



# STATE OF CONNECTICUT

DEPARTMENT OF PUBLIC UTILITY CONTROL  
TEN FRANKLIN SQUARE  
NEW BRITAIN, CT 06051

**DOCKET NO. 00-07-19 DPUC REPORT ON THE ASSESSMENT OF PERSONAL  
PROPERTY OF ELECTRIC DISTRIBUTION, GAS AND  
WATER COMPANIES**

January 31, 2001

By the following Commissioners:

Donald W. Downes  
Linda Kelly Arnold  
Glenn Arthur

## **REPORT**

### **I. INTRODUCTION**

#### **A. SUMMARY**

The Department of Public Utility Control, in consultation with the Secretary of the Office of Policy and Management, conducted a study regarding the assessment of personal property of electric distribution companies, gas companies and water companies. Within the Department's and the Secretary's report there are significant differences across municipalities regarding the manner in they value utility personal property for property tax assessment. Increased taxes on utilities' personal property translate directly into higher utility rates by law. Disparate property assessments shift taxes from residents of the taxing municipality to utility customers of other

municipalities. Municipalities and the utilities would benefit from the uniform assessment of utility personal property. The best of the considered methods for doing so is the net book value method. More uniform assessments would provide improved predictability of both revenues to municipalities and costs to utilities. The Department recommends that legislation be enacted to value utility personal property for local property tax assessment using the net book value method.

## **B. STATUTORY CHARGE**

Pursuant to Public Act 00-186, An Act Concerning the Assessment of the Personal Property of Certain Public Service Companies, Requiring the Registration of Electric Generating Facilities and Exempting Certain Persons Involved with Communications-Related Property Negotiations from the Real Estate Broker Licensing Statutes (Public Act 00-186), the Department of Public Utility Control (Department) in consultation with the Office of Policy and Management (OPM) was required to conduct a study regarding assessment of personal property of electric, gas and water utilities. The Statute required the Department to examine the “effect of the disparate assessment methodologies on the rates paid by utility customers.” The Department must report its findings to the General Assembly, specifically to the Energy and Technology and Finance, Revenue and Bonding Committees by January 2001. The Department and OPM have examined the effects of disparate assessment methodologies on the rates paid by utility customers in Connecticut. This report (Report) is being submitted in compliance with the mandate.

## **C. BACKGROUND**

During the 1999/2000 legislative session, the Department and OPM sponsored Senate Bill 530, An Act Concerning the Assessment of the Personal Property of Certain Public Service Companies (Senate Bill 530). Senate Bill 530 proposed to revise the manner in which cities and municipalities value personal property owned by utilities. Senate Bill 530 did not pass. However, Public Act 00-186 was passed to direct further study by the Department and OPM, leading to this report.

## **D. CONDUCT OF THE PROCEEDING**

The Department opened this proceeding pursuant to Public Act 00-186. It is classified as an uncontested proceeding. By Notice of Request for Written Comments dated October 16, 2000, the Department received Written Comments from participants. By notice of Oral Comments and additional Written Comments dated October 27, 2000, the Department heard Oral Comments on November 1, 2000, and received additional Written Comments from participants. The Department issued a draft Report on January 22, 2001, for comment by the participants.

## **E. PARTICIPANTS TO THE PROCEEDING**

OPM, Office of Consumer Counsel (OCC), The United Illuminating Company (UI), BHC Company (BHC), The Connecticut Business and Industry Association (CBIA), City of Bridgeport (Bridgeport), Connecticut Water Company (CWC), Connecticut Conference of Municipalities (CCM), The Southern Connecticut Gas Company (SCG),

Connecticut American Water Company (CAWC), Yankee Gas Services Company (Yankee), The Connecticut Light and Power Company (CL&P together with Yankee, NU Companies), Connecticut Natural Gas Corporation (CNG), City of New Haven (New Haven), City of Meriden (Meriden), Town of Easton (Easton), Town of Vernon (Vernon) and Birmingham Utilities (Birmingham) were designated as participants to the proceeding.

