OF MINNESOTA
DEPARTMENT OF STATE
FILED
DEC 1 1 1975 - 2:36 pm

Joan Anderson Growe
Secretary of State

FILED
RICHARD L. BRUBACHER
Commissioner of Administration

DEC 11 1975

BY Edie Stauderman
AUTH. SIGNATURE 3:40 PM.

LAW OFFICE

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PROFESSIONAL ASSOCIATION

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December 2, 1975

Mr. Michael Miller
Special Assistant Attorney General
State Capitol
Saint Paul, Minnesota 55155

Re: Department of Revenue Proposed Rules
for Ad Valorem Taxation of Utilities

Dear Mr. Miller:

As you know, we represent Northern States Power Company in this matter and have submitted a statement to the Commissioner of Revenue concerning his proposed rules. We take issue with the portion thereof relating to integrated companies and believe it is incumbent on the Attorney General to reject proposed rule 3(g) as being unconstitutional and in excess of the Commissioner's statutory authority. This letter will serve primarily as a summary of the issues which Jack Sjoholm and I intend to discuss with you at the meeting we have requested for this purpose.

By letter dated October 13, 1975, we made extensive legal arguments to the Commissioner for inclusion in the hearing record. This letter should be in your file as a part of the record. In case it is not, I have enclosed a copy for your information. We refer you to that letter for the arguments discussed there and will not repeat them here. Two additional matters should, however, be brought to your attention.

1. Effect of Proposed Rule 3(g).

It is appropriate to explain the importance of the

provision in question and its effect upon NSP. At the outset it should be remembered that the purpose of the proposed rules is to value the operating properties of the utilities, such as generating plants and distribution facilities. Non-operating properties, such as land, office buildings and rights of way, are not assessed by the Commissioner but by the local taxing districts, and are therefore excluded from the final valuation under proposed rule 5.

Of the numerous gas utilities in the state, only three are integrated companies. Of these three, NSP is the only major utility and as such is the only major gas utility in the state whose gas property would be valued under the electric rather than the gas formula.

Under the first paragraph of proposed rule 3(c), the cost factor for operating properties is computed after allowing for depreciation. For each kind of utility there is a maximum allowed depreciation. For electric companies, this is 15%, and for gas companies it is 45%. For NSP, however, gas properties would be valued the same as its electric properties and depreciation would therefore be limited to 15%. For example, if two gas utilities have property whose actual depreciation is 30%, one company would get the full benefit of 30% while NSP would be limited to 15%. Thus, despite the fact that the Department finds a higher depreciation to be appropriate for gas properties than for electric properties, NSP's gas properties will not have this benefit and will have a value which is artificially high and discriminatory.

The second important effect of the integrated company provision relates to capitalization rates. Under rule 3(d), electric companies have a capitalization rate of 7.75%, while gas companies have 8%. The income for NSP's gas utility would be capitalized at 7.75%, while all other major gas utilities would use 8%. This would result in a higher valuation under the income approach for NSP's gas utility than for other gas utilities.

The combination of lower depreciation and a lower capitalization rate will mean that NSP's gas utility property will be valued much higher than the same property would be valued for any other gas utility. NSP has determined that

for taxes payable in 1976, the actual taxes for its gas utility would be several hundred thousand dollars higher than they would be if its gas utility were treated the same as other gas utilities. Since taxes are an element of any utility's costs, NSP's gas customers (located primarily in Ramsey, Washington and Dakota counties) will suffer a greater burden because of taxes than will the customers of the other gas utilities. Not only will this burden be imposed upon existing customers of NSP, but industrial firms intending to use gas may well choose to locate, for example, in Minneapolis rather than in St. Paul simply because of the higher cost to them in St. Paul resulting from this discriminatory tax treatment of NSP's gas properties.

Proposed rule 3(g) is therefore a very significant one. It is important to NSP and to its customers, and the legal problems surrounding it should receive serious consideration.

2. Department Testimony to Support the Rule.

At the time of submission of our letter of October 13, we did not have the transcript of the hearing held September 23, 1975. The first several pages of the transcript contain the statements of persons from the Department of Revenue, explaining the proposed rules and the reasons for them. The entire rationale for proposed rule 3(g) is contained in a single paragraph on pages 13 and 14.

This statement attempts at the outset to minimize the impact of the provision. It states that "within Minnesota there are three such operations, and in all cases the smaller utility operation is less than 10% of the total." As discussed above, however, even though NSP's gas utility is much smaller than its electric utility, the impact of this provision is very significant. It must be recognized that NSP's properties represent approximately 4% of all the assessed valuation in the state and pays more property taxes per year than any other single taxpayer in the entire state. Even 10% of the company's total operation therefore represents a very large tax resource in itself, and an argument that the effect of rule 3(g) is de minimus is entirely inappropriate.

There then follows a brief statement of the reasons why the Department proposes to treat both utilities of an integrated company under a single formula.

The first two reasons are closely related to each other and are stated in their entirety as follows:

> "When an integrated company issues bonds, borrows money, or sells stock, it does so, not on an operation basis, but on a company-wide basis. These factors of bond yield, interest rates, and stock yield affect the capitalization rate. To assign two different cap rates to an integrated company would be unrealistic; therefore we assign only that rate which the major operation indicates. In addition, had we chosen to use a Stock and Debt indicator of value, we would have been compelled to value an integrated utility as one due to the fact that the value or price of the stock is set on the whole operation, not on one portion or the other."

There are three responses to this statement. The first and most obvious one is that the Department in fact rejected the validity of the stock and debt indicator of value, for the reasons stated at pages 8 and 9 of the transcript. As stated there, this approach does not accurately achieve the purpose of the valuation process, which is to value the operating properties of the utilities.

Second, as explained in our earlier letter, all of the income and investments of each utility are kept separate from those of each other utility. That bonds or stock may be sold on a company-wide basis, therefore, does not impede the separation of these items with respect to the two utilities.

Third, the statement addresses only the capitalization rate, which has a much less significant effect on the value than does the depreciation. Even if this argument were accepted, it would justify only the use of the same capitalization rate for the gas and electric utilities, while preserving the different depreciation factors.

The only other reason given for special treatment of

integrated companies was as follows, on page 14:

> "Similarly, such a company may well have many plant items which are common to both operations. It may be almost impossible to separate these items, therefore, we feel using that method of cost valuation which applies to the major operation is the most feasible way to proceed." (Emphasis added.)

This statement states two possibilities but does not and cannot recognize either of them as a reality. As outlined in our earlier letter, the operating properties of the gas utility are in fact physically separate from those of the electric utility. It must also be kept separate for accounting purposes as required by the Federal Power Commission. Items which are common to the two utilities, such as office buildings, are not even valued under the proposed rules but are left to local valuation by the local taxing districts. This argument has been discussed at length in our letter of October 13 and does not demonstrate any rational basis for the proposed rule.

Thus it is clear that the Department has not demonstrated a need or rational basis for a rule which singles out NSP as the only major gas utility whose property will be valued under the electric formula. While there may be a reason for this proposal, no legally sufficient reason has been stated and none exists. Proposed rule 3(g) constitutes an improper classification in violation of state and federal constitutional provisions, it is arbitrary and unreasonable, it exceeds the authority of the Commissioner, and it has no reasonable relationship to statutory purposes. The Attorney General should therefore reject this provision in accordance with his duties under Minn. Stat. §15.0412, and Rule Atty. Gen. 305(b)(2).

If proposed rule 3(g) is found to be invalid, it will not be necessary to rewrite or revise the remaining rules. The simple deletion of 3(g) and the definition of "integrated company" in proposed rule 2 is all that is required. Furthermore, no further public hearing would be necessary to make this change, since 3(g) was not even included in

the proposed rules as announced prior to the hearing. It was not until we raised this issue in our letter of October 13 that 3(g) was inserted as a provision in the rules themselves.

Very truly yours,

Douglas L. Skor

DLS:joy
Enc.

cc: Jack Sjoholm, Jr.

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October 13, 1975

Commissioner Arthur C. Roemer
Minnesota Department of Revenue
Centennial Office Building, 2nd Floor
Saint Paul, Minnesota 55145

Re: In the Matter of the Proposed Adoption of Rules of the Department of Revenue Relating to Property (ad valorem) Tax

Dear Commissioner Roemer:

Northern States Power Company has consulted our office with respect to the proposed rules on ad valorem taxation of utilities, which were the subject of a public hearing held on September 23, 1975. We are submitting this statement with Mr. Jack Sjoholm, Jr., an attorney in NSP's law department, for inclusion in the hearing record. Because of the intervention of the legal holiday on October 13, the 20-day comment period extends through October 14.

We wish to discuss a series of legal issues pertaining to the intention of the Department to place NSP in a special category as an "integrated company" and treat it differently from all other major utilities in the state.

The proposed rules prescribe three different valuation formulas for electric, gas and pipeline companies. While Section 2 contains a definition of the term "integrated company," there is no further reference in the proposed rules to integrated companies. It was stated at the hearing, however, that the Department intends to value the operating property of integrated companies under the formula which is applicable to the larger portion of the company's business.

NSP is the only major integrated company in the state.

It provides both gas and electric service. Since the electric utility comprises the larger portion of NSP's business, the Department proposes to value the property of NSP's gas utility under the electric formula rather than the gas formula.

In his prepared statement submitted at the hearing, Mr. Robert Dolan of NSP explained some of the financial and other reasons why this unique treatment of NSP is not appropriate. We will address the serious legal shortcomings with the proposed procedure.

1. The special classification of integrated companies is a denial of equal protection of the laws under the state and federal constitutions.

The Department proposes three different formulas because of its determination that each kind of utility has unique financial and regulatory characteristics. The only logical application of such a valuation system is to use the gas formula for NSP's gas utility. Yet the effect of the Department's proposal, by valuing NSP's gas utility under the electric formula, is to place NSP's gas utility in a class by itself and disregard the reasons for having three different formulas in the first place.

Because of the differences in the formulas, the Department's proposal would impose on NSP's gas utility a tax burden substantially greater than that of all other major gas utilities. NSP's gas customers will ultimately be the victims of this discrimination, since it increases NSP's cost of serving them.

The state may, of course, establish classifications for purposes of taxation. However, any classification "must be reasonable, not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike." National Tea Co. v. State, 205 Minn. 443, 448, 286 N.W. 360 (1939), quoting Louisville G. & E. Co. v. Coleman, 277 U.S. 32, 37, 48 S.Ct. 423, 425 (1928). And once having established a classifica-

tion, "it is definite that under both the State and Federal Constitutions taxes must be uniform upon the same class of property." In Re Petition of Dulton Realty, Inc. v. State, 270 Minn. 1, 15, 132 N.W.2d 394 (1964).

The Department has designated a classification of gas utilities separate from electric and pipeline companies. If this is a legitimate classification, the Department may not then treat one major gas utility differently from all the others. This constitutes unlawful discrimination because it singles out NSP "for discriminatory treatment by subjecting [it] to taxes not imposed on others of the same class." Township of Hillsborough v. Cromwell, 326 U.S. 620, 623, 66 S.Ct. 445, 448 (1946).

Thus in the National Tea case a graduated gross sales tax imposed upon chain store owners, which varied solely according to the volume of sales, was held to be unconstitutional. The class of chain stores was a proper one, but the further division of this class into 11 different classes based on sales volume was unlawful.

More directly in point is the Dulton case. There the court invalidated the practice of the Duluth assessors of applying different percentages of market value to various tracts of real property within the city. The court found no basis for the distinctions, holding that "where deviation is the result of applying different ratios to market value of property of the same class, the courts have no choice other than to hold that the resulting tax would be discriminatory. ..." 270 Minn. at 16.

It may be appropriate for the Department to establish a separate classification for the gas utilities. The Department has cited specific reasons why the gas formula should be different from the electric and pipeline formulas. But the Department has not demonstrated and cannot demonstrate any rational basis for using the electric formula for NSP's gas utility merely because NSP is an integrated company. The sole purpose of the formulas is to determine the value of these properties, and the mere fact that the two utilities are integrated has no effect on the value of their respective operating properties.

The only reason offered by the Department at the hearing

to explain the proposal for integrated companies was the alleged difficulty of separating an integrated company's properties for purposes of valuation. However, as outlined in detail in Mr. Dolan's supplemental statement of October 13, the operating properties of NSP's two utilities are already separated and can easily be identified by the Department. The plants and distribution facilities of the gas and electric utilities are, of course, physically separate. And all property used by both utilities, such as office buildings and land, is non-formula assessed and therefore should not have to be separated.

To the extent that any separation is required, the Department need only recognize that all integrated companies are required by the Federal Power Commission to maintain completely separate accounts for each utility. This long-established system of separate accounts is prescribed by the FPC in its Uniform System of Accounts, published in 18 CFR Part 101. Such separation is also necessary at the state level, for purposes of rate hearings before the Minnesota Public Service Commission. All of the income and investments of each utility are kept separate from those of each other utility, and there is no difficulty in identifying which property belongs to which utility.

Thus the argument that it is difficult to separate the properties of an integrated company has no merit. It certainly falls far short of being an adequate basis for a different method of valuing properties of integrated companies.

Administrative convenience is a particularly inappropriate standard when it alone causes one major gas utility to suffer a tax burden far greater than that imposed upon all other gas utilities. The attempt by the Department to justify the former "Hatfield formula" on the basis of "simplicity of administration" was in fact specifically rejected by the court in Ind. Sch. Dist. No. 99 v. Commissioner of Taxation, 297 Minn. 378, 211 N.W.2d 886 (1973). The court insisted that "administrative considerations" could not justify adoption of a system which was not expressly authorized by the legislature. 297 Minn. at 386.

Since there is no rational basis for the proposed valuation procedure for integrated companies, it would be an arbi-

trary and unconstitutional classification if adopted.

2. The special treatment of integrated companies is beyond the authority of the Commissioner.

The proposed method of valuing integrated companies goes beyond the authority of the Commissioner. It exceeds the authority delegated to the Commissioner by statute and involves a policy-making function which is reserved to the legislature.

In Wallace v. Commissioner of Taxation, 289 Minn. 220, 184 N.W.2d 588 (1971), the court declared invalid a rule which had been formally adopted by the Commissioner. In rejecting the Commissioner's arguments in support of the rule, the court stated:

> "While it is true, as the Commissioner argues, that he has been given authority to enact regulations with reference to the administration of income tax laws (Minn. St. 15.0412 and 15.0413), he is mistaken in his assumption that the substance of Regulation 2008(5) is within the scope of his power to regulate. It is well established that the legislature may confer discretion on the Commissioner in the execution or administration of the law. It may not give him authority to determine what the law shall be or to supply a substantive provision of the law which he thinks the legislature should have included in the first place. [Citations omitted.]" 289 Minn. at 231.

It is arguably appropriate, in light of the Supreme Court's opinion in Ind. Sch. Dist. No. 99 v. Commissioner of Taxation, supra, to establish formulas for valuing gas, electric and pipeline properties, in spite of the fact that the legislature has not specifically required or authorized the use of such formulas. However, there is nothing in the statute or the court's opinion which could possibly authorize a separate classification containing only one major gas utility merely because that utility is part of an integrated company. The lack of authority for such a classification is suggested by the court in the Dulton case:

> "It has been suggested that real property might be classified by assessors as to type, i.e., farm, lakeshore, residential, commercial, etc.; and that

when so classified by them, even though different percentages were applied to the market values of properties in different classifications, this would not invalidate taxes on properties within a classification to which the identical percentage had been applied. We are of the opinion that before such classifications could be undertaken by assessors some statutory enactment, delegating authority therefor to them, with standards for guidance, would be essential. At present, §273.13 manifests a legislative intent to reserve any authority in this field to the legislature." (Emphasis added.) 270 Minn. at 22.

The special classification for integrated companies must therefore be rejected.

3. The proposed method for valuing integrated companies is not contained in the proposed rules and therefore may not be used by the Department.

For some unexplained reason, the proposed treatment of integrated companies is not contained in the proposed rules. Regardless of the reason for this omission, it is a fatal defect.

The Department has recognized that the appropriate method for adopting formulas for utilities is to promulgate rules. This is required by the Administrative Procedure Act. Minn. Stat. §15.0411, subd. 3, as amended effective July 1, 1975, defines "rule" to include "every agency statement of general applicability and future effect ... made to implement or make specific the law enforced or administered by it or to govern its organization or procedure." Neither the Commissioner nor the Department of Revenue is an agency exempt from this requirement under subdivision 2. It is therefore necessary to follow the rule-making procedure to adopt any formula; the formula constitutes a policy decision of general applicability and future effect, made to implement the statutes pertaining to valuation of property.

This was recognized by the Minnesota Supreme Court in In Re Answer of Minnesota Power and Light Company, 289 Minn.

64, 182 N.W.2d 685 (1970), a case involving the statutory exemption from ad valorem taxation of tools and machinery used in the production and distribution of "marketable products." In a bulletin issued to assessors throughout the state, the Commissioner of Taxation attempted to restrict this exemption to tools and machinery used in producing and distributing "tangible" marketable products, thus denying the exemption for electric utilities. In finding this interpretation invalid as going beyond the provision of the statute, the court held that the bulletin from the Commissioner to the assessors was of no force and effect. The court stated:

> "This bulletin was not a rule adopted pursuant to the procedures set forth in Section 15.0412 of the Administrative Procedure Act, Minn. St. 15.01 to 15.41, although the act is expressly applicable to the Commissioner. Minn. St. 15.0411. Rather, it was simply a bulletin or directive to the assessors emanating from the office of the Commissioner of Taxation." 289 Minn. at 70.

It is therefore clear that if the Department seeks to treat integrated companies different from the other utilities, it must specify this treatment in the rules. As written, the rules on their face will require the Department to treat NSP's gas utility under the gas formula; the rules themselves preclude any other method.

The omission from the proposed rules of the separate procedure for integrated companies is not a minor defect which can be cured without further notice and hearing. There are numerous persons, organizations, and taxing districts with a very direct interest in this matter which were deprived of the requisite notice and which had no knowledge of the Department's intentions with regard to integrated companies. Had all interested parties been aware of this proposal, there may well have been additional appearances made and interests presented. The public has been deprived of this right.

Furthermore, once having decided to adopt the proposed formulas and having promulgated them as rules, the Commissioner does not have the discretion to change any of them without subsequent amendments to the rules. The fourth

paragraph of proposed rule 1 states that the formulas are to be used for 1975 and subsequent years "or until, in the opinion of the Commissioner of Revenue, different conditions justify a change." However, any such change would have to be implemented by amending the rules in accordance with statutory procedures.

Minn. Stat. §270.11, subd. 6, does not authorize the Commissioner to change the valuation of utility property without regard to the formulas contained in the rules. Any change pursuant to §270.11 could only be undertaken in order to make a valuation comply with the rules. Rules promulgated under Chapter 15 have the force and effect of law and are binding upon the Commissioner as well as the utilities. Minn. Stat. §15.0413, subd. 1. No state official or agency may adopt a rule and then choose to apply it in some situations and modify it in others.

4. The Commissioner has failed to demonstrate a need for the unique treatment of integrated companies, as required by the Administrative Procedure Act.

When adopting any rule, the Commissioner is subject to the statutory requirement in §15.0412, subd. 4, that he "shall make an affirmative presentation of facts establishing the need for and reasonableness of the rule proposed for adoption." The Attorney General has elaborated upon this requirement in his Rule Atty. Gen. 302 (g). Absent a showing of the need for different treatment of integrated companies, and the reasonableness of such treatment, the Attorney General will be compelled by statute to disapprove it.

As discussed under Section 1 above, no policy or statutory justification was offered for this proposal, and none can be made. The only rationale offered was the alleged difficulty of separating the properties of an integrated company. We have already discussed at length the invalidity of this argument. For these same reasons, it can only be concluded that there has been no showing of need for the special classification and that the proposal is unreasonable.

CONCLUSION

For all of the above reasons, the Department may not lawfully value the property of NSP's gas utility under the electric formula. Since the proposal to do so was not included in the proposed rules, no change is required except to delete the definition of "integrated company," which serves no purpose.

In view of the Department's presentation at the hearing on September 23, it would be appropriate when adopting the rules, however, for the Commissioner to announce his intention to apply the rules as written and thus value the properties of integrated companies separately.

Very truly yours,

Douglas L. Skor

DLS:joy

cc: C. H. Luther, Deputy Attorney General
Jack Sjoholm, Jr., NSP

October 13, 1975

Mr Arthur C Roemer
Commissioner of Revenue
Minnesota Department of Revenue
Centennial Office Building
St Paul, Minnesota 55101

re: In the matter of the Proposed Adoption of Rules of the Department of Revenue relating to Property (Ad Valorem) Tax.

Dear Commissioner:

In addition to the testimony submitted at the public hearing on September 23, 1975, I wish to submit additional data for your consideration relative to:

1. The valuation of the NSP gas utility on an integrated basis

2. The increased valuation of major generating facilities

In the oral presentation by the Department of Revenue at the hearing on September 23, 1975, it was stated that the Department intends to value all the operations of integrated companies under the formula which is applicable to the largest of the company's utility operations. Under this method, NSP's gas utility is valued under the electric utility formula. The only real justification offered in support of this treatment is the apparent difficulty in separating and apportioning the various utility operations within an integrated company. However, there is no such difficulty. In fact, there is no separation nor apportionment required since integrated companies are required to maintain separate and distinct accounts for every utility operation in the company. This system of separate accounts is required by the Federal Power Commission under its Uniform System of Accounts. The income and the investments of the gas utility and the electric utility are totally separate and distinct. Therefore, there is no problem of identifying which properties are part of which utility. There are a very few items of property that are used in both the gas and electric operations, but these are recorded in a separate account and NOT ONE of these is centrally assessed. The NSP General Office in Minneapolis falls within this account. This system of separate and distinct accounts is neither new nor unique. It is required by the FPC

FPC + rate proceedings

and it is necessary for the separate rate processes at both the state and federal levels. Quite simply, there is no problem of identifying and separating the gas and electric investments and income of an integrated company. The justification put forward by the Department of Revenue is falacious and would significantly discriminate against NSP gas customers and increase NSP's cost of serving them.

Under the unit concept using original cost method the attempt is to determine market value through a variety of indicators that have their origin in fact and in original books of record.

The proposal to use the national average of installed capacity as another indicator of value results in a cost of replacement and therefore does not appear on the balance sheet. Cost of replacement is not based upon fact but rather upon the hypothetical proposition of the cost of replacing a facility that furnishes a service with a substitute facility furnishing that same service. This may be a valid approach to some property with an unrestricted market but would hardly be economically acceptable in an industry so dependent upon technological innovations. Potential purchasers of non-regulated competitive industries are free to act without restriction from reglatory agencies. If the value of a property exceeds the cost of constructing a plant capable of performing the same service the prospective buyer is free to build one and compete with the existing plant. The prospective purchaser of a utility plant cannot exercise such freedom, he has no such choice. Because of the very size of the plant of a utility the market is severely restricted which lessens the opportunity for its disposal. In the event of a sale of utility property any premium paid over the original cost depreciated must be charged to Account 100.5 and must be written off within a limited time. Therefore any stated value of utility property based on something other than original cost depreciated is a fallacious approach and does not produce market value. The additional value created by using the average cost approach is applied to the existing value of that particular generating facility. The result is a larger investment than what is actually represented. Only those areas that host major generating facilities would benefit from such a plan. It would therefore magnify the existing problem of increasing the tax base in those areas. This would reinforce the argument of those who criticize the unit value method or any other plan that is calculated on a situs basis. It is also predicted that this antagonism is not likely to abate until a better method of apportionment is accomplished.

It has been implied that for the purpose of using original cost less depreciation as the value determinant the comparison of the tax base to the rate base is improper. However, economists, tax administrators, assessors, and appraisers make constant reference to the relationship that exists between the tax base and the rate base.

"Also, for locally regulated utilities, net investment is the base used for determining the permissable rate of return." 1/

"As a measure of value, original cost is admittedly a definite and readily ascertainable sum. It is also a fixed dollar figure, and becomes the basis for rates - or the rate base." 2/

"As the term (value) is used in its economic sense, value is determined by the earning power of the property used and useful in producing the earnings. The result is reasoning in a circle, by arriving at the value of the property and then using the valuation so determined as the principal determinant of the earnings to be allowed upon the property which in turn determines the property's value." 3/

"Original Cost is also sound in the case of utility properties, because their earning capacity or earning power is based on original cost less physical depreciation." 4/

"There is a coexisting belief that value in the case of public utility property is independent of public utility regulations. For to ask what is the effect of regulation on value is to presume that there is an effect. And that is what I am going to argue." 5/

The Joint Interim Committee on Assessment Practices, February, 1959, stated that because a purchaser of utility property can only earn on original cost less depreciation that should be the basis for value.

Using cost of replacement for determining value of industrial property is sometimes acceptable because the appraiser or assessor has difficulty in determining actual depreciation as it applies to the original cost which in itself is not necessarily readily available. This is not true in the utility sector of course because our accounting practices are rigidly enforced by the FPC.

The Virginia State Corporation Commission has held that utility property cannot be worth more than original cost less depreciation and represents the maximum value of the property to its owners, the stockholders, or to

1/ Simplifying the Valuation Process: D. W. Stuver

2/ Public Utilities Report: Basic Understanding Series No.7

3/ The Valuation of Public Utilities: Wilson, Herring & Eutsler

4/ An Oregon State Tax Commission Review: 1959

5/ Public Utilities Fortnightly: Warren J Samuels, Sept. 2, 1971

the purchaser of a public service corporation. It held therefore that it would assess public utilities on depreciated original cost. 6/

Original cost probably is the most definite measure and the least conjectural of all bases of valuation.

The main argument of proponents of the cost of reproduction and cost of replacement basis is that the owners of regulated industries should fare no better than the investors of non-regulated competitive industries. However in exchange-value economics the real value of a plant is not determined by the cost of reproducing the identical plant but by the cost of producing the commodity in a new plant having the most modern equipment required to produce the article. No one would be willing to invest in an obsolete plant if a new one could be built to be operated at much lower operating expenses per unit of product if such a plant could be built for the same cost as the obsolete one. It is the cost of building a modern plant of similar capacity that determines the value of a plant in an unregulated competitive industry, and not the cost of reproduction of a similar plant. Hence, reproduction cost does not cause the owners of a regulated enterprise to fare the same as the investors in unregulated competitive enterprises. 7/

We therefore recommend that the gas facilities be valued on the merits of the gas utility as originally proposed and that the additional value for major generating facilities based on the average cost of installed capacity be abandoned.

Very truly yours,

Robert J Dolan
Manager Property Tax

6/ Assessment of Properties of Electric Power Utilities: L B Younger, Assistant Director Public Utilities Taxation, State Corporation Commission, Richmond, Virginia

7/ Public Utility Valuation: Wilson, Herring & Eutsler

PHILLIPS PETROLEUM COMPANY

BARTLESVILLE, OKLAHOMA 74004

Petroleum Products Group

G. J. MORRISON
Vice President
Marketing Division

TO OUR CUSTOMERS:

Americans will face the prospect of higher fuel bills if certain politicians are successful in their drive to break up the so-called integrated oil companies - those engaged in the various phases of the industry, ranging from drilling for oil to marketing petroleum products.

By breaking down the companies into numerous small firms, the proposed "divestiture" scheme would rob them of the efficiency of integrated operation while introducing costly duplication of personnel and functions. The resulting higher operating costs would likely be reflected in higher product prices at the service station pump.

Behind the proposed legislation in Congress is the faulty notion that breaking down the integrated companies would create competition. The fact is that vigorous competition already exists in the industry. There are more than 10,000 producers of crude oil, more than 130 refining companies and more than 15,000 wholesalers of petroleum products competing for business.

Integrated operations aren't peculiar to the petroleum industry. They are found in industries as diverse as food and automobiles. The reasons for organizing a business in this way are to reduce uncertainty of supply and to increase efficiency, thereby providing products to consumers at lower prices.

Those in Congress who support divestiture legislation are playing a reckless game in weakening the oil industry at the very time when the nation must increase energy supplies. For politicians even to consider such drastic actions makes it difficult to plan long-term investments in multi-million dollar projects such as exploration, refineries and pipelines.

Furthermore, because the many new and smaller companies resulting from divestiture would not have the same capacity to borrow money as the integrated firms, they would not be able to spend as much for energy development. The result of reduced investment, of course, would be reduced supplies for the consumer.

The adverse impact that this type of legislation would have on the nation cannot be overemphasized.

Cordially,

G. J. Morrison

ADMIN. 1000

STATE OF MINNESOTA

DEPARTMENT Administration

Office Memorandum

TO : Arthur C. Roemer
Commissioner of Revenue
201 Centennial Office Building

DATE: December 3, 1975

FROM : Michael B. Miller
Special Assistant
Attorney General

SUBJECT: Revenue Rules/Ad Valorem Taxation of Utilities

Enclosed herewith are the above-captioned rules, two of which are rejected for the following reasons:

A. Tax Ad Val 3(g):
   1. Substantial change from Rules as Proposed;
   2. No demonstrated need;
   3. No demonstrated factual basis in the record;
   4. No clear relation to statutory purpose;
   5. No basis for this distinction as required by the Equal Protection clause of the state and federal constitutions.

B. Tax Ad Val 3(h): impermissibly vague.

MBM/mb

Enclosure

ADMIN. 1000

STATE OF MINNESOTA

DEPARTMENT Administration

Office Memorandum

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MBM/mb

Enclosure

Administration

Arthur C. Roemer
Commissioner of Revenue
201 Centennial Office Building

December 3, 1975

Michael B. Miller
Special Assistant
Attorney General

Revenue Rules/Ad Valorem Taxation of Utilities

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MBM/mb

Enclosure

DEPARTMENT OF REVENUE

AD VALOREM TAX REGULATIONS

As Proposed

CHAPTER ONE: VALUATION AND ASSESSMENT OF ELECTRIC, GAS DISTRIBUTION, AND PIPELINE COMPANIES (UTILITY COMPANIES)

TaxAdVal 1 INTRODUCTION. On October 19, 1973, the Minnesota Supreme Court in Independent School District No. 99, et al. v. Commissioner of Taxation, 297 Minn. 378, ruled that in estimating the market value of utility properties for ad valorem tax purposes, the assessing authorities must consider every element and factor affecting market value. The assessment formula used to value operating utility property since 1962, based solely on the original cost less limited depreciation and commonly known as the "Hatfield Formula," was thus invalidated as a rule of general application.

These regulations are promulgated to fill that void and reflects the manner in which the value of utility property will be estimated by utilizing data relating to the cost of the property and the earnings of the company owning the property.

Since the Commissioner of Revenue is by statute the assessor of some of the utility property in the State of Minnesota and has supervisory powers of all assessments of property, and may raise or lower values pursuant to Minnesota Statutes, Section 270.11, he will estimate the valuation of the entire system of a utility company operating within the state. The entire system will be valued as a unit instead of valuing the component parts and the

resulting valuation will be "allocated" or assigned to each state in which the utility company operates. Finally, by the process of apportionment, the portion allocated to Minnesota will be distributed to the various taxing districts within the state. All data used in the valuation, allocation, and apportionment process will be drawn from reports submitted to the Department of Revenue by the utility companies. These reports will include Minnesota Department of Revenue Annual Utility Reports (UTL Forms), Annual Reports to the Federal Power Commission and Annual Reports to the Interstate Commerce Commission. Periodic examinations of the supporting data for these reports will be made by the Department of Revenue.

The methods, procedures, indicators of value, capitalization rates, weighting percents, and allocation factors will be used as described in TaxAdVal 3 through 7 for 1975 and subsequent years, or until, in the opinion of the Commissioner of Revenue, different conditions justify a change.

As in all property valuations the Commissioner of Revenue reserves the right to exercise his judgment whenever the circumstances of a valuation estimate dictate the need for it.

TaxAdVal 2 DEFINITIONS: As used in this chapter, the following words, terms and phrases shall have the meanings given to them by this regulation, except where the context clearly indicates a different meaning.

Allocation - the process of dividing the unit value of a utility company among the states in which the utility operates.

