



Local Finance Opinion

LFO-2019-1
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TOPIC: Assessing Utility Properties

ISSUE: Evolving Court Decisions Affecting Determination of Fair Cash Value of Utility Properties

This LFO examines changes in the law governing the valuation of the personal property assets of utility companies and the resulting change in guidance from the Bureau of Local Assessment (BLA) on the appropriate method of valuation for purposes of local property tax assessment.

1. What was the legal basis for BLA’s guidance in its certification standards that assessors use “net book value” in assessing personal property assets of utility companies?

BLA based its presumptive reliance on “net book value,” most recently issued in Informational Guideline Release (IGR) 2017-01, upon two decisions of the Supreme Judicial Court (SJC) - *Boston Edison Co. v. Assessors of Watertown*, 387 Mass. 298, 301 (1982) (*Watertown*) and *Montaup Electric Co. v. Assessors of Whitman*, 390 Mass. 847 (1984) (*Montaup*). These cases held that valuation using “net book value” is presumed to be the appropriate method to determine fair cash value of utility assets unless assessors can demonstrate special circumstances warranting an alternative valuation approach, such as replacement cost new less depreciation. Valuation by “net book” looks to the original cost of property when first put into use, reduced by accrued depreciation.

The court’s determination of “net book value” as the presumptive method to determine fair cash value was based upon the then longstanding position of the Department of Public Utilities (DPU) that, “if a regulated utility sells an asset to another regulated, public utility, the basis of that asset in the hands of the transferee remains the same as that of the transferor for rate-making purposes. Thus, if Edison were to sell any of its taxable personal property in Watertown to another public utility that other utility would be allowed a return on the transferred property based on that property’s net book, or rate base, value, and not on any higher purchase price it might have paid.” Therefore, the value or earning power of the utility property was affected by the DPU’s restriction and was required to be considered in determining fair cash value. However, “net book cost of the property does not set an upper limit on the property’s value for local taxation purposes.” *Watertown*, pp. 301-302. Special circumstances may warrant a valuation higher than “net book value.”

In the *Montaup* decision (page 855), the SJC acknowledged that while the taxpayer has the burden of establishing overvaluation when challenging a property tax assessment, “a regulated utility should not be required to establish the lack of special circumstances which were enumerated in *Watertown*, until there is

some evidence offered by the assessors to show that, because of such circumstances, the relevance of rate base value is put in question.” As a result, assessors were required to show special circumstances before using a valuation method other than the “net book value” approach.

2. What “special circumstances” would allow assessors to value utility property using a method other than “net book value”?

The *Watertown* court provided a nonexclusive list of examples of “special circumstances” that might induce a buyer of utility property to pay more than the “net book value” or rate base value of the property and, if shown by assessors, would allow a valuation method other than “net book value.” *Watertown*, at 306.

Special circumstances include:

- a) The return actually earned by the utility may exceed or be expected to exceed the rate of return approved in the allowed rate and encourage a buyer to pay more than the rate base.
- b) There is a possibility that the rules of law or governing agency decisions might be changed to make an investment in the company more attractive.
- c) The potential for growth in a utility’s business may warrant a buyer to pay more than the utility’s net book cost of particular property.
- d) The possibility of finding a buyer that is not a public utility.

3. Have there been changes in the law or regulatory policy since *Montaup* that cast doubt on the presumptive use of net book value?

Yes. Beginning in the 1990’s, a change in DPU’s regulatory policy eroded the presumption of net book value as the method of valuation for property tax purposes. As discussed in *Stow Municipal Electric Dept. v. Dept. of Public Utilities*, 426 Mass. 341, 347 (1997), the change involved DPU endorsing a more flexible approach to valuing utility property, changing from a mandatory rule that always limited a buyer of utility property to the seller’s rate base to a case-by-case determination.

In the *Stow* case, the DPU employed net book value as its “starting point” for the valuation of electric-generating assets that the Stow Municipal Electric Department was acquiring from the Hudson Light and Power Department. But given its discretion to consider “any other element which may enter into a determination of fair value,” the DPU used a blended appraisal approach relying 50% on net book value and 50% on reproduction cost new less depreciation, in setting the purchase price for the Hudson personal property. Both parties challenged this hybrid methodology; however, the SJC found the “department’s 50% weighting of reproduction cost new less depreciation [to be] well within its discretion.” *Stow*, at page 345.

4. What effect has this change in DPU regulatory policy had on the valuation of utility assets for property taxation purposes?

In 2011, the SJC considered an appeal from the Appellate Tax Board (ATB) in *Boston Gas Co. v. Assessors of Boston*, 458 Mass. 715 (2011). In this case, the assessors had used a valuation method other than net book value to value the taxpayer’s utility property. Specifically, they used a valuation method that gave equal weight to the property’s net book value and its reproduction cost new less depreciation. The SJC held that the ATB’s finding that changes in the utility regulatory environment (see changes described in the *Stow* case above) and other special circumstances justified the use of a

valuation method other than “net book” and that the method used provided a reliable estimate of the fair cash value of the property.

Most recently, in *NSTAR Electric Co. v. Assessors of Boston*, 94 Mass. App. Ct. 1123 (2019), the appeals court, in a Rule 1:28 Memorandum Decision, upheld an assessment of utility property that was also not based upon net book value. The assessors in this case used the same method of valuation as in the *Boston Gas* case. For fiscal year 2012, while the net book value of the property was \$1.155 billion, the assessors valued it at \$1.586 billion. For fiscal year 2013, the net book value was \$1.182 billion and the assessors valued it at \$1.635 billion. NSTAR’s appeal argued that the record did not support a finding of special circumstances to allow assessors to deviate from using the “net book value” of the property. The appeals court disagreed, stating that the assessors (and ATB) had relied upon relevant DPU decisions made from 1993 to 2010 to show that the DPU’s carry-over rate base rule has changed. The change in the regulatory rule provided special circumstances to warrant deviation from net book value. The assessors had also shown that NSTAR had actually received a higher rate of return than its approved rate of return, another “special circumstance” described in the *Watertown* case above. The showing of special circumstances by the assessors permitted a valuation other than by net book value and, upon this showing, the burden of proof then shifted back to the utility to prove overvaluation, which it could not.

5. How will BLA certification standards for assessors reflect the evolution in the law regarding valuation of utility assets?

Both the *Boston Gas* and the *NSTAR* cases demonstrate that the ATB and the appellate courts have accepted that the DPU’s carry-over rate base rule has changed over the years and that this change is a “special circumstance” warranting deviation from the net book valuation approach. In each of these cases, the assessors also demonstrated other special circumstances to warrant another valuation approach. As a result of these decisions, we believe that net book cost should no longer be the default method of valuation of utility property or conclusive for purposes of the fair cash value standard of G.L. c. 59, § 38. As a result, BLA will be modifying its certification guidance that previously gave presumptive validity to net book cost as the standard for valuing utility assets and will be advising assessors to consider other data relevant to value, including data that shows that utility assets will generate greater returns than net book value would suggest. Such data, as well as the change in DPU regulatory rules, would constitute “special circumstances” to allow the use of other valuation approaches. For purposes of mass appraisal, BLA will be accepting a method that gives equal weight to the property’s net book value and its reproduction cost new less depreciation. Although we note that the continuing relevance of net book value to property tax assessments is uncertain, the recent court and ATB decisions have upheld utility valuations based upon this approach.¹



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¹ See *NSTAR*, at page 12, where the court noted expert testimony that “net book value is an accounting entry and not a valuation method.”