## **II. UTILITY PERSONAL PROPERTY VALUATION**

### **A. HISTORY**

This Report discusses utility personal property, which is defined for rate making purposes as plant and equipment, including mains, services, poles, wires, pipes and all related equipment. Buildings and land are classified as real property, not personal.

Current methods used by the municipalities to value utility personal property include: original cost, actual cost of the property when it was placed in service, using assessors' schedules; net book value, which is original cost using Department approved depreciation rates; unit price; negotiated values; and replacement value, which is a market value method. Net book value is a method used by most of the municipalities. It is also consistent with ratemaking practices. See discussion below.

The original cost method using assessors' schedules sets 10-year depreciation lives for most utility personal property, while the net book value method uses depreciation rates approved by the Department, which could correspond to lives of 30 to 40 years for most utility personal property. The unit price method sets a specific value for similar property regardless of the year it is placed in service. Replacement value revalues the original cost of the property in today's dollars. Different methods of calculating replacement value include use of indexes, such as the Handy Whitman Index of Public Utility Construction Costs, to modify the original cost and market based methodologies, such as direct sales comparison, cost analysis and income analysis. Replacement value generally results in higher valuations than the other methods. Some participants refer to original cost as historical cost and replacement value as reproduction cost.

The NU Companies report personal property values using the net book value method in all the municipalities in which they have personal property. Net book value is accepted by each municipality, with the exception of Meriden, see discussion below. NU Companies Comments, p. 1; Tr. 11/1/00, p. 16. Within the 21 municipalities that UI has personal property, four different assessment methods are used: original cost used in six municipalities, unit price used in seven municipalities, net book used in seven municipalities and modified unit price used in one municipality. UI Comments, Attachment A.

Southern and CNG use the unit cost methodology by agreement with most of the municipalities within their respective service territories. Southern is currently involved in a dispute with Bridgeport regarding the value of its personal property. However, CNG's Hartford property is valued using the Handy Whitman Index of construction costs to determine replacement value. Southern Comments, p. 2; CNG Comments, pp. 1 and 2;

Tr. 11/1/00, pp. 23 and 24; Decision dated September 6, 2000, in Docket No. 99-09-03RE01, Application of Connecticut Natural Gas Corporation for a Rate Increase – Allowable Property Tax Expense, p. 2.

The majority of municipalities in which BHC and Connecticut Water have personal property use historical cost to value the property. However, some property is valued based on DPUC depreciation rates and others use the assessors' schedules. In addition, some municipalities use the replacement value method and some use a town valuation. BHC believes that the majority of municipalities use original cost with the assessors' schedules. BHC Comments, p. 1 and Attached Schedule; Connecticut Water Comments, Schedule A. All of the municipalities in which Birmingham has personal property use original cost and the assessors' schedules to value property. In addition, to raise property taxes, Derby changed its methodology in 1999 to net book value and values Birmingham's personal property, such as mains, services and hydrants, using the net book value method. Birmingham Comments, p. 1. CAWC also submits property values to the municipalities in which it has personal property, with the exception of Greenwich, at original cost using the assessors' schedules. Greenwich values utility personal property at 50% of net additions on an on-going basis without adjustment. CAWC Comments, p. 1.

Within the last couple of years, several municipalities, looking for new revenue sources, have switched or have looked into switching from the use of original cost or book value methods to the replacement value method. The result has been dramatically increased personal property assessments in some municipalities.

New Haven and Meriden have calculated personal property values using various replacement value methods. Meriden has also used original cost. New Haven Comments, p. 1; Meriden Comments, p. 1. In the mid 1990s, New Haven attempted to impose the replacement value method on UI. Under the replacement value method, UI's personal property taxes would have increased significantly. UI appealed the assessment and eventually reached a settlement with New Haven. The settlement resulted in no change to property tax on UI's personal property; instead all increases were applied to generation plant. UI Comments, p. 2 and Attachment A.