Apportionment - the process of distributing that portion of the utility company's unit value which has been allocated to Minnesota to the various taxing districts in which the utility company operates.

Book depreciation - the depreciation shown by a utility company on its corporate books, and allowed the company by various regulatory agencies.

Capitalization rate - the relationship of income to capital investment or value, expressed as a percentage.

Electric company - any company engaged in the generation, transmission or distribution of electric power, excluding cooperatives and municipal corporations.

Gas distribution company - any company engaged in the distribution of natural or synthetic gas excluding cooperatives and municipal corporations.

Installed capacity - the number of kilowatts a power plant is capable of producing as shown by the nameplates affixed to the generators by the manufacturer.

Integrated company - any company engaged in two or more utility operations within Minnesota, such as electric distribution and gas distribution, within the framework of one corporate structure.

Major generating plant - any steam electric power plant capable of generating 25,000 KW (kilowatts) or more; or any

hydroelectric, internal combustion, or gas turbine power plant capable of generating 10,000 KW or more.

Net operating earnings - earnings from operations of the utility after the deduction of operating expenses, depreciation, and taxes but before any deduction for interest.

Non-formula assessed property - property of a utility which is valued by the local or county assessor rather than by the Commissioner of Revenue.

Operating property - any property, except land that is directly associated with the generation, transmission, or distribution of electricity, natural gas, gasoline, petroleum products, or crude oil. Examples of operating property include, but are not limited to substations, transmission and distribution lines, generating plants, and pipelines. Land, garages, warehouses, office buildings, pole yards, radio communication towers, and parking lots are examples of non-operating property.

Pipeline company - any company engaged in the transmission of natural gas, gasoline, petroleum products or crude oil via a fixed line of pipes.

System plant - the total property of a utility company's operations in all states in which it operates.

Unit value - the value of a utility company taken as a whole without any regard to the value of its component parts.

Weighted pipe line miles - the product obtained by multiplying the number of miles of a pipeline by the diameter in inches.

Example: a 6 mile pipeline having 3 miles with a 10 inch diameter and 3 miles with a 30 inch diameter would have a weighted miles value of 120.

TaxAdVal 3 VALUATION. (a) GENERAL. Because of the unique character of public utility companies, such as being subject to stringent government regulation over operations and earnings, the traditional approaches to valuation estimates of property (cost, capitalized income and market) must be modified when utility property is valued. Consequently, for the 1975 and subsequent assessment years, until economic and technological factors dictate a change, the value of utility company property will be estimated in the manner provided in this chapter.

(b) MARKET APPROACH. Market value implies a price for which an entire public utility enterprise might reasonably change hands between willing and informed buyers and sellers. The term presupposes a market of normal activity, no urgency to buy or sell on the part of either buyer or seller, and continued operation of the utility as a single entity. Public utility property is seldom transferred as a whole unit under these circumstances. Consequently, after consideration of this approach, it has been decided that valuation of utility properties by this approach is speculative and unrealiable and will not be employed as a method of valuation for utility property at this time.

(c) COST APPROACH. The cost factor that will be considered in the utility valuation formula is the original cost of the

system plant, and improvements, plus the original cost of construction work in progress on the assessment date. To reflect physical deterioration, depreciation will be allowed as a deduction from cost in the amount allowed on the accounting records of the utility company, as such records are required to be maintained by the appropriate regulatory agency. Depreciation, however, shall not exceed the prescribed percentage of cost: for electric companies, 15 percent; for gas distribution companies, 45 percent; pipeline companies, 45 percent.

When valuing electric company property the "average cost per kilowatt of installed capacity" will also be considered. Any excess of average cost per kilowatt of installed capacity over the actual cost multiplied by the kilowatts of installed capacity will be added to the original cost of the plant, and reduced by the same rate of depreciation applicable to the original cost. The average cost per kilowatt of installed capacity is computed by averaging the construction costs for major generating plants for the five most recent years available, by type of plant, as shown in the latest issues of the Federal Power Commission publications, Hydroelectric Plant Construction Cost and Annual Production Expenses and Steam-Electric Plant Construction Cost and Annual Production Expenses.

The following examples illustrate this procedure. In both examples assume that the five year study of the most recent construction data available from Federal Power Commission publications indicates that the average cost per kilowatt of installed capacity in a fossil fuel steam plant is $150 per kilowatt. Each of the

two plants is of this type.

		#1	#2
1.	Plant		
2.	Installed capacity	100,000 KW	50,000 KW
3.	Year in Service	1960	1940
4.	Cost of Plant	$15,200,000	$3,500,000
5.	Cost per KW	$152	$70
6.	Average cost per KW	$150	$150
7.	Excess (line 6 - 5)	--	$80
8.	Additional value (line 7 x 2)	--	$4,000,000

The cost indicator of value computed in accordance with this regulation will be weighted for each class of utility company as follows: electric companies, 85 percent; gas distribution companies, 75 percent; pipeline companies, 75 percent.

(d) INCOME APPROACH TO VALUATION. The income indicator of value will be estimated by averaging the net earnings of the utility company for the most recent three years. The average net earnings will be capitalized at the rate that is currently used for the industry. Capitalized earnings are the present worth of the future returns that the property is expected to produce. After considering, as far as possible, all conditions that may exist in the future that may affect the present annual return, including risk, life expectancy of the property, and cost of money, the capitalization rates used to compute value for the 1975 assessment will be: electric companies, 7.75 percent; gas distribution companies, 8 percent; pipeline companies, 8.25 percent. The income indicator of value computed in accordance with this regulation will be weighted for each class of utility

company as follows: electric companies, 15 percent; gas distribution companies, 25 percent; pipeline companies, 25 percent.

(e) UNIT VALUE COMPUTATION. The unit value of the utility company will be the total of the weighted indicators of value.

The following is an example of the computation of the unit value:

Cost indicator of value	$5,000,000 x	75% =	$3,750,000
Income indicator of value	$4,800,000 x	25% =	$1,200,000
Unit Value of Pipeline Company		100%	$4,950,000

(f) VALUATION OF UTILITY PROPERTY OF COOPERATIVES. Cooperative associations shall have their utility property valued on the basis of historical cost only since they do not operate on the traditional profit-making basis. Depreciation will be allowed as a deduction from cost at increments of 2.5 percent per year but the maximum shall not exceed 25 percent for property used in the generation, transmission or distribution of electric power.

(g) VALUATION OF NON-PUBLIC UTILITY PROPERTY. Property used for utility purposes but owned and operated by a company whose principal business activity is not that of operating a public utility or any other utility property for which a method of valuation is not expressly provided in this chapter shall be valued by such methods as may be determined by the Commissioner to reflect a fair and equitable value.

TaxAdVal 4 ALLOCATION. (a) GENERAL. After the unit value of the utility property has been estimated, the portion of value which is attributable to Minnesota must be determined. This process of dividing the unit value of a utility company among the states in which the utility operates is called allocation. Each

of the factors in the allocation formula is assigned a weighted percentage to denote the relative importance assigned to that factor. The resulting sum of the weighted factors multiplied by the unit value yields the valuation of the utility property which will, after the adjustments described in TaxAdVal 5, be subject to ad valorem tax in the State of Minnesota.

The factors to be considered in making allocations of unit value to Minnesota for the utility companies and the weight assigned to each factor for each class are specified in this regulation.

(b) ELECTRIC COMPANIES. The original cost of the utility property located in Minnesota divided by the total original cost of the property in all states of operation is weighted at 90 percent. Gross revenue derived from operations in Minnesota divided by gross operations revenue from all states is weighted at 10 percent.

The following example illustrates this formula, assuming a unit value of $20,000,000.

Example 1.

Minnesota plant cost / System plant cost	($115,000,000) / ($205,000,000)	x .90	=	50.49%
Minnesota gross revenue / Systems gross revenue	($ 40,000,000) / ($105,000,000)	x .10	=	3.8%
Total percentage allocable to Minnesota				54.29%
Unit value of system plant				$ 20,000,000
Amount of value allocable to Minnesota				$ 10,858,000

(c) GAS DISTRIBUTION COMPANIES. The allocation of value of gas distribution companies shall be made considering the same factors as are used to determine the allocation of value of

electric companies. The weight given to the original cost factor will be 75 percent, and gross revenue shall be weighted 25 percent.

(d) PIPELINE COMPANIES. In addition to the cost factor and the gross revenue factor, the factor of weighted pipe line miles shall be considered in allocating the value of pipeline companies. Weighted pipe line miles means the number of miles of pipeline multiplied by the diameter of the pipe, measured in inches. To illustrate, a pipeline line 6 miles long has 3 miles of pipe with a diameter of 10 inches and 3 miles of pipe with a diameter of 30 inches. The weighted pipe line miles is 120.

3 miles x 10" diameter	=	30
3 miles x 30" diameter	=	90
Weighted pipe line miles		120

The following example illustrates the allocation of value of property of a pipeline company and the weights given to each factor.

Example 2.

Minnesota plant cost / System plant cost	($13,500,000) / ($39,300,000)	x .75	=	25.76%
Minnesota gross revenue / System gross revenue	($2,980,000) / ($9,300,000)	x .05	=	1.60%
Minnesota weighted pipe line miles / System weighted pipe line miles	($ 9,500) / ($27,100)	x .20	=	7.01%
Total percentage allocable to Minnesota				34.37%

TaxAdVal 5 ADJUSTMENTS FOR NON-FORMULA ASSESSED OR EXEMPT PROPERTY. After the Minnesota portion of the unit value of the utility company is determined, any property which is non-formula assessed or which is exempt from ad valorem tax, will be deducted from the unit value. Only that qualifying property located within the State of Minnesota may be excluded.

The following properties will be valued by the local or county assessor and, therefore, the formula provided herein for the valuation of utility property will not be applicable for such property.

1. Land
2. Non-operating property
3. Rights of way

The Minnesota portion of the unit value will be reduced by the original cost of these items except that in the case of non-operating property, the deduction shall be original cost, less the rate of depreciation applicable in the valuation process pursuant to TaxAdVal 3.

A deduction from the Minnesota portion of the unit value shall also be made for property, real or personal, which is exempt from ad valorem tax. For instance, pollution control equipment for which an exemption has been granted, is exempt. A deduction from the unit value shall be made at original cost, less the applicable rate of depreciation used in the valuation process pursuant to TaxAdVal 3. The value of personal property, such as office machinery and vehicles, which is not taxed, shall also be excluded from the unit value. The deduction shall be at original cost less the applicable rate of depreciation utilized in the valuation process.

The utility company shall have the burden of proof to establish that the value of any property should be excluded from the Minnesota portion of the unit value. Accordingly, the utility company shall have the responsibility to submit in the form required by the Commissioner of Revenue, such schedules of exempt or non-formula assessed property as he may require.

TaxAdVal 6 APPORTIONMENT. After the unit valuation of the utility company has been allocated to the State of Minnesota, the determined amount shall be apportioned or distributed to the taxing districts in Minnesota in which the company operates. This apportionment will be made by the Commissioner of Revenue on the basis of information submitted by the utility companies in annual reports filed with the Commissioner.

The following information must be submitted for each taxing district:

1. The market value of the company's operating property by classification, as reflected in the last assessment.

2. The original cost of any new additions since the last assessment, including work in progress on the assessment date.

3. The market value of any retirements made after the last assessment, as reflected in that assessment.

The last market value of each company's operating utility property in each taxing district, plus original cost of new construction, reduced by last market value of property retired since the last assessment, shall be divided by its total market value in Minnesota. For this purpose, the last market value and the last assessment shall mean the latest assessment immediately prior to the current assessment. The portion of unit value to be assigned to each taxing district will be the resulting percentage multiplied by the Minnesota portion of unit value, as adjusted pursuant to TaxAdVal 5.

TaxAdVal 7 COMPREHENSIVE EXAMPLE. An illustration of the methods and procedures described in TaxAdVal 3, 4, 5 and 6 is as follows:

Example 1. COMPUTATION OF UNIT VALUATION OF AN ELECTRIC COMPANY.

		Amount	Reference
1.	Utility Plant (Cost)	$200,000,000	F.P.C. Report
2.	Construction in Progress	5,000,000	F.P.C. Report
3.	Additional Value From Average Cost per K.W. Computation	4,000,000	Example 2, Line 8
4.	Total Plant	209,000,000	1 + 2 + 3
5.	Non-Depreciable Plant (Land, Intangibles, Etc.)	15,000,000	F.P.C. Report
6.	Depreciable Plant	194,000,000	4 - 5
7.	Depreciation (Maximum 15%)	29,100,000	6 x 15%
8.	Total Depreciated Plant Plus Non-Depreciable Plant	179,900,000	4 - 7

		Reference	1971	1972	1973
9.	Net Operating Income	F.P.C. Report	8,000,000	8,500,000	9,000,000
10.	Capitalized Income @ 7.75%		103,225,806	109,677,419	116,129,032
11.	3 Year Total Capitalized Income			329,032,257	
12.	3 Year Average Capitalized Income (line 11 ÷ 3)			109,677,419	

13.	Total Depreciated Plant	179,900,000	Weighted @ 85%	152,915,000
14.	3 Year Average Capitalized Income	109,677,417	Weighted @ 15%	16,451,613
15.	Market		Weighted @ 0%	---
16.	Unit Value			169,366,613

Example 2. COMPUTATION OF AVERAGE COST PER KILOWATT OF INSTALLED CAPACITY.

ASSUME THAT A 5 YEAR STUDY OF MOST RECENT CONSTRUCTION DATA AVAILABLE FROM THE F.P.C. SHOWS THAT THE AVERAGE COST PER KILOWATT OF INSTALLED CAPACITY IN A FOSSIL FUEL STEAM PLANT IS $150.00 PER KILOWATT.

1.	Plant	#1	#2
2.	Installed Capacity	100,000 K.W.	50,000 K.W.
3.	Date in Service	1960	1940
4.	Cost of Plant	$15,200,000	$3,500,000
5.	Cost Per K.W.	$152.00	$ 70.00
6.	Average Cost Per K.W.	$150.00	$150.00
7.	Difference (if any) (line 6 - 5)	---	$ 80.00
8.	Additional Value (line 7 x 2)	---	$4,000,000

Example 3. ALLOCATION OF UNIT VALUATION OF ELECTRIC COMPANY TO MINNESOTA.

		Amount	Reference
1.	Utility Plant System	$200,000,000	F.P.C. Report
2.	Construction Work in Progress	5,000,000	F.P.C. Report
3.	Total Utility Plant System	205,000,000	1 + 2
4.	Utility Plant Minnesota	110,000,000	UTL Report
5.	Construction Work in Progress Minnesota	5,000,000	UTL Report
6.	Total Utility Plant Minnesota	115,000,000	4 + 5
7.	Minnesota Plant to System Plant	56.10%	6 ÷ 3
8.	Weighting Factor	90%	
9.	Minnesota Weighted % Original Cost	50.49%	7 x 8
10.	Gross Revenue System	105,000,000	F.P.C. Report
11.	Gross Revenue Minnesota	40,000,000	UTL Report
12.	Minnesota Revenue to System Revenue	38.10%	11 ÷ 10
13.	Weighting Factor	10%	
14.	Minnesota Weighted % Revenue	3.81%	12 x 13
15.	Total Minnesota Percent	54.30%	9 + 14
16.	Unit Value	169,366,613	Example 1, line 16
17.	Minnesota Portion of Unit Value	$ 91,966,071	15 x 16

Example 4. COMPUTATION OF APPORTIONABLE VALUE OF UTILITY COMPANY.

			Amount	Reference
1.	Minnesota Portion of Unit Value		91,966,071	Example 3, line 17
2.	Excludable Items:			
	a. Land Assessed Locally		3,000,000	UTL Report
	b. Land Rights		---	
	c. General Plant Items	10,000,000		UTL Report
	d. Pollution Control Equipment	10,000,000		UTL Report
	e. Less Depreciation @ 15%	3,000,000		(c + d) x 15%
	f. Net General Plant & Pollution Control Items		17,000,000	(c + d) - e
	g. Total Excludable Items		20,000,000	a + f
3.	Minnesota Apportionable Value		71,966,071	1 - 2g

Example 5. APPORTIONMENT TO LOCAL TAXING DISTRICTS OF MINNESOTA PORTION OF UNIT VALUE AFTER ADJUSTMENTS.

ASSUME: TAX DISTRICTS 1 AND 2 HAVE POWER PLANTS AND DISTRIBUTION LINES.
TAX DISTRICTS 3 AND 4 HAVE DISTRIBUTION LINES ONLY.
MINNESOTA PORTION OF UNIT VALUE AFTER ADJUSTMENTS = $71,966,071.

TAX DISTRICT	1	2	3	4	Total
1. Last Market Value:					
a. Structures	$ 5,000,000	$10,000,000			$15,000,000
b. Machinery	10,000,000	20,000,000			30,000,000
c. Personal Property	1,000,000	3,000,000	$ 6,000,000	$ 5,000,000	15,000,000
d. Total	$16,000,000	$33,000,000	$ 6,000,000	$ 5,000,000	$60,000,000
2. Additions Including Construction in Progress at Original Cost			3,000,000	3,000,000	6,000,000
3. Retirements at Last Market Value (Machinery)		(1,000,000)			(1,000,000)
4. Additional Value Due to Average Cost per Kilowatt Computation ($4,000,000 Less 15% Depreciation Allowance)	3,400,000				3,400,000
5. Updated District Total	$19,400,000	$32,000,000	$ 9,000,000	$ 8,000,000	$68,400,000
6. Percent of Total (Line 5 by Tax District ÷ Line 5 Total)	28.36%	46.78%	13.16%	11.70%	100.0%
7. Portion of Minnesota Adjusted Unit Value (Line 6 x $71,966,071)	$20,409,578	$33,665,728	$ 9,470,735	$ 8,420,030	$71,966,071
8. New Market Value*					
a. Structures	$ 6,451,468	$10,520,540			$16,972,008
b. Machinery	12,904,976	19,990,709			32,895,685
c. Personal Property	1,053,134	3,154,479	9,470,735	8,420,030	22,098,378
d. Total	$20,409,578	$33,665,728	$ 9,470,735	$ 8,420,030	$71,966,071

*Computed by finding percentage of 1a, 1b, 1c plus any additions and minus any retirements in 2, 3, 4 ÷ line 5. This percentage x line 7 equals new market value by classification. Example: District 2, line 1b ($20,000,000) minus line 3 ($1,000,000) = $19,000,000 ÷ line 5 ($32,000,000)= 59.38% x line 7 ($33,665,728) = $19,990,709.

12/2/75 Tax Rules – Meeting Rule 3(G)

① Basis for dist. integrated util. as a class?
② Lack of auth. for this
③ N/ in proposed rules – no effective rebuttal – all 3 off. parties knew
④ No need for sep. rule –

10/13/75 letters

Also:

12/2/75 letter

⑤ Effect – Ⓐ Dep. – Cost Income

→ bus v. electric – (would be same under int. rule)
3c – diff. methods (full 30% for gas 15% for electric)
Effect: n/ dep. gas prop. as others do
Results in artificially high rate

② Transcript → Ⓑ Cap. rates → gas – 8.0%
elec. 7.75%

Shorts NSP by ¼%
Higher cost to NSP customers
Location of future utility

1976 – Taxes of several hundred thousand dollars (subst. effect)

Q of app. util. prop. (gas v. elec.)
Shor says phys. sep. – as no need for rule →
Rules n/attempt to value common prop (office) as n/ oper. prop. –
Valued separately –

p. 14 Tr. says "may have" common prop."

2 others: Interstate – sep. like NSP
One operation

(2)

Comm'r Roehmer

1. Const. permits classifications.

M P & L case – must consider all elements of value

Earnings – int. co's have savings due to commonality

Arg: int. incr. income, which off. val.

Gas co's –
Electric co's –
Integrated co's – all treated alike

Willing buyer – pay more for int. util.

Tax Dept: Gaske – cap. rates →

No basis in record – for rate on hist. test. year income basis –

Sloor: ① N/stated at hearing
② Only effect is on income, n/cost
Small pt. of formula
should off. cap. rate, n/depr

Stated basis was depreciation n/ income factor

Tax dept: Co. prop. → as whole

Sloor Rule against diff. as to PSP –

ADMIN. 1000
3

STATE OF MINNESOTA

DEPARTMENT OF REVENUE - A.G.

Office Memorandum

TO : MICHAEL B. MILLER
Special Assistant Attorney General

DATE: November 24, 1975

FROM : C. H. LUTHER
Deputy Attorney General

SUBJECT: Department of Revenue
Ad Valorem Tax Regulations

I am returning herewith the above captioned rules which you returned to Gerald W. Pahl on or about October 29, 1975. I am also attaching an original and two copies of the Certificate of Compliance with Rule Making Procedures.

C. H. Luther

C. H. LUTHER

CHL/db
cc: A. C. Roemer
Gerald W. Pahl

Exhibit A

STATE OF MINNESOTA

COUNTY OF RAMSEY

BEFORE ARTHUR C. ROEMER

COMMISSIONER OF REVENUE

In the Matter of the Proposed Adoption
of Rules of the Department of Revenue
Relating to Property (Ad Valorem) Tax

NOTICE OF HEARING

Notice is hereby given that a public hearing will be held pursuant to Minnesota Statutes 1974, Section 15.0412, Subdivision 4, as amended by Laws 1975, Chapter 380, in the above-entitled matter, in the State Office Building, Auditorium (Room 83), St. Paul, Minnesota, on September 23, 1975, commencing at 10:00 a.m. and continuing until all representatives or other interested groups or persons have had an opportunity to be heard concerning adoption of the proposed rules captioned above by submitting either oral or written data, statements or arguments. Persons may submit written statements or briefs without appearing at the hearing.

The Commissioner proposes to adopt rules to effectively implement legislation relating to the valuation and assessment of electric, gas distribution, and pipeline companies (utility companies). A copy of the proposed rules is attached hereto.

Persons who wish to present oral comments in addition to written comments or suggestions should submit to Lyle H. Ask, Director of Property Equalization Division, by September 18, 1975, an outline of the topics and the time they wish to devote to each topic.

STATE OF MINNESOTA
DEPARTMENT OF REVENUE

Arthur C. Roemer

COMMISSIONER OF REVENUE

STATE OF MINNESOTA

COUNTY OF RAMSEY

BEFORE ARTHUR C. ROEMER

COMMISSIONER OF REVENUE

In the Matter of the Proposed Adoption of Rules of the Department of Revenue Relating to Property (Ad Valorem) Tax

ORDER FOR HEARING

To effectively implement legislation relating to the valuation and assessment of electric, gas distribution, and pipeline companies (utility companies), the Minnesota Commissioner of Revenue deems it necessary to consider adoption of the proposed rules captioned above pursuant to the authority vested in me by Minnesota Statutes 1974, Section 270.06.

NOW, THEREFORE, IT IS ORDERED, this 22nd day of August, 1975, that a public hearing on the proposed rules captioned above be held in the State Office Building, Auditorium (Room 83), St. Paul, Minnesota, commencing at 10:00 a.m., and continuing until all representatives of associations or other interested groups or persons have had an opportunity to be heard.

IT IS FURTHER ORDERED, that notice of said hearing be given to all representatives of associations or other interested groups or persons who have registered their names with the Secretary of State for that purpose.

STATE OF MINNESOTA
DEPARTMENT OF REVENUE

Arthur C. Roemer

COMMISSIONER OF REVENUE

STATE OF MINNESOTA

COUNTY OF RAMSEY

BEFORE ARTHUR C. ROEMER

COMMISSIONER OF REVENUE

In the Matter of the Proposed Adoption
of Rules of the Department of Revenue
Relating to Property (Ad Valorem) Tax

CERTIFICATE

I hereby certify that the attached list consisting of 437 labels and two sheets constitute the complete list of persons, associations and other interested groups who as of 9:00 o'clock a.m., this eighteenth day of August, 1975, have requested pursuant to M.S. 1974, Section 15.0412, that their names be placed on file with the Secretary of State for the purpose of receiving notice of public hearing on proposed rules on the subject captioned above.

Joan Growe

Secretary of State
JOAN GROWE

By Virginia Daniels

AFFIDAVIT

Gerald W. Pahl, being duly sworn on oath deposes and says:

1) That he is an employee of the Department of Revenue of the State of Minnesota.

2) That on the eighteenth day of August, 1975, he went to the Secretary of State's office for the State of Minnesota and requested a current list of all representatives of associations or other interested groups or persons who had registered their names with the Secretary of State for the purpose of obtaining notices of public hearings relating to the promulgation of rules pursuant to M.S. 15.0412.

3) That on the eighteenth day of August, 1975, in response to the above request, the Secretary of State provided him with such a list, consisting of 437 mailing labels and two sheets of names.

Further affiant sayeth not.

Gerald W Pahl

Subscribed and sworn to before me
this 22nd day of August, 1975.

Katherine J. Zimmerman
Notary Public

KATHERINE J. ZIMMERMAN
Notary Public, Ramsey County, Minn.
MY COMMISSION EXPIRES
April 26, 1978

Exhibit B

STATE OF MINNESOTA

COUNTY OF RAMSEY

In the Matter of the Proposed Adoption
of Rules of the Department of Revenue
Relating to Property (Ad Valorem) Tax

AFFIDAVIT OF MAILING

Gerald W. Pahl, being first duly sworn on oath says; that he now is and at all times material hereto, was the Research Attorney of the Department of Revenue of the State of Minnesota; that on August 22, 1975, he did cause the attached notice to be mailed through the United States mails to all of the individuals or associations who are registered with the Secretary of State as desiring to be notified of hearings concerning tax matters by placing a copy of said notice in an envelope addressed to said individuals or associations at the address furnished by the Secretary of State and placing said envelope in the United States mails with adequate postage thereon.

Gerald W Pahl

Subscribed and sworn to before me
this 22nd day of August, 1975.

Katherine J. Zimmerman
Notary Public

KATHERINE J. ZIMMERMAN
Notary Public, Ramsey County, Minn.
MY COMMISSION EXPIRES
April 26, 1978

STATE OF MINNESOTA

COUNTY OF RAMSEY

BEFORE ARTHUR C. ROEMER

COMMISSIONER OF REVENUE

In the Matter of the Proposed Adoption of Rules of the Department of Revenue Relating to Property (Ad Valorem) Tax

STATEMENT OF NEED

The above captioned rules are new rules of the Department of Revenue.

It is necessary to adopt these rules to insure that property owned or leased by electric, gas distribution and pipeline companies is assessed and valued at a uniform rate for each class of property. Such property has previously been assessed pursuant to a formula which was not promulgated in accordance with the Administrative Procedure Act, Minnesota Statutes, Sections 15.01 to 15.41. The Minnesota Supreme Court in Independent School District No. 99, et al. v. Commissioner of Taxation, 297 Minn. 378, has indicated its disapproval of said formula and has stated that all relevant factors in addition to original cost less depreciation must be considered in determining market value.

STATE OF MINNESOTA
DEPARTMENT OF REVENUE

Arthur C. Roemer

COMMISSIONER OF REVENUE

STATE OF MINNESOTA

COUNTY OF RAMSEY

BEFORE ARTHUR C. ROEMER

COMMISSIONER OF REVENUE

In the Matter of the Proposed Adoption of Rules of the Department of Revenue Relating to Property (Ad Valorem) Tax

FINDINGS OF FACT

The above-entitled matter came on for hearing before the Commissioner of Revenue of the State of Minnesota on the 23rd day of September, 1975, at 10:00 A.M. in the State Office Building Auditorium (Room 83), St. Paul, Minnesota, after proper notice required by M.S. 1974, Section 15.0412 was served upon all persons, associations and other interested groups registered with the Secretary of State for that purpose.

After affording interested persons an opportunity to present written and oral data, statements and arguments, having heard all of the testimony, having considered all of the evidence adduced and upon the records, files and proceedings herein, I find the following:

1. In more than 30 states public utility property is assessed by a central state agency. A significant number of local assessors lack the expertise and training to value utility property.

2. It is a widely accepted practice of state tax authorities to utilize the unit appraisal for purposes of valuing utility property for assessment purposes.

3. In determining the unit valuation of utility property for property tax purposes, the taxing authorities throughout the United States generally employ some type of formula.

4. The Minnesota Supreme Court in Independent School District No. 99, et al. v. Commissioner of Taxation, 297 Minn. 378, 211 N.W. 2d 886, ruled that the formula used to value utility property for Minnesota property tax purposes since 1962 is inconsistent with the statutory mandates for assessing properties and therefore is arbitrary and unreasonable.

5. There are three principle approaches employed by appraisers to determine market value of property--cost, income and market.

6. An insignificant number of sales of substantial operating property of utility companies in the United States have occurred, and sales of entire operating units are very rare. Because of the nature of the industry, utility property is unique and comparisons of property sold are speculative.

7. Where formulas are utilized by taxing authorities in other states to value utility property, cost is deemed to be most indicative of value and is weighted most heavily in the formulas.

8. The concept "average cost per kilowatt of installed capacity" is a form of replacement cost or indexed original cost.

9. Based on data contained in Moody's Public Utility Manual, Federal Reserve Bulletins, and National Tax Journal, as such data relates to interest and bond yields of utility companies for 20 years, stock yields for 10 years, and capital structure for 10 years, the average capitalization rate for utility companies is 8.02 percent.

10. Capitalization rates for elective utility companies are slightly above the average rate for all utility companies and the capitalized rate for pipeline companies is slightly below the average rate for all utility companies.

11. Cooperative associations do not operate on the same basis as investor owned companies inasmuch as earnings of cooperatives are distributed on the basis of patronage and not ownership. The earnings of the cooperative association depend on the arbitrary policy of the entity as to whether the entity shall have a high rate of earnings and a high patronage dividends or a low rate of earnings and low patronage dividends.

12. The Minnesota Legislature in enacting M.S. 273.40 and 273.41 has given certain utility property owned by cooperative associations a classification different from other utility property.

13. Three companies conduct two integrated utility operations within the state of Minnesota, either as a pipeline and gas distribution company or as a gas distribution and electric company. In each case, the smaller utility operation is less than 10 percent of the total.

14. Integrated utility companies issue bonds, borrow money and sell stock on a company basis, rather than on an operational basis.

STATE OF MINNESOTA
DEPARTMENT OF REVENUE

Arthur C. Roemer

COMMISSIONER OF REVENUE

STATE OF MINNESOTA

COUNTY OF RAMSEY

BEFORE ARTHUR C. ROEMER

COMMISSIONER OF REVENUE

In the Matter of the Proposed Adoption of Rules of the Department of Revenue Relating to Property (Ad Valorem) Tax

ORDER ADOPTING RULES

The above-entitled matter came on for hearing before the Revenue Commissioner of the State of Minnesota on the 23rd day of September, 1975, at 10:00 A.M. in the State Office Building Auditorium (Room 83), St. Paul, Minnesota, after proper notice required by M.S. 1974, Section 15.0412, Subdivision 4, as amended by Laws 1975, Chapter 380 was served upon all persons, associations and other interested groups registered with the Secretary of State for that purpose.

After affording interested persons an opportunity to present written and oral data, statements and arguments, having heard all of the testimony, having considered all of the evidence adduced and upon the records, files and proceedings herein, and applicable statutory standards or criteria, and having confirmed the need for the above captioned rules.

NOW, THEREFORE, IT IS ORDERED that these rules identified as rules of the Department of Revenue relating to property (ad valorem) tax are adopted this 17th day of October, 1975, pursuant to authority vested in me by Minnesota Statutes 1974, Section 270.06.

STATE OF MINNESOTA
DEPARTMENT OF REVENUE

Arthur C. Roemer

COMMISSIONER OF REVENUE

STATEMENT OF COMPLIANCE WITH

MANUAL OF RULE MAKING PROCEDURES

I, Gerald W. Pahl, do hereby declare that I have examined the proposed rules and all related documents and that, based on them and my personal familiarity with the applicable procedures, the Manual of Rule Making Procedures has been followed. Any exceptions are noted below.

