



.6) 445-8900

May 3, 1977

Dear

Re: Valuation of Distribution Franchises

Your opinion of April 18, 1977, and the issues discussed therein have been carefully reviewed and considered by both the valuation appraisal staff and the property tax legal staff. Our responsive conclusions upon which your 1977 assessment will be based are discussed below. If you desire to further pursue these issues, it is suggested that you do so directly at the time of your appearance before the Board on May 19, 1977.

1. Franchises Are an Element of the Operating Unit.

We are in agreement with this proposition. Special franchises are an integral component of the utility's distribution system. As such they will be appraised as unitary and operating property of the utility. This conclusion represents an exception to the paragraph entitled "Nonunitary properties described", Assessment Practices of the State Board of Equalization Relating to Public Utilities, page 15.

2. The De Luz Case is Distinguishable from the Valuation of Unitary Utility Franchises.

In our view the impact of *De Luz* cannot be limited to the specific facts therein. The general and precise holdings represent the California Supreme Court's interpretation of California Constitution, Article XIII, section 1, in relation to the valuation of property for purposes of ad valorem taxation. In other words, we view *De Luz* as a judicial mandate to employ a precise appraisal method to establish the full value of any possessory interest. It is the establishment of a valuation principle rather than a mere technique to be used in the appraisal of rental units. We conclude that *De Luz* controls the standard of "full value" and must be applied to utility special franchises.

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3. The Value of a Franchise as a Separate Non-Exclusive Property Right is Statutorily Limited to the Costs Incurred in Its Acquisition and Capitalizing as Income the Current Franchise Fees Paid to Cities and Counties is a Violation of De Luz.

We have concluded that PUC, section 6263, does not apply to valuation of special franchises for purposes of ad valorem taxation. By contemporaneous adoption in the 1937 Act and reenactment, Stats. 1951, c. 764, it seems to be *pari materia* with section 6262 and limited to valuation for purposes of condemnation. In contrast Revenue and Taxation Code, section 23154, provides in pertinent part:

...but is not in lieu of any taxes or assessments upon special franchises owned, held or used by said corporations. All such special franchises shall be assessed annually by the board, at their actual value, in the same manner as is provided for the assessment of other property to be assessed by said board under Section 19 of Article XIII of the Constitution of this State, and shall be subject to taxation to the same extent and in the same manner as other property so assessed by said board.

It therefore seems clear that PUC, section 6263 is not controlling, but that the Board is required to assess the special franchises in its regular manner.

The special franchise is for all practical purposes an easement in otherwise tax exempt property and this is well within the meaning of possessory interest as defined in Revenue and Taxation Code, section 107, and the numerous judicial decisions thereunder. We agree that superficially it may appear that the actual franchise payments of P. are being capitalized to ascertain the value, but on the other hand, we can say that in fact market payments are being capitalized in that PUC, section 6231, statutorily sets the market price that would be paid by any prospective purchaser.

4. Franchise Fees are a Regular Expense of the Unitary System and are not Amortization or Rent.

Your support for this proposition is based on the "Uniform System of Accounts" and the fact that the Public Utilities Commission treats the franchise fee as a regular expense. Although every effort is made to achieve accounting

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uniformity, in certain instances we must deviate from this procedure. California Constitution, Article XIII, section 1, mandates that all property be appraised at its full value. The special franchise is a valuable right to possess and use tax exempt property. Consistency to valuation principle rather than accounting technique is compelled in this instance. To do otherwise would be in disregard of the *De Luz* rule and would discriminate against the owners of other possessory interests.

Conclusion

Pursuant to Revenue and Taxation Code, section 23154, the staff will value all special franchises held by Pacific Gas and Electric. They will be appraised in the same manner as other possessory interests assessed by the Board. In this regard, Rules 21 through 28 (Title 18, Cal. Admin. Code) will be strictly adhered to and the distinction between Rule 25 and Rule 26 will be applicable. The sample materials previously forwarded did not contain an example of a *Pre-De Luz* interest. It is, therefore, requested that you immediately forward a representative sample along with a tabulation of all your special franchises that will demonstrate the effective date, the expiration date and the franchise fees paid during the past year.

Very truly yours,