In 1994 Meriden hired a firm to audit the NU Companies' personal property. As a result, the NU Companies' personal property was revalued using replacement value and Meriden raised CL&P's and Yankee's property values in excess of 40%. Meriden is currently facing appeal by CL&P and Yankee. The NU Companies do not dispute that replacement value will generally produce the highest value for the current cost of personal property. However, replacement cost alone is not necessarily fair market value. In developing fair market value using the replacement value method, an appraiser must consider functional and economic depreciation in addition to physical depreciation because of the regulatory restrictions on the earnings potential of the property. Tr. 11/1/00, p. 9.

Recently, Waterbury also factored into its 2000-2001 budget additional revenues for increased property taxes to be paid by the utilities.

**B. ISSUES**

The current practice in which many different methods are used by municipalities to value utility personal property makes it difficult for both the municipalities and the Department to check valuations proposed by the utilities. Audits are often necessary; however, the need for such might be significantly decreased if a common method was used.

There are a number of concerns relative to municipalities switching to the replacement value method. Changing to this method could result in significant rate increases to utilities regulated by the Department. If more municipalities switch to the replacement value method, utilities will likely seek approval to increase rates to customers to recover the increase in property taxes. Ratepayers, who are also the taxpayers, reimburse the utilities for this type of mandated cost. As previously discussed, municipalities have begun switching to property valuation methods, which result in higher values. In Meriden, personal property taxes paid by CL&P were increased by approximately 40% when the municipality switched its assessment method. If all municipalities were to raise taxes by a similar percentage rate, there could be rate increases to utility customers.

There is concern about the negative effect that the increase in property taxes will have on the business climate in the State. Utility rates are an important factor when businesses are considering expansion or locating new operations within the State. Utility rates are generally higher in Connecticut than other regions so it is critical to take all steps necessary to minimize any future rate increases. In the case of electric utilities, ratepayers recently achieved a 10% savings through electric restructuring. There is concern that as municipalities switch to the replacement value method and utilities seek rate increases to recover the increase in property taxes, the 10% savings could be jeopardized.

If more municipalities switch methods of assessing personal property, the utilities are likely to appeal the higher assessments. This will result in an increase in costly litigation that will take up a great deal of time of representatives of the municipalities and the utilities. In addition, differing methodologies among municipalities makes it more difficult for the Department to verify and approve the proposed property tax expense in utility rate proceedings.

Contributions in aid of construction (CIAC) is another issue that raises concern. On occasion, a developer or new customer asks a utility for service that is different from standard service or is not cost effective for the utility to install. Sometimes, the customer is willing to contribute to the cost of installing the new plant to get the needed service. The money paid to the utility is called CIAC. The question is who should pay property taxes on CIAC, the utility or the customer benefiting from the contribution. Some utilities account for CIAC by crediting it to the construction work order. Therefore, the amount charged to the plant account, initial book value, is net of CIAC. Other utilities do not credit the work order for the contribution. The full cost of the job is charged to the plant account and the CIAC is recorded as an offset to rate base, reducing the amount of the plant investment upon which the utility can earn a return.

### C. SOLUTION

Requiring the use of the net book value method would eliminate disparate valuation methods across industries that currently exist in some municipalities and eliminate disparate methods for the same industry and possibly the same utility across different municipalities. A uniform method of assessment would result in a number of positive impacts to cities and municipalities by providing equity, consistency and predictability with respect to the property tax treatment of utility personal property. A uniform method would reduce the time necessary to audit the utility companies and make it easier to evaluate future personal property tax estimates at the time of rate cases.

Under the net book value method, most municipalities will actually see an increase from their current assessments. Currently, it is estimated that aside from Meriden, only 14 municipalities would incur minimal reductions in current tax revenues from changing the current method of valuation to net book value. At this time, it is not possible to predict the impact on Meriden because of the current litigation. If Meriden prevails in its lawsuit with the NU Companies and legislation is subsequently passed requiring the assessment method be changed to net book value, then Meriden's tax revenues would decline. However, if the utilities were to prevail, then Meriden would not be greatly impacted. Recently, Waterbury also factored into its 2000-2001 budget additional revenues for increased property taxes to be paid by the utilities. Revenue from taxes could decline for Waterbury if the assessment method was changed to net book value.