Gerald W. Pahl

Research Attorney
Department of Revenue
State of Minnesota

Dated: October 17, 1975

STATE OF MINNESOTA

DEPARTMENT OF REVENUE

In the Matter of the Proposed Adoption
of Rules of the Department of Revenue
Relating to Property (Ad Valorem) Tax

September 23, 1975

Diane E. DeNet

STATE OF MINNESOTA

DEPARTMENT OF REVENUE

In the Matter of the Proposed Adoption)
of Rules of the Department of Revenue) TRANSCRIPT
Relating to Property (Ad Valorem) Tax)

The above-entitled matter came duly on for hearing on September 23, 1975, at 10:00 a.m., before Arthur C. Roemer, Commissioner of Revenue, in the State Office Building, Auditorium (Room 83), St. Paul, Minnesota.

APPEARANCES:

Arthur C. Roemer, Commissioner of Revenue

Louis Plutzer, Deputy Commissioner of Revenue (Acting)

Gerald W. Pahl, Research Attorney

Lyle H. Ask, Director, Property Equalization Division

James G. O'Brien, Manager, State Assessed Properties Section

Gerald D. Garski, Public Utility Examiner

Judith M. Carling, Public Utility Examiner

Robert McSwain, Consultant for Department of Revenue

Dale Busacker, Administrative Assistant, House Tax Committee

Dennis Emmen, Otter Tail Power Company

Vernon L. Kester, Otter Tail Power Company

Raymond L. Erickson, Hanft, Fride, O'Brien & Harries, Attorney for Minnesota Power and Light Company

Edward T. Fride, Hanft, Fride, O'Brien & Harries, Attorney for Minnesota Power and Light Company

Jennings F. Johnson, Minnesota Power and Light Company

John F. McGrath, Minnesota Power and Light Company

Howard R. Alden, Minnesota Power and Light Company

Michael Gehlen, North Central Public Service

James A. Smith, North Central Public Service

Arthur W. Carlson, Jr., Minnesota Gas Company

Robert M. Foster, Northern Natural Gas Company

Turner Tefft, Northern Natural Gas Compnay

Robert Ehlers, Jr., Ehlers & Associates

Roy L. Reid, Williams Brothers Pipe Line

Barney E. Sullivan, Portal Pipe Line Company

Jack Sjoholm, Jr., Northern States Power Company

Thomas Connelly, Northern States Power Company

Robert Dolan, Northern States Power Company

George Lucas, Inter City Gas

Bruce McLean, Inter City Gas

Tom Jenks, Ramsey County Department of Taxation

William E. Carlson, Ramsey County Assessor

Robert T. Locky, St. Louis Park City Assessor

George S. Marks, Lakehead Pipe Line Company

George Maas, Lakehead Pipe Line Company

Donald B. Crossweller, Great Lakes Gas Transmission Company

R. F. Osborne, Great Lakes Gas Transmission Company

Marlo E. Beheng, Great Lakes Gas Transmission Company

Carl Fredrickson, Independent School District #99

Richard Wiitanen, Carlton County Assessor

Peter S. Popovich, Peterson, Popovich, Knutson & Flynn, Special Attorney for Carlton County Independent School District #99

James S. Knutson, Peterson, Popovich, Knutson & Flynn,
Special Attorney for Carlton County
Independent School District #99

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WHEREUPON, the following proceedings were had:

MR. ROEMER: The meeting will please come to order.

The purpose of this meeting today is to hold a public hearing pursuant to Minnesota Statutes 1974, Section 15.0412, as amended by Laws 1975, Chapter 380, for the purpose of affording the public an opportunity to express themselves on the adoption of the proposed new rules relating to property tax, that is the ad valorem tax. This public hearing is held pursuant to the following Notice of Hearing, and I quote:

"Notice is hereby given that a public hearing will be held pursuant to Minnesota Statutes 1974, Section 15.0412, Subdivision 4, as amended by Laws 1975, Chapter 380, in the above-entitled matter, in the State Office Building, Auditorium (Room 83), St. Paul, Minnesota, on September 23, 1975, commencing at 10:00 a.m. and continuing until all representatives or other interested groups or persons have had an opportunity to be heard concerning adoption of the proposed rules captioned above by submitting either oral or written data, statements or arguments. Persons may submit written statements or briefs without appearing at the hearing.

The Commissioner proposes to adopt rules to effectively implement legislation relating to the valuation and assessment of electric, gas distribution, and pipeline companies (utility companies). A copy of the proposed rules is attached hereto.

Persons who wish to present oral comments in addition to written comments or suggestions should submit to Lyle H. Ask, Director of Property Equalization Division, by September 18, 1975, an outline of the topics and the time they wish to devote to each topic."

I will now ask the reporter to mark this notice as Department of Revenue Exhibit "A," which will become a part of the record of this hearing.

The notice was mailed on August 22, 1975, to the accredited representatives of trade associations and other groups and individuals who registered their names with the Secretary of State as desiring to be notified of hearings of this kind in regard to tax matters, as shown by the latest list furnished by the Secretary of State. The mailing of these notices is evidenced by an Affidavit of Gerald Pahl, Research Attorney for the Department of Revenue.

I have here this Affidavit, which I will ask the reporter to mark as Exhibit "B," which will become a part of the record of this hearing.

I would like to remind you that under Minnesota Statutes, Section 10A.01, Subdivision 11 (1974), any individual engaged for pay or other consideration for the purposes of representing persons or associations attempting to influence administrative action, such as the promulgation of these rules, must register with the State Ethics Commission as a lobbyist within five days of the commencement of such activity by the individual. The State Ethics Commission is located at 410 State Office Building (that is this building), St. Paul, Minnesota 55155.

After this hearing is concluded, any written material may be submitted up to twenty days after the hearing and will become a part of the record.

Before I hear testimony from those who have asked to be heard and comments from the public on these rules, I would like Lyle Ask, Director of the Property Tax Equalization Division, and

Mr. James O'Brien, Manager of the State Assessed Property Section, to explain these rules in some detail and state why we believe these rules are reasonable and necessary.

MR. ASK: O.k., thank you, Commissioner.

To start with, I would like to inform you why we feel we need regulations.

As a direct result of the Minnesota Supreme Court decision, commonly called the School District #99 case, filed October 19, 1973, our Department was charged with the responsibility of developing a new method for valuing the various types of public utilities operating within our State. The Supreme Court did not specifically reject the use of the so-called Hatfield Formula, but did express its disapproval of it as the sole criterion for valuing public utility property. The Court noted that the statutes require that property be assessed at market value. The development of this new method for determining market value was not unilateral. The Department of Revenue held a long series of meetings at which both industry and assessors were well represented and encouraged to express their ideas.

Why do we need central assessment?

After a very thorough study of the local assessment versus state assessment, we concluded that the assessment of public utility companies and large scale electric generating plants require a high degree of expertise, which is normally not available to local assessors. We noted that over 30 states assess public utilities through some central agency. Therefore,

we feel the assessment of public utility property should be done at the state level.

Why we use unit value method.

The process by which an assessor (or anyone else, for that matter) arrives at his opinion of the value of a property is the appraisal or valuation process. In public utility valuation, it is customary to use what is known as a unit appraisal. This is an appraisal of an integrated property as a whole, without any reference to the value of its component parts. It is to be distinguished from a fractional appraisal, which is a valuation of one of the parts without reference to the value of the whole, and from a summation appraisal, which is a valuation of the whole derived by adding two or more fractional appraisals.

Unit appraisals are usually preferable to summation appraisals in all types of valuation work. They are markedly superior where there is considerable obsolescence or considerable going-concern value because there is no good method by which to measure obsolescence or going-concern value as such. Unit appraisals are preferable to summation appraisals in utility valuation work for the added reason that evidences of unit value are more readily available for utility properties than the evidences of fractional values, due to the record-keeping procedures of the utilities.

The reason why a unit appraisal is usually preferable to a summation appraisal can be illustrated by asking the value of the left hind leg of a horse. If the horse has a going-concern value, it is obvious that the animal's worth could not be

ascertained by placing a value on the several parts of its anatomy and adding up these values.

Another favorite illustration is the luxury hotel in an unattractive, desolate setting. Its value is obviously much less than the amount that one would derive by separately valuing the materials and labor that went into its construction and adding these separate values. The only way in which the horse or the hotel can be valued in any realistic sense of the word is by the unit appraisal methods.

Therefore, it is our intention to assess the value of the utility system as a whole, then to apportion to Minnesota that portion lying within its borders. This is not contrary to the due process clause of the Constitution. In Wallace v. Hines, 253 U.S. 66, 69 (1920), Justice Holmes, speaking for the Court, said:

> "The only reason for allowing a State to look beyond its borders when it taxes the property of foreign corporations is that it may get the true value of the things within it, when they are part of an organic system of wide extent, that gives a value above what they would otherwise possess."

Mr. Commissioner, I would like at this time to have Mr. O'Brien speak on behalf of the various valuation processes.

MR. ROEMER: Mr. O'Brien.

MR. O'BRIEN: Mr. Commissioner, ladies and gentlemen.

Why we have not used a market approach indicator.

Market value implies a price for which an entire public utility enterprise might reasonably change hands between willing and informed buyers and sellers. The term presupposes a market

of normal activity, no urgency to buy or sell on the part of either buyer or seller, and continued operation of the utility as a single entity. Public utility property is seldom transferred as a whole unit under these circumstances. Consequently, valuation of utility properties by this method is speculative and, we feel, unreliable.

A substitute for the Market Approach to Value which can be used is called the Stock and Debt or Band of Investment Method. It relies on the accounting principle of assets equals liabilities plus ownership. Thus, if we ascertained the market value of the common and preferred stock and the market value of the various issues of bonds and deducted therefrom the current liabilities, we have the value of the assets. After excluding non-operating assets and exempt assets (such as automobiles, trucks, as so forth), we would arrive at a unit value for the operating property of the utility. There are, of course, problems if certain property is leased, whether or not it should be included in the assessment. The criticisms of the stock and debt approach are, of course, the difficulty with reference to the method allowing for the influence of non-operating assets, of estimating the value of non-operating securities, and to the inclusion or exclusion (as the case may be) of current liabilities in the computation. Additional objections are:

1) The stock market does not deal in values; stock prices are not to be confused with values.

2) The securities traded do not reflect the value of the untraded securities in the same issue; market price ignores

value of control.

3) The value of the securities is not the same as the value of the underlying property.

Therefore, while both the Market Approach and its substitute, the Stock and Debt Method, were considered for the valuation process, they were not used.

Why we use the Cost Approach.

The Cost Approach to Value implies that the original cost of the property is a good indicator of value. Since cost is the expense incurred in the acquisition, it is assumed that the person paying this expense will not ordinarily expend more than what he thinks the property is worth. The cost data for utilities is easily gathered from various reports, and in most instances it is carefully scrutinized by regulatory agencies. We, therefore, feel that it is a reliable, accurate approach to value. For this reason we have assigned more weight to the cost indicator of value in our valuation process than the other indicators of value.

Why we apply depreciation to cost.

The original cost of any utility property must be reduced by certain amounts of depreciation to allow for obsolescence and general wearing out. We have allowed the cost to be reduced by the book depreciation or certain maximums, whichever is less. The holding of the depreciation at a certain maximum acts as a hedge against inflation. Even though a company's property may be old, the cost of replacing the facility at today's prices would, no doubt, be more than the original cost

at the time of installation. Holding the depreciation at a specified maximum recognizes the fact that a facility may be wearing out while also making an allowance for the fact that to replace or reproduce the facility would produce more value. The electric industry has an overall book depreciation rate of approximately 25 percent. This rate is due in part to the fact that the state of the art in electric power generation and transmission has advanced rapidly over the past years (witness the advent of nuclear power plants), and the companies have replaced to keep up with technology, we are allowing the electric companies a maximum depreciation rate of 15 percent.

Gas distribution and pipeline companies have a larger overall rate of depreciation due partly to the type of business they are engaged in. The technology used in a pipeline has not changed markedly for a number of years. A buried pipe is, after all, a buried pipe and while it might be preferable to have a larger or smaller pipe at certain times, once a pipeline is installed it is usually kept in place for a long period of time. This tends to build up large depreciation allowances. We recognize this fact but still only allow these utilities 45 percent depreciation, again in an attempt to hedge against inflation.

Why we use "Average Cost Per Kilowatt of Installed Capacity Factor."

The cost indicator of value as used in our valuation method refers to original cost less depreciation. In the course of our meetings certain taxing authorities raised the question of

using some form of replacement or reproduction cost, especially when dealing with electric utilities, to adjust the values for inflation. We then considered using various methods to allow for inflation, including: replacement cost, reproduction cost, indexed original cost, inflation factor percentages, acquisition adjustment, and major plant update. All of these approaches were rejected for one reason or another. We then adopted the "Average Cost Per Kilowatt of Installed Capacity" approach. This method computes a five year national average cost of building a major generating plant. This average is then applied to all major plants operated by the utilities. If the average is higher than the original cost of the plant the original cost is brought up to the average; if the average is lower no adjustment is made.

We feel this is a fair, workable method for a number of reasons:

1) It makes no adjustment on smaller standby type units which are often kept in working condition by a utility for peak emergency use only.

2) By using a national average the utility in Minnesota gets the benefit of warm weather building methods which are usually less costly.

3) The method gives the utility the advantage of the most advanced technology used in building of power plants, and refutes the argument that, "We wouldn't build a plant like that today."

4) It typically produces an additional value only for older plants and does not produce an "across-the-board" increase

for the newer plants built in times of higher prices.

Why we use income indicator of value.

A cardinal principle in appraisal theory is: It is the income which a property is expected to yield that determines its value. For this reason we use an income indicator of value. In order to measure the expected earnings of a utility, an average of past earnings is used as a guide. We use an average to provide stability and avoid abrupt peaks and valleys in valuation. We are of the opinion that while the income indicator is a good measure of value, it is not as reliable in a regulated industry as the cost factors, hence we have assigned it less weight.

Capitalization rates and why we use the various ones.

In computing our capitalization rates, or the amount of return a company would be expected to earn on its investment, we had a number of ideas in mind. We first attempted to compute an average cap rate for an average utility. We then attempted to apply this rate in such a way that all companies within one industry would be given the same rate; this was done in order to assure that all members of a given industry were being treated alike. In computing our rate we used three sources: Moody's Public Utility Manual, Federal Reserve Bulletins, and the National Tax Journal. We studied the average capital structure (that is debt, stocks, bonds) of utilities for 10 years, the interest and bond yields of utilities for 20 years (as many companies have long term bonds and loans of up to 30 years), and stock yields of utilities for 10 years. All of this data combined to give us an average cap rate for an average utility of 8.02 percent. We then extrapolated this rate to our three

industries. We determined that gas distribution companies were probably the most "average" utilities and so assigned a rate of 8 percent to them. Electric utilities were better than average in that they normally had slightly lower interest rates and, therefore, assigned a rate of 7 3/4 percent to them; pipelines are a bit more risky in that they are not a monopoly operation but a common carrier, hence we have given them a rate of 8 1/4 percent.

Why cooperatives are valued by use of cost only.

The reasons we have cited for not using market, or stock and debt indicators in the valuation of investor-owned utilities hold true also for cooperatives. In addition, we find that we can give no credibility to the income approach to value because cooperatives, by definition, are not profit making entities. One cooperative may have the philosophy of high rates--high dividends, while a comparable cooperative may want low rates--low patronage dividends. Net earnings do not show a true picture of worth, but are tied to policy. Therefore, in the valuation of cooperatives we use cost only and believe it to produce a satisfactory valuation.

Finally, the method we are proposing to use for integrated companies.

Integrated companies, those involved in two or more utility operations, will be valued by using the method of valuation and allocation which applies to the larger of the operations. Within Minnesota there are three such operations, and in all cases the smaller utility operation is less than 10

percent of the total. When an integrated company issues bonds, borrows money, or sells stock it does so, not on an operation basis, but on a company-wide basis. These factors of bond yield, interest rates, and stock yield affect the capitalization rate. To assign two different cap rates to an integrated company would be unrealistic; therefore, we assign only that rate which the major operation indicates. In addition, had we chosen to use a Stock and Debt indicator of value, we would have been compelled to value an integrated utility as one due to the fact that the value or price of the stock is set on the whole operation, not on one portion or the other. Similarly, such a company may well have many plant items which are common to both operations. It may be almost impossible to separate these items, therefore, we feel using that method of cost valuation which applies to the major operation is the most feasible way to proceed.

Mr. Commissioner, I will turn it back, with your permission, to Mr. Ask to finish our testimony.

MR. ASK: Thank you.

The allocation and why we use different allocation weights.

In the process of allocating the unit value we had a number of considerations in mind. These considerations included:

1) The allocation factors used must be readily available.

2) The allocation factors must be a raw statistic and not an allocated statistic, and this statistic must not have been developed by means of some formula.

3) The allocation factor should be either one of quantity (property) or quality (use).

4) Since it is property which is being allocated, the most weight should be given to the property factor. The Western States Association of Tax Admininistators in its report on "Utility Allocation" recommends a weighting of 75 percent on property and 25 percent on use as being ideal.

5) Different industries and different types of operations require different methods of allocation.

With these ideas in mind, we allocated the three industries as follows:

Gas distribution companies are allocated on a basis of 75 percent gross plant and 25 percent gross revenue. In this industry sales normally are in a direct relation to the distribution plant. It would be most uncommon if not impossible to have a large investment in distribution plant in one state and a large proportion of a company's sales in another. We have, therefore, used the weighting as suggested by the Western States Association of Tax Administrators.

Electric utilities are allocated on the basis of 90 percent gross plant and 10 percent gross revenue. It is becoming more and more necessary in the electric industry to build plants not where a company wants them built, but where they are allowed to build them. This may mean that a company serving one state almost exclusively and hence having most of its revenue in that state, may in fact have a large investment in generating plants in another state. Placing a large weight on sales would,

therefore, distort the allocation, hence we place most of our weight on property.

Pipeline companies are allocated on a 75 percent gross plant, 5 percent revenue, and 20 percent weighted pipeline miles basis. One problem in pipeline allocation is that of geographical boundaries. A pipeline may lie in one state for pactically its total length, except that it crosses a state line to deliver all its product in a second state. One state has all the property, the second has all the sales. Clearly in the pipeline industry the property factor must have the most weight. We have tempered the straight gross plant factor with a weighted pipeline miles approach. Normally, areas of most use would have larger diameter pipes which result in a greater weighted pipeline miles factor; larger diameter pipes usually cost more to install than smaller diameter, hence this factor strikes a balance between gross plant and gross revenue.

Deduction of non-formula assessed property; why we deduct certain items.

The theory of unit value is that all property of a company is valued. Some of the property within this unit may be non-taxable, exempt or valued by some other method. These items are deducted from the unit before apportionment. In the case of depreciable plant items, general plant and pollution control devices, the depreciation applied to the item when it went into the unit value will again be applied when it is taken out. In the case of non-depreciable items, land for instance, no depreciation will be used. It has been suggested that items

valued locally should be taken out of the unit value at whatever market value is placed on them by the local authority. This cannot be done for two reasons: One, if a property is included in the unit value at X dollars, it must come out at X dollars, not Y dollars. To do otherwise is not only faulty arithmetic but could, in extreme cases, even result in negative and unrealistic residual values. Two, the local appraisal is done on a fractional basis not a unit basis; to subtract a fractional value from a unit value is like comparing apples and oranges.

The apportionment; why do we use the apportionment method?

The process employed in spreading the unit value among the various taxing districts is called apportionment. We use as a basis for our distribution of values a form of cost. Since the tax we are speaking of is, after all, a property tax, it becomes apparent that the location of the property is where it should be taxed. The location or situs of the property is also the area in which the costs are incurred. Therefore, by using a cost factor of apportionment we are able to insure that each taxing district receives a value for whatever property is located within its boundaries.

It is our intention to apportion the valuation, at least for the current year or so, on a proportionate basis of what each taxing district received in the prior year.

Mr. Commissioner, I think that completes what we would like to get on the record.

MR. ROEMER: Thank you, Mr. Ask.

Is there anyone that would like to question either Mr. O'Brien or Mr. Ask about any part of their presentation?

(No response.)

Before we get into oral testimony, I would like to remind the people in attendance that a state law adopted in 1975 limits increases in valuation in one year to 10 percent, or 25 percent of the difference between last year's values and the market value in any current year. This was apparently done by the legislature to stabilize the valuation of a taxpayer's property, and to provide some stability to the tax rolls. We are also considering applying that decrease, if it applicable in any case, applying that principle to decreases, if those decreases are applicable in any individual assessment. That is, if our new formula would decrease values more than 10 percent or would decrease values substantially, the 10 percent or one-fourth of the difference would apply.

As I indicated earlier, the notice requested anybody who wished to be heard today to advise us of the fact that they wished to be heard and the time that they wished to use. There are four people who have asked to be heard, and I will give their names and the time that they've asked for their presentation. They will not be limited to that time, but it was merely a guide in the conduct of the hearing, because I will be calling upon these people in the order in which we received their request.

The first one was Minnesota Power and Light, represented by Ed Fride, who asked for 30 minutes. The next one was Vern Kester of Otter Tail Power, who requested 10 minutes. The third one was the law firm of Peterson and Popovich,

Mr. Jim Knutson requested 30 minutes. I'm sorry, there is a change. Mr. Fride has asked for 40 minutes, Mr. Kester for 10, Mr. Knutson of Peterson and Popovich, 30 minutes, and Mr. Bob Dolan of Northern States Power has asked for 10 minutes. Then others that may wish to present any testimony will also be given an opportunity to be heard.

I'd like to repeat that any written material may be submitted up to 20 days after the hearing, and it will become a part of the record.

The first person I'd like to recognize then is Mr. Ed Fride of Minnesota Power and Light. Would you please come up to the microphone, Mr. Fride.

MR. FRIDE: Mr. Commissioner, members of the staff, ladies and gentlemen. I appreciate the opportunity to be heard this morning in connection with your consideration of the proposed new regulations.

My name is Edward Fride. I'm a member of the Duluth law firm of Hanft, Fride, O'Brien & Harries. I'm here on behalf of Minnesota Power and Light Company. My appearance is in opposition to the proposed regulations. Let me suggest at the outset, however, that having expressed opposition, as will be documented as we proceed here, I want to assure the Commissioner and members of the staff and the audience that Minnesota Power and Light Company is very much willing to, in fact encourages, further dialogue in connection with the problems under consideration. We recognize the difficulities that the

Commissioner and the staff face in this matter. We believe there is a need for flexibility in the adoption of rules, if indeed rules are to be adopted at all, and we certainly stand ready to cooperate with the Commissioner and with the staff in every respect possible in consideration of these kinds of concerns.

I might just suggest at the outset that a capsule of the reason why we feel constrained to oppose the proposed regulations is because our reading of them results in four basic conclusions: nmber one, they're unnecessary; number two, they're premature; number three, they are of questionable legality; and number four, the result of their application would be inequitable.

Now, I have filed with the Commissioner and staff a prepared statement. I do understand that a transcript is being made of the proceedings and that the statement that has been filed will be a part of the record in this instance. I would, in the interest of time, perhaps, I can shorten the presentation somewhat by not referring in length to the prepared statement; but it does have with it five attachments, which I believe may be of some value in considering the subject matter; and I would just suggest, again, as the first speaker here today (other than representatives of the Commissioner and the staff), that I believe when I said originally that the proposed regulations are unnecessary, they're unnecessary in our judgment because of the predicate and the supposition that somehow the Minnesota Supreme Court decision casts upon the Commissioner the obligation to issue new regulations.

We don't read the decision that way. I don't believe that's consistent with what has developed both preceding and subsequent to the Minnesota Supreme Court decision. As a matter of fact, a reading of the decision, I submit, reflects that the burden that is cast is not cast upon the Commissioner; the burden that is cast is cast upon the Minnesota Tax Court to make a further determination consistent with the Supreme Court decision; and, therefore, there's certainly in our judgment no need for these new regulations, and there is certainly no need for the adoption of new regulations in a time frame which perhaps may be inadequate to fully consider all the various aspects of these problems.

Now, in connection with the Supreme Court decision, I appeared as counsel for Minnesota Power and Light Company. My learned colleagues, Mr. Popovich and Mr. Knutson, appeared for the taxing districts in that case; and perhaps, since the whole series of rules have been proposed on the premise of the Supreme Court decision, it might be of some value to give a little consideration to the background, the factors that were involved, and what transpired with respect to that particular litigation.

As I'm sure all of you know, when Commissioner Hatfield began to consider the problem of the ad valorem taxation of public utilities back in 1961 and 1962, he and the staff made a comprehensive investigation of what were the attributes of the then method and what were among the possible methods that were open to the Commissioner, and what the results would be if particular methods were adopted, and he really made a very

comprehensive and quite a thorough investigation, assisted at that time, I'm sure, by the then Deputy and now Commissioner. As a result of this, he concluded in 1962 that the best indication of market value for public utilities, after considering all of the various factors, was, in effect, the original cost less a limited amount of depreciation. By limiting the amount of depreciation, the then Commissioner and staff concurred in the view that there would be a factor of appreciation in connection with that subject.

Now, from 1962, when that formula (if it wants to be called a formula) was adopted, right up until 1966 the method was working. It worked throughout Minnesota. There were no challanges to it of any substance. It did result in production of significant revenues for the State of Minnesota. The method of staggering the impact on the various taxing districts worked well, and right up until 1966 there was no real complaint about that method of establishing market value for public utilities.

In 1966, the three taxing districts which were involved in the litigation, the Township of Thompson, Thompson, and the County of Carlton, then adopted through the County Board, a different basis upon which to tax the property of Minnesota Power and Light, the utility here involved.

We have kind of an unusual situation in that district, in that I believe that Minnesota Power and Light Company is responsible for perhaps approximately 80 percent of the valuation in those districts. You have a rather unique situation in that connection.

Be that as it may, the decision of the County Board was appealed by the taxpayer, consistent with the State's formula and in support of the State's formula to the Commissioner, who then issued a decision in effect affirming that the market value of the taxpayer's property in those districts was the original cost less this limited amount of depreciation.

From that ruling, the taxing districts then appealed to the Minnesota Tax Court, where a significant, I believe, and certainly a lengthy trial resulted. The end result of that was that, as is reflected in Exhibit 1 to the statement which I have submitted, the Minnesota Tax Court, on September 20, 1971, issued its decision and affirmed on a trial de novo basis the determination of the Commissioner of the market value of the property under consideration. And, I think it's significant to note, as we trace a little bit of the history of this, what the Tax Court said, and I quote in part:

> "In forming its opinion, this Court has considered all of the factors normally employed by appraisers of property, including among other things the earning capacity of the property, the original cost, the capital structure, the reproduction cost, and the testimony of experts as to so-called comparable sales.
>
> We have given consideration to all of the methods of valuation suggested by the appellants, by the Commissioner, and by the taxpayer, and we find that the method employed by the Commissioner comes closest to the market value. We find that many of the other methods suggested have very little relationship to market value.
>
> There also is sufficient evidence to indicate that the Commissioner took into consideration all of the possible methods

> or approaches to the valuation, and that the formula he adopted was the 'best thing' he could find.
>
> The fact that the Commissioner finally determined to use a certain method of valuation to the apparent exclusion of other methods, does not establish that he was arbitrary and capricious if the method arrived at was fair and equitable. We find that the valuation arrived at by the Commissioner was fair and equitable."

That decision, incidentally, was written by Judge John Knapp. John Knapp was then and is now the Chairman of the three judge Minnesota Tax Court.

The taxing districts then appealed that decision to the Minnesota Supreme Court, and the Minnesota Supreme Court, in a decision which, presumably is the premise for the adoption of these regulations, issued its decision on October 19, 1973. This has been marked as Exhibit 2 to the statement which I have submitted.

Again, I think it's significant to note what the Court really said. It said this, and I quote, at the outset:

> " * * * Because we are unable to determine upon the record submitted that the Tax Court, in affirming the commissioner's order, made a de novo determination of the ultimate issue necessarily presented, namely, the market value of the property for tax purposes pursuant to statutory mandates as interpreted and applied by our prior decisions, and because the application of a formula alone for determining market value would be arbitrary and unreasonable, we reverse and remand to the Tax Court for further proceedings consistent with this opinion."

It was unusual to me in reading the decision, and perhaps unusual to anybody who reads the record, that the following, also, is contained in this decision, and I believe really gives support to what we submit was the ruling of the Tax Court. The Supreme Court said this, and I quote:

> "In rejecting the formula as applied to this case, we do not mean to suggest that in any individual case the one making the determination of market value might not, after considering all factors, conclude that original cost less limited depreciation most closely approximates market value. Our concern is that the reasoning of the Tax Court is susceptible of being interpreted as holding that in all cases the market value of all utility properties can be determined by application of the 1962 formula alone."
>
> And then, this significant sentence:
>
> "If we could conclude that the Tax Court intended no such interpretation and that it did (although not specifically) determine the market value upon a consideration of every factor affecting it (as its memorandum does seem to suggest), we could uphold the Tax Court's decision."
>
> They go on to say:
>
> "Since we cannot conclude that the Tax Court determined the ultimate question which would be dispositive of the dispute between the tax assessing authorities and the taxpayer and the commissioner, i.e., the market value of the properties for the tax assessment year 1966, established in accordance with statutory mandates, we must reverse and remand for further proceedings consistent with this opinion."

Nowhere does one see any reference to an obligation on the Commissioner to issue new regulations; only an obligation on

the Tax Court to reconsider the matter and make a determination in the event that they have not previously done so.

And then what happened? Back in the Tax Court an order was entered on October 16, 1974, and is appended to my statement as Exhibit Number 3. Once the ruling of the Supreme Court was made we asked the Tax Court to simply amend, if it found it necessary, its findings based on the extensive record that already been made before it. There was also a request made to them to issue an order for a new trial on all issues.

The Tax Court, in their order of October 16, 1974, did state, and I quote:

> "IT IS HEREBY ORDERED that a new trial on all issues be held and that the case be placed on the regular calendar of this Court for assignment of an appropriate trial date."

Subsequently, the taxpayer requested the Tax Court to reconsider that determination. And, this spring on May 30, 1975, and this is the last ruling now of the Tax Court prior to the commencement of the new trial, and in that decision, on May 30, 1975, it did say that it was holding to the position that there be a new trial on all issues.

And, I think it's significant to note that Judge Knapp, still Chairman of the Tax Court, said in a special concurring opinion, quote:

> "It is my opinion that in its original decision this Court did 'Give due weight to every element and factor affecting market value', of the subject property. In its Memorandum of September 20, 1971, this Court said:"

(and that's the same quote that I earlier spoke to, that they'd given consideration to all the methods and so forth). Then he goes on to say this:

> "I am of the opinion that after considering all factors, this Court did make a de novo determination of the market value. We did not arrive at the market value by the use of the formula alone. Apparently, however, we did not make that clear enough for the Minnesota Supreme Court so the Court has remanded the matter to us for further proceedings."

In other words, I believe that a fair reading of at least Judge Knapp's view is that when this matter comes back for retrial; and incidentally, another reason why I suggest that these rules are premature is that the Tax Court has now set a pretrial hearing in this matter for September 29 of 1975 and has issued its order for a new trial commencing on November 24 of 1975; and I submit that certainly at the very least that it is, perhaps, worthwhile for you to consider the advisability of waiting until the Tax Court has done that which the Supreme Court asked them to do, to remand the matter for a determination of market value, prior to issuing new regulations, which in effect suggest that we're filling a void here. There is no void, I suggest. The system is working. Taxes are being collected, and until the Tax Court makes a ruling, we believe that it may very well result in simply an affirmation of the market value as earlier determined.

I think also significant to note, that of all the taxing districts in this State, it is only in this one instance in this rather unique atmosphere in Carlton County that there has

been a challange to the basis of determining the market value.

Now, another exhibit which has been appended is Exhibit 5, and that is an order dated May 23 of 1975 from the Public Service Commission, and I think as one of the speakers earlier on said, earnings are perhaps one of the prime considerations in making a determination of market value, and obviously, anybody trying to do business in Minnesota, presumably if they're going to be taxed on a one basis, perhaps, they ought to be able to earn on the same basis or vice versa. If they can only earn on original cost, then perhaps that is the primary basis, I submit, for taxation.

