SUPREME COURT OF OHIO

Centerior Fuel Corp. v. Zaino

90 Ohio St. 3d 540 (Ohio 2001) · No. 99-1987 · Decided January 17, 2001

SUMMARY

The Ohio Supreme Court considered whether nonutility companies leasing nuclear fuel rods to public utilities could exclude capitalized construction interest costs when valuing the rods for personal property tax purposes. The court interpreted R.C. 5711.21(C) and R.C. 5727.11 to require valuation based on capitalized cost excluding capitalized construction interest. It affirmed the Board of Tax Appeals' decisions in favor of the fuel companies.

CASE DETAILS

COURT	Supreme Court of Ohio
WRITING FOR THE COURT	Alice Robie Resnick, J.; Moyer, C.J.; Douglas, J.; F.E. Sweeney, J.; Pfeifer, J.; Lundberg Stratton, J.; McMonagle, J.
JURISDICTION	Ohio
DECIDED	January 17, 2001
DOCKET	99-1987
DISPOSITION	affirmed
PROCEDURAL POSTURE	The Tax Commissioner and county auditors appealed as of right from decisions of the Ohio Board of Tax Appeals reversing personal-property-tax assessments against Centerior Fuel Corporation and OES Fuel, Inc.
STANDARD OF REVIEW	The Supreme Court reviewed the BTA's decisions and affirmed them as reasonable and lawful.
PRECEDENTIAL VALUE	Published Ohio Supreme Court opinion; precedential
PARTIES	Thomas M. Zaino, Tax Commissioner of Ohio, Edward H. Zupancic, Lake County Auditor, James Snider, Ottawa County Auditor v. Centerior Fuel Corporation, OES Fuel, Inc.

TOPICS

property tax · state and local tax · tax · statutory interpretation · administrative law

PRACTICE AREAS

state and local taxation | property taxation | administrative appeals

QUESTIONS PRESENTED

1. Whether, under Ohio's personal property tax valuation statutes, nonutility lessors of nuclear fuel rods may exclude capitalized construction interest costs from the property's capitalized cost.
2. Whether the Tax Commissioner could use an alternative valuation method instead of the statutory capitalized-cost method without presenting evidence that the statutory method failed to reflect true value.
3. Whether the construction interest costs were includable because they were reimbursable.

HOLDINGS

1. For personal property tax valuation, a nonutility lessor's nuclear fuel rods leased to a public utility must be valued as if owned by the public utility, using capitalized cost while excluding all capitalized construction interest costs.
2. The Tax Commissioner may use an alternative valuation method only when the statutory capitalized-cost method would not result in the property's true value, and the commissioner failed to establish that condition here.
3. The fact that the construction interest costs were reimbursable did not make them includable in the property's taxable capitalized cost because the costs had been capitalized by the fuel companies.

KEY QUOTATIONS

> *"The purpose of R.C. 5727.11(G) is to arrive at a valuation for utility property that is based on a capitalized cost that excludes all capitalized construction interest cost."* (542)

> *"Therefore to have its personal property valued in the same manner as the electric utility, the nonutility need not use the FERC formulas to calculate an AFUDC amount."* (542-543)

> *"Accordingly for the reasons set forth above, we find the decisions of the BTA to be reasonable and lawful, and they are hereby affirmed."* (543)

FACTUAL BACKGROUND

Centerior Fuel Corporation and OES Fuel, nonutility companies, leased nuclear fuel rods to public utilities that owned interests in the Perry and Davis-Besse nuclear power plants. In financing the construction of new fuel rods, the companies capitalized interest incurred during construction but expensed interest incurred after the rods were placed in service. On their 1990-1995 personal property tax returns, the companies excluded the capitalized construction interest from the fuel rods' book value, while the Department of Taxation added the interest back in auditing the returns.

PROCEDURAL HISTORY

After auditing the fuel companies' personal property tax returns for tax years 1990 through 1995, the Ohio Department of Taxation increased the property's valuation by adding capitalized construction interest costs. The Tax Commissioner affirmed the assessments on reassessment, but the Board of Tax Appeals reversed. The Tax Commissioner and county auditors appealed to the Supreme Court of Ohio, which affirmed the BTA decisions.

DISPOSITION

affirmed

CASES CITED

- Consumers' Counsel v. Pub. Util. Comm., 6 Ohio St. 3d 377, 453 N.E.2d 673 (1983)
- Texas E. Transm. Corp. v. Tracy, 78 Ohio St. 3d 83, 676 N.E.2d 523 (1997)

OPINION

Centerior Fuel Corp. v. Zaino 90 Ohio St. 3d 540

RESNICK, J.