Under the net book value method, the actual value of personal property equals its original cost and reflects depreciation lives and salvage rates approved by the Department. The Department uses net book value to determine the amount that the utilities will be allowed to recover through rates. Since utilities recover their investment and receive a return on their investment, they have an incentive to accurately report it. However, for personal property valuation purposes, a reasonable cost estimate may be used if original cost is not known.

The goal of depreciation is to systematically recover the cost of a plant asset over its estimated useful life. Depreciation schedules are determined through depreciation studies and approved in each utility's rate proceeding; thereby fairly accounting for the uniqueness of each utility's personal property. Depreciation rates are set for each utility plant account. For some utilities, the Department sets depreciation rates that are utility specific based on the utility's experience historically. Other utilities rely on guidelines produced by the National Association of Regulatory Utility Commissioners (NARUC) for depreciation rates for each category of equipment. The guidelines present the equipment lives as a range of values. The utilities select lives for the equipment that they believe are appropriate, which are subject to Department approval.

The Department can and does modify the proposed depreciation rates in some instances. The Department may adjust lives based upon its knowledge and expertise regarding the life of a particular piece of equipment or the actual experience of other Connecticut utilities. The Department calculates depreciation rates on a remaining life

basis. That means that each time new depreciation rates are set, the remaining life of the group of assets in each account is calculated. The Department uses the straight-line depreciation method, equal amounts of depreciation are recorded for each year of an asset's life.

As utility plant and equipment is depreciated, its value declines each year. This could result in lower property values if the net book value method is used, however, this rarely occurs because utilities are usually upgrading their systems, expanding services or replacing older equipment, which increases the book value of the plant. Additionally, retirements do not reduce the net book value of the plant. When a piece of equipment is retired, the utility credits the plant account and debits the reserve account, where the depreciation was recorded, for the original cost of the asset. For personal property valuation purposes, total depreciation for each asset account shall not exceed 80%. This results in a 20% minimum for plant values. As part of the discussion on Proposed Senate Bill 530 and in an effort of compromise, the Department proposed a 30% floor for plant values to satisfy some municipalities. Therefore, if an asset is still in service after the end of its estimated service life, the municipality would still be able to assess taxes on 20% to 30% of its original cost, resulting in additional revenues for property that is still in service but no longer has any book value. However, the participants did not reach agreement on this issue and the 30% did not make it into the final version of the bill last year. A similar floor would be appropriate in any future proposals.

Each utility submits an annual report to the Department, which includes the balances in all plant accounts. To ensure consistency, as part of the annual report, the utility would provide personal property values by municipality that could be reconciled with the net book value for each plant account. Therefore, the utilities should report to the municipalities all property at the appropriate value, because those property values could be reconciled by account to the book values provided to the Department. Since the utilities recover their investment in the plant by incorporating the book values into rates, the utilities have a monetary incentive to report all property at the highest justifiable property values. The annual reports are public documents and would enable the assessors to check and verify personal property values reported to them with Department records at any time. Therefore, assessors would spend much less time auditing utility records. However, if underreporting somehow does occur, by comparing the values presented to the municipality and the Department, the municipalities can determine the error and reclaim any lost or underpaid taxes. The net book value method would also allow the assessors to compare the values reported for similar property located in other municipalities.

#### **D. PARTICIPANT COMMENTS**

The NU Companies, UI and Connecticut Water believe that disparate methodologies may lead to cross-subsidization of utility rates between residents of different municipalities. If one municipality uses an assessment methodology, such as replacement cost, that produces higher taxes, when those taxes are factored into the utilities' rates all ratepayers share in paying the higher taxes to support that municipality. The NU Companies, UI, CNG, BHC and Connecticut Water believe that using a common methodology, net book value, would promote consistency and predictability in property tax treatment. BHC further stated that the net book value method is fair and

equitable for the valuation of industry specific property. The NU Companies further state that increasing utility personal property taxes may potentially drive businesses out of the State. UI has no objection to the use of reasonable assessment methodologies, applied consistently and reasonably to all utility personal property no matter in which jurisdiction it is located. UI further states that the same item of utility personal property should be valued using the same assessment methodology, regardless of where it is located. However, the NU Companies believe that all businesses in Connecticut file their personal property values based on original cost. NU Companies Comments, pp. 2-4; UI Comments, pp. 2 and 3; Connecticut Water Comments, pp. 2 and 4; Tr. 11/1/00, p. 33; CNG Comments, p. 2; BHC Comments, pp. 1 and 2.