In the order appended as Exhibit 5, the Northern States Power Company (in a case which I was not involved) had asked for a rate increase from the Public Service Commission (which, as you know, was set up by a recent act of the Legislature); they wanted to submit evidence to support a rate increase, including such factors and evidentiary considerations as fair value, reproduction costs, current value, and trended original cost. On the basis of objections by certain of the taxing districts, the Public Service Commission denied that opportunity, struck that kind of testimony and prepared exhibits from consideration and said, and I quote:

> "The Company shall confine its evidence of plant valuation to original cost depreciated."

And, so obviously, a utility operating in Minnesota is faced with that determination as a basis for any consideration of rates. And the result, of course, is that they can earn only on original cost depreciation.

Since these new regulations purport to operate on a totally different basis, although paying "lip service," and I don't mean to use that word unkindly, but there is running through the proposed regulations some of these concepts of earnings of original cost of appreciation and depreciation. But when you take the result of it and apply it to a utility attempting to do business in Minnesota, you really end up with a far different situation insofar as taxation is concerned as compared to the opportunities to earn.

Now, therefore, I do suggest that the admonition of the Supreme Court is not to the Commissioner, but to the Tax Court; that since the present system is working, since no one else has challanged it, and since we will soon, hopefully, have a ruling of the Tax Court on the facts then before it, that it is unnecessary and premature to adopt the regulations here under consideration.

As I said at the outset, not at all unmindful of the concerns of the Commissioner and of the staff in trying to face this problem, as I understand it, the basis again as proposed is central appraisal, if you will. We don't have any quarrel with that. We think it's intelligent. We think it's a smart thing to do.

As I understand it also, the primary premise for these new regulations is not to generate additional revenues for the State of Minnesota. In fact, as I understand it, at least in the early years, the result may be a decrease in the revenues generated from the utilities.

But, be that as it may, I don't believe that that kind of temporary result should operate to support what we believe on the whole is an inappropriate method of taxation.

Now, the legality of the proposed rules, I believe is addressed in the memorandum. I don't think that we can really get, or at least I don't suggest that we can really logically take the position, well, the Commissioner's (if you want to call it the Hatfield Formula, so be it), the Hatfield Formula was struck down by the Supreme Court and, therefore, it is not good for investor-owned utilities, but it is perfectly good for cooperatives. I don't see the consistency in that. I don't think that that's the proper basis to issue regulations for the taxation of utilities. I believe that there are those who would suggest that there's an invidious discrimation here involved in the manner in which investor-owned utilities are singled out on the one hand, co-ops on the other, gas and pipeline companies on another; different rates premised, I believe, on what may be some questionable assumptions, and the composite of that will purport to solve the problem, as I suggested at the outset, really doesn't exist anyway. I don't believe that's appropriate, and we suggest, certainly, that the different treatment for the pipelines and the co-ops, the artificial limits on earning and depreciation certainly pose insurmountable problems to the application of this particular regulation.

Moreover, I'm sure that all of us are trying, in the final analysis, to be practical. I don't think anybody wants any severe dislocation of the revenues to the taxing districts. And

nobody is naive enough to suggest that in some way various taxing districts now providing goods and services to their constituents should be deprived that opportunity to the extent of whatever revenues are generated from utilities. We have to have some kind of a methodology to accomplish that; but, more to the point, when you take the 1971 index and look at that and say this the basis upon which to look at kilowatt hour cost, and you say perhaps in the future we'll revise it; well, I suppose there are some that would suggest that '71 is a pretty long time ago, but we understand that even that index is not going to be made anymore, so that when we engrave that in the regulations, I think we have some severe concerns in terms of the overall situation.

I am not here, and certainly Minnesota Power and Light Company is not here, asking for any reduction in the present ad valorem taxes. We are not here suggesting any dislocation of revenues for the taxing districts. What we are suggesting is that the Legislature meant what it said when it said that you have to value all property in this State at market value.

I don't think that by the device, if you will, of saying we're not going to do it, that that thereby comports with the obligation that all of us have as citizens to follow the mandate of the Legislature.

The fact that there is not an acknowledged ready market of a willing buyer and willing seller for utility property, that's certainly true. We suggested that in the Tax Court. We suggested that to the Commissioner. It's a matter of fact. That does not mean, however, I suggest that one simply disregards the

value of a utility and disregard the obligation to come up with a market value which equates with the various authorities contained in the statutes and regulations of Minnesota.

So, I do suggest, in closing, that perhaps it is unnecessary to adopt these regulations. Certainly it's, we submit, premature. Certainly, we are concerned about the legality; and even if we were to concede for the purposes of discussion the legality, I don't think that the Commissioner will have any assurance of stability, because if in fact we are getting to a situation where (call it what you will, it ends up pretty close to replacement costs as the new basis for valuation), we are going to result in substantially increased taxes, which is going to have the necessary effect of substantially increased rates to consumers in Minnesota. We are going to have a concern about whether or not new plants are built or whether it isn't cheaper and more economic under these regulations to add on to existing plants. We're going to have concern about sitings of plants, and when we look around us at the energy concerns that all of us are facing in this nation, I don't believe that it squares with really what I'm sure is the intent of the Commisioner and of the staff to have a fair basis for valuing utility property as well as other property in the State.

I do suggest, as I said at the outset, that certainly Minnesota Power and Light Company is willing and desirous to engage in dialogues with the Commissioner and with all those interested and try to evidence the kinds of flexibility which we suggest also ought to accommodate some of the concerns that have

been addressed.

Thank you, very much.

MR. ROEMER: Thank you, Mr. Fride.

Before I call on the next speaker, I have a couple of comments that I'd like to make.

First of all, the exhibits that have been filed by Mr. Fride and by others are on inspection in the Department of Revenue, and anybody who wishes to see them or to copy them certainly may do so.

One other comment that lest there be any misunderstanding, from the opening comments of Mr. Fride that the proposed formula was rather hastily devised, I would like to review for the people here today the procedure that we followed leading up to these proposed rules. We have asked that there be representatives of the electric companies, and in fact the three larger companies, N.S.P., Otter Tail, and M.P. & L. were represented at our discussions. M.P. & L. had two representatives, Mr. Harries and Mr. Johnson at most of our meetings. We did ask the assessors to meet with us. Many of these assessors attended all of these meetings over a year's time; many of them are leading assessors, like Gordon Moe of Minneapolis, county assessors, Charlie Anderson, Thomas Kurpius, Gene Bopp, Marty Walsh, that assisted us in the preparation of the proposal that we have before us today.

We also considered the formulas used by other states and discussed the matter with experts in the field of utility valuation in other states in the nation. So, we have been

working on this over a year.

There were some comments following the adoption of the last formula in 1962 that that formula was enacted without permitting public comment after consultation only with representatives of the utility companies. We wanted to avoid this by including assessors in all of our deliberations, and holding a public hearing, which we are holding today, to permit any interested member to express his comments on it.

The next speaker that I would like to call upon is the representative of the Otter Tail Power Company, Mr. Vern Kester.

MR. KESTER: Mr. Commissioner and members of this hearing board, my name is Vernon L. Kester, Tax Accountant for Otter Tail Power Company. Also attending this hearing with me today is Mr. Dennis Emmen, our company Controller.

I wish to thank you for the opportunity to be heard in the matter of the proposed assessment procedures for utilities, and before I get into my prepared text here, I would like to indicate that we do concur with the statements that Mr. Fride just has covered.

I believe you all have copies of my statement. I'll get into that now.

In the proposed formula for the assessment of electric utilities, a depreciation rate of 15 percent has been set as opposed to the 2 1/2 percent per year, up to a maximum of 25 percent, under the previously used formula. In our opinion, a rate of 15 percent is unrealistic. Otter Tail Power Company's system depreciation as of December 31, 1974, was 36.4 percent.

Our projected system depreciation for year end 1975 is 27.5 percent, and this includes our new, large generating plant in South Dakota.

A major factor, with respect to assessment of our property, is the age of our generation plants in Minnesota. Following is a listing of our steam and diesel plants and the dates acquired. I won't read each individual one of those, but you will note that the plants are aged from 1911, our plant at Canby, and our most recent unit was our Hoot Lake Unit #3, which went on the line in 1964. So, from this we can conclude that most of our generating units in Minnesota are getting considerably old. When comparing the efficiency and cost of operation of newer and more modern generating facilities with the majority of the plants listed above, it becomes a matter of economic necessity to treat our plants as standby and emergency units. With the exception of our most recent units added at Hoot Lake, our remaining plants are operated only when absolutely necessary. Considering the age, efficiency and economic value of these plants, a depreciation rate of 15 percent appears to be woefully inadequate.

Two of our steam generating plants were retired this year. The plant at Canby was retired on May 1, and the Crookston plant was retired on June 1. The Canby plant had no generation during the entire year 1974, and the Crookston plant was operated on a limited basis due to obsolescence. In our system of bookkeeping, taxes based on the 1975 assessments will be accrued as expenses in 1975, and the taxes will be paid in 1976. It does

not seem logical to include the full book cost of such property as the above-mentioned plants in the determination of our assessment for 1975. We are certain that assessments made on the local level recognize obsolescence and earning potential of property. There is no way that we can recover property taxes on property that no longer produces revenue.

Another factor that bears consideration is that utilities are capitalizing costs that other types of business would be allowed to expense. Our accounting procedures are determined by Federal Power Commission regulations, and we find each year that we are spending a large number of dollars in replacing and improving facilities. The majority of these costs must be capitalized and normally do not increase the earning capability of our property. We are continually rebuilding distribution systems, replacing poles and other equipment in transmission lines, moving lines due to road construction, and making other expenditures that do not result in additional revenue to the Company. The primary thing that does result from these costs is additional tax base. Granted, we are increasing the life of this property, but considering the age of the property being replaced and because we are not increasing earnings, a depreciation factor of 15 percent does not give us much relief for the costs involved. In spite of the fact that we are continually making expenditures of this type and capitalizing the costs, our system depreciation is still over 36 percent.

Another factor that does not affect our Company at the present time, but will affect us substantially in the future, is

the proposal to add value to a generating plant when its cost per kilowatt of installed capacity falls below the national average cost for large generating plants. It is my understanding that the average cost to be used for 1975 assessments is about $135 per kilowatt. It will be a very short period of time, and this average will increase to many times that amount. For example, the cost per kilowatt of installed capacity of our Big Stone, South Dakota, plant is about $375. The projected cost of our Coyote I plant to be built in North Dakota is $795 per kilowatt. When the calculation of the average cost of generating plants includes those now being constructed, the results will add unrealistic valuations to old and high operation cost plants.

We must also take exception to the proposal that electric cooperatives are to be assessed on a different basis than investor-owned utilities. For example, our company has several substations in which there is joint ownership with a cooperative. It does not seem logical that our equipment would be assessed on one formula while the equipment owned by the cooperative, in the same substation, is assessed under a different formula. Another example is where we have joint ownership of a high voltage transmission line. If Otter Tail owns a line from point A to point B, and a cooperative owns an identical line from point B to point C and with both utilities having the same investment, should not the assessments be the same for both parties? We believe that utility property should be assessed on an equalized basis regardless of ownership. Under the proposed formula, this is not possible.

It is our opinion that the proposed formula for assessing electric utilities will result in a further disparity in the matter of equalization of assessments. Adoption of a depreciation rate of 15 percent will result in a step backwards for our company in achieving equalization with other taxpayers. We believe that the depreciation rate should be increased to a figure more in line with the book depreciation rates of utilities. We also urge that a factor be included in the formula that will recognize the true value of old and obsolete property with little or no revenue producing potential, especially when the property is in the process of being retired. We also urge reconsideration of the factor that would add value to the large generating plants when installed cost is below the national average. This will add a considerable tax burden to utilities that will multiply as the national average costs reflect present and future construction costs. We must also protest the proposal that would assess cooperatives on a different formula than investor-owned utilities.

The proposed formula, in its present form, will increase Otter Tail Power Company's market value and consequently its property taxes above a level that we feel represents our share of the property tax burden. Our customers will be the ultimate victims of these added tax costs, and we would be doing them a gross injustice if we did not strive for tax equalization.

This concludes my presentation.

MR. ROEMER: Thank you, Mr. Kester.

The next hearing request is from the law firm of

Peterson and Popovich, Mr. Popovich.

MR. POPOVICH: Mr. Commissioner, Mr. Plutzer, Mr. Ask, Mr. O'Brien, Mr. Garski, I want to compliment the Department on what its been trying to do for the last year or so in respect of this very knotty problem.

I should say at the foremost that I am registered under the new Ethics Act, and have been so since the Act has been passed.

I should tell the Commissioner, what we had planned to do with our time was to permit, in addition to myself we have the expert that the county had hired and testified in the hearing, who has prepared a short comment as to some of the details of the formula that he could much better relate to you than I could. So, I want to reserve some time for him. We do have the Chairman of the County Board here and the County Assessor in case they may have any comment to make. They haven't yet so indicated to me.

I didn't think that we would be relitigating the M.P. & L. case here today. Very frankly, one could go on and on in that litigation as it's spread over a number of years. But, let's put a few things in perspective, because I do not want Mr. Fride's comments to color the responsibility of the Commissioner and the Department in applying his particular words.

Bear in mind that the Commissioner's formula in 1962 was adopted without a public hearing. There was some consultation among some tax paying people, and I believe, Commissioner, you were Deputy at that time, so you know what went into that. We did raise that question during the hearings, that

the taxing people did not have an opportunity of getting involved and that, consequently, any formula should have greater breadth of participation. I want to compliment you and the Department on setting this hearing today so that very thing could be done.

After the Commissioner's formula went into effect (bear in mind that that started to move down a little bit year by year; it had a ten-year period to go into effect), the average county board commissioner, the average county assessor (and there were changes up in Carlton County during this period of time); there was no great change as in '63, '64, and '65, what happened in '66, though, is that the taxpayer, not wanting to wait for the ten-year period to lapse, decided to file an application to hasten it and to put it into effect immediately. He was challenging the very formula that they are now supporting, because they said we didn't want to wait for the ten years. That then caused the consternation. County board retained Lawrence Yetka, who's now a member of the Supreme Court, who in turn suggested that our office be involved. We took over the handling of the particular case. We had to go in because the impetus came from the taxpayer, and at that point we decided to look into the whole formula, what the total impact was.

At that time the Thompson Township plant, the plant in Thompson Township, paid some 80 percent, it was 80 percent of the tax base of that county. What the taxpayer wanted to do was to hasten the formula so that in the end result the valuation by that plant would be down to some 20 percent of the assessed valuation of the county. They wanted to get the assessed

valuation reduced to a figure of approximately $400,000 under the laws then in effect, which if you multiplied by three would be roughly $1,200,000 under today's approach to assessed valuation. Clearly, clearly an indication that the taxing public officials had to do something.

It's been a long laborious process. Each year there has been a Chapter 278 proceedings filed. There backlogged in the District Court of Carlton County. Each one of them are awaiting the final decision on what should be the value in 1966. So, when someone addresses you and says there is not need for something to be done, there certainly is, because we don't know at this particular point in time what the valuations will ultimately be without contest. We cannot go on year after year after year with Chapter 278 proceedings being filed.

All right, we appeared before the Commissioner; Commissioner Hatfield sustained his formula, we went to the Tax Court. It was a long lengthy hearing. We prepared our expert, Mr. Spencer, from Seattle, Washington, to come on in and make a complete study, big booklet. I believe I sent it to the Commissioner, and you have a copy as well as the Tax Court and other people that were interested in it.

It was only after his appraisal was made that the County at that point said we now have a valuation based on market, as we see it, and that's what they then ordered the County Assessor to put on the tax rolls by an appropriate County Board resolution.

At that point the taxpayer started another action up in District Court in St. Louis County to prohibit that type of setting of the valuation based on our market value appraisal that had been received. They lost that case, and from then on, from 1967 and on, the values that have been placed on the tax rolls are the values that have been based upon the appraisal of our expert that the County hired for the benefit of itself and the Township and the school district.

Each year thereafter, Chapter 278 proceedings have been filed, and as I said, have not yet been litigated because they're awaiting to see what's ultimately going to happen.

What we're interested in, of course, is not only taking care of the last nine years that is still in abeyance because under Chapter 278 proceedings the taxpayer has only been paying one-half and then one-fourth of his taxes. There have been a backlog of taxes unpaid.

This has caused a problem with the school district, so that the Legislature has had to adopt a special law to take care of that school district, because of the aid formula and the tax base and what they haven't been able to receive; and the Commissioner, obviously, should be aware of that; not only that, as aware as the matter went on that we were going to move into state regulation, and in 1974 the Legislature did pass the state regulatory bill. At that particular point in time there was an attempt to try to put on that bill before the House Tax Committee a clarifying amendment to the extent that for ad valorem tax purposes original cost would be the method to be used. In other

words, reinstating the Hatfield Formula.

I see Mr. Plutzer smiling. He was there that particular day. The Commissioner was attending a tax conference up in northern Minnesota, as I recall at the time. You weren't at the particular hearing.

And, we, of course, told the Committee the background of the case, and rather than tie up the rate regulation bill with an ad valorem thing that hadn't had much of a hearing, other than that particular day, the Committee refused to take any action.

All the reason more why it's necessary for the Commissioner and the Department to be doing something today so that a value can be set on properties, including these properties under controversy, from this point forward. And hopefully, in the litigation that has been going on we'll eventually settle and dispose of the last nine years that is still there.

So, that there is a need for the Department to act, and, obviously, whatever decision you make here today is not going to be retroactive. It is going to be for what are values for utility companies from this point forward.

So, rather than say there's nothing needed, there's a great need. Nothing would be needed, I suppose, as far as this isolated situation in Carlton County, if the parties could get together, settle the matter, dispose of the last nine years, and arrive at a figure they could live with. Now, that hasn't been able to be accomplished at all; so that, in effect, if that were done, so that the parties could tell you we've settled our differences, then you could take with some grain of wisdom

(if you wanted to call it that), that since they settled their problems, perhaps we ought not to do anything, or need not do anything.

On the other hand, the Department and the Commissioner must be mindful of what the Supreme Court said in its Opinion. It is true that the only thing under consideration at that time was one isolated issue, and that issue was, what was the value of properties in consideration for the taxable year 1966? And, it's true, as you read the particular Tax Court decision and the Supreme Court decision that followed it and reversed them, the matter was remanded back for back determination. Several motions were made by Mr. Fride and the taxpayer to then set a market value based on the original Commissioner's finding. Tax Court, as then constituted after the Opinion came down, refused. The matter is being tried and being set for a complete trial de novo, completely new.

In effect, if we were in district court and the matter were remanded back for complete in the trial, Judge Knapp wouldn't be sitting on it. We'd have another judge; but, because of the nature of the Tax Court, he is still sitting on it, and we have two members of the Tax Court who will hear this matter from scratch and evaluate all the testimony and evidence to be given.

Well, what is the admonition of the Supreme Court to the Department and all taxing officials in that Opinion that came down in the fall of 1973, forgetting about the isolated issue of what the value should be on that plant? The Supreme Court didn't say that that's the only matter that was wrong with the formula

as how it was applied in that instance. When you read the Opinion as a whole, and the Court obviously went on to give the complete guidelines to the taxing officials of our state, they said the difficulty we have with the formula approved by the Tax Court, which was the original Hatfield Formula, is that it makes market value synonymous with original cost taking into account limited depreciation and gives no weight to any other factor affecting market value.

Now, can you ignore what the Supreme Court said when they said that? As we have indicated in numerous decisions, original cost is only one of several relevant factors which should be considered in determining market value. The reason other factors such as reproduction costs, earning capacity, and comparable sales prices should also be considered is because the statute referred to read together and require that assessing authorities:

> "consider and give due weight to every element and factor affecting the market value."

Not just one, every one should be considered. And then they go on further, in this very lengthy Opinion, and it says:

> "The record makes inescapable our conclusion that determining the market value of the subject property by application of the formula alone ignores the statutory mandates for assessing properties and is therefore arbitrary and unreasonable."

Now, how can any commissioner or any department of taxation ignore that language? And then follows the additional language that they say in which we are remanding the matter back

for the Tax Court to make a determination of what the market value will be. And why? Because, they say in the very quote that was buried in the larger that Mr. Fride gave you:

> "Our concern is that the reasoning of the Tax Court is susceptible of being interpreted as holding that in all cases the market value of all utility properties can be determined by the application of 1962 formula alone."

In other words, they said you can't do it based on the '62 formula alone, and you must consider these other relevant factors.

Now, I'm not completely happy with the proposed regulations before you, because, obviously, we're committed to getting the highest taxable base for our County. We would prefer reproduction costs less depreciation or obsolescence. It gives us a higher figure.

But, it is true that applying the formula, as you have set it out in the matter under consideration today, does take into consideration the relevant elements to arrive at market value and does arrive at a compromise between this very low figure that the taxpayer wanted to get at (we didn't institute the litigation; they did; we responded to it), against a higher figure that we would prefer to have over on reproduction costs. And yet, when you look at what the ultimate would be if we've applied it to these particular properties, it's in between there, and something that both parties obviously, with all relevant factors considered, would have to live with. A compromise is a compromise. An approach is an approach. But, at least your approach considers other things other than just original cost

depreciated.

Plus the fact, as the Supreme Court pointed out in that Opinion, which your formula would take care of because of the factors you have considered, we had a sale of the properties in 1927 over the original cost of 1907 of six million more than what was carried on the books. And under original cost they were using 1907 figures. At least in their original cost they should have the sales price of 1927 on, and that wasn't done. And under your proposed formula those things get washed out in the very factors that are being considered.

So, we believe it's timely, it's necessary in order to take care of the situation from this point forward, at least in this County, so that we can get this matter at rest; and eventually, whether it's in the Tax Court or the Supreme Court, we'll arrive at a figure for what the valuation should have been in 1966, and then all those backlog cases up in Carlton County for '67, '68, '69, all the way through this year will finally be disposed of once we get that applied. And that in itself will take time. But, why do we have to go on for another ten years and have the future clouded as well as the last nine years is concerned.

With those background materials, and I said I didn't think we'd be litigating the M.P. & L. case here today, but there are a number of factors that the Department should be aware of, and the reading of the Supreme Court decision should be read in all four corners; I don't care what the Tax Court said in its decision (and I know that's Exhibit Number 1 or 2 attached to Mr. Fride's statement); they were reversed, they were reversed,

and the Supreme Court said, take it back, you didn't consider all the things; and then when Mr. Fride made his motions to put the formula into effect, at that time after the Supreme Court had ruled, the Tax Court refused to do so and granted a complete new trial de novo, and now we're going to go in it.

And incidentally, in the particular cases (the Supreme Court pointed this out), they thought that perhaps the record, since we went in on the basis and all the parties were on it including the Tax Court, that we were limited to proving that the Commissioner was arbitrary and capricious; and that, therefore, our burden of proof was in a different vein. Actually, they said the hearing should be determined on what is the market value and not limited to the burden that we had of showing that he was arbitrary or capricious. So, that widens the scope of the hearing yet to be commenced.

With that as background, Mr. Commissioner and members of the panel, I'd like to call on Mr. Leon Spencer. He has a short memorandum that he will pass to you.

Mr. Spencer is a civil engineer. He's licensed in the states of Washington, Alaska, Minnesota, Hawaii, Massachusetts, Virginia, and Arizona. Since 1955, he's engaged throughout the country in over 80 utility appraisals with aggregate appraised values of over $825 million. He's appeared in other states. He's been hired by the states of Vermont, Massachusetts, New Hampshire; both by local subdivisions of government as well as the state tax departments there to assist them in arriving at ad valorem taxes.

May I say this if I don't have an opportunity to get up when you get through, I do not know what Mr. Fride has in his statement, and usually after rules and regulations hearing has been concluded, I believe there's a period of time in which final statements can be submitted; I think it's 30 days.

MR. ROEMER: Twenty days.

MR. POPOVICH: All right. We would get a copy of his statement. I would want to address myself to the classification concept that Mr. Fride brought up, because in my opinion, you can properly classify. You can make the differences that you've had in this particular formula. We've had different kinds of ad valorem approaches for refineries, for parking ramps, for a number of things. I believe this citation should be given to the Commissioner on that particular point, and we wish that opportunity to respond there.

Without any further adieu, may I call Mr. Spencer, who will go through the report through his comments as to some technical changes that should be made; and if there any questions that, Commissioner, you wish to ask him, or any of your people, feel free to do so.

In closing, may I say that we've looked forward to this day. We think it's appropriate. We want to commend you and your Department people for the work you've done on it. I wish I'd have had a greater opportunity of participating; but we did have some opportunity. Mr. Knutson, Mr. Rhude from our office, were kindly given an audience by Mr. Garski and Mr. O'Brien. They did participate, and as I said we're supporting the formula as a

compromise. It's, obviously, an approach. You have considered the elements. It's not as far as we'd like to go, but at least we're now coming to grips with the problem that has been with this state, and in particular Carlton County, for some period of time.

MR. ROEMER: Thank you, Mr. Popovich.

Mr. Spencer.

MR. SPENCER: Mr. Commissioner, members of the staff, ladies and gentlemen, my name is Leon Spencer. I'm a consulting engineer and appraiser from R. W. Beck and Associates, whose principal office is located in Seattle, Washington.

I have been asked to prepare comments on the document entitled "Department of Revenue Ad Valorem Tax Regulations, Chapter One: Valuation and Assessment of Electric, Gas Distribution, and Pipeline Companies" consisting of some seventeen pages.

My comments are largely in the form of law changes, wording changes, additions, and perhaps deletions of certain items that appear in that particular document.

My comments, that have been printed and distributed to you, reference the various pages and the line number as I have counted the lines, at any rate, on the various pages. Perhaps it would be well and just to go through those various items so that others in the audience would have some idea of the nature of the comments and what they specifically have to deal with.

My first comment has to do with the concept of owning property, and throughout my comments the tenure is that the word "owning" should also be qualified to include some reference to

"utilizing." It has been my experience recently that some public utilities have found it necessary to ease their capital expenditures by leasing property, and this then has brought in property for their use without a capital expenditure, without recording it upon their books, and perhaps they are not even the taxpayer responsbile for that property. But, where tax property is to be taxed at the situs, in some states at any rate, the user is taxed. If not, it is well, I think, to have it brought to the Commissioner's attention that this property does exist and that there should be someone taxed for this property.

So, with that in mind, on page 1, line 13, I have suggested the words "or utilizing" would follow the word "owning" the property.

On page 4, between lines 2 and 3, I would suggest a new definition, an additional definition for "Minor Generating Plant," which would be: "Any steam-electric, hydroelectric, internal combustion or gas turbine plant, smaller than a major generating plant. The valuation, then, would be determined on the same basis as transmission and distribution station equipment." That was suggested merely to, shall we say, complete the picture of taxation, inasmuch as it didn't appear that these were specifically identified elsewhere in the document.

Again, on page 4, line 9, the reference to the word "owned or leased."

On page 6, line 13, the suggestion that the words be inserted following "actual cost". The words would be "of production plant (except land)".

On page 6, line 17, I would suggest the insertion of "of production plant (except land)" following the words "construction costs". This would merely define more specifically what I believe it is the intent of the document to convey.

On page 6, line 17, I would suggest the words be inserted "in the continental United States" following the word "plants". This is in the context of determining cost of steam-electric and hydroelectric plants. The books cited refer to plants in Puerto Rico, I believe the Virgin Islands, Alaska, and Hawaii, many of which might not have a degree of comparability that I think is sought here. So, I would suggest that it be limited to the continental United States.

Page 6, line 22, I would suggest the addition of the words "and Gas Turbine Electric Plant Construction Cost and Annual Production Expenses". This is another publication by the Federal Power Commission, the first edition of which has just been released this year. It is a companion document to the hydroelectric and the steam-electric plant construction costs booklets that have been previously cited.

I might add, incidentally, along that line, I checked with an acquaintance in the document section of the Federal Power Commission this morning. I raised the question as to the likelihood of these documents being suspended. First off, he stated that he knew of no suspension plan, or none that had come to his attention, and that he would check further into the matter, however. He did state one item that may have led to a misunderstanding. He stated that, "Yes, the Federal Power

Commission was no longer publishing the Steam-electric Plant Production Cost or the Hydroelectric Plant Construction Cost. However, they are being printed by the General Printing Office." The distinction being that the Federal Power Commission is not doing it itself, but the documents will be continued as far as this person knew.

My next comment has to do with page 6, line 22, the suggestion of a new sentence as follows: "Average cost per kilowatt of installed capacity will be determined after excluding (a) federally constructed, multi-purpose projects, (b) nuclear electric generating plants, and (c) pumped storage plants." This again is a means at getting at more comparable types of plants that you wish to determine an average cost for. Certainly, pumped storage plants should be compared with other pumped storage plants, and likewise with nuclear plants, rather than in some average that might be applied to coal-fired steam plants.

On page 7, line 16, a suggestion that, line 16 through line 19, a suggestion that the following two sentences be stricken from the proposed rules. Those sentences are: "The average net earnings will be capitalized at the rate that is currently used for the industry. Capitalized earnings are the present worth of the future returns that the property is expected to produce." Those two sentences, in my opinion, do not add a great deal to the meaning of the document and could, perhaps, lead to be the basis of future litigation.

On page 11, line 16, insert the words "the effectiveness and cost of which has been certified to the Commissioner of Revenue by the Environmental Protective Agency and". Those words would follow the word "equipment". That is merely a means of having another party certify to the Commissioner an inspection procedure that is normally carried on by that agency anyway, so that the Commissioner of Revenue, of Taxation, would not have to make the determination of whether a particular facility did in fact abate pollution and what it's value might be, that this would be done by people who regularly do this sort of thing. This is the case in certain other states where I have worked, that the taxing bodies do not have to go through this step, and that they simply rely upon statements that are furnished them by other agencies.

Again, on page 12, line 11, a reference to leased properties, the inclusion of the reference to leased property, the inclusion of the words "including the cost of leased taxable property."

Page 13 and page 14, add the items "Utility Plant Leased". so that a separate statement could be used to identify any property that is under the control of the taxpayer that is leased.

Similarly, on page 15, add the words "Utility Plant Leased".

On page 17, Item 1, add "(including leased plant)" after the words, and I have a misprint on my document, "Last Market Value" rather than "Lost Market Value".

Those, Mr. Commissioner, constitute the comments that I have made upon these documents.

Thank you.

MR. ROEMER: Thank you, Mr. Spencer.

Mr. Popovich, do you have anything further that you wish to present as part of your testimony?

MR. POPOVICH: We've taken up our 30 minutes. I did confer with the County people. At this time they wouldn't have anything further to add.

I might just say that, I intended to say while I was talking earlier, when Mr. Fride mentioned the possibility that, addressing himself to the Public Service Order that's before you as Exhibit Number 5, I think it's the last exhibit; I believe the rule of law is that you can have one basis for ad valorem taxes and another basis for rate making purposes; and obviously, until the Legislature does act, we have to arrive at what market value is, and I'll be happy to provide what citations we can to support that concept. I'm not concerned that the Public Service Commission has issued an order for rate making purposes because taxation is only one aspect of expense of the whole number of things that they look at, and that for ad valorem tax purposes, which just makes one aspect of expense that there can be a different rate base, any your approach here and this formula approach would be justified would not be illegal in that respect.

MR. ROEMER: Thank you, Mr. Popovich.

We have one more person who has asked to be heard. It is around 12:00. For the purpose of determining whether we

should continue and conclude this before lunch, or whether we should break and come back, could I ask for a show of hands from all of those who have not asked to be heard that would like to be heard in connection with these proceedings.

(No response.)

No one?

Well, then we will continue with the last person who has asked to be heard, Mr. Bob Dolan of Northern States Power Company.

MR. DOLAN: Mr. Commissioner, I have a statement that I would like to read into the record, copies of which I have just distributed.

Mr. Commissioner, for the record, my name is Robert Dolan, Manager of the Property Tax Department for Northern States Power Company.

May I say at the outset that we also concur with the testimony of Mr. Fride.

