12/31/90

State of Minnesota
Department of Revenue

In the Matter of the Proposes Rules of the Department of Revenue Governing the Valuation and Assessment of Electric, Gas Distribution and Pipeline Companies (Utility Companies)

STATEMENT OF NEED AND REASONABLENESS

The above-captioned rules are being proposed in order to update and revise the current Rules of the Department of Revenue Relating to Ad Valorem (Property) Taxes. The current rules have been in effect since 1975. They have been revised many times. Once in 1976, 1979, 1982, 1983, 1984, 1985, 1986, 1987, 1988, and again in 1989; however, it is the announced intention of the Department of Revenue to revise the rules whenever conditions, economic or otherwise, dictate a need for revision. It is now the opinion of the Commissioner of Revenue that the rules should be revised.

This document has been prepared as a verbatim affirmative presentation of the facts necessary to establish the statutory authority, need for, and reasonableness of the proposed new rules. It is submitted pursuant to Minn. Rule 1400.0500 requiring a Statement of Need and Reasonableness.

A Notice of Intent to Solicit Outside Information or Opinions in the preparation of these proposed rules was published in the State Register on September 24, 1990 (15 S.R. 804). Additionally, an open forum type discussion meeting was held on October 25, 1990. This meeting was attended by members of the Department of Revenue together with county representatives and representatives of various utility companies. A list of those in attendance, the agenda, and meeting notes relative to this meeting is available in the Department of Revenue. Various suggestions and comments made at this meeting were received and duly considered by the agency.

Authority to Adopt Rules

Minn. Stat. 270.06(14) states that the Commissioner of Revenue shall: .."promulgate rules having the force and effect of law, for the administration and enforcement of the property tax;" The above captioned rules are encompassed within this authority.

Further, Minn. Stat. 270.11, Subd. 1 and 6 gives the Commissioner of Revenue the authority to review, modify, revise, raise or lower the assessed valuation of any real or personal property of any individual, co-partnership, company, association or corporation. The Commissioner of Revenue is also charged with the responsibility under Minn. Stat. 273.33, Subd. 2; 273.37, Subd. 2; and 273.38 of assessing the... "personal property, consisting of the pipeline system of mains, pipes and equipment attached thereto, of pipeline companies and others engaged in the operations or business of transporting natural

Depreciation is made up of three factors:

1. Physical deterioration, which is the loss in value from original cost caused by normal use and wearing out of the property.
2. Functional obsolescence, which is a loss in value because of functional deficiencies or inadequacies within the property itself. Normally, functional obsolescence would result from technological changes which result in better, more efficient techniques.
3. Economic obsolescence, which is a loss in value caused by factors outside the property itself.

In the case of most utilities the various elements of depreciation are considered by the Federal Energy Regulatory Commission which then specifies what rates of depreciation are to be used by the various utilities for different classes of assets.

The rules now in effect allow the electric companies a maximum of 20% depreciation plus 50% of any excess depreciation over the 20% maximum and other utilities a maximum of 50% depreciation plus 50% of any excess over the 50% maximum. The proposed rule would allow the Commissioner of Revenue to review the depreciation deducted and reduce the amount if it was determined that the amount deducted was excessive. The actual expected life of the property will be considered in determining the market value of the property.

The agency recognizes that in most instances the utility is limited in its earnings by its rate base; (rate base is normally original cost less depreciation). However, it is readily apparent that sometimes the property of utilities may last a longer or shorter period of time than originally anticipated. This provision will allow an adjustment to be made when the property will last a significantly longer period of time than the depreciation period be used by the utility.

The change to 8100.0300 also deletes the reference to the depreciation limitation used in the previous years assessment. This reference is no longer needed. The agency believes that the proposed provisions are a reasonable and viable method of determining the proper depreciation allowance.

The last change to the rules is the addition of 8100.0700. This rule provides for the equalization of utility property in accord with a court case recently decided. In the Minnegasco case the Minnesota Supreme Court decided that the utility real property valued by the commissioner of revenue should be equalized to the level of assessment of other commercial/industrial property assessed by the local assessors. Equalization will not be done if the level of assessment is greater than 90%. Further, it was decided that utility personal property is a separate class of property for the purpose of equalization and since no sales gas, gasoline or other petroleum products by pipelines... transmission lines of less than 69kv, transmission lines of 69kv and above located in an unorganized township and distribution lines, (of electric companies) and equipment attached thereto, having a fixed situs outside the corporate limits of cities... the distribution lines, and the attachments and appurtenances thereto, (of electric companies)". Such assessments are best discharged through the promulgation of such rules as are being proposed here.

Adoption of Proposed Rules
Need and Reasonableness

The agency is currently proposing two revisions to the existing body of the ad valorem rules for utility property and one additional rule. These revisions concern Minn. Rules 8100.0200, Introduction, Minn. Rules 8100.0300, Valuation and the addition of Minn. Rules 8100.0700, Equalization.

The first proposed rule adds two additional reports to those the Commissioner will use when completing the valuations. The Reports to the Public Utility Commission include reports on the remaining lives of depreciable property. This will be used to review the depreciation deducted in the other reports filed with the Department of Revenue. The second type of report is the Annual Reports to Shareholders. These reports are used to review the operating results and the future expectations of the utility companies. The agency believes the proposed rule is reasonable and necessary to consider all factors in the valuation of utility companies.

The second proposed change in the rules concerns the amount of depreciation which will be allowed as a reduction of the cost of the utility's property. There are several types of cost which are used in the appraisal of utilities:

1. Original Cost - Original cost is the actual cost of a property when it was first acquired or constructed.
2. Book Cost - Book cost is the original cost of a property less accrued depreciation.
3. Reproduction Cost - Reproduction cost is the present dollar cost to reproduce a replica of the existing property, i.e. what the property would cost today. Reproduction cost is obtained by trending known costs up or down, depending on whether current construction costs are greater or less than when the property was first constructed.
4. Replacement Cost - Replacement cost is the present dollar cost to replace a property with one having similar or equal usefulness.

The estimation of value by use of the cost approach requires the use of the proper type of cost, and then computing the loss in value due to depreciation.

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