Vernon believes that it is necessary to switch from historic cost minus depreciation to replacement cost new minus depreciation because “all other properties are assessed utilizing replacement cost new minus depreciation.” Vernon believes that a utility’s ability to recover a return of and on its investment does not necessarily correspond with the present value of the personal property. Vernon Comments, p. 1.

CCM is concerned that with the net book value method assessors could not require utilities to produce additional documentation to verify the reported property values and that all property is reported. CCM believes that it is likely that values reported under the net book value method are below the fair market value of the property. CCM believes the use of the net book value method would provide predictability, but not equity and consistency as it relates to personal property taxes of other taxpayers. In addition, CCM believes that the net book value method would eliminate the ability of assessors to choose the most appropriate method of determining the fair market value of personal property for tax purposes. CCM Comments, pp. 2-5.

Bridgeport concurs with CCM that each municipality should be allowed to continue to utilize whichever recognized assessment methodology will assist them in the fair distribution of the overall tax burden that is specific to that municipality. Further, Bridgeport believes that it is not necessary for all utility taxes to be derived from the same methodology since all other operation and maintenance expenses for each utility vary by region, based either on where their customers receive the service or where the utility plant and equipment are located. However, Bridgeport also believes the Department’s assistance in verifying the actual amount of plant and equipment owned by each utility will insure that the most accurate and utility specific depreciation rates are being applied to each utility. Bridgeport further stated that it is more accurate to depreciate utility personal property using Department approved depreciation rates, then depreciation rates determined on a broader scale. Bridgeport Comments, p. 3; Bridgeport Additional Comments, pp. 1 and 2.

Easton and BHC commented that a DPUC verified list of utility personal property would enable municipalities to easily verify the value of all personal property after it has been reconciled with the amounts reported to the Department. Easton Comments, p. 1; BHC Comments, p. 2.

New Haven believes that Proposed Senate Bill 530 would have harmed its tax base and amounts to special exceptions to the state and municipal basic tax principles to benefit a particular industry. New Haven states that different municipalities have

varying dates of revaluation, and have widely varying tax rates. This does not, of itself, suggest differences in methodologies or techniques. In addition, Connecticut statutes concerning property assessment are based upon Ad Valorem taxation regardless of community location. New Haven further states that the cardinal rule of assessment methodology in Connecticut is equity within the jurisdiction. New Haven Comments, pp. 2 and 4. Meriden states that municipalities are required by law to assess taxes based upon the true and actual value of property. Meriden Comments, p. 1.

Regarding CIAC, the NU Companies believe that more information would have to be gathered on all components of a utility's rate base before a decision could be made as to whether or not CIAC should be included in personal property values for property tax purposes. NU Companies Comments, p. 6. UI states that the value of the CIAC is to the customer, not to the utility. Therefore, if the CIAC is to be taxed, it should be the responsibility of the customer benefiting from the equipment. UI Comments, p. 6. BHC, Birmingham, and Connecticut Water believe that CIAC should not be included in utility personal property values. BHC Comments, p. 3; Birmingham Comments, p. 9; Connecticut Water Comments, p. 8. Easton, New Haven, Bridgeport, CNG, CCM, CAWC and Meriden took the position that since the utility owns the contributed property, it should be included in utility personal property values. Easton Comments, p. 2; New Haven Comments, p. 4; Bridgeport Comments, p. 4; CNG Comments, p. 5; CCM Comments, p. 5; CAWC Comments, p. 3; Meriden Comments, p. 4.

## **E. CONCLUSION AND RECOMMENDATIONS**

### **1. Conclusion**

As demonstrated by the comments received from participants, there are misconceptions regarding the manner in which municipalities value utility personal property. There is also disagreement on how to define the value of utility personal property. This could lead to inappropriate valuation (i.e., if an assessor does not have the correct relevant facts to assess the property correctly). The Department concurs with an observation that UI made: "the disparate comments filed with the Department underscore the need for review of this issue." Tr. 11/1/00, p. 34.