The purpose of this hearing is to consider testimony pertaining to the proposed adoption of "Ad Valorem Tax Regulations" for certain utility companies. The unit value method of determining the value of utility property is the most widely used and accepted system used by state tax administrators. There are approximately 34 states that centrally assess public utility property, and most of them do so on the unit value system. The purpose of our testimony, therefore, is not to critize the unit value concept but rather in the interest of our customers, to protest certain factors included in the proposed regulations. The Department has proposed that three formulas be

adopted; one for electric utilities, one for gas distribution companies, and one for pipeline companies.

Our concerns lay in three major areas. First in the order of importance is the proposal for adjusting the value of major generating plants. Second is the proposal to combine our company's facilities thereby treating our electric and gas property on the same basis for tax purposes, and the third the various rates used in the formula, namely, the limited depreciation rates, the inadequate capitalization rates, and disproportionate weighting factors.

Our most significant objection pertains to the adjustment of value for major generating plants. The five year average cost per kilowatt of installed capacity was indicated to be $133 per kilowatt. Based on our current projections, the average cost of installed capacity for NSP will more than double during the next ten years. The estimated effect of this projection would add $3,200,000,000 to the original cost of our major generating plants. For example, the Allen S. King plant has an original cost current book value of $82,000,000. Projecting the installed cost per KW for the next ten years would result in an increased accumulated taxable value of over $600,000,000.

To this extent we contend the proposed additive method is contrary to accepted appraisal practices, violates the orderly process of valuation, and cannot, by its inclusion in the formula, produce market value.

Our second area of major concern is the combining of our company's facilities for tax purposes. The properties of a gas distribution company are valued on the unit value system in a manner similar to the properties of an electric utility. The only differences between the two formulas are the various rates and a philosophical difference if the gas utility is part of a multiple utility operation. Gas distribution utilities are allowed to reduce their original cost by their reserve for depreciation to the limit of 45 percent; net income is capitalized at 8 percent, and the two are weighted at 75 percent and 25 percent respectively.

I would like to mention two legal issues pertaining to the proposed regulations. First, it is our understanding that the Department intends to value all of NSP's operating property under the electric formula, instead of valuing the property of our gas utilities separately under the gas formula. Because we are an integrated company, we will be treated uniquely in this respect. This procedure will place a higher tax burden on our gas utility than on all other gas utilities. We believe there are serious legal shortcomings with this procedure.

Second, though we have been informed that this procedure will be followed, there is no provision to this effect in the proposed regulations. The regulations as written say nothing about integrated companies, and would require that our gas utility be treated under the gas formula. Special treatment of NSP as an integrated company is a very significant aspect of the proposed valuation schemes, and we doubt that it can be

enforced unless it is contained in the regulations. Please be advised that our attorneys will provide you with a detailed written statement on these matters within the next 20 days for inclusion in the record.

Having a separate formula for gas properties admits that there are substantial differences in the financial patterns and property between the electric and gas utilities. The product is different, the properties for distribution are different, the rate structure is different. The difference between depreciation reserves proves that gas properties are older, and, therefore, must be treated and valued separately. The differences are sufficient to preclude the combining of utilities, electric and gas for tax purposes. The depreciation schedules, rate structure, and economic projections of all gas suppliers are based upon the same data and, therefore, the results are virtually identical. There should be no difference, therefore, in the market value of the gas property of a singular gas utility as compared with another simply because one also generates electricity.

Our current depreciation reserve for our gas facilities, according to the FPC, amounts to 29 percent. This supports the argument that to compel us to use a depreciation rate of 15 percent in view of the actual of 29 percent, almost double, and in view of what other gas suppliers may use is clearly restrictive.

The Department has indicated that it will use three different capitalization rates in valuing utility property. The

rate for electrics, for instance, would be 7 3/4 percent, for gas distribution companies it would be 8 percent, and for pipeline companies it would be 8 1/4 percent. The Department has used a 20-year interest rate and bond yield study as part of its calculation of a cap rate. We feel a 20-year average is unreasonable. The amount of outstanding debt of that age is rapidly being replaced. It would be more realistic to limit the period of the study to ten years. Those ten years should then be divided into two five-year groups and appropriately weighted to account for the rapid changes in the market. However, because we are unable to verify other data used by the Department in the computation of the cap rates, we cannot accept the rates as they are proposed.

There are three basic approaches used in computing capitalization rates, but only the Band of Investment method can be depended upon to provide acceptable results for public utilities. The Band of Investment method looks to industry medians of debt and equity costs and prorates them in proportion to their respective security market values.

We have arrived at a cap rate through the use of the Band of Investment method that more closely recognizes the economic pressures of today's market. We submit, therefore, for your consideration a capitalization rate of 9 percent. The cap rate was determined by calculating the various capitalization ratios of short term debt, long term debt, preferred equity and common equity. The cost factors were weighted in relation to the capitalization ratios and the resulting weighted cost produced a

capitalization rate of 9.045 percent, which has been reduced for brevity to 9 percent.

The capitalization rate of 9 percent should, therefore, be applied to the net income of the gas utility. The capitalization ratios are the same for the gas facilities of NSP as they are for the electric facilities. Therefore, since the ratios cannot be identified by utility, either electric or gas, there is justification for using a coincidental cap rate for both facilities. The argument of identical capitalization ratios, however, is insufficient when applied to the theory of identical depreciation limits, because depreciation speaks directly to investment, and this can be clearly identified by utility under the FPC uniform system of accounts. As long as the plant investment can be identified in accordance with the FPC regulations, there is no reason for not using the actual utility depreciation reserve.

Although most states value electric and gas utilities by one set of factors in the unit value formula, Minnesota presents a unique situation. The formula before us proposes that the market value of the gas properties of a non-integrated gas utility is to be determined on the basis of its individual economic indicators while the market value of the gas properties of an integrated utility is to be determined on the basis of the economic indicators of its electric operation. It is neither a logical approach on the basis of the foregoing data, nor is it a proper approach, because it is not provided for in the regulations.

Under these circumstances it is impossible to justify how one gas utility can be favored with one set of valuation parameters while yet another gas utility is penalized under a different set.

If the constitutional guarantees against discrimination are to be met, then the combined formula as suggested for gas facilities of integrated utilities must be abandoned in favor of the individual gas valuation formula.

The valuation of an integrated utility by any combination method is improper and violates the very reason we are here, that is, to determine the most appropriate method of discovering public utility market value.

In the third area of concern your attention is directed to the various factors of the formula. The formula established by the Department for the electric utility valuation limits the depreciation to 15 percent, limits the capitalization rate to 7 3/4 percent, and provides a weighting of 85 percent to cost and 15 percent to income. Regardless of the actual depreciation reserve we are prevented from using a more conservative 15 percent.

A very fundamental definition of depreciation is the loss of value from any and all causes. The formula presumably allows for all aspects of depreciation within the categories of physical deterioration, functional and economic obsolescence. But there also exists functional depreciation through inadequacy. It is the necessity to replace in whole or in part plant and equipment because demand exceeded capacity. This can result in

the replacement of equipment well before it would otherwise wear out. The old adage that "more buildings are torn down than fall down" is especially true of utilities. Close to 80 percent of the property we retire is retired because of functional rather than physical obsolescence.

Because of the inability to accurately quantify the rates for functional and economic obsolescence we recommend that the Commissioner restore the depreciation limit to the originally considered 25 percent. A 15 percent limit on depreciation is too restrictive, because it denies the utility the economic benefit of using its individual depreciation reserve which reflects the full scope of depreciation.

The capitalization rate of 9 percent should also be applied to the electric facilities for the same reason as I outlined for the gas facilities.

The formula before us states that the cost factor will be weighted at 85 percent while the income approach will be weighted at 15 percent. This obviously produces a market value heavily favoring the cost approach. While it is conceded that cost factor should bear the predominant weighting it is submitted that the 85 percent is exhorbitant in view of the inflationary pressures which reduce the purchasing power of everyone's dollar.

The overall effect of the proposed weighting factors overstates the value of the cost approach at a time when our investments are already inflated and reduces the value of the income approach at a time when income is deflated. Greater recognition, therefore, should be given to the reduced earnings

through a higher weighting factor.

We, therefore, recommend that the Commissioner adopt the original concept of weighting the cost at 75 percent and the income at 25 percent.

This concludes our testimony, and we appreciate the opportunity to appear before you.

MR. ROEMER: Thank you, Mr. Dolan.

We have been advised that written statements will be filed by four companies: Williams Brothers Pipe Line, Montana-Dakota Utilities, Northern Natural Gas, and the Minnesota Gas Company. These will be available for inspection after they are received in the Department of Revenue.

Is there anyone who has not been heard that would wish an opportunity to speak on the proposed rules this morning?

(No response.)

Seeing no one, is there anyone of the previous speakers that would like to add anything further to the testimony that they have presented earlier this morning?

(No response.)

Since there is no further testimony to be presented at this hearing, I want to thank all the witnesses for their comments concerning our proposed rules. As I indicated before, the record will be kept open for twenty days for the submission of any written material, which will be made a part of the record on these rules.

Thank you, very much.

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October 13, 1975

Commissioner Arthur C. Roemer
Minnesota Department of Revenue
Centennial Office Building, 2nd Floor
Saint Paul, Minnesota 55145

Re: In the Matter of the Proposed Adoption of Rules of the Department of Revenue Relating to Property (ad valorem) Tax

Dear Commissioner Roemer:

Northern States Power Company has consulted our office with respect to the proposed rules on ad valorem taxation of utilities, which were the subject of a public hearing held on September 23, 1975. We are submitting this statement with Mr. Jack Sjoholm, Jr., an attorney in NSP's law department, for inclusion in the hearing record. Because of the intervention of the legal holiday on October 13, the 20-day comment period extends through October 14.

We wish to discuss a series of legal issues pertaining to the intention of the Department to place NSP in a special category as an "integrated company" and treat it differently from all other major utilities in the state.

The proposed rules prescribe three different valuation formulas for electric, gas and pipeline companies. While Section 2 contains a definition of the term "integrated company," there is no further reference in the proposed rules to integrated companies. It was stated at the hearing, however, that the Department intends to value the operating property of integrated companies under the formula which is applicable to the larger portion of the company's business.

NSP is the only major integrated company in the state.

It provides both gas and electric service. Since the electric utility comprises the larger portion of NSP's business, the Department proposes to value the property of NSP's gas utility under the electric formula rather than the gas formula.

In his prepared statement submitted at the hearing, Mr. Robert Dolan of NSP explained some of the financial and other reasons why this unique treatment of NSP is not appropriate. We will address the serious legal shortcomings with the proposed procedure.

1. The special classification of integrated companies is a denial of equal protection of the laws under the state and federal constitutions.

The Department proposes three different formulas because of its determination that each kind of utility has unique financial and regulatory characteristics. The only logical application of such a valuation system is to use the gas formula for NSP's gas utility. Yet the effect of the Department's proposal, by valuing NSP's gas utility under the electric formula, is to place NSP's gas utility in a class by itself and disregard the reasons for having three different formulas in the first place.

Because of the differences in the formulas, the Department's proposal would impose on NSP's gas utility a tax burden substantially greater than that of all other major gas utilities. NSP's gas customers will ultimately be the victims of this discrimination, since it increases NSP's cost of serving them.

The state may, of course, establish classifications for purposes of taxation. However, any classification "must be reasonable, not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike." National Tea Co. v. State, 205 Minn. 443, 448, 286 N.W. 360 (1939), quoting Louisville G. & E. Co. v. Coleman, 277 U.S. 32, 37, 48 S.Ct. 423, 425 (1928). And once having established a classifica-

tion, "it is definite that under both the State and Federal Constitutions taxes must be uniform upon the same class of property." In Re Petition of Dulton Realty, Inc. v. State, 270 Minn. 1, 15, 132 N.W.2d 394 (1964).

The Department has designated a classification of gas utilities separate from electric and pipeline companies. If this is a legitimate classification, the Department may not then treat one major gas utility differently from all the others. This constitutes unlawful discrimination because it singles out NSP "for discriminatory treatment by subjecting [it] to taxes not imposed on others of the same class." Township of Hillsborough v. Cromwell, 326 U.S. 620, 623, 66 S.Ct. 445, 448 (1946).

Thus in the National Tea case a graduated gross sales tax imposed upon chain store owners, which varied solely according to the volume of sales, was held to be unconstitutional. The class of chain stores was a proper one, but the further division of this class into 11 different classes based on sales volume was unlawful.

More directly in point is the Dulton case. There the court invalidated the practice of the Duluth assessors of applying different percentages of market value to various tracts of real property within the city. The court found no basis for the distinctions, holding that "where deviation is the result of applying different ratios to market value of property of the same class, the courts have no choice other than to hold that the resulting tax would be discriminatory. ..." 270 Minn. at 16.

It may be appropriate for the Department to establish a separate classification for the gas utilities. The Department has cited specific reasons why the gas formula should be different from the electric and pipeline formulas. But the Department has not demonstrated and cannot demonstrate any rational basis for using the electric formula for NSP's gas utility merely because NSP is an integrated company. The sole purpose of the formulas is to determine the value of these properties, and the mere fact that the two utilities are integrated has no effect on the value of their respective operating properties.

The only reason offered by the Department at the hearing

to explain the proposal for integrated companies was the alleged difficulty of separating an integrated company's properties for purposes of valuation. However, as outlined in detail in Mr. Dolan's supplemental statement of October 13, the operating properties of NSP's two utilities are already separated and can easily be identified by the Department. The plants and distribution facilities of the gas and electric utilities are, of course, physically separate. And all property used by both utilities, such as office buildings and land, is non-formula assessed and therefore should not have to be separated.

To the extent that any separation is required, the Department need only recognize that all integrated companies are required by the Federal Power Commission to maintain completely separate accounts for each utility. This long-established system of separate accounts is prescribed by the FPC in its Uniform System of Accounts, published in 18 CFR Part 101. Such separation is also necessary at the state level, for purposes of rate hearings before the Minnesota Public Service Commission. All of the income and investments of each utility are kept separate from those of each other utility, and there is no difficulty in identifying which property belongs to which utility.

Thus the argument that it is difficult to separate the properties of an integrated company has no merit. It certainly falls far short of being an adequate basis for a different method of valuing properties of integrated companies.

Administrative convenience is a particularly inappropriate standard when it alone causes one major gas utility to suffer a tax burden far greater than that imposed upon all other gas utilities. The attempt by the Department to justify the former "Hatfield formula" on the basis of "simplicity of administration" was in fact specifically rejected by the court in Ind. Sch. Dist. No. 99 v. Commissioner of Taxation, 297 Minn. 378, 211 N.W.2d 886 (1973). The court insisted that "administrative considerations" could not justify adoption of a system which was not expressly authorized by the legislature. 297 Minn. at 386.

Since there is no rational basis for the proposed valuation procedure for integrated companies, it would be an arbi-

trary and unconstitutional classification if adopted.

2. The special treatment of integrated companies is beyond the authority of the Commissioner.

The proposed method of valuing integrated companies goes beyond the authority of the Commissioner. It exceeds the authority delegated to the Commissioner by statute and involves a policy-making function which is reserved to the legislature.

In Wallace v. Commissioner of Taxation, 289 Minn. 220, 184 N.W.2d 588 (1971), the court declared invalid a rule which had been formally adopted by the Commissioner. In rejecting the Commissioner's arguments in support of the rule, the court stated:

> "While it is true, as the Commissioner argues, that he has been given authority to enact regulations with reference to the administration of income tax laws (Minn. St. 15.0412 and 15.0413), he is mistaken in his assumption that the substance of Regulation 2008(5) is within the scope of his power to regulate. It is well established that the legislature may confer discretion on the Commissioner in the execution or administration of the law. It may not give him authority to determine what the law shall be or to supply a substantive provision of the law which he thinks the legislature should have included in the first place. [Citations omitted.]" 289 Minn. at 231.

It is arguably appropriate, in light of the Supreme Court's opinion in Ind. Sch. Dist. No. 99 v. Commissioner of Taxation, supra, to establish formulas for valuing gas, electric and pipeline properties, in spite of the fact that the legislature has not specifically required or authorized the use of such formulas. However, there is nothing in the statute or the court's opinion which could possibly authorize a separate classification containing only one major gas utility merely because that utility is part of an integrated company. The lack of authority for such a classification is suggested by the court in the Dulton case:

> "It has been suggested that real property might be classified by assessors as to type, i.e., farm, lakeshore, residential, commercial, etc.; and that

when so classified by them, even though different percentages were applied to the market values of properties in different classifications, this would not invalidate taxes on properties within a classification to which the identical percentage had been applied. We are of the opinion that before such classifications could be undertaken by assessors some statutory enactment, delegating authority therefor to them, with standards for guidance, would be essential. At present, §273.13 manifests a legislative intent to reserve any authority in this field to the legislature." (Emphasis added.) 270 Minn. at 22.

The special classification for integrated companies must therefore be rejected.

3. The proposed method for valuing integrated companies is not contained in the proposed rules and therefore may not be used by the Department.

For some unexplained reason, the proposed treatment of integrated companies is not contained in the proposed rules. Regardless of the reason for this omission, it is a fatal defect.

The Department has recognized that the appropriate method for adopting formulas for utilities is to promulgate rules. This is required by the Administrative Procedure Act. Minn. Stat. §15.0411, subd. 3, as amended effective July 1, 1975, defines "rule" to include "every agency statement of general applicability and future effect ... made to implement or make specific the law enforced or administered by it or to govern its organization or procedure." Neither the Commissioner nor the Department of Revenue is an agency exempt from this requirement under subdivision 2. It is therefore necessary to follow the rule-making procedure to adopt any formula; the formula constitutes a policy decision of general applicability and future effect, made to implement the statutes pertaining to valuation of property.

This was recognized by the Minnesota Supreme Court in In Re Answer of Minnesota Power and Light Company, 289 Minn.

64, 182 N.W.2d 685 (1970), a case involving the statutory exemption from ad valorem taxation of tools and machinery used in the production and distribution of "marketable products." In a bulletin issued to assessors throughout the state, the Commissioner of Taxation attempted to restrict this exemption to tools and machinery used in producing and distributing "tangible" marketable products, thus denying the exemption for electric utilities. In finding this interpretation invalid as going beyond the provision of the statute, the court held that the bulletin from the Commissioner to the assessors was of no force and effect. The court stated:

> "This bulletin was not a rule adopted pursuant to the procedures set forth in Section 15.0412 of the Administrative Procedure Act, Minn. St. 15.01 to 15.41, although the act is expressly applicable to the Commissioner. Minn. St. 15.0411. Rather, it was simply a bulletin or directive to the assessors emanating from the office of the Commissioner of Taxation." 289 Minn. at 70.

It is therefore clear that if the Department seeks to treat integrated companies different from the other utilities, it must specify this treatment in the rules. As written, the rules on their face will require the Department to treat NSP's gas utility under the gas formula; the rules themselves preclude any other method.

The omission from the proposed rules of the separate procedure for integrated companies is not a minor defect which can be cured without further notice and hearing. There are numerous persons, organizations, and taxing districts with a very direct interest in this matter which were deprived of the requisite notice and which had no knowledge of the Department's intentions with regard to integrated companies. Had all interested parties been aware of this proposal, there may well have been additional appearances made and interests presented. The public has been deprived of this right.

Furthermore, once having decided to adopt the proposed formulas and having promulgated them as rules, the Commissioner does not have the discretion to change any of them without subsequent amendments to the rules. The fourth

paragraph of proposed rule 1 states that the formulas are to be used for 1975 and subsequent years "or until, in the opinion of the Commissioner of Revenue, different conditions justify a change." However, any such change would have to be implemented by amending the rules in accordance with statutory procedures.

Minn. Stat. §270.11, subd. 6, does not authorize the Commissioner to change the valuation of utility property without regard to the formulas contained in the rules. Any change pursuant to §270.11 could only be undertaken in order to make a valuation comply with the rules. Rules promulgated under Chapter 15 have the force and effect of law and are binding upon the Commissioner as well as the utilities. Minn. Stat. §15.0413, subd. 1. No state official or agency may adopt a rule and then choose to apply it in some situations and modify it in others.

4. The Commissioner has failed to demonstrate a need for the unique treatment of integrated companies, as required by the Administrative Procedure Act.

When adopting any rule, the Commissioner is subject to the statutory requirement in §15.0412, subd. 4, that he "shall make an affirmative presentation of facts establishing the need for and reasonableness of the rule proposed for adoption." The Attorney General has elaborated upon this requirement in his Rule Atty. Gen. 302 (g). Absent a showing of the need for different treatment of integrated companies, and the reasonableness of such treatment, the Attorney General will be compelled by statute to disapprove it.

As discussed under Section 1 above, no policy or statutory justification was offered for this proposal, and none can be made. The only rationale offered was the alleged difficulty of separating the properties of an integrated company. We have already discussed at length the invalidity of this argument. For these same reasons, it can only be concluded that there has been no showing of need for the special classification and that the proposal is unreasonable.

CONCLUSION

For all of the above reasons, the Department may not lawfully value the property of NSP's gas utility under the electric formula. Since the proposal to do so was not included in the proposed rules, no change is required except to delete the definition of "integrated company," which serves no purpose.

In view of the Department's presentation at the hearing on September 23, it would be appropriate when adopting the rules, however, for the Commissioner to announce his intention to apply the rules as written and thus value the properties of integrated companies separately.

Very truly yours,

Douglas L. Skor

DLS:joy

cc: C. H. Luther, Deputy Attorney General
Jack Sjoholm, Jr., NSP

NSP

NORTHERN STATES POWER COMPANY

MINNEAPOLIS, MINNESOTA 55401

October 13, 1975

Mr Arthur C Roemer
Commissioner of Revenue
Minnesota Department of Revenue
Centennial Office Building
St Paul, Minnesota 55101

re: In the matter of the Proposed Adoption of Rules of the Department of Revenue relating to Property (Ad Valorem) Tax.

Dear Commissioner:

In addition to the testimony submitted at the public hearing on September 23, 1975, I wish to submit additional data for your consideration relative to:

1. The valuation of the NSP gas utility on an integrated basis

2. The increased valuation of major generating facilities

In the oral presentation by the Department of Revenue at the hearing on September 23, 1975, it was stated that the Department intends to value all the operations of integrated companies under the formula which is applicable to the largest of the company's utility operations. Under this method, NSP's gas utility is valued under the electric utility formula. The only real justification offered in support of this treatment is the apparent difficulty in separating and apportioning the various utility operations within an integrated company. However, there is no such difficulty. In fact, there is no separation nor apportionment required since integrated companies are required to maintain separate and distinct accounts for every utility operation in the company. This system of separate accounts is required by the Federal Power Commission under its Uniform System of Accounts. The income and the investments of the gas utility and the electric utility are totally separate and distinct. Therefore, there is no problem of identifying which properties are part of which utility. There are a very few items of property that are used in both the gas and electric operations, but these are recorded in a separate account and NOT ONE of these is centrally assessed. The NSP General Office in Minneapolis falls within this account. This system of separate and distinct accounts is neither new nor unique. It is required by the FPC

and it is necessary for the separate rate processes at both the state and federal levels. Quite simply, there is no problem of identifying and separating the gas and electric investments and income of an integrated company. The justification put forward by the Department of Revenue is falacious and would significantly discriminate against NSP gas customers and increase NSP's cost of serving them.

Under the unit concept using original cost method the attempt is to determine market value through a variety of indicators that have their origin in fact and in original books of record.

The proposal to use the national average of installed capacity as another indicator of value results in a cost of replacement and therefore does not appear on the balance sheet. Cost of replacement is not based upon fact but rather upon the hypothetical proposition of the cost of replacing a facility that furnishes a service with a substitute facility furnishing that same service. This may be a valid approach to some property with an unrestricted market but would hardly be economically acceptable in an industry so dependent upon technological innovations. Potential purchasers of non-regulated competitive industries are free to act without restriction from reglatory agencies. If the value of a property exceeds the cost of constructing a plant capable of performing the same service the prospective buyer is free to build one and compete with the existing plant. The prospective purchaser of a utility plant cannot exercise such freedom, he has no such choice. Because of the very size of the plant of a utility the market is severely restricted which lessens the opportunity for its disposal. In the event of a sale of utility property any premium paid over the original cost depreciated must be charged to Account 100.5 and must be written off within a limited time. Therefore any stated value of utility property based on something other than original cost depreciated is a fallacious approach and does not produce market value. The additional value created by using the average cost approach is applied to the existing value of that particular generating facility. The result is a larger investment than what is actually represented. Only those areas that host major generating facilities would benefit from such a plan. It would therefore magnify the existing problem of increasing the tax base in those areas. This would reinforce the argument of those who criticize the unit value method or any other plan that is calculated on a situs basis. It is also predicted that this antagonism is not likely to abate until a better method of apportionment is accomplished.

It has been implied that for the purpose of using original cost less depreciation as the value determinant the comparison of the tax base to the rate base is improper. However, economists, tax administrators, assessors, and appraisers make constant reference to the relationship that exists between the tax base and the rate base.

"Also, for locally regulated utilities, net investment is the base used for determining the permissable rate of return." 1/

"As a measure of value, original cost is admittedly a definite and readily ascertainable sum. It is also a fixed dollar figure, and becomes the basis for rates - or the rate base." 2/

"As the term (value) is used in its economic sense, value is determined by the earning power of the property used and useful in producing the earnings. The result is reasoning in a circle, by arriving at the value of the property and then using the valuation so determined as the principal determinant of the earnings to be allowed upon the property which in turn determines the property's value." 3/

"Original Cost is also sound in the case of utility properties, because their earning capacity or earning power is based on original cost less physical depreciation." 4/

"There is a coexisting belief that value in the case of public utility property is independent of public utility regulations. For to ask what is the effect of regulation on value is to presume that there is an effect. And that is what I am going to argue." 5/

The Joint Interim Committee on Assessment Practices, February, 1959, stated that because a purchaser of utility property can only earn on original cost less depreciation that should be the basis for value.

Using cost of replacement for determining value of industrial property is sometimes acceptable because the appraiser or assessor has difficulty in determining actual depreciation as it applies to the original cost which in itself is not necessarily readily available. This is not true in the utility sector of course because our accounting practices are rigidly enforced by the FPC.

The Virginia State Corporation Commission has held that utility property cannot be worth more than original cost less depreciation and represents the maximum value of the property to its owners, the stockholders, or to

1/ Simplifying the Valuation Process: D. W. Stuver

2/ Public Utilities Report: Basic Understanding Series No.7

3/ The Valuation of Public Utilities: Wilson, Herring & Eutsler

4/ An Oregon State Tax Commission Review: 1959

5/ Public Utilities Fortnightly: Warren J Samuels, Sept. 2, 1971

the purchaser of a public service corporation. It held therefore that it would assess public utilities on depreciated original cost. 6/

Original cost probably is the most definite measure and the least conjectural of all bases of valuation.

The main argument of proponents of the cost of reproduction and cost of replacement basis is that the owners of regulated industries should fare no better than the investors of non-regulated competitive industries. However in exchange-value economics the real value of a plant is not determined by the cost of reproducing the identical plant but by the cost of producing the commodity in a new plant having the most modern equipment required to produce the article. No one would be willing to invest in an obsolete plant if a new one could be built to be operated at much lower operating expenses per unit of product if such a plant could be built for the same cost as the obsolete one. It is the cost of building a modern plant of similar capacity that determines the value of a plant in an unregulated competitive industry, and not the cost of reproduction of a similar plant. Hence, reproduction cost does not cause the owners of a regulated enterprise to fare the same as the investors in unregulated competitive enterprises. 7/

We therefore recommend that the gas facilities be valued on the merits of the gas utility as originally proposed and that the additional value for major generating facilities based on the average cost of installed capacity be abandoned.

Very truly yours,

Robert J Dolan
Manager Property Tax

6/ Assessment of Properties of Electric Power Utilities: L B Younger, Assistant Director Public Utilities Taxation, State Corporation Commission, Richmond, Virginia

7/ Public Utility Valuation: Wilson, Herring & Eutsler

WILLIAMS PIPE LINE COMPANY
ONE OF THE WILLIAMS COMPANIES

AD VALOREM TAX DEPARTMENT
P.O. BOX 3448
TULSA, OKLAHOMA 74101
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JOE W. EDENS, MANAGER
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RONALD T. DWYER
JOE C. EADES
WILLIAM B. MOORE

September 11, 1975

Mr. Arthur C. Roemer
Commissioner of Revenue
State of Minnesota
Centennial Office Building
St. Paul, Minnesota 55145

Attention: Mr. Lyle H. Ask
Director of Property Equalization Division

Dear Mr. Roemer:

Re: Public Hearing in the Matter of the Proposed Adoption of Rules Relating to Property Tax

We have reviewed the proposed rules furnished to us as they pertain to the proposed valuation method for assessment of pipeline properties.

In our opinion the valuation method of computing distributable value as presently proposed could and does cause a pipeline to be taxed on a total value in excess of true unit value.

We respectfully ask that our attached statement be given study and that our suggestion for a change in the formula be given consideration.

Yours very truly,

Roy L. Reid

Roy L. Reid

RLR:pf

Attachment

SUGGESTED CHANGE IN PROPOSED
METHOD OF PIPELINE VALUATION

Comments

We are in agreement with the general definition of unit value - the value of a utility company taken as a whole without any regard to the value of the component parts.

We are also of the opinion that a unit value when established applies to the entire utility system regardless of whether it lies in one state or many states. If the utility was entirely within the confines of one state, the unit value would be the total value distributed to various counties of the state.

Under the proposed formula we find that the treatment for non-formula assessed property (land--locally assessed) causes taxable value to be added to the unit value resulting in a final total assessment higher than "unit value" as originally determined.

We refer to the following example:

Assume: Total Land Cost in 1940 of $260,000
1975 Market Value of Same Land $2,000,000

1975 Minnesota Computed Unit Value		$25,000,000
Excludable Items:		
Land--Locally Assessed	$260,000	
Land Rights	300,000	
Intangible Plant	200,000	
Total Excludable Items		760,000
Unit Value Less Excludable Items		$24,240,000
Add Back Land at Value Locally Assessed		2,000,000
Total Distributable Value on Which Company Will Pay Taxes		$26,240,000

Suggested Revision

We suggest that a change in the method of computation of pipeline assessments be made whereby total land (locally assessed) will be excluded from the unit value at the locally assessed market value rather than the land cost value.

This change would result in a company's taxable value being the same Minnesota unit value as originally computed and in accordance with true unit value.

MONTANA-DAKOTA UTILITIES CO.

400 NO. FOURTH ST. • BISMARCK, NO. DAK. 58501 • TEL. (701) 224-3000

September 16, 1975

Mr. James G. O'Brien, Manager
State Assessed Properties Section
Property Equalization Division
Department of Revenue
Centennial Office Building
St. Paul, MN 55145

Dear Mr. O'Brien:

I have reviewed the proposed rules and regulations pertaining to the assessment of utility property and agree with the proposed rules and regulations in part. I do feel that when a capitalization rate is established, it should be geared to the present cost of money and, therefore, I go on record of requesting that a minimum of nine percent be adopted. I do not feel, for gas companies, that the eight percent cap rate is realistic. There are other areas which could cause my company some concern; however, at this point in time they are not significant and I am sure could be resolved at a future date.

Yours truly,

Noel M. Engelhorn

NOEL M. ENGELHORN
Tax Agent

NME:jeb

Lakehead Pipe Line Company, Inc.

G. S. MARKS
Manager Right-of-Way
Claims & Tax Department

H. D. GUSTAFSON
Assistant Manager

3025 Tower Avenue
Superior, Wisconsin 54880

October 10, 1975

GCD-3409

Mr. Lyle H. Ask
Director of Property Equalization
Department of Revenue
Centennial Building
St. Paul, Minnesota 55101

Dear Mr. Ask:

Enclosed are comments in the matter of the proposed adoption of rules relating to property (Ad Valorem) tax.

Very truly yours,

G. S. Marks

GSM/cas
Encl.

LAKEHEAD PIPE LINE COMPANY, INC.