Alice Robie Resnick, J. These two cases have been consolidated for review. The appellees, Centerior Fuel Corporation ("CFC") and OES Fuel, Inc. ("OES Fuel") ("fuel companies"), are nonutilities that lease nuclear fuel rods to public utilities that are part owners of either the Perry nuclear power plant in Lake County or the Davis-Besse nuclear power plant in Ottawa County. The tax years at issue are 1990-1995. CFC leases fuel rods to the Cleveland Electric Illuminating Company and the Toledo Edison Company. OES Fuel leases fuel rods to Ohio Edison Company and Pennsylvania Power Company. In order to raise the millions of dollars needed to pay for construction of new fuel rods, the fuel companies have entered into multiple borrowing arrangements with various banks and brokerage firms. While the materials for the fuel rods are being refined and fabricated, the fuel companies capitalize the interest costs they incur on the funds they have borrowed to finance the construction. The interest costs the fuel companies incur after the fuel rods are placed in service are expensed. When the fuel companies filed their original or amended personal property tax returns for tax years 1990-1995, they excluded the capitalized construction interest cost from the book value of the fuel rods. However, after auditing the fuel companies, the Department of Taxation increased the valuation by adding back the capitalized construction interest cost. On review of petitions for reassessment, the Tax Commissioner affirmed the assessments. The fuel companies appealed to the Board of Tax Appeals ("BTA"), where the commissioner's *541assessments were reversed. The Tax Commissioner has appealed the BTA's decision in both cases. In addition to the Tax Commissioner's appeals, separate appeals have been filed in case No. 99-1987 by the auditors of Lake and Ottawa Counties. These causes are now before the court upon appeals as of right. The sole question in these cases is whether for personal property tax valuation purposes the fuel companies can exclude the amounts they have capitalized on their books for the cost of funds borrowed to construct fuel rods. R.C. 5711.21(C) provides that the true value of personal property leased to a public utility and used by it directly in the rendition of a public utility service “shall be determined in the same manner that the true value of such property is determined under section 5727.11 of the Revised Code if owned by the public utility.” Former R.C. 5727.11(B) (now [A]) provides that the true value of the taxable personal property of an electric public utility “shall be determined by a method of valuation using cost as capitalized on the public utility’s books and records.” However, former R.C. 5727.11(G) (now [E]) provides that the true value “shall not include the allowance for funds used during construction or interest during construction which has been capitalized on the public utility’s books and records as part of the total cost of the taxable property.” Combining these statutory provisions results in a method of valuation for the lessor fuel companies that is based on capitalized cost, but excludes from the capitalized cost the allowance for funds used during construction or the interest during construction that has been capitalized on the books as part of the total cost. Because the fuel rods are leased to the electric utilities they are to be valued as if they were owned by the electric utilities. Therefore, we must consider how the fuel rods would be valued if they were owned by the electric utilities. The Public Utilities Commission of Ohio requires electric utilities operating in Ohio to follow accounting procedures established by the Federal Energy Regulatory Commission (“FERC”). Ohio Adm.Code 4901:1-9-05. The phrase “allowance for funds used during construction” (“AFUDC”) used in R.C. 5727.11(G) is an accounting term used by FERC in its regulations covering electric utilities. Title 18, C.F.R., Subchapter C, Part 101, Electric Plant Instructions, Section 3A(17). This court has described AFUDC as “an accounting mechanism which recognizes capital costs associated with financing construction. Generally, the capital costs recognized by AFUDC include interest charges on borrowed funds and the cost of equity funds used by a utility for purposes of construction.” Consumers’ Counsel v. Pub. Util. Comm. (1983), 6 Ohio St.3d 377, 378, 6 OBR *542428, 429, 453 N.E.2d 673, 674. In their book Principles of Public Utility Rates (2 Ed.1988) 248, Bonbright, Danielson, and Kamerschen state, “The primary purpose of AFUDC is to capitalize the costs of financing construction, separate the effects of the construction program from current operations, and to allocate current capital costs to future periods when these capital facilities are producing revenue.” The Federal Power Commission, the predecessor to FERC, stated the following reasoning for capitalizing construction interest costs: “Interest costs are actually incurred and can be viewed in the same manner as labor, materials, equipment and other costs which are incurred and properly capitalized during construction.” 