If a municipality desires to increase its revenues through higher property taxes, it cannot impose taxes on the residents of other municipalities. However, if a municipality increases utility personal property taxes, the utility will then pass that increase on to its ratepayers, who reside and own businesses in other municipalities, effectively imposing one municipality's taxes on another municipality's taxpayers.

Theoretically, a municipality may believe it could increase its revenues by increasing taxes to a captive taxpayer, namely a utility. However, the utility has an exclusive franchise and in effect operates under a social contract, which requires the utility to serve all customers. Under that scenario, the utility's rates are based on its cost of service, including property taxes, and it is allowed to charge and collect those rates from all customers. Therefore, the utility would pass along that increase through higher rates to its customers, including businesses. If the cost of doing business gets too high, a business may leave the area or Connecticut altogether taking its tax revenue with it. The result is fewer taxpayers available to be assessed taxes, resulting in higher

taxes for everyone. Uniform, fair utility personal property taxes, therefore, contribute to the economic health of Connecticut, whereas higher utility rates do not.

Under legislation requiring municipalities to use the net book value method, municipalities would give up the possibility in the future of even higher tax revenues that could be calculated using the replacement value method; however, such an increase would likely be vigorously fought by the utility companies. Agreement on the net book value method would create greater certainty to municipalities and utilities and result in far less time and money spent on litigation because the utilities are less likely to challenge the municipalities' assessments. Consistency would also make it easy for municipalities to verify valuations and reduce the need for audits.

The Department believes that the best way in which to address utility personal property taxes is to be fair, consistent and equitable. The Department recognizes that the municipalities need to be treated fairly in their right to assess personal property taxes. However, the municipalities do not have the right to impose an unfair tax burden on the utilities, which would then be passed on to the ratepayers in all of the municipalities the utility serves. The Department has examined the impact on municipalities that would result from a change to the net book value method. The net book value method would avoid shifting inequitable personal property tax increases, resulting from an individual municipality's use of the replacement value method, assessed by a municipality to utility ratepayers. The Department concludes that assessing utility personal property using the net book value method will balance the needs of the municipalities and the utilities and lead to fair taxation for all. In addition, the municipalities would be able to predict future revenues and utilities could forecast personal property tax expense with a degree of certainty. Predictability for both groups better positions them to determine the best way to meet the remainder of their requirements.

The net book value method is also consistent with utility ratemaking and how a utility earns a return of and on its investment in plant and equipment. Therefore, the Department would be able to easily verify each municipality's method of calculating property taxes in rate proceedings. Requiring the use of the net book value method would mean that most municipalities would receive an increase in property taxes, a few would stay the same or be reduced. Of course, if a municipality receives increased property taxes, utilities would incur small rate increases. However, these increases are significantly less than could occur if all municipalities raised their taxes based on replacement values. While the Department is reluctant to raise utility costs in any way, it is willing to accept this outcome because it will be offset by consistency and less confusion to the municipalities, the utilities and the Department. In addition, all of the utility's ratepayers would be treated fairly and no one will be subsidizing ratepayers in other municipalities.

## **2. Recommendations**

The Department recommends that legislation be enacted to value utility personal property using the net book value method. The legislation should allow for easy verification of utility personal property values by municipalities.

**DOCKET NO. 00-07-19 DPUC REPORT ON THE ASSESSMENT OF PERSONAL  
PROPERTY OF ELECTRIC DISTRIBUTION, GAS AND  
WATER COMPANIES**

This Decision is adopted by the following Commissioners:

Donald W. Downes

Linda Kelly Arnold

Glenn Arthur

CERTIFICATE OF SERVICE

The foregoing is a true and correct copy of the Decision issued by the Department of Public Utility Control, State of Connecticut, and was forwarded by Certified Mail to all parties of record in this proceeding on the date indicated.

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Louise E. Rickard  
Acting Executive Secretary  
Department of Public Utility Control

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1/31/01

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Date