Comments Regarding Proposed Adoption of
Unit Valuation of Utility Properties

1. The rate of capitalization of 8¼% for oil pipe lines is too low and in the case of Lakehead, is not justified. The rate should be in excess of 10%. The same rate should not be used for all pipe line companies as financing and other inherent differences such as rate bases as determined by the I.C.C. for oil lines and the F.P.C. for gas lines.

2. It is stated in the first paragraph of a Memorandum to the Commissioner of Revenue dated November 6, 1974, that the use of the "Unit" valuation of utility property is widely accepted. It is also an accepted principle by states that use the "Unit" method, that income to be capitalized is adjusted to reflect the relationship of assets generating income that are not assessed by the State to those that are assessed by the State. The adjustment is calculated by determining the percentage of the depreciated excludable and locally assessed property to the total depreciated plant. The income to be capitalized is then reduced this percentage. In Minnesota the assets generating income but not assessed by the State include land, right of way, pumping stations, vehicles and other work equipment. This is not accomplished with the present formula.

3. Depreciation should not be limited to 45%.

4. Prior to the determination of a utility assessment, there should be an opportunity for an informal hearing with the assessing officials and the company's representatives participating. This would afford the opportunity to discuss the current years operation and income prospects for the current year. Four such informal hearings could be accomplished each day and are not time consuming. Differences of opinion can be reconciled at the informal hearing rather than an assessment being determined by the Department without the benefit of all facts which could necessitate a formal hearing.

5. It is strongly suggested that a member or members of the Department of Revenue's staff become familiar with each company's operations and verify claimed economic obsolescence and other items of a similar nature.

6. It would seem that if at all possible, the adoption of the "Unit Value" method should be delayed for at least one year. This would permit the evaluation of the impact on the local units and the tax paying utility. In the meantime, the Department could become better informed in regard to the present and future outlook of the utilities.

2223 Dodge Street
Omaha, Nebraska 68102
Telephone 402-348-4000

Northern Natural Gas Company

September 17, 1975

Mr. Arthur C. Roemer
Commissioner of Revenue
Minnesota Department of Revenue
Centennial Office Building
St. Paul, Minnesota 55101

In the matter of the Proposed Adoption of Rules of the Department of Revenue Relating to Property (Ad Valorem) Tax.

Attached is a written statement containing comments and suggested changes in the proposed Ad Valorem Tax Regulation, Chapter One; Valuation and Assessment of Electric, Gas Distribution, and Pipeline Companies (Utility Companies). We urge adoption of our proposed changes in the rules and regulations.

We do not request time for an oral presentation of the statement. However, we do wish to reserve the right to orally comment on any statements made at the public hearing on these proposed rules.

Sincerely,

PROPERTY TAX DEPARTMENT

R. M. Foster

R. M. Foster
Regional Director

RMF:sj
Attachment
cc: Lyle Ask - Property Equalization Division

In the Matter of the Proposed Adoption of Rules and Regulations of the Minnesota Department of Revenue Relating to Property (Ad Valorem Tax), Chapter One: Valuation and Assessment of Electric, Gas Distribution and Pipeline Companies (Utility Companies).

Statement By
Northern Natural Gas Company
2223 Dodge Street
Omaha, Nebraska 68102

Northern Natural Gas Company welcomes the opportunity to comment and make suggestions to the proposed rules in the determination of Minnesota's market value of utilities. We agree with the purpose of the regulations. We accept the principle of system-wide market value determination with a portion of such system market value being allocated to Minnesota. After careful review, we do have several suggestions to improve and/or clarify the proposed rules. The suggestions are in conformity with accepted appraisal principles of unit valuation and the unique character of public utilities as expressed in TAX AD VAL 3 Valuation (a) General.

The recommended suggestions to the rules are presented below with language changes keynoted to page, line and rule number. General comments precede each suggestion listing the reasons for making the changes.

TAX AD VAL 1 Introduction.

We suggest that the word "determined" be substituted for "estimated" on line 12, page 1; that the word "determine" be substituted for "estimate" on line 18, page 1, TAX AD VAL 1 Introduction.

TAX AD VAL 2 Definitions.

Two definitions, "Net Operating Earnings" and "System Plant" are not clear as to the intent of the Department to value all property; i.e., utility and non-utility or just utility property. In addition, it is possible for a utility to receive earnings recorded in net operating earnings from property that is not

being included with property being valued by the Department. We believe the suggested changes will clarify the situation to insure a proper unit valuation determined from comparable indicators of value.

We recommend all of lines 3, 4 and 5 of page 4, Tax Ad Val 2 Definitions, be stricken and the following be substituted:

"Net operating earnings -- earnings from system plant of the utility after the deduction of operating expenses, depreciation and taxes but before any deduction for interest."

We recommend lines 20 and 21, page 4, Tax Ad Val 2 Definitions, be stricken and the following substituted:

"System Plant -- the total tangible property, real and personal, of a company which is used in its utility operations in all states in which it operates."

As a matter of clarification and to be consistent with the definition of system plant, we recommend that lines 22 and 23, page 4, Tax Ad Val 2 Definitions, be stricken and the following be substituted:

"Unit Value -- the value of the system plant of the utility company taken as a whole without any regard to the value of its component parts."

As a matter of clarification and to be consistent with the example of weighted pipeline miles, we recommend line 25, page 4, Tax Ad Val 2 Definitions, be stricken and the following be substituted:

"the number of miles of each size of pipeline by the diameter in inches of each size."

Further, the result of the weighted pipeline miles computation is not a value but a product; and we recommend that the first word, line 3, page 5, Tax Ad Val 2 Definitions, "value" be stricken and that "product" be substituted.

TAX AD VAL 3 Valuation.

As a matter of clarification, we recommend that in line 25, page 5, Tax Ad Val 3 Valuation, (c) Cost Approach that the following words "less depreciation" be inserted after the word "cost."

Depreciation allowed by the regulatory agencies is for more than physical deterioration. Therefore, we believe it is erroneous to state the allowed depreciation of the companies books is for only physical depreciation. We recommend that the phrase "To reflect physical deterioration," lines 2 and 3, page 6, Tax Ad Val 3 (c) Cost Approach be stricken.

The statement in Tax Ad Val 3 Valuation (a) General refers to the unique character of public utility companies and the stringent government regulations over operations and earnings. These very government regulations require the complete depreciation of property, and at the end of its economic life no residual remains. Therefore, it is not in accordance with accepted appraisal principles of utilities to establish a maximum allowable depreciation. It is recommended that part of line 6, beginning with the word "Depreciation" and all of lines 7, 8 and 9, page 6, Tax Ad Val 3 Valuation (c) Cost Approach, be stricken.

To conform to the definition employed in the proposed regulations, it is suggested that the word "operating" be inserted between the words "net earnings," line 15 and at the end of line 16, page 7, Tax Ad Val 3 Valuation (d) Income Approach to Valuation.

The rate of capitalization changes as conditions affecting income and cost of money change. Appraisal theory indicates the lowest a capitalization rate can be is the current cost of money and the highest rate is the return demanded by equity capital. The rates of capitalization proposed in the rules are too low

considering today's economic conditions.

We suggest all of lines 20, 21, 22, 23, 24, 25 and the first word of line 26, page 7, Tax Ad Val 3 Valuation (d) Income Approach to Value be stricken and the following be substituted:

"After considering, as far as possible, all conditions that may exist in the future that may affect the present annual return, including risk, life expectancy of the property, and current cost of money, the capitalization rates used to compute value for assessments will be determined annually by the Commissioner of Revenue, and for 1975 will be a minimum of 7.75% for electric companies; 8.00% for gas distribution companies; and 8.25% for pipeline companies."

TAX AD VAL 4 Allocation.

The unit valuation theory is to determine the market value of the system as a whole without regard to the value of individual parts. Once the system value of system plant is determined, that value is then allocated to each of the states in which the system plant is located. The allocation should be such so that no more than 100% is allocated to the total states. The market value of a pipeline within a state is dependent upon the value of the entire pipeline system. For natural gas transmission pipelines, no one part of the system has any greater value than another--each part earns equally whether a state is a bridge state or a terminal state. Consequently, the best allocation factor for pipelines and the one most frequently employed in states adopting the unit value approach is the ratio of state original cost to system original cost.

Two of the three allocation factors proposed in the rules, gross revenue ratio and weighted pipeline miles, have no relevancy in detemining a share of

system value to a state for property tax purposes. Gross revenues would be zero for a pipeline bridging the state and would be 100% if all of the product were sold in a single state. However, the product to be transported is dependent upon the entire integral system.

Weighted pipeline miles or use of pipeline miles in any form is a meaningless statistic. Such a figure has no relationship to use or function of a pipeline system and should not be used in allocation of a system market value among the states.

We recommend all of Tax Ad Val 4 Allocation (d) Pipeline Companies, page 10 be stricken and the following substituted:

"The original cost of the utility property located in Minnesota divided by the total original cost of the utility property in all states of operation is weighted at 100%."

TAX AD VAL 5 Adjustment for Non-Formula Assessed or Exempt Property.

We suggest that the words "Minnesota portion of the" be inserted at line 28, page 10, preceeding the words "unit value." On page 11, at lines 17 and 21, we again suggest that the words "Minnesota portion of the" be inserted to precede "unit value."

TAX AD VAL 6 Apportionment.

As a matter of clarification and to be consistent with the example in Tax Ad Val 7, we suggest that the words "and has been adjusted pursuant to Tax Ad Val 5" be added after the word "Minnesota," line 2, page 12, Tax Ad Val 6 Apportionment.

TAX AD VAL 7 Comprehensive Example.

No suggested change.

We wish to thank you for your consideration of the written statement. We would be pleased to answer any questions you have concerning this statement and the recommended changes.

Respectfully submitted,

NORTHERN NATURAL GAS COMPANY

R. M. Foster

R. M. Foster, Regional Director
Property Tax Department

September 17, 1975

MAILED
SEP 24 1975

FAEGRE & BENSON

1500 NORTHWESTERN BANK BUILDING

MINNEAPOLIS, MINNESOTA 55402

AREA CODE 612

338-7571

September 23, 1975

State of Minnesota
Department of Revenue
Second Floor
Centennial Office Building
St. Paul, Minnesota 55145

RE: Proposed Ad Valorem Tax Regulations

Gentlemen:

We are attorneys for Montana-Dakota Utilities Co., a gas utility that has a small gas distribution system in Crookston, Minnesota.

They have requested us to make comments on the proposed method of calculating the valuation of utility property for ad valorem property tax purposes in Minnesota. Our comments are as follows:

1. The Crookston gas system is entirely separate from and is not inter-connected with the Montana-Dakota gas utility inter-connected system that exists in western North Dakota, South Dakota and Wyoming.

We respectfully suggest that the regulations be clarified in a situation like that of the Crookston gas distribution system so that Montana-Dakota will be required to report only the cost, valuations, income, etc., from the Crookston system and will not be requested to furnish data from its other gas utility system.

Such a clarification will substantially reduce the burden upon the utility of furnishing the information and the burden upon the Commission of examining it.

A similar situation may exist with utilities that have large systems operating within and without Minnesota, but also have separate non inter-connected utility systems outside of the State of Minnesota. We further suggest that

in such case the proposed regulations be clarified so that a separate utility system wholly without the State of Minnesota need not be lumped in with a system which is both within and without the State.

2. The Minnesota Public Service Commission recently issued an order that the depreciated original cost of a utility system was required to be used for rate making purposes.

The proposed method of fixing the value of utility property for ad valorem property tax purposes does not adopt that concept, but limits the amount of depreciation that can be taken against original cost and provides for an addition to the valuation of the utility plant based on earnings.

It therefore appears that the regulations for the valuation of utility plant for property tax purposes will require a higher value for that purpose than is permitted for rate making purposes.

We suggest that serious constitutional law questions will arise with respect to the validity of State action which fixes one valuation of a utility plant for rate making purposes and a higher valuation for ad valorem property tax purposes.

3. We further suggest that serious constitutional questions will arise from the provision in the proposed regulation which fixes the valuation of utility property of cooperatives on a different basis, and probably lower, than is used for fixing the valuation of utility property of other organizations.

Very truly yours,

George D. McClintock

GDM:sjb

Minnegasco minnesota gas company

E. H. Swetman, Jr.
Controller

733 marquette avenue, minneapolis, minnesota 55402

September 22, 1975

Mr Arthur C Roemer
Commissioner of Revenue
State of Minnesota

RE Proposed Adoption of Rules of the Department of Revenue Relating to the Valuation and Assessment of Electric, Gas Distribution and Pipeline Companies (Utility Companies).

Dear Sir

We have read and given careful consideration to the subject Rules. It is our conclusion that the concepts embodied in the Rules represent a realistic approach to the matter of utility company assessment and that for the most part the Rules contain provisions which effectively carry out these concepts.

In a sincere effort to further that effectiveness, and to achieve greater clarity in the Rules, Minnesota Gas Company submits the following comments and suggestions for your consideration.

Tax Ad Val 3(c)

The percentage limitations on depreciation provided for in this paragraph have no effect on Minnesota Gas Company at the present time, since the Company's accumulated provision for depreciation now approximates only 28% of cost. However, we are concerned as to the reasonableness of percentage limitations which have no apparent foundation in fact. We submit that any amount of accumulated depreciation which reasonably reflects the age, condition and remaining useful life of utility property would be recognized by a potential purchaser in determining value and, therefore, should be recognized in estimating the market value of utility properties for ad valorem tax purposes. Accordingly, we urge that the maximum percentages specified in the proposed Rules be eliminated.

Tax Ad Val 3(d)

This paragraph provides that the income indication of value shall be based upon "net earnings". Under Tax Ad Val 2 there is no definition of "net earnings"; however, there is a definition for "net operating earnings". Example 1 uses the term "net operating income" in illustrating the calculation of the income component of value.

We believe it is intended that the basis to be used in calculating the income component of value is "Net Utility Operating Income" as that term is generally employed in the industry. Accordingly, we suggest that the proposed Rules be revised to use, in all instances where applicable, the term "Net Utility Operating Income" or "Net Operating Income".

Tax Ad Val 3(c) and 5

Under the uniform systems of accounts prescribed by both the Federal Power Commission and the National Association of Regulatory Utility Commissioners, certain amounts are to recorded as utility plant and recognized as such for rate-making purposes, although they do not represent actual physical property of the type subject to ad valorem tax, nor do they represent any part of the value of actual physical property. Many of these items are classified under the applicable systems of accounts as "Intangible Plant"; others are recorded throughout the various plant classifications.

We mention this condition because of a concern which stems from the fact that Tax Ad Val 5 of the proposed Rules makes no mention of these items, and Example 1, in fact, includes "intangibles" in the plant figures used to arrive at Unit Value. We submit that the classification of an item as "property" for rate-making purposes does not necessarily cause that item to become property, or to become a part of the value of property for ad valorem tax purposes. Rather we believe that the effect of rate base and rate making procedures on the value of utility property are given appropriate recognition through provisions in the proposed Rules which include capitalized income as a component of unit value.

Examples of the types of items we have reference to and which we submit should be excluded from a determination of assessed values for ad valorem tax purposes, are as follows:

1. Costs associated with organizing a business concern.
2. Costs associated with obtaining franchises, consents, etc.
3. Funds contributed toward the cost of facilities owned by and taxable to others.
4. Inventories of meters, regulators, and similar items not in utility service.
5. Intangible costs associated with locating and developing underground storage reservoirs.
6. Allowance for funds used during construction (in effect, the accrual of earnings to be collected from future revenues).

Thank you for giving consideration to these matters.

Yours truly,

E H Swetman, Jr

E H Swetman, Jr
Controller

EHS/hg

STATE OF MINNESOTA

COUNTY OF RAMSEY

BEFORE ARTHUR C. ROEMER

COMMISSIONER OF REVENUE

In the Matter of the Proposed Adoption of Rules of the Department of Revenue Relating to Property (Ad Valorem) Tax

STATEMENT ON BEHALF OF
INTERSTATE POWER COMPANY

Interstate Power Company (Interstate) submits this written statement in response to the Notice of Hearing in the above matter which it has received.

I. Introduction

Interstate Power Company is an investor-owned public utility, incorporated under the laws of the State of Delaware, having its principal office at 1000 Main Street, Dubuque, Iowa, 52001. Interstate is engaged in the electric and gas public utility businesses in the States of Iowa, Minnesota, and Illinois, with approximately 70% of its business being transacted in Iowa, 25% in Minnesota, and 5% in Illinois. It provides electric service in 21 counties in the southern part of Minnesota, through its interconnected electrical system, and it provides retail gas service in Albert Lea and several small Minnesota communities, through its Minnesota distribution system, which receives gas directly from the pipeline supplier, and which system is not interconnected in any way with the balance of Interstate's gas properties.

II. Market Value

Minnesota statutory law (M.S.A. §§277.03, Subd. 8; 273.11, Subd. 1; and 273.12) mandates that all property within the State must be valued at its market value, with certain generally inapplicable exceptions. The proposed regulations, specifically including Tax Ad Val 3 (b), by their terms purport to specifically reject market value as a method of valuation, contrary to statutory requirements. The intent of these regulations seems, in fact, to be to provide a method of determining market value by employing only two of the three traditional approaches to the determination of market value; specifically, of those three traditional approaches, 1) comparable sales, 2) costs, and 3) income, the proposed regulations as drafted would seem to be intended to eliminate the comparable sales approach to market value, because of the lack of comparable market activity, and to, therefore, rely entirely on the other two approaches. It cannot be disputed that there is no market of normal activity for utility properties as a going enterprise; however, the absence of comparable sales does not mean that the statutory and reasonable requirement of determining market value should not be met. A proper cost approach and income approach to market value may be employed to determine market value, the price at which willing and informed buyers and sellers would be likely to agree in the event of a transfer without duress. It is submitted that the proposed regulations should be revised so that their language comports with such apparent intent, and with statutory mandate.

III. Integrated Company

Interstate, being engaged in both the electric and gas public utility businesses within Minnesota, falls within the definition of "integrated company" contained in the proposed regulations.

The effect of the proposed regulations as they would apply to Interstate as an "integrated company" may be to value its gas properties on the same basis as its electric properties, which would result in a higher valuation than if those same properties were owned by a separate gas distribution company.

Tax expense is a cost of service item, and as such is passed on to consumers through the rates charged. It is totally unfair and discriminatory to penalize Interstate's gas customers through higher rates imposed to cover higher property taxes simply because they are served by an integrated company rather than a separate gas distribution company.

The proposed regulations, to the extent that they differentiate between the valuation of similar property owned by integrated companies and gas distribution companies, are unacceptable, and at variance with the statutory requirement of determining market value.

IV. Non-Interconnected Gas Properties

Although Interstate's entire electric system is interconnected, Interstate's gas properties in Minnesota are not interconnected in any way with the balance of its gas properties. All gas properties related to Interstate's Minnesota gas operation are physically located in Minnesota and readily identifiable.

It does not seem reasonable or practical in attempting to arrive at an

equitable assessment at market value of Interstate's Minnesota gas properties to go the route of first establishing a unit value for the Company.

We urge your further consideration of this portion of the proposal so that these inequities and burdens may be avoided.

V. Adjustments for Average Cost per Kilowatt

Proposed rule Tax Ad Val 3 (c) contains a provision that will increase the assessed valuation of those electric generating plants whose actual cost per kilowatt of generating capacity is below the average cost per kilowatt of generating capacity constructed in the most recent five-year period, as reported by the Federal Power Commission, on the basis of such difference.

The effect of this proposal would be to value old, less efficient plants the same as plants with an average age of two and one-half years. Many of such older plants are retained and used only for peaking or standby purposes, and are subject to higher operating costs and more frequent equipment breakdowns, decreasing their actual value.

Because of the rapid rate of inflation, the values for taxing purposes of those plants with "below average" costs will continue to increase annually. Additionally, over a period of time, more and more of the older, less efficient plants will be revalued for taxing purposes as the five-year average costs increase.

We respectfully request that further consideration be given to this proposal because to establish values as proposed would be in-

appropriate and inconsistent with actual fair market value.

VI. Valuation of Utility Property of Cooperatives

The proposed regulations establish a different method for determining the assessed valuation of utility property of cooperatives than for determining such value of investor-owned utility property, which would seem to grant a substantial tax advantage to the cooperatives. As property is required to be assessed at its market value, there is no legal justification for discrimination between the property of cooperatives and other utilities. The market value of property does not depend upon the nature of the owner of that property; cooperatives and investor-owned utilities may purchase and sell utility property between themselves, pursuant to free negotiations; the actual market value thereby established obviously is identical as to both entities.

VII. Conclusion

Interstate respectfully requests that the proposed Ad Valorem Tax Regulations applicable to the valuation and assessment of electric, gas distribution, and pipeline companies (utility companies) be revised to meet the objections presented by the foregoing comments, and further requests an opportunity to review and comment upon such revised proposed regulations before their final consideration and adoption.

Respectfully submitted,

INTERSTATE POWER COMPANY
By Springer, Carstedt & Kurlander,
Its Attorneys

By: William D. Carstedt
William D. Carstedt

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STATE OF MINNESOTA

COUNTY OF RAMSEY

BEFORE ARTHUR C. ROEMER

COMMISSIONER OF REVENUE

In the Matter of the Proposed Adoption of Rules of the Department of Revenue Relating to Property (Ad Valorem) Tax

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STATEMENT ON BEHALF OF INDEPENDENT SCHOOL DISTRICT NO. 99, THOMSON TOWNSHIP, VILLAGE OF SCANLON, INDEPENDENT SCHOOL DISTRICT NO. 98, INDEPENDENT SCHOOL DISTRICT NO. 93, and CARLTON COUNTY, MINNESOTA.

Submitted by

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I. INTRODUCTION

This memorandum will be confined to comments relating to those portions of the proposed ad valorem tax rules which relate to privately owned electric utilities doing business solely in the State of Minnesota.

The Minnesota Supreme Court in Independent School District No. 99, et al. v. Commissioner of Taxation, 297 Minn. 378, 211 N.W. 2d 886 (1973), has determined that the so-called "Hatfield Formula" or the 1962 formula used to determine the valuation of utility property for purposes of taxation does not comport with Minnesota statutes requiring that all property be assessed at market value. It is therefore incumbent upon the Department of Revenue to develop a new and different method in determining market value of utility property.

The proposed rules considered at the public hearing conducted on September 23, 1975 were developed over a period of approximately one year during which several meetings were held and attended by representatives of the utility industry, assessors and other interested

parties. The proposed rules, as pointed out at the hearing, were developed from the ideas, recommendations and suggestions of all concerned parties as well as the research of Department staff. The Department is to be commended for inviting input from all concerned parties and for holding a public hearing upon due notice. As you know, the 1962 formula was adopted without a public hearing and after consultation with only representatives of the utility industry.

II. THE PROPOSED RULES ARE IN COMPLIANCE WITH THE APPLICABLE STATUTORY REQUIREMENTS AND CONSTITUTE A SIGNIFICANT IMPROVEMENT OVER THE 1962 ASSESSMENT FORMULA.

A. The Proposed Rules Adequately Reflect Market Value By Taking Into Account Cost Reproduction And Income Factors.

After giving due consideration to all significant approaches to determining market value, the proposed rules use the basic cost approach in valuing utility property. In addition, the factors of income, reproduction and depreciation are also taken into account. Inclusion of these basic valuation factors obviously constitutes an improvement over the old formula which simply excluded consideration of any factor other than original cost and depreciation.

Like the 1962 formula, depreciation is limited to a specified percentage in recognition of inflation factors. Limiting depreciation to a maximum takes into account obsolescence and normal wear and tear, and at the same time makes an allowance for the fact that a replacement facility would produce more value. The electric utility industry over the past ten years or so has made significant advances in technology which the Department recognizes in setting the depreciation limitation at 15%.

Unlike the 1962 formula, the proposed rules take into account replacement or reproduction costs through the "average cost per kilowatt of installed capacity". Reproduction costs less depreciation is an important and well-established factor to be considered in valuing utility property for tax purposes. The 1962 formula simply excludes any consideration of replacement or reproduction factors. Numerous decisions have upheld the significance and validity of reproduction costs in valuing utility property. These decisions include: Assessors of Quincy v. Boston Consol. Gas Co., (1941) 309 Mass. 60, 34 N.E. 2d 623; Connecticut Light and Power Co. v. Town of Monroe (1962) 149 Conn. 450, 181 A. 2d 118; Appeal of Goldberg, Pa. Com. Pl., 3 Adams L.J. 50

(1961); DeLuz Homes v. County of San Diego (1955) 45 Cal. 2d 546, 290 P. 2d 544; California Portland Cement Co. v. State Board of Equal. (1967) 63 Cal. Rptr. 5, 432 P. 2d 700; Ketchikan Packing Co. v. City of Ketchikan (1958), 167 F. Supp. 846; People ex rel. Wangelin v. St. Louis Bridge Co., (1934) 357 Ill. 245, 191 N.E. 300; Northern Natural Gas Company v. Dwyer (1971), 208 Kan. 337, 492 P. 2d 147; Pantlind Motel Co. v. Michigan State Tax Com'n (1966), 3 Mich. App. 170, 141 N.W. 2d 699; State Tax Commission v. Brandt Cabinet Works (1953) 202 Md. 533, 97 A. 2d 290.

Prior to deciding upon inclusion of the average cost per kilowatt of installed capacity factor, consideration was given to the replacement costs, reproduction costs, indexed original costs, inflation factor percentages, acquisition adjustment and major plant update methods. While it is our position that actual reproduction costs new, less depreciation is the most up-to-date and accurate method of establishing market value of utility property, it is apparent that the Department's proposed rules constitute a reasonable approach to a difficult problem which has been carefully thought out and based upon consideration of all significant factors

relating to market value. Surely, the utilities cannot be heard to complain about the five year averaging of production costs which, when added to the lag time involved in the publication of the cost figures, surely is significantly less than current reproduction costs.

As pointed out in the Department's presentation at the hearing, there are compelling reasons in support of the average cost per kilowatt of installed capacity factor, which is really a limited application of the reproduction method. The production cost factor does not affect smaller units which are not used on a regular ongoing basis. The national cost average is surely lower than the Minnesota average where weather and other factors affecting the construction industry cause building costs in Minnesota to be higher than the national average. The average cost per kilowatt of installed capacity factor does not discriminate against, but actually encourages, the construction of the most modern and efficient power plants.

The proposed rules, unlike the 1962 formula, also take into account an income indicator of value. This is another factor which was completely ignored under the old formula. Certainly, the earnings and yield with

respect to a particular property is a well-established indicia to be used in determining the market value of property. See State of Minnesota v. Federal Reserve Bank of Minneapolis (D.C. 1938), 25 Federal Supplement 14; Kittery Electric Light Company v. Town of Kittery (Maine 1966) 219 A. 2d 728; Alstores Realty, Inc. v. State of Minnesota (1970), 286 Minn. 343, 176 N.W. 2d 112.

In recognition of the fact that income is not as reliable an indicia of value as cost factors in a regulated industry, the income over a three year average is weighted at 15% and all the cost factors at 85%. Averaging income of the last three years does not appear to be unreasonable. An averaging of income seems to be a more fair and stable indicator than to use, for instance, one year's earnings. Given year to year fluctuations in income, an averaging method appears to be most tenable and reasonable.

While we have not made a study of the issue, the 7.75% cap rate assigned to the electric utility industry is based upon a Department study of Moody's Public Utility Manual, Federal Reserve Bulletins, and the National Tax Journal. Apparently, the Department has made a study of

the capital structure in the utility industry for 10 years, interest and bond yields of utilities for 20 years and stock yields for 10 years. Based upon the sources used and the time periods involved, the cap rate developed appears to be formed on a reasonable and well-thought out basis.

B. The Proposed Rules Meet The Pertinent Statutory Requirements Relating To Market Value On All Assessed Property.

The paramount consideration is the adoption of a method of valuation which meets the statutory mandates with respect to market value. M.S. 273.11, provides:

> "Except as provided in Subd. 2, All property shall be valued at its market value. In estimating and determining such value, the assessor shall not adopt a lower or different standard of value because the same is to serve as a basis of taxation, nor shall he adopt as a criterion of value the price for which such property would sell at auction or at a forced sale, or in the aggregate with all the property in the town or district; but he shall value each article or description of property by itself, and at such sum or price as he believes the same to be fairly worth in money. In assessing any tract or lot of real property, the value of land, exclusive of structures and improvements, shall be determined, and also

the value of all structures and improvements thereon, and the aggregate value of the property, including all structures and improvements, excluding the value of crops growing upon cultivated land." (Emphasis added)

M.S. 272.03, Subd. 8 provides:

" 'Market Value' means the usual selling price at the place where the property to which the term is applied shall be at the time of assessment; being the price which could be obtained at private sale and not at forced or auction sale."

M.S. 273.12 provides:

"It shall be the duty of every assessor and board, in estimating and determining the value of lands for the purpose of taxation, to consider and give due weight to every element and factor affecting the market value thereof, including its location with reference to roads and streets and the location of roads and streets thereon or over the same, and to take into consideration a reduction in the acreage of each tract or lot sufficient to cover the amount of land actually used for any improved public highway and the reduction in area of land caused thereby, provided, that in determining the market value of vacant land, the fact that such land is platted shall not be taken into account. An individual lot of such platted property shall not be assessed in excess of the assessment of the land as if it were unplat-

> ted until the lot is improved with a permanent improvement all or a portion of which is located upon the lot, or for a period of three years after final approval of said plat whichever is shorter. When a lot is sold or construction begun, the assessed value of that lot or any single contiguous lot fronting on the same street shall be eligible for reassessment. It shall be the duty of every assessor and board, in estimating and determining the value of lands for the purpose of taxation, to consider and give due weight to lands which are comparable in character, quality, and location, to the end that all lands similarly located and improved will be assessed upon a uniform basis and without discrimination and, for agricultural lands, to consider and give recognition to its earning potential as measured by its free market rental rate." (Emphasis added)

In Independent School District No. 99, et al v. Commissioner of Taxation, supra, the Minnesota Supreme Court made it clear that the 1962 formula does not meet these statutory criteria as interpreted in earlier decisions, stating:

> "The difficulty we have with the formula approved by the Tax Court is that it makes market value synonymous with original cost, taking into account limited depreciation, and gives no weight to other factors affecting market value. As we have indicated in numerous decisions, original cost is only one of several rele-

vant factors which should be considered in determining market value. See, e.g., Crossroads Center, Inc. v. Comr. of Taxation, 286 Minn. 440, 176 N.W. 2d 530 (1970); Alstores Realty, Inc. v. State, 286 Minn. 343, 176 N.W. 2d 112 (1970). The reason other factors such as reproduction cost, earning capacity, and comparable sales prices should also be considered is because the statutes referred to, read together, require that assessing authorities 'consider and give due weight to every element and factor affecting market value thereof * * *.' §273.12." 211 N.W. 2d at 890.

"Despite difficulties in appraising utility properties, the seeming necessity for some type of formula, and the evidence which supports the Tax Court's conclusion that in devising the formula the commissioner was acting reasonably and within his authority to achieve a just, fair, and uniform valuation of such properties, the record makes inescapable our conclusion that determining the market value of the subject property by application of the formula alone ignores the statutory mandates for assessing properties and is therefore arbitrary and unreasonable." 211 N.W. 2d at 891.

The proposed rules comply with the statutory mandates relating to assessment of property at market value. Rule No. 1 specifically states that the Independent School District No. 99, et al v. Commissioner of Taxation case, supra, requires that the market value of utility property must be determined upon a consideration of "every element and factor affecting market value". The rigid 1962 formula, at the same time, is rejected as being too rigid and not in compliance with the statutory requirements.

The proposed rules, unlike the 1962 formula, adopt a broader approach in estimating market value and include original costs, replacement costs, depreciation and income. Furthermore, and most important, Rule 1 specifically provides additional flexibility in that the Commissioner "reserves the right to exercise his judgment whenever the circumstances of a valuation estimate dictate the need for it." Clearly, the proposed formula which takes into account the major elements comprising market value, together with the flexibility the Commissioner reserves, is in compliance with the statutory mandates.