40 F.R. 23322. The construction of nuclear fuel rods is the type of construction cost eligible for AFUDC. Title 18, C.F.R., Subchapter C, Part 101, Electric Plant Instructions, Section 3A(17) states that AFUDC applies to “construction work in progress plus nuclear fuel in process of refinement, conversion, enrichment, and fabrication.” The Tax Commissioner states that the lessor fuel companies failed to prove the extent to which their construction interest cost would have been excludable as AFUDC if the fuel rods had been owned by the utilities. The commissioner also states that no calculation of AFUDC under the FERC formulas was made by either the fuel companies or the BTA. The commissioner misconstrues the purpose of R.C. 5727.11(G). The purpose of R.C. 5727.11(G) is to arrive at a valuation for utility property that is based on a capitalized cost that excludes all capitalized construction interest cost. The maximum amount of construction interest cost that an electric utility can capitalize as AFUDC is determined by mathematical formulas developed by FERC. Title 18, C.F.R., Subchapter C, Part 101, Electric Plant Instructions, Section 3A(17). Any construction interest cost incurred in excess of the AFUDC maximum, or in excess of any amount less than the AFUDC maximum that an electric utility actually capitalizes as AFUDC, is expensed. Thus, for the purpose of valuing an electric utility's own personal property, the exclusion of AFUDC from the total capitalized cost results in a valuation that is based on a capitalized cost that excludes all capitalized construction interest cost. Therefore to have its personal property valued in the same manner as the electric utility, the nonutility need not use the FERC formulas to calculate an AFUDC amount. When a nonutility lessor deducts all of its capitalized construction interest cost from the total capitalized cost of the property, it is achieving the same result as that achieved by an electric utility that excludes AFUDC from a valuation that originally included only those interest costs allowed by AFUDC. As required by R.C. 5727.11(G), the resulting valuation for both the electric utility and the nonutility lessor is based on the capitalized cost that excludes the *543allowance for funds used during construction, whether denominated as AFUDC or capitalized construction interest cost. Squire, Sanders & Dempsey, L.L.P., Bebe A. Fairchild, Abby R. Levine and David J. Young, for appellees. Betty D. Montgomery, Attorney General, and James C. Sauer, Assistant Attorney General, for appellant Thomas M. Zaino, Tax Commissioner of Ohio. In the alternative, the commissioner states that the fuel rods should have been valued using a valuation method other than the statutory method based on capitalized cost. To support his position, the commissioner cites former R.C. 5727.11(B) (now [A]), which provides, "If the commissioner finds that application of this [statutory] method will not result in the determination of true value of the public utility's taxable property, he may use another method of valuation." In Texas E. Transm. Corp. v. Tracy (1997), 78 Ohio St.3d 83, 86, 676 N.E.2d 523, 525, we affirmed an alternate valuation, stating that "where rigid application of the statute would be inappropriate, the presumption of value must yield to other competent evidence reflecting true value." However, in this case the Tax Commissioner presented no evidence to show that the application of the statutory measure of value was inappropriate. Appellants Edward Zupancic, the Auditor of Lake County, and James Snider, the Auditor of Ottawa County, filed similar notices of appeal. In their appeals they contend that CFC should not have been able to exclude the construction interest costs because these costs were reimbursable. The auditors' contention is contrary to R.C. 5727.11(G) (now [E]). The relevant point is that these construction interest costs were capitalized by CFC. If CFC is to be treated the same as an electric utility, then the capitalized construction interest cost cannot be included in the capitalized cost for valuation purposes. Accordingly for the reasons set forth above, we find the decisions of the BTA to be reasonable and lawful, and they are hereby affirmed.

Decisions affirmed. Moyer, C.J., Douglas, F.E. Sweeney, Pfeifer and Lundberg Stratton, JJ., concur. McMonagle, J., concurs in judgment. Timothy E. McMonagle, J., of the Eighth Appellate District, sitting for Cook, J. Charles E. Coulson, Lake County Prosecuting Attorney, Michael P. Broum and James R. Dugan, Assistant Prosecuting Attorneys, for appellant Edward H. Zupancic, Lake County Auditor. Mark E. Mulligan, Ottawa County Prosecuting Attorney; Baumgartner & O’Toole, Kenneth S. Stumphauzer and Daniel D. Mason, for appellant James Snider, Ottawa County Auditor.