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April 30, 2008

State Board of Equalization
Attention: Sherrie Kinkle
Property and Special Taxes Department
P.O. Box 942879
Sacramento, CA 94279-0064

Re: Obsolescence for Equipment of State-Assessed Telephone Companies

Dear Ms. Kinkle:

On behalf of state-assessed telephone companies and locally-assessed telecommunication companies represented by my firm, the following comments respond to the discussion paper issued by the State-Assessed Properties Division on *Obsolescence for Equipment of State-Assessed Telecommunication Companies* (**Letter to Assessors No. 2008/014**).

Page 1, line 1: The contemplated Board guidelines should be captioned "Obsolescence for Equipment of State-Assessed Telephone Companies".

Article 13, section 19 of the California Constitution establishes Board assessment jurisdiction over "telephone" companies. The word "telecommunication" does not appear in that section of the Constitution. Decades ago, California appellate courts established that, as a matter of law, the Board has assessment jurisdiction over "telephone" companies. The Board's contemplated guidelines should separately define "telephone" companies and "telecommunication" companies, and should separately distinguish, for jurisdictional and valuation purposes, among incumbent local exchange companies, competitive local exchange companies, interexchange companies, internet service providers, voice over internet protocol suppliers, cable television companies providing telephone services, wireless carriers, paging and mobile radio telephone companies. The Board's anticipated guidelines should also define "locally-assessed telecommunication companies".

Page 1, lines 24-25 (and throughout discussion paper): "... staff considers the replacement or reproduction cost approaches ..."

The "replacement" cost model and "reproduction" cost approach are not interchangeable. It should be clarified under what circumstances each method is

preferred or disfavored in valuing high tech telephone equipment and, additionally, criteria for substantiating obsolescence in the "replacement" cost model should be contrasted against requirements for measuring obsolescence under the "reproduction" cost approach.

Page 2, lines 24-26 (and throughout discussion paper): "... will provide guidelines (criteria, requirements, etc.) for state assesses to measure and substantiate their claims for obsolescence and for staff to recognize obsolescence beyond the level already reflected in staff's value indicators."

The SAPD has consistently taken the position that telephone equipment obsolescence is "fully captured" in the Board's Replacement Cost Less Depreciation model. The Board's guidelines should include examples showing specifically how ordinary and extraordinary obsolescence are "already reflected" in the Board's replacement cost model for high technology telephone equipment.

Page 2, line 29: "Depreciation is defined in Assessors' Handbook Section 501, *Basic Appraisal* (AH 501), as a decrease in utility resulting in a loss in property value; it is the difference between estimated replacement or reproduction cost new as of a given date and market value as of the same date."

AH 501 recognizes that "[t]he most difficult aspect of the cost approach is the estimation of depreciation. Depreciation in an appraisal sense is defined as a loss of value from any cause." (AH 501, page 80) The SAPD's discussion paper provides minimal guidance regarding how to measure obsolescence in high tech telephone equipment. The Board's guidelines should more thoroughly address several key factors identified in AH 501, particularly "cost to cure" and "inutility" criteria for key telephone equipment asset categories.

Page 3, line 11: "AH 501 lists several methods that an appraiser may use when estimating depreciation. . . ."

In recent years, the SAPD has rejected obsolescence studies filed by telephone companies as unreliable, due to the significant difficulty of accurately projecting future cash flows. Similarly, the SAPD has dismissed obsolescence claims by ascribing revenue shortfalls to imprudent management. The SAPD has also rejected telephone company equipment obsolescence claims based on the view that ongoing equipment additions and concurrent equipment obsolescence are mutually exclusive. Board staff has criticized replacement cost data and economic life inputs used by taxpayers, but has identified no acceptable criteria for measuring "income shortfall" resulting from telephone technology obsolescence. The Board's guidelines should include examples showing proper application of functional and economic obsolescence principles specifically to key categories of high technology telephone equipment.

Page 6: SAPD's discussion paper recognizes that there is no consistent standard for measuring obsolescence (**line 2**); that data for analysis can vary greatly from company to company (**line 8**); that equipment classifications may not be reliable (**line 9**); and, that measurement of obsolescence remains a moving target which at times can be difficult to determine (**page 9, line 22**). SAPD's discussion paper also recognizes that functional and economic obsolescence have resulted from marketplace dynamics and technological advances in telephone company equipment. The Board's guidelines should include examples, based on those observations, showing proper application of functional and economic obsolescence principles specifically to key categories of high technology telephone equipment.

Page 7, lines 8-15 : "Straight-Line or Age-Life; Sales Data Method; Breakdown Method; Cost to Cure; Capitalization of Loss of Income; and, Utilization Analysis." The SAPD discussion paper cites very few legal authorities, despite consideration of equipment obsolescence in Assessors' Handbook 501, *Basic Appraisal* (pages 80-85); Assessors' Handbook 502, *Advanced Appraisal* (pages 21-30); Assessors' Handbook 504, *Assessment of Personal Property and Fixtures* (pages 70-81); the Board's *State Assessment Manual* (pages 6-7); and, the Board's *Unitary Valuation Methods Manual* (pages 23-30). The Board's guidelines should include examples, based on those authorities, showing proper application of functional and economic obsolescence principles specifically to key categories of high technology telephone equipment using (1) straight-line or age-life; (2) sales data method; (3) cost to cure; (4) capitalization of loss of income; and, (5) utilization analysis.

Page 8, lines 9-14: "Accounting standards, such as FASB Statements 141 and 144, require a company to write-down its assets (when applicable) to adequately recognize or account for loss in value of those assets". The Board's guidelines should emphasize that strict mandates and limitations govern FASB asset write-downs and related disclosures to stakeholders.

Page 8, line 24: "Percent good factors based on average remaining life (ARL) of a particular class of property take into account how a property will be replaced by the adoption of new technology. The ARL is impacted by the severity of competition within the industry. However, the main concern with using ARL as presented by certain companies is that the ARL does not take into account a company's actual investment and the type of investment required to remain competitive. Thus, ARL should not be based only on competition and technology in the industry without consideration of actual investment history. . ." The Board's guidelines should differentiate between "remaining economic life" (REL) and "average remaining life" (ARL). Those guidelines should also set forth criteria that will enable telephone and telecommunication industry appraisal experts to quantify and reconcile differing competitive business models.

Page 8, line 34 – Page 9, line 2: “The inutility model relies on proper measurement of standard capacity. Inutility generally measures the difference between theoretical or practical capacity versus actual production. The inutility model is best known for its use in measuring differences in operating levels for production or manufacturing facilities. The use of the inutility model in measuring operating differences for non-production properties can be problematic. Determining accurate practical capacity and actual production levels for telecommunication properties can be difficult.” The Board’s guidelines should include examples showing proper application of functional and economic obsolescence principles specifically to key categories of high technology telephone equipment using an “inutility” approach. (See also, discussion above regarding Page 7, lines 8-15 of SAPD discussion paper.)

Page 9, lines 3-18: “A per unit replacement value” The Board’s guidelines should elaborate on possible criteria and examples applicable to high technology telephone equipment.

Please contact me at peter@pmichaelslaw.com if you have questions or require additional information about this letter.

Very truly yours,


Peter Michaels

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