C. The Proposed Rules Are A Proper Exercise Of The Commissioner's Powers And The Application Of These Rules Do Not Discriminate Against Any Class Of Taxpayer.

The statement filed on behalf of Minnesota Power and Light suggests that the proposed rules do not adequately reflect, or even relate to, market value and therefore are beyond the Commissioner's power and illegal. Apparently, it is contended that no formula can properly be adopted in estimating the market value of utility property. This contention is clearly without merit. The Supreme Court in the Independent School District No. 99 case, supra, specifically acknowledges the practical necessity of employing some type of formula in valuing property with no ready market place. The Court said:

> "Despite difficulties in appraising utility properties, the seeming necessity for some type of formula. . . . " (Emphasis added)
> 211 N.W. 2d at 891.

In developing the proposed rules, the Department has taken into consideration all significant factors bearing upon market value, and on this basis has developed a formula. At the same time, the proposed rules

specifically provide that the Commissioner may still exercise his judgment whenever circumstances warrant. It is difficult to conceive of a formula which provides a more tenable basis in estimating market value of utility property or more flexibility.

Minnesota Power and Light also argues that establishing the market value of electrical coops on a different basis than investor owned utilities constitutes invidious discrimination and an illegal property tax classification in violation of the equal protection clause of the Fourteenth Amendment to the United States Constitution and the uniformity clause of Article IX, Section 1 of the Minnesota Constitution. No authority is cited in support of this argument and an analysis of the issue reveals its lack of merit.

First, only the legislature has power to create property tax classifications. The proposed rules do not establish any classification of property, but rather establish rules pursuant to the Commissioner's authority under M.S. 270.11 to determine market value for assessment purposes. In other words, these rules do no more than establish a basis upon which to determine the valuation of utility property, and, of course, differences among the various utilities must be considered.

The legislature has long recognized the fundamental difference between electrical coops and large power generating investor owned utilities. M.S. 273.40 and M.S. 273.41 establish a special category for coops as distinguished from the large utility companies. These sections read as follows:

> "273.40 ANNUAL TAX ON COOPERATIVE ASSOCIATIONS. Cooperative associations organized under the provisions of Laws 1923, Chapter 326, and laws amendatory thereof and laws supplemental thereto, and engaged in electrical heat, light or power business upon a mutual, non-profit, and cooperative plan in rural areas, as hereinafter defined, are hereby recognized as quasi-public in their nature and purposes; but such cooperative associations, which operate within the corporate limits of any city shall be assessed on the basis of 40 percent of the market value of that portion of its property located within the corporate limits of any city as provided for in section 273.13."

> "273.41 AMOUNT OF TAX; DISTRIBUTION. There is hereby imposed upon each such cooperative association on December 31 of each year a tax of $10 for each 100 members, or fraction thereof, of such as-

> sociation. The tax, when paid, shall be in lieu of all personal property taxes, state, county, or local, upon distribution lines and the attachments and appurtenances thereto of such associations located in rural areas. The tax shall be payable on or before March 1 of the next succeeding year, to the commissioner of revenue. If the tax, or any portion thereof, is not paid within the time herein specified for the payment thereof, there shall be added thereto a specific penalty equal to five percent of the amount so remaining unpaid. Such penalty shall be collected as part of said tax, and the amount of said tax not timely paid, together with said penalty, shall bear interest at the rate of four percent per annum from the time such tax should have been paid until paid. The commissioner shall deposit the amount so received in the general fund of the state treasury."

The coops basically transmit and distribute electricity, but very few have their own power plants to generate their own power. Minnesota Power and Light has also asserted that the original cost less depreciation method proposed in valuing coops will result in lower taxes on the coops and thus constitute unlawful discrimination. This simply is not the case. Data developed by the Department of Revenue staff indicates that virtually all coops will pay a higher tax based upon the

1962 formula than upon the formula proposed under the new rules.

It is logical not to include the coops under the proposed formula because of the income factor. As a matter of policy, some coops charge low rates and pay low dividends (thus have low income). Other coops prefer to charge higher rates and pay higher dividends. Thus income in the case of coops is not a matter of earnings capacity but rather a matter of policy. Thus, the coops which have a high rate and high dividend policy would pay a higher tax than a comparable coop facility which did not choose to pay out higher dividends.

CONCLUSION

Although we feel the best indicia of market value is reproduction costs new, less depreciation, the Department's proposed rules are a reasonable and workable approach which, unlike the 1962 formula, comply with statutory provisions requiring that market value be the basis of property tax assessment. After giving due consideration to all major factors affecting value, the proposed rule takes into account original costs,

income and to a limited extent reproduction costs. This meets with the statutory mandate that due consideration and use of all acceptable methods of valuation be employed. Accordingly, we can support adoption of the proposed rules.

Respectfully submitted,

Peter S. Popovich

and

James E. Knutson

STATE OF MINNESOTA

COUNTY OF RAMSEY

BEFORE ARTHUR C. ROEMER

COMMISSIONER OF REVENUE

In the Matter of the Proposed Adoption of Rules of the Department of Revenue Relating to Property (Ad Valorem) Tax

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STATEMENT ON BEHALF OF INDEPENDENT SCHOOL DISTRICT NO. 99, THOMSON TOWNSHIP, VILLAGE OF SCANLON, INDEPENDENT SCHOOL DISTRICT NO. 98, INDEPENDENT SCHOOL DISTRICT NO. 93, and CARLTON COUNTY, MINNESOTA.

Submitted by

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I. INTRODUCTION

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The proposed rules considered at the public hearing conducted on September 23, 1975 were developed over a period of approximately one year during which several meetings were held and attended by representatives of the utility industry, assessors and other interested

parties. The proposed rules, as pointed out at the hearing, were developed from the ideas, recommendations and suggestions of all concerned parties as well as the research of Department staff. The Department is to be commended for inviting input from all concerned parties and for holding a public hearing upon due notice. As you know, the 1962 formula was adopted without a public hearing and after consultation with only representatives of the utility industry.

II. THE PROPOSED RULES ARE IN COMPLIANCE WITH THE APPLICABLE STATUTORY REQUIREMENTS AND CONSTITUTE A SIGNIFICANT IMPROVEMENT OVER THE 1962 ASSESSMENT FORMULA.

A. The Proposed Rules Adequately Reflect Market Value By Taking Into Account Cost Reproduction And Income Factors.

After giving due consideration to all significant approaches to determining market value, the proposed rules use the basic cost approach in valuing utility property. In addition, the factors of income, reproduction and depreciation are also taken into account. Inclusion of these basic valuation factors obviously constitutes an improvement over the old formula which simply excluded consideration of any factor other than original cost and depreciation.

Like the 1962 formula, depreciation is limited to a specified percentage in recognition of inflation factors. Limiting depreciation to a maximum takes into account obsolescence and normal wear and tear, and at the same time makes an allowance for the fact that a replacement facility would produce more value. The electric utility industry over the past ten years or so has made significant advances in technology which the Department recognizes in setting the depreciation limitation at 15%.

Unlike the 1962 formula, the proposed rules take into account replacement or reproduction costs through the "average cost per kilowatt of installed capacity". Reproduction costs less depreciation is an important and well-established factor to be considered in valuing utility property for tax purposes. The 1962 formula simply excludes any consideration of replacement or reproduction factors. Numerous decisions have upheld the significance and validity of reproduction costs in valuing utility property. These decisions include: Assessors of Quincy v. Boston Consol. Gas Co., (1941) 309 Mass. 60, 34 N.E. 2d 623; Connecticut Light and Power Co. v. Town of Monroe (1962) 149 Conn. 450, 181 A. 2d 118; Appeal of Goldberg, Pa. Com. Pl., 3 Adams L.J. 50

relating to market value. Surely, the utilities cannot be heard to complain about the five year averaging of production costs which, when added to the lag time involved in the publication of the cost figures, surely is significantly less than current reproduction costs.

As pointed out in the Department's presentation at the hearing, there are compelling reasons in support of the average cost per kilowatt of installed capacity factor, which is really a limited application of the reproduction method. The production cost factor does not affect smaller units which are not used on a regular ongoing basis. The national cost average is surely lower than the Minnesota average where weather and other factors affecting the construction industry cause building costs in Minnesota to be higher than the national average. The average cost per kilowatt of installed capacity factor does not discriminate against, but actually encourages, the construction of the most modern and efficient power plants.

The proposed rules, unlike the 1962 formula, also take into account an income indicator of value. This is another factor which was completely ignored under the old formula. Certainly, the earnings and yield with

respect to a particular property is a well-established indicia to be used in determining the market value of property. See State of Minnesota v. Federal Reserve Bank of Minneapolis (D.C. 1938), 25 Federal Supplement 14; Kittery Electric Light Company v. Town of Kittery (Maine 1966) 219 A. 2d 728; Alstores Realty, Inc. v. State of Minnesota (1970), 286 Minn. 343, 176 N.W. 2d 112.

In recognition of the fact that income is not as reliable an indicia of value as cost factors in a regulated industry, the income over a three year average is weighted at 15% and all the cost factors at 85%. Averaging income of the last three years does not appear to be unreasonable. An averaging of income seems to be a more fair and stable indicator than to use, for instance, one year's earnings. Given year to year fluctuations in income, an averaging method appears to be most tenable and reasonable.

While we have not made a study of the issue, the 7.75% cap rate assigned to the electric utility industry is based upon a Department study of Moody's Public Utility Manual, Federal Reserve Bulletins, and the National Tax Journal. Apparently, the Department has made a study of

the capital structure in the utility industry for 10 years, interest and bond yields of utilities for 20 years and stock yields for 10 years. Based upon the sources used and the time periods involved, the cap rate developed appears to be formed on a reasonable and well-thought out basis.

B. The Proposed Rules Meet The Pertinent Statutory Requirements Relating To Market Value On All Assessed Property.

The paramount consideration is the adoption of a method of valuation which meets the statutory mandates with respect to market value. M.S. 273.11, provides:

> "Except as provided in Subd. 2, All property shall be valued at its market value. In estimating and determining such value, the assessor shall not adopt a lower or different standard of value because the same is to serve as a basis of taxation, nor shall he adopt as a criterion of value the price for which such property would sell at auction or at a forced sale, or in the aggregate with all the property in the town or district; but he shall value each article or description of property by itself, and at such sum or price as he believes the same to be fairly worth in money. In assessing any tract or lot of real property, the value of land, exclusive of structures and improvements, shall be determined, and also

the value of all structures and improvements thereon, and the aggregate value of the property, including all structures and improvements, excluding the value of crops growing upon cultivated land." (Emphasis added)

M.S. 272.03, Subd. 8 provides:

" 'Market Value' means the usual selling price at the place where the property to which the term is applied shall be at the time of assessment; being the price which could be obtained at private sale and not at forced or auction sale."

M.S. 273.12 provides:

"It shall be the duty of every assessor and board, in estimating and determining the value of lands for the purpose of taxation, to consider and give due weight to every element and factor affecting the market value thereof, including its location with reference to roads and streets and the location of roads and streets thereon or over the same, and to take into consideration a reduction in the acreage of each tract or lot sufficient to cover the amount of land actually used for any improved public highway and the reduction in area of land caused thereby, provided, that in determining the market value of vacant land, the fact that such land is platted shall not be taken into account. An individual lot of such platted property shall not be assessed in excess of the assessment of the land as if it were unplat-

> ted until the lot is improved with a permanent improvement all or a portion of which is located upon the lot, or for a period of three years after final approval of said plat whichever is shorter. When a lot is sold or construction begun, the assessed value of that lot or any single contiguous lot fronting on the same street shall be eligible for reassessment. It shall be the duty of every assessor and board, in estimating and determining the value of lands for the purpose of taxation, to consider and give due weight to lands which are comparable in character, quality, and location, to the end that all lands similarly located and improved will be assessed upon a uniform basis and without discrimination and, for agricultural lands, to consider and give recognition to its earning potential as measured by its free market rental rate." (Emphasis added)

In Independent School District No. 99, et al v. Commissioner of Taxation, supra, the Minnesota Supreme Court made it clear that the 1962 formula does not meet these statutory criteria as interpreted in earlier decisions, stating:

> "The difficulty we have with the formula approved by the Tax Court is that it makes market value synonymous with original cost, taking into account limited depreciation, and gives no weight to other factors affecting market value. As we have indicated in numerous decisions, original cost is only one of several rele-

vant factors which should be considered in determining market value. See, e.g., Crossroads Center, Inc. v. Comr. of Taxation, 286 Minn. 440, 176 N.W. 2d 530 (1970); Alstores Realty, Inc. v. State, 286 Minn. 343, 176 N.W. 2d 112 (1970). The reason other factors such as reproduction cost, earning capacity, and comparable sales prices should also be considered is because the statutes referred to, read together, require that assessing authorities 'consider and give due weight to every element and factor affecting market value thereof * * *.' §273.12." 211 N.W. 2d at 890.

"Despite difficulties in appraising utility properties, the seeming necessity for some type of formula, and the evidence which supports the Tax Court's conclusion that in devising the formula the commissioner was acting reasonably and within his authority to achieve a just, fair, and uniform valuation of such properties, the record makes inescapable our conclusion that determining the market value of the subject property by application of the formula alone ignores the statutory mandates for assessing properties and is therefore arbitrary and unreasonable." 211 N.W. 2d at 891.

The proposed rules comply with the statutory mandates relating to assessment of property at market value. Rule No. 1 specifically states that the Independent School District No. 99, et al v. Commissioner of Taxation case, supra, requires that the market value of utility property must be determined upon a consideration of "every element and factor affecting market value". The rigid 1962 formula, at the same time, is rejected as being too rigid and not in compliance with the statutory requirements.

The proposed rules, unlike the 1962 formula, adopt a broader approach in estimating market value and include original costs, replacement costs, depreciation and income. Furthermore, and most important, Rule 1 specifically provides additional flexibility in that the Commissioner "reserves the right to exercise his judgment whenever the circumstances of a valuation estimate dictate the need for it." Clearly, the proposed formula which takes into account the major elements comprising market value, together with the flexibility the Commissioner reserves, is in compliance with the statutory mandates.

C. The Proposed Rules Are A Proper Exercise Of The Commissioner's Powers And The Application Of These Rules Do Not Discriminate Against Any Class Of Taxpayer.

The statement filed on behalf of Minnesota Power and Light suggests that the proposed rules do not adequately reflect, or even relate to, market value and therefore are beyond the Commissioner's power and illegal. Apparently, it is contended that no formula can properly be adopted in estimating the market value of utility property. This contention is clearly without merit. The Supreme Court in the Independent School District No. 99 case, supra, specifically acknowledges the practical necessity of employing some type of formula in valuing property with no ready market place. The Court said:

> "Despite difficulties in appraising utility properties, the seeming necessity for some type of formula. . . . " (Emphasis added) 211 N.W. 2d at 891.

In developing the proposed rules, the Department has taken into consideration all significant factors bearing upon market value, and on this basis has developed a formula. At the same time, the proposed rules

specifically provide that the Commissioner may still exercise his judgment whenever circumstances warrant. It is difficult to conceive of a formula which provides a more tenable basis in estimating market value of utility property or more flexibility.

Minnesota Power and Light also argues that establishing the market value of electrical coops on a different basis than investor owned utilities constitutes invidious discrimination and an illegal property tax classification in violation of the equal protection clause of the Fourteenth Amendment to the United States Constitution and the uniformity clause of Article IX, Section 1 of the Minnesota Constitution. No authority is cited in support of this argument and an analysis of the issue reveals its lack of merit.

First, only the legislature has power to create property tax classifications. The proposed rules do not establish any classification of property, but rather establish rules pursuant to the Commissioner's authority under M.S. 270.11 to determine market value for assessment purposes. In other words, these rules do no more than establish a basis upon which to determine the valuation of utility property, and, of course, differences among the various utilities must be considered.

The legislature has long recognized the fundamental difference between electrical coops and large power generating investor owned utilities. M.S. 273.40 and M.S. 273.41 establish a special category for coops as distinguished from the large utility companies. These sections read as follows:

> "273.40 ANNUAL TAX ON COOPERATIVE ASSOCIATIONS. Cooperative associations organized under the provisions of Laws 1923, Chapter 326, and laws amendatory thereof and laws supplemental thereto, and engaged in electrical heat, light or power business upon a mutual, non-profit, and cooperative plan in rural areas, as hereinafter defined, are hereby recognized as quasi-public in their nature and purposes; but such cooperative associations, which operate within the corporate limits of any city shall be assessed on the basis of 40 percent of the market value of that portion of its property located within the corporate limits of any city as provided for in section 273.13."
>
> "273.41 AMOUNT OF TAX; DISTRIBUTION. There is hereby imposed upon each such cooperative association on December 31 of each year a tax of $10 for each 100 members, or fraction thereof, of such as-

> sociation. The tax, when paid, shall be in lieu of all personal property taxes, state, county, or local, upon distribution lines and the attachments and appurtenances thereto of such associations located in rural areas. The tax shall be payable on or before March 1 of the next succeeding year, to the commissioner of revenue. If the tax, or any portion thereof, is not paid within the time herein specified for the payment thereof, there shall be added thereto a specific penalty equal to five percent of the amount so remaining unpaid. Such penalty shall be collected as part of said tax, and the amount of said tax not timely paid, together with said penalty, shall bear interest at the rate of four percent per annum from the time such tax should have been paid until paid. The commissioner shall deposit the amount so received in the general fund of the state treasury."

The coops basically transmit and distribute electricity, but very few have their own power plants to generate their own power. Minnesota Power and Light has also asserted that the original cost less depreciation method proposed in valuing coops will result in lower taxes on the coops and thus constitute unlawful discrimination. This simply is not the case. Data developed by the Department of Revenue staff indicates that virtually all coops will pay a higher tax based upon the

1962 formula than upon the formula proposed under the new rules.

It is logical not to include the coops under the proposed formula because of the income factor. As a matter of policy, some coops charge low rates and pay low dividends (thus have low income). Other coops prefer to charge higher rates and pay higher dividends. Thus income in the case of coops is not a matter of earnings capacity but rather a matter of policy. Thus, the coops which have a high rate and high dividend policy would pay a higher tax than a comparable coop facility which did not choose to pay out higher dividends.

CONCLUSION

Although we feel the best indicia of market value is reproduction costs new, less depreciation, the Department's proposed rules are a reasonable and workable approach which, unlike the 1962 formula, comply with statutory provisions requiring that market value be the basis of property tax assessment. After giving due consideration to all major factors affecting value, the proposed rule takes into account original costs,

income and to a limited extent reproduction costs. This meets with the statutory mandate that due consideration and use of all acceptable methods of valuation be employed. Accordingly, we can support adoption of the proposed rules.

Respectfully submitted,

Peter S. Popovich

and

James E. Knutson

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that it must consider Minnesota Statute 290.29 Subd. 2 regarding times for filing of claims since it is not applicable in this situation. Therefore, it is the opinion of this Court that the unpaid income taxes of the decedents are still due the State of Minnesota and can be collected pursuant to the provisions of this section.

Under the provisions of Minnesota Statute 290.29 Subdivision 1, the transferee is liable at law or in equity for the payment of the taxes due herein. The determination of whether or not each transferee is jointly and severally liable for the obligation appears to be a more difficult decision. However, it is the opinion of this Court that each transferee is jointly and severally liable for the total amount of taxes due provided, however, that equitably he could not be held for an obligation in excess of the total amount of the net proceeds received by him from the estate. Further, that any single transferee or group of transferees made to pay any deficient taxes due pursuant to this decision have a right of contribution from the other transferees of the property distributed in the estate of the decedent and said contribution should be based on a pro rata distribution of the total amount collected hereunder as related to the pro rata share of each transferee under the estate of the decedent under consideration.

Therefore, it is the opinion of this Court that the appellants hereunder are jointly and severally liable for the total amount of tax determined hereunder with the right of contribution from other transferees as outlined herein.

[¶ 200-578] Independent School District No. 99 et al. v. Commissioner of Taxation et al.

Minnesota Tax Court, Docket Nos. 1409 and 1415, September 20, 1971.

Property taxes—Assessment of public utility property.—In 1962, the Commissioner of Taxation instituted a change in the method of assessing utility property after he had considered the existing inequities in the basis used for ad valorem valuation of such property. The new method necessitated substantial adjustments in the assessment of utility property. The Court ruled that the application of the Commissioner's formula was not arbitrary, capricious or unreasonable, as contended by the appellants, and that adoption of the formula was within the legal authority conferred on the Commissioner. Basing his adjustment on the new formula, the Commissioner properly reduced the assessed valuation of a hydro-electric plant.

See ¶ 22-704.

For appellants: James E. Knutson of Peterson & Popovich.

For appellee: Don G. Paterick, Special Assistant Attorney General.

For intervenor: Edward T. Fride of Sullivan, Hanft, Hastings, Fride & O'Brien.

By his Order dated November 15, 1966, the Commissioner of Taxation reduced the assessed valuation of the Thomson Hydro-Electric Plant in Thomson Township from $1,081,646 to $906,230. Both the appellants and the intervenor appealed from the decision of the Commissioner. The appeals were consolidated for trial.

There is no dispute as to the value of the land and the water rights in this proceeding. The parties have stipulated that the Court shall consider only the value of the structures and the machinery of the plant herein involved.

Decision

The Order of the Commissioner of Taxation dated November 15, 1966, is hereby affirmed.

Findings of Fact

John Knapp

1. Appellants, Independent School District No. 99, Independent School District No. 98, and Independent School District No. 93, are public school corporations organized and existing under the laws of the State of Minnesota.

2. Appellants, Thomson Township and the Village of Scanlon, are municipal corporations duly organized and existing under the laws of the State of Minnesota.

3. Appellant, Carlton County, is a duly organized and existing County under the laws of the State of Minnesota.

4. The intervenor, Minnesota Power & Light Company, is a Minnesota corpora-

tion duly organized and existing under the laws of the State of Minnesota, doing business and holding title to property in the State of Minnesota within said County.

5. Properties in question in the instant case are all located in Carlton County, Minnesota. The taxing districts, property descriptions established by local taxing authorities, and assessed value thereof as determined by the Commissioner of Taxation's Order of November 15, 1966, are as follows:

Carlton County, Thomson Township — School District No. 99

Lots A & B, Aud. Subd. #14;
Lots A, B, C, D, E, Aud. Subd. #15;
Lots D, E, J, K, Aud. Subd. #16—$906,230

6. A resolution adopted by the County Board of Carlton County on August 15, 1966, established the assessed valuation of the subject property as $1,081,646.

7. On November 15, 1966, the Minnesota Commissioner of Taxation made and entered, and in due course transmitted to the appropriate taxing authorities of Carlton County, the Order of said Commissioner of Taxation, directing that the assessed valuation of the respective properties aforesaid should be decreased in the respective amounts applicable to the legal descriptions of real property as specified in said Order of November 15, 1966.

8. Af a special meeting of the Board of County Commissioners of Carlton County, held on November 17, 1966, said Board adopted the following motion:

> Motion made to order the County Assessor to follow the County Board of Equalization's values on all Minnesota Power & Light Company properties located in Carlton County, as set in August, 1966, rather than use the decrease directed by Rolland F. Hatfield, State Tax Commissioner. Motion made by A. D. Smith, seconded by G. A. Stransberg and carried.

9. Appellant herein, Independent School District No. 99, Thomson Township, Village of Scanlon, Independent School District No. 98, Independent School District No. 93, and Carlton County, Minnesota, filed a Notice of Appeal in the Tax Court dated December 14, 1966, as follows:

> From the Order of the Commissioner of Taxation, and the State Board of Equalization dated November 15, 1966, relating to the application for the reduction of assessed valuation of the Thomson Hydro-Electric Station in Carlton County, Minnesota, by the Minnesota Power and Light Company for the year 1966.

10. Intervenor, Minnesota Power & Light Company, filed a Notice of Appeal dated January 5, 1967, from the Order of the Commissioner of Taxation dated November 15, 1966, as follows:

> To the extent that said Order denies the Petition of taxpayer to reduce the assessed valuation of the property herein above described to $468,133 for the assessment year of 1966.

11. At the commencement of trial herein on February 17, 1969, appellants' taxing districts challenged the jurisdiction of the Tax Court, contending that the Order which appellants appealed from dated November 15, 1966, was entered by the State Board of Equalization. The Tax Court finds that the Order in question was made by the Commissioner of Taxation in his capacity as Commissioner of Taxation.

12. In 1961 and 1962 the Minnesota Commissioner of Taxation, his staff and consultants, considered existing inequities and problems in the then utilized basis for ad valorem valuation of electric utility, petroleum and gas pipe line companies. After extensively considering various means and methods to properly fulfill the Commissioner's legal responsibility, the Commissioner determined and by letters dated May 31, 1962, announced a change in the basis for ad valorem valuation indicating:

> . . . The new method of valuing the property of electric utility and petroleum and gas pipe line companies which we have decided to adopt, beginning with the year 1962, will be based on cost. From this will be deducted depreciation of 25% in the case of property over 10 years old. New property will be depreciated at the rate of 2½% a year for the first 10 years. In all instances this depreciated cost will be equalized at 33⅓%. By allowing only 25% depreciation, we are recognizing appreciation in value of older property.
>
> Cost of replacement will be considered as new cost. The depreciated cost of the item replaced or retired may be deducted from the cost of replacement in determining the net taxable cost. This net cost will be allowed depreciation at the same rate as new property. . . .

13. By letter dated July 9, 1962, addressed to all County Boards of Equalization, the Commissioner referred to public property assessment equalization, stating in part:

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Assessments of this class of property are made either directly by the Commissioner of Taxation or equalized by his office on the basis of detailed information on the property involved . . . This year I am making the assessments of public utility property on a basis that will reflect 33⅓% of market value . . . In order to reflect market value uniformly, I have, by extensive study, developed a method substantially different from the method previously used in assessing public utility property . . .

14. Appellants herein have challenged the application of the Commissioner's 1962 formula as arbitrary, unreasonable and capricious. The Court finds that the Commissioner's 1962 formula is not arbitrary, capricious or unreasonable. Its adoption by the Commissioner in 1962 and its application as reflected in the Order of November 15, 1966, here challenged, is within the legal authority conferred on the Commissioner.

15. The reproduction in kind of the subject property would not be a reasonable business venture.

Conclusions of Law

1. The Order of November 15, 1966, was properly issued by the Commissioner in his status as Commissioner of Taxation.

2. The Commissioner's formula, as adopted in 1962 and applied thereafter, is not arbitrary, capricious or unreasonable and is within the legal authority conferred upon the Commissioner of Taxation.

3. The Commissioner of Taxation's Order of November 15, 1966, is affirmed in its entirety.

Memorandum

In 1962 the Commissioner of Taxation instituted a change in the method of assessing utility property. Under the new method all such property was valued at the original acquisition cost with an annual depreciation of 2½ percent. The depreciation was limited to ten years, however, and consequently a residual value of 75 percent was placed on each item of property. The true and full value was taken at one-third of the depreciated or residual cost.

The institution of this new method created the necessity of substantial adjustments in many instances. These adjustments were both upward and downward. In order that no taxing district would suffer material losses in taxable value and no taxpayers would be subjected to drastic increases, it was decided to establish a differential from the 1961 basis and to adjust the differential by 10 percent each year. Such process prevailed until the 1966 assessment.

In 1966, after directives contained in Court decisions, it was determined by the Commissioner of Taxation that all differentials be cancelled and that the valuations of all properties be adjusted to conform to the 1962 formula. These appeals are the result of a decision to put the new formula into effect.

The appellants contend that the adoption of the Commissioner's formula was an arbitrary, capricious and unreasonable exercise of the Commissioner's statutory powers. They contend that reproduction cost, less depreciation, or some other formula should have been the basis upon which the valuation should have been determined.

The Commisisoner has authority to value utility properties under Minnesota Statutes Section 270.06.

The sole question for determination by this Court is the market value of the so-called "Thomson Plant" owned by Minnesota Power and Light Company in Thomson Township, in Carlton County, Minnesota.

Minnesota Statutes Section 273.11 provides that all propery shall be valued at its market value. If there were an open market for public utility properties, and more particularly hydro-electric plants, evidence of the sale price of comparable properties would be the best approach to the market value of the instant property. The appellants contend that there were comparable sales and one of the appellants' witnesses testified in regard to two so-called sales in the United States. One of them was the Big Bend property and the other was the Lake Chelan property. We find, however, that each of the sale referred to lacked the elements necessary to make it a valid sale between a willing seller and a willing buyer. We find, therefore, that there is no such market and we must turn to other indices of value to determine the market value.

Even though market value is difficult and next to impossible to ascertain, the Commissioner and this Court have the burden of finding the market value of the property in question.

In the syllabus of *Crossroads Center (Rochester) Inc., et al. v. Commissioner*, 176

N. W. (2d) 530, the Minnesota Supreme Court said:

> Land must be assessed on the basis of market value and Minn. St. 273.12 requires the assessor to consider and give due weight to every factor affecting the market value. Although income is one factor to be considered, other factors which bear on sale value include location, cost of construction, cost of reproduction, purpose for which building was used, the intrinsic value or worth of the building, the price at which the owner is willing to sell, the price at which buyers who may use the property for some purpose are willing to buy, and the price at which similar property, if any, has sold.

In forming its opinion, this Court has considered all of the factors normally employed by appraisers of property, including among other things the earning capacity of the property, the original cost, the capital structure, the reproduction cost, and the testimony of experts as to so-called comparable sales.

We have given consideration to all of the methods of valuation suggested by the appellants, by the Commissioner, and by the taxpayer, and we find that the method employed by the Commissioner comes closest to the market value. We find that many of the other methods suggested have very little relationship to market value.

There also is sufficient evidence to indicate that the Commissioner took into consideration all of the possible methods or approaches to the valuation, and that the formula he adopted was the "best thing" he could find.

The fact that the Commissioner finally determined to use a certain method of valuation, to the apparent exclusion of other methods, does not establish that he was arbitrary and capricious if the method arrived at was fair and equitable. We find that the valuation arrived at by the Commissioner was fair and equitable.

In the case of *Dulton Realty, Inc. v. State,* 270 Minn. 1, 132 N. W. (2d) 394, the Minnesota Supreme Court said:

> . . . It is definite that under both the State and Federal Constitutions, taxes must be uniform upon the same class of property; . . .
>
> In order to satisfy the requirement of uniformity, it is almost mandatory that some kind of formula or method be employed.

The appellants contend that other formulas are more equitable in arriving at market value. Considerable evidence was introduced on formulas based on reproduction cost, replacement cost, capitalized earnings, and stock debt, and appellants' expert witness contended that those formulas form a better basis for arriving at market value. We fail to see, however, that the employment of any of those formulas, or a combination of them, assures a more equitable valuation of the property.

The appellants' chief argument seems to be based on a formula employing reproduction cost.

The Minnesota Supreme Court has recognized that the use of reproduction cost in the valuation of properties indulges in a number of unfounded assumptions.

State v. Tri-State Telephone & Telegraph Company, 204 Minn. 516, 284 N. W. 294.

A preponderance of the Courts from other jurisdictions has held that reproduction cost less depreciation is not a fair measure of value, and many Courts have rejected testimony based solely on reproduction cost.

Before giving weight to reproduction cost, it must be shown that substantial reproduction of the property, in kind, would be a reasonable business venture. We find that, in that instant case, substantial reproduction of the present facility would not be a reasonable business venture, so we cannot give much weight to reproduction cost as a basis for value.

In the opinion of this Court, reproduction cost is the least valid approach to value in the instant case because it ignores technological advances allowing for greater efficiency of plant and equipment, and does not take into account the earning capacity of the plant.

There was really no disagreement among the experts testifying at the hearings, including those testifying for the appellants, that the earnings of public utility property are a controlling factor in determining what a willing buyer would pay for a utility property. If the earning capacity is too low to invite the investment of capital, a prospective purchaser will not be interested.

There is considerable logic to the argument that earnings determine the value. It is a commonly accepted fact that public

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utility companies depend largely on public financing and if the earnings are inadequate a prospective purchaser will not be interested in the purchase of the property. A prudent and knowledgeable buyer could not afford to pay more than original or book-cost less depreciation if rates are based on those values.

It is contended by the appellants that even if the Commissioner's formula of original cost less depreciation were to be accepted, then the higher sale price of the 1927 sale should be the beginning basis. It is the opinion of this Court that in the year 1927, and in the years shortly thereafter, this would have been a valid argument, but the Commissioner's formula also has an artificial limitation in the amount of depreciation allowed. If we took the 1927 sale price as the beginning basis, we would then feel compelled to take a more normal depreciation for each of the years since that date and we would arrive at a valuation lower than that arrived at by using the Commissioner's formula.

This Court takes judicial notice of the fact that all real properties in Minnesota have had a natural appreciation in value between the years 1927 and 1966, but we feel that adequate allowance is made for this appreciation in the Commissioner's formula. The artificial limitation of the depreciation to 25 percent eliminates possible arguments relating to the amount of depreciation to be allowed, and does have the effect of recognizing appreciation in values.

As was pointed out by some of the witnesses, depreciation is very much of a matter of judgment. It is the opinion of this Court that if the property had a greater market value in 1927 and in the subsequent years, as a result of the sale in that year, the inflated values created by that sale have not added any value to the plant in the present-day market and if that sale price were taken into consideration, additional depreciation or some other adjustment would have to be made to eliminate the artificial values created by that sale.

Appellants have not established that the selection of the original cost less depreciation formula was unreasonable in 1962, or that there has been a change in circumstances that would make the selection of this formula less reasonable in 1966.

There is no evidence to support the claim that the 1962 formula was arbitrary, capricious, or unreasonable. Giving the most charitable interpretation to the appellants' evidence, it simply results in a claim that one formula should have been adopted in preference to another formula because one "expert" contends that reproduction cost new, less depreciation, is preferable.

Where a municipality challenges an Order of the Commissioner of Taxation, the municipality has the burden of proving the incorrectness, if any, of the Order. *The City of Chisholm v. Commissioner and U. S. Steel,* Docket No. 1404, *Village of McKinley v. Commissioner,* M. B. T. A. 1014. We find that the appellants herein have failed to sustain this burden.

With respect to the appeal by the intervenor, no evidence was presented to substantiate the further reduction prayed for by the intervenor.

We have found that the Commissioner of Taxation had the authority to adopt the formula in question, and that this formula is a reasonable and proper basis upon which to value Minnesota utility properties for the purpose of ad valorem taxation. We conclude that the value arrived at in the instant case is fair and equitable.

[¶ 200-579] Sellner Manufacturing Co., Inc. v. Commissioner of Taxation.

Minnesota Tax Court, Docket No. 1545, November 3, 1971.

Sales and use taxes—Exemption for shipments outside the state.—The sales tax does not apply to products that a Minnesota corporation engaged in the manufacture, sale and repair of an amusement ride sold to customers domiciled outside Minnesota. The customers took delivery of the purchased products at the company's manufacturing plant in Minnesota but immediately removed the products from the state and did not subsequently return them to Minnesota, except in the course of interstate commerce. Sec. 297A.25, Subd. 1(d), provides that the exemption applies to goods whose ultimate destination is outside of Minnesota. The Court ruled that "ultimate destination" is not the point of delivery to the buyer but the point at which the beneficial use of the product would take place. In this instance, the beneficial use of the product took place outside Minnesota.

No. 226 (1972)

Tax Court

Rogosheske, J.
Took no part, Todd, J.
Yetka, J., Scott, J.

Independent School District
No. 99, et al,

Relators,

43428 vs.

Commissioner of Taxation,

Respondent,

Minnesota Power & Light Company,
intervenor,

Respondent.

Endorsed
Filed October 19, 1973
John McCarthy, Clerk
Minnesota Supreme Court

S Y L L A B U S

1. In determining market value of utility properties for ad valorem tax purposes, the assessing authorities, pursuant to statutory mandates, should consider and give due weight to every element and factor affecting market value.

2. A formula making original cost less limited depreciation synonymous with market value violates statutory mandates for determining market value and, when employed to the exclusion of a consideration of all valuation factors, is arbitrary and unreasonable.

Reversed and remanded.

Heard and considered en banc.

O P I N I O N

ROGOSHESKE, Justice.

Certiorari by relators, all local tax assessing authorities, to review a decision of the Tax Court affirming respondent commissioner of taxation's order reducing the assessed valuation for 1966 for ad valorem tax purposes of portions of the structures and machinery of the Thomson Hydroelectric Station, owned by Minnesota Power & Light Company, intervening respondent taxpayer. Because we are unable to

MP3L Exhibit 2

determine upon the record submitted that the Tax Court, in affirming the commissioner's order, made a de novo determination of the ultimate issue necessarily presented, namely, the market value of the property for tax purposes pursuant to statutory mandates as interpreted and applied by our prior decisions, and because the application of a formula alone for determining market value would be arbitrary and unreasonable, we reverse and remand to the Tax Court for further proceedings consistent with this opinion.

The structures and machinery of the hydroelectric station are a portion of the land and water rights of the taxpayer located on the St. Louis River in Thomson Township, Carlton County. The station was constructed in 1907 by the Great Northern Power Company. The original construction cost of the structures and machinery was $5,253,230.33. In 1927, the taxpayer purchased the station from Great Northern Power Company. The tax assessing authorities claim the purchase price was $11,631,770.82, representing $6,379,000 over the original cost of construction. Numerous improvements, additions, and machinery replacements were made between 1907 and 1966.

In August 1966, the assessed value of the property in question was fixed by the tax assessing authorities in which it was located at $1,081,646.[1] On November 15, 1966, in response to taxpayer's petition, the commissioner of taxation, acting pursuant to his authority to reduce the assessed valuation of any real or personal property[2] and in accordance with a newly devised formula for assessing utility properties issued an order reducing the assessed value from $1,081,646 to $906,230. Presumably because of the lowering of the value of the tax base, the

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[1] In 1966, the assessed value for the type of property here involved was determined by computing 33 1/3 percent of the true and full value, which true and full value was 33 1/3 percent of the market value.

[2] Minn. St. 270.11, subd. 6, provides: "The commissioner of taxation shall raise or lower the assessed valuation of any real or personal property, including the power to raise or lower the assessed valuation of the real or personal property of any individual, copartnership, company, association, or corporation; * * *." See, also, § 270.06(1).

Carlton County Board of Commissioners, by formal motion, refused to accede to the commissioner's order and, joining with the taxing districts, appealed to the Tax Court. Intervening taxpayer, whose petition to reduce the assessed value of its property to $468,133 was denied by the commissioner's order, also appealed. At the extensive de novo trial before the Tax Court, the evidence introduced was primarily directed to supporting or rebutting the claim of the tax assessing authorities that the so-called 1962 formula--adopted and applied since 1962 as the sole basis by which the market value of all Minnesota utility properties was to be determined for ad valorem tax purposes and upon which the order reducing the assessed value of the property in question was based--was arbitrary, capricious, and unreasonable. Aided by expert opinion testimony, the tax assessing authorities presented various formulas to value utility properties--including replacement cost, capitalized earnings, comparable sales, indexed cost, and reproduction cost new less depreciation—all seeking to establish that the commissioner's original-cost approach embodied in the 1962 formula did not adequately reflect the market value of the property and that reproduction cost new less depreciation together with a consideration of all other factors or methods of valuation was the proper approach. Taxpayer produced other experts who testified that, although the original-cost approach may not reflect the value of certain types of property, it is a proper approach in valuing utility properties.

There appears to be no disagreement that some type of formula is normally employed by taxing authorities throughout the United States for valuation for tax purposes of utility properties.[3] It also appears without challenge that in 1961, when a new commissioner was appointed,

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[3] Apart from the fact of the uniqueness of the real and personal property and the utility's status as a regulated monopoly, the primary reason and justification for the use of a formula is that neither the local authorities nor the staff of the commissioner is adequate or always qualified to make periodic, personal, on-the-spot appraisals of each article or description of property. It was admitted that no such appraisal was made by the commissioner's staff of the subject property.

there was a necessity to design and adopt some type of formula to replace the method of valuation used prior to his taking office because, the commissioner determined, the so-called unit-method formula, employed since 1940,[4] was neither a satisfactory nor uniformly applied method of valuing utility properties.[5] In 1961, the commissioner and his staff began studying the problem. After examining valuation methods used in other states and consulting with representatives of various utility companies,[6] he announced on May 31, 1962, by letter to the county assessing authorities, a change in the basis for valuation:

> "The new method of valuing the property of electric utility and petroleum and gas pipeline companies which we have decided to adopt, beginning with the year 1962, will be based on cost. From this will be deducted depreciation of 25% in the case of property over ten years old. New property will be depreciated at the rate of 2 1/2% a year for the first ten years. In all instances this depreciated cost will be equalized at 33 1/3%. By allowing only 25% depreciation, we are recognizing appreciation in value of older property.
>
> "Cost of replacement will be considered as new cost. The depreciated cost of the item replaced or retired may be deducted from the cost of replacement in determining the net taxable cost. This net cost will be allowed depreciation at the same rate as new property.
>
> * * * * *
>
> "Presently [utility real property is] for the most part assessed at 45% of original cost. Where special obsolescence problems have developed, a lower percentage may have been applied. In 1962, the method of assessing will be substantially the same for real property as for personal property of utilities. New installations will be assessed at 33 1/3% of cost. 2 1/2% of depreciation will be allowed each year for ten years and a residual value of 75% of cost will be maintained until the facility is removed. All changes of assessment, after removals and additions have been accounted for, are to be limited to 10%."

As the Tax Court found, application of this original-cost-less-limited-depreciation formula, when first adopted in 1962, necessitated substantial adjustments in many taxing districts and "[i]n order that

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[4] The record lacks any comprehensible disclosure of the valuation formula applied prior to 1962.

[5] See, In re Petition of Dulton Realty, Inc. v. State, 270 Minn. 1, 132 N. W. 2d 394 (1964).

[6] The tax assessing authorities complain that they were not consulted

no taxing district would suffer material losses in taxable value and no taxpayers would be subjected to drastic increases," the commissioner authorized a 10-percent limit each year in changes in valuation based on the new formula. In 1966, the commissioner canceled the upward transitional differentials.[7] The tax assessing authorities challenge the 1962 formula arguing that the formula does not reflect market value and that a different formula should be used.[8]

The critical as well as the only disputed finding of the Tax Court challenged here is:

> "Appellants [the tax assessing authorities] herein have challenged the application of the Commissioner's 1962 formula as arbitrary, unreasonable and capricious. The Court finds that the Commissioner's 1962 formula is not arbitrary, capricious or unreasonable. Its adoption by the Commissioner in 1962 and its application as reflected in the Order of November 15, 1966, here challenged, is within the legal authority conferred on the Commissioner."

As conclusions of law, the court determined:

> "The Order of November 15, 1966, was properly issued by the Commissioner in his status as Commissioner of Taxation.
>
> "The Commissioner's formula, as adopted in 1962 and applied thereafter, is not arbitrary, capricious or unreasonable and is within the legal authority conferred upon the Commissioner of Taxation.
>
> "The Commissioner of Taxation's Order of November 15, 1966, is affirmed in its entirety."

As we interpret the findings and accompanying memorandum, the Tax Court did not, perhaps understandably because of the confusion at the outset of the hearings, determine de novo the market value of the property.[9] Rather, it decided that the 1962 formula which the commissioner applied to reduce the assessed value was a reasonable formula which, of all the formulas available, "comes closest" to determining market value. Absent from the findings is a specific determination of

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[7] See, In re Petition of Dulton Realty, Inc. v. State, supra.

[8] Although the 1962 formula was applied from 1962 through 1965 as the basis for valuing all Minnesota utility properties, including the subject properties, no prior adjudicated challenge to the formula has been made.

[9] Minn. St. 271.06, subd. 6, provides in part: "The tax court shall hear, consider, and determine every appeal de novo upon the issues made by the notice and the return."

market value even though the parties, as well as the memorandum of the Tax Court, acknowledge that the "sole" or "basic," and in our view necessarily the ultimate, question presented was the "market value" of the structures and machinery of the so-called Thomson plant.

In 1966, our statutory scheme for determining valuation of properties for tax purposes mandated that (Minn. St. 1965, § 273.11)--

> "[a]ll property shall be assessed at its true and full value in money. In determining such value, the assessor shall * * * value each article or description of property by itself, and at such sum or price as he believes the same to be fairly worth in money. * * *"

That section further provided that in assessing improved property the value of the land, the value of the structures, and the aggregate value shall be determined. Section 272.03, subd. 8, provided that "full and true value" was the "usual selling price at the place where the property to which the term is applied shall be at the time of assessment being the price which could be obtained at private sale and not at forced or auction sale." Finally, § 273.12 imposed a duty on every "assessor and board, in determining the value of lands for the purpose of taxation, * * * to consider and give due weight to every element and factor affecting the market value * * *."

The difficulty we have with the formula approved by the Tax Court is that it makes market value synonymous with original cost, taking into account limited depreciation, and gives no weight to other factors affecting market value. As we have indicated in numerous decisions, original cost is only one of several relevant factors which should be considered in determining market value. See, e.g., Crossroads Center, Inc. v. Commr. of Taxation, 286 Minn. 440, 176 N. W. 2d 530 (1970); Alstores Realty, Inc. v. State, 286 Minn. 343, 176 N. W. 2d 112 (1970). The reason other factors such as reproduction cost, earning capacity, and comparable sales prices should also be considered is because the statutes referred to, read together, require that assessing authorities "consider and give due weight to every element and factor affecting market value thereof * * *." § 273.12.

Notwithstanding the fact that the formula does not give due weight

to other factors bearing on market value, the commissioner and the taxpayer offer a number of justifications for use of the formula. One of the justifications advanced is that the formula results in uniformity of application. Even apart from the doubtful assertion that the use of the formula promotes uniformity of valuation, there has been no showing that compliance with statutory mandates requiring consideration of all relevant factors violates the uniformity principle.

A more persuasive argument advanced in support of the use of an original-cost-less-depreciation formula in utility valuation cases is that, because of the regulated nature of the utility industry, the most that a willing buyer would pay for such property is net book cost. More specifically, the argument is that a willing buyer would not pay more for the utility property than the amount on which he would be able to earn a fair return, and since utility rates are based on net book cost, the buyer would know that if he paid more than net book cost he would not be able to earn a fair return. A main difficulty with this position is that the rate-making procedure of Minnesota utilities is only partially regulated: The state itself apparently provides no such regulation, and the Federal Power Commission does so only with respect to power sold for resale, which, the record suggests but does not establish, amounts to only about 10 percent of the total power produced by the subject property. But the argument especially loses force when one considers the fact that when taxpayer bought the station in 1927, it paid considerably more for it than its net book value. In this respect the New Hampshire Supreme Court made the following relevant comment in an opinion relating to tax valuation of utility property (Public Service Co. v. New Hampton, 101 N. H. 142, 151, 136 A. 2d 591, 598 [1957]):

> "In connection with [the argument] that net book cost and the value for tax purposes must be the same, it seems that, among other considerations, changing price levels would render such a method impractical and unfair. The inequities of holding rigidly to the formula of net book cost for tax purposes can well be illustrated by assuming two approximately equivalent plants in the same town, the first built in an era

> of high costs, such as the present, and the second built in a low-cost era such as we encountered in the '30s and may well experience in the future. Applying the net book cost theory * * * the town would be entitled to a higher tax value on the older [more expensive] plant than on the newer one [built in the depression], though the latter was performing the same function, was equally well constructed, and contained newer and less worn equipment."

Another argument is that use of the formula makes for simplicity of administration. Undoubtedly, this is true. However, in the absence of express legislative authority to employ a unique formula for valuing utility properties distinct from other taxable properties, administrative considerations cannot justify completely ignoring the statutory mandates that due weight be given to all factors affecting market value.

Despite difficulties in appraising utility properties, the seeming necessity for some type of formula, and the evidence which supports the Tax Court's conclusion that in devising the formula the commissioner was acting reasonably and within his authority to achieve a just, fair, and uniform valuation of such properties, the record makes inescapable our conclusion that determining the market value of the subject property by application of the formula alone ignores the statutory mandates for assessing properties and is therefore arbitrary and unreasonable.

In rejecting the formula as applied to this case, we do not mean to suggest that in any individual case the one making the determination of market value might not, after considering all factors, conclude that original cost less limited depreciation most closely approximates market value. Our concern is that the reasoning of the Tax Court is susceptible of being interpreted as holding that in all cases the market value of all utility properties can be determined by application of the 1962 formula alone. If we could conclude that the Tax Court intended no such interpretation and that it did (although not specifically) determine the market value upon a consideration of every factor affecting it (as its memorandum does seem to suggest), we could uphold the Tax Court's decision. Since we cannot conclude that the Tax Court determined the ultimate question which would be dispositive of the dispute between the tax assessing authorities and the taxpayer and

the commissioner, i.e., the market value of the properties for the tax assessment year 1966, established in accordance with statutory mandates, we must reverse and remand for further proceedings consistent with this opinion.

Reversed and remanded.

MR. JUSTICE TODD took no part in the consideration or decision of this case.

MR. JUSTICE YETKA and MR. JUSTICE SCOTT, not having been members of this court at the time of the argument and submission, took no part in the consideration or decision of this case.

RECEIVED

OCT 21 1974

STATE OF MINNESOTA

TAX COURT

DOCKET NOS. 1409 & 1415

Independent School District No. 99,
Thomson Township, Village of Scanlon,
Independent School District No. 98,
Independent School District No. 93,
and Carlton County, Minnesota, Appellants,

-vs-

The Commissioner of Taxation, Appellee.
Docket No. 1409

and

Minnesota Power and Light Company, Intervenor.
Docket No. 1415

NOTICE OF ENTRY OF ORDER

Mr. Edward T. Fride
Hanft, Fride, O'Brien & Harries
Attorneys at Law
1200 Alworth Building
Duluth, Minnesota 55802

YOU WILL PLEASE TAKE NOTICE that the Tax Court entered its Order on October 16, 1974 in the above entitled matter and a copy thereof is herewith transmitted to you by certified mail.

Dated at St. Paul, Minnesota, this 16th day of October 1974.

MINNESOTA TAX COURT

By Marcella Barrett
Clerk

MP&L Exhibit 3

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OCT 21 1974

STATE OF MINNESOTA

TAX COURT

DOCKET NOS. 1409 & 1415

Independent School District No. 99,
Thomson Township, Village of Scanlon,
Independent School District No. 98,
Independent School District No. 93,
and Carlton County, Minnesota, Appellants,

-vs-

The Commissioner of Taxation, Appellee.
Docket No. 1409

and

Minnesota Power and Light Company, Intervenor.
Docket No. 1415

I, Marcelle Morath, Clerk of the said Tax Court and custodian of its records, do hereby certify that I have compared the attached copy of Order in the above entitled matter with the signed original thereof on file and on record in the office of the Tax Court and that the same is a true and correct copy of said original and of the whole thereof as entered on October 16, 1974.

Dated at St. Paul, Minnesota, this 16th day of October 1974.

Marcelle Morath
Clerk, Minnesota Tax Court

RECEIVED
OCT 21 1974

STATE OF MINNESOTA

TAX COURT

Independent School District No. 99,
Thomson Township, Village of Scanlon,
Independent School District No. 98,
Independent School District No. 93,
and Carlton County, Minnesota, Appellants,

-vs-

The Commissioner of Taxation, Appellee.

Docket No. 1409

and

Minnesota Power and Light Company, Intervenor.

Docket No. 1415 Order Entered October 16, 1974.

The above entitled matter having been heard by this Court in a trial de novo, the decision rendered thereupon having been appealed to the Supreme Court, and the Supreme Court having reversed this Court's decision and remanding the case back to this Court for further proceedings in accordance with the Supreme Court opinion;

And having heard the arguments and having the benefit of the briefs of both parties herein in relation to the question of whether this Court should order a new trial or merely adopt amended findings based on the original record;

And upon all the files, records, and proceedings herein;

IT IS HEREBY ORDERED that a new trial on all issues be held and that the case be placed on the regular calendar of this Court for assignment of an appropriate trial date.

Duane M. Peterson

MEMORANDUM

The original trial herein was tried on the theory that the question before the Court was whether or not the Commissioner's formula was unreasonable, arbitrary or capricious. The Supreme Court, in its opinion, clearly indicates that the issue is rather what was the reasonable market value of the property at the time of the assessment. This Court did not really make a finding of market value in the first trial although one can argue with some logic that this Court's acceptance of the Commissioner's formula was implicitly a finding that the Commissioner's formula reflected the market value.

We are constrained from adopting that reasoning, particularly in view of the language of the Supreme Court indicating its disapproval of the Commissioner's formula and the need to consider all other relevant factors in determining market values. We quote:

> The difficulty we have with the formula approved by the Tax Court is that it makes market value synonymous with original cost, taking into account limited depreciation, and gives no weight to other factors affecting market value. As we have indicated in numerous decisions, original cost is only one of

several relevant factors which should be considered in determining market value. See Crossroads Center v. Commissioner of Taxation, 286 Minn. 440, 176 N.W. (2d) 530 (1970); Alstores Realty, Inc. v. State, 286 Minn. 343, 176 N.W. (2d) 112 (1970). The reason other factors such as reproduction cost, earning capacity, and comparable sales prices should also be considered is because the statutes referred to, read together, require that assessing authorities consider and give due weight to every element and factor affecting the market value thereof . . . S273.12.

The Tax Court will not, therefore, in the supplemental hearings, place a burden on the appellants to prove that the Commissioner's formula was arbitrary, unreasonable or capricious. The issue will be what was in fact the market value at the time of the assessment.

The Court is particularly thankful to counsel for both appellants and intervenor for their excellent briefs on the questions faced by the Court.

MINNESOTA TAX COURT

Duane M. Peterson

John Knapp

Harry L. Munger

RECEIVED
JUN 5 1975
E. T. F.

STATE OF MINNESOTA

TAX COURT

Independent School District No. 99,
Thomson Township, Village of Scanlon,
Independent School District No. 93,
Independent School District No. 93,
and Carlton County, Minnesota, Appellants,

-vs-

The Commissioner of Taxation, Appellee.

Docket No. 1409

and

Minnesota Power and Light Company, Intervenor.

Docket No. 1415

The petition of the intervening respondent for a rehearing and a vacation of the Court's Order of October 16, 1974, having been duly heard upon oral argument and upon the briefs of counsel and all the files, records and proceedings herein, the petition for rehearing and the motion to vacate are hereby denied. It is further ordered that the case be placed back on the active trial calendar.

MEMORANDUM

The Court's Order of October 16, 1974, fully set out in its Memorandum appended thereto, the reasons for its

MP&L Exhibit 4

decision to retry the case on all issues. It appears to the Court that those reasons still apply.

MINNESOTA TAX COURT

Duane H. Pedersen

Harry L. Munger

Dated: May 30, 1975.

SPECIAL CONCURRING OPINION

It is my opinion that in its original decision this Court did "Give due weight to every element and factor affecting market value", of the subject property. In its Memorandum of September 20, 1971, this Court said:

> In forming its opinion, this Court has considered all of the factors normally employed by appraisers of property, including among other things the earning capacity of the property, the original cost, the capital structure, the reproduction cost, and the testimony of experts as to so-called comparable sales.
>
> We have given consideration to all of the methods of valuation suggested by the appellants, by the Commissioner and by the taxpayer, and we find that the method employed by the Commissioner comes closest to market value. We find that many of the other methods suggested have very little relationship to market value.

I am of the opinion that after considering all factors, this Court did make a de novo determination of the market value. We did not arrive at the market value by the use of the formula alone. Apparently, however, we did not make that clear enough for the Minnesota Supreme Court so the Court has Remanded the matter to us for further proceedings.

I am at a loss to know what we can do but to grant a new trial, particularly in view of the fact that there has been a turnover of two of the three members of the Tax Court since the matter was first heard.

I am assuming that the Supreme Court wants us to make a finding of the market value and because the new members neither heard the testimony nor observed the witnesses they do not feel that they can make a proper finding of the market value without a full hearing on the merits.

MINNESOTA TAX COURT



John Knapp

Dated: May 30, 1975.

BEFORE THE MINNESOTA PUBLIC SERVICE COMMISSION

Karl F. Rolvaag	Chairman
Ronald L. Anderson	Commissioner
Arlen I. Erdahl	Commissioner
Katherine E. Sasseville	Commissioner
Richard W. Session	Commissioner

In the Matter of Northern States Power Company's Proposed Increase in Rates for Electric Service in the State of Minnesota.

ORDER TO STRIKE

ER-2-1

Northern States Power Company (hereinafter "the Company") filed the prepared testimony of its witnesses herein on January 2, 1975. On May 10, 1975, the Company filed with the Commission supplemental prepared testimony and exhibits FPV-2 of Frank P. Vixo (revised to original cost) and on May 16, 1975, the Company filed revised prepared testimony of Frank P. Vixo (revised to original cost). On May 6, 1975, the Company also filed revised testimony for David McElroy, Edward G. Glass, and supplemental testimony for Keith E. Sorenson.

In its pre-hearing order dated March 25, 1975, the Commission provided that prepared written testimony of each party shall be considered as offered into evidence when filed for the purpose of motions to strike by other parties and that motions to strike the Company's prepared written testimony be filed with the Commission by May 6, 1975. The Commission thereafter permitted the parties to amend their motions to strike to include revised testimony filed by the Company.

The participating staff, the Suburban Rate Authority and the Cities of Minneapolis and St. Paul variously made timely motions to strike all or parts of the testimony and exhibits filed on January 2, 1975, of various Company witnesses on the grounds that it related to the determination of rate base on the basis of "fair value," "reproduction cost,""current value," and "trended original cost."

MP&L Exhibit 5

The City of St. Paul also made a timely motion to dismiss or hold in abeyance the Company's application for a rate increase until it files certain additional testimony concerning the basis for the change in rate design which it proposes.

Liberty Plaza, Inc., made a timely motion to strike all parts of the testimony of Keith E. Sorenson and all parts of any other prepared testimony submitted by the Company concerning "all electric rates."

In a reply brief filed with the Commission on May 13, 1975, the Company stated that "it has decided that it will confine its evidence of plant valuation to original cost depreciated in the present electric rate hearings," but did not "waive its position that the present statute requires the Commission, when considering plant valuation evidence, to take into account factors other than original cost, nor its position that Minnesota Law requires the Commission to consider as evidence of plant valuation relevant factors other than original cost."

On May 14, 1975, the full Commission heard oral argument by all parties making motions to strike except Liberty Plaza, Inc., and by the Company.

APPEARANCES were as follows:

Mr. Gene R. Sommers, Attorney, 414 Nicollet Mall, Minneapolis, Minnesota 55422, appeared on behalf of the petitioner, Northern States Power Company.

Mr. Leonard J. Keyes, Attorney, W-2200 First National Bank Building, St. Paul, Minnesota 55101, appeared on behalf of the petitioner, Northern States Power Company.

Mr. Samuel L. Hanson, Attorney, W-2262, First National Bank Building, St. Paul, Minnesota 55101, appeared on behalf of the petitioner, Northern States Power Company.

Mr. Thomas J. Stearns, Assistant City Attorney, 647 City Hall, Courthouse, St. Paul, Minnesota 55101, appeared on behalf of the City of St. Paul.

Messrs. Clayton L. Lefevere and David J. Kennedy, Attorneys, 1100 First National Bank Building, Minneapolis, Minnesota 55402, appeared on behalf of Suburban Rate Authority.

Mr. Arvid M. Falk, Assistant City Attorney, 328 M City Hall, Minneapolis, Minnesota, appeared on behalf of the City of Minneapolis.

Mr. John Van de North, Attorney, 4610 IDS Center, Minneapolis, Minnesota 55402, appeared as counsel for participating department staff.

Mr. Jerome L. Getz, Special Assistant Attorney General, appeared as counsel to the Commission.

At the oral argument the participating staff and moving intervenors argued that the Company should not be permitted to withdraw its testimony based on "fair value," and that the Commission should decide the question of whether "fair value" testimony is permissible on the merits. The Company repeated its offer to withdraw such testimony except for certain testimony which allegedly also related to inflation. The Company also stated that its withdrawal of the proposed testimony was conditional. If the Commission wished to determine the issue of fair value on the merits, the Company would retract its offer because it was prepared to proceed to that issue and wanted to have its testimony on the record. The Company stipulated for the record that it was willing to withdraw certain specified portions of its witnesses' testimony contained in the Suburban Rate Authority's motion and the other portions requested to be excluded by the other parties.

Now, therefore, on the basis of the motions to strike and oral argument of the parties and the offer by the Company to withdraw certain testimony, it is hereby

ORDERED

(1) The Company shall confine its evidence of plant valuation to original cost depreciated.

(2) The following testimony is hereby stricken:

TESTIMONY OF DAVID F. McELROY

1. P. 20, Answer to Question 29, third sentence of paragraph 5.

2. P. 20, Answer to Question 29, paragraph 6.

TESTIMONY OF JOHN B. GILLETTE

All testimony and exhibits.

TESTIMONY OF FRANK P. VIXO FILED JANUARY 2, 1975

1. P. 2, Answer to Question 7, sentence beginning "My study. . . ." to end of paragraph.

2. P. 3, Answer to Question 8, last line: ". . .and (5) the fair value rate base."

3. Pp. 15-18, Questions and Answers 29, 30, 31 and 32.

4. P. 19, Answer to Question 36, all of second paragraph.

5. P. 22, Answer to Question 41, first full sentence beginning, "I show. . . ."

6. Pp. 26-27, all of the Question and Answer No. 43.

7. P. 27, all of the Question and Answer No. 44.

8. Exhibit FPV-1, Schedule 1, all of last two sections in table, beginning "AVERAGE NET OPERATING. . . ."

9. Exhibit FPV-1, Schedule 2, p. 3, all of Columns B and C.

10. Exhibit FPV-1, Schedule 3, p. 2, all of Columns B and C to "Deduct" and last line of Column C.

TESTIMONY OF EUGENE W. MEYER

1. P. 14, Answer to Question 16, first full sentence beginning, "Dr. Herz has. . . ."

2. P. 15, Question 17, ". . .on equity of 13% base on the fair value of investment,. . . ."

3. P. 15, Answer to Question 17, ". . .13% on equity based on the fair value of investment. . . ."

4. P. 16, Answer to Question 17, ". . .and use fair value rate base in its procedures."

TESTIMONY OF HENRY HERZ

1. P. 3, Answer to Question 4, ". . .a fair rate of return, applicable to fair value rate base, and alternatively. . . ."

2. P. 5, Answer to Question 7, ". . .than 9.0 percent if a fair value rate base is adopted, and not less. . ." and ". . .if the rate base is measured only in bookkeeping dollars."

3. Pp. 6-8, Answer to Question 10, first full sentence of second paragraph on p. 6, first full sentences of first and second paragraphs and all of the last paragraph except last sentence on p. 7, and second sentence in first full paragraph on p. 8.

4. P. 9, Answer to Question 12, in paragraph beginning "A fair rate of return. . ." ". . .which in this case is sought to be fair value."

5. P. 26, Answer to Question 28, portion of last sentence beginning with ". . .and with reference. . . ."

6. P. 27, Answer to Question 29, last full paragraph.

7. Pp.32-33, Answer to Question 36, second full paragraph.

8. P. 36, Answer to Question 41, lines 9-19.

9. Exhibit No. HH-1, Schedule A-1, all of Items 1. through 1.25 and all of column entitled "Fair Value Basis."

10. Exhibit No. HH-1, Schedule A-3, all of Items 6.1 through 6.122 and all of Item 7.11.

(3) The motion of the City of St. Paul insofar as it seeks to dismiss or hold in abeyance the Company's application is denied.

(4) The motion of Liberty Plaza, Inc. is denied.

(5) This order is effective immediately.

BY ORDER OF THE COMMISSION

LAWRENCE J. ANDERSON
Secretary

DATED: May 23, 1975

(S E A L)