

IN THE SUPREME COURT OF OHIO

THE OHIO BELL TELEPHONE COMPANY,

CASE NO. 07-1807

Appellee,

v.

On appeal from the Board of Tax Appeals,
Case No. 2005-K-202

WILLIAM W. WILKINS, Tax Commissioner
of Ohio,

Appellant.

BRIEF OF APPELLEE THE OHIO BELL TELEPHONE COMPANY

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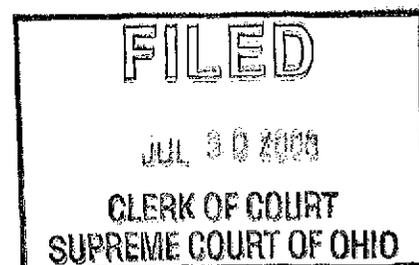


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I. INTRODUCTION

The Board of Tax Appeals (the "Board" or "BTA") did not err in determining the fair market value of certain public utility personal property owned by Appellant, The Ohio Bell Telephone Company ("Ohio Bell"). The arguments of Appellant, the Tax Commissioner of Ohio (the "Commissioner"), although unnecessarily segregated into eight propositions of law, in reality have four aspects. First, the Commissioner argues that the Board lacked jurisdiction or lacked the ability to review the Tax Commissioner's Final Determination because Ohio Bell relied upon an appraisal report in its appeal to the Board but did not submit that report to the Tax Commissioner during his administrative review (Propositions of Law Nos. 1, 3). Second, the Commissioner argues that the Board lacked jurisdiction because Ohio Bell failed to specify in its Notice of Appeal that its valuation claim would rely on appraisal evidence (Propositions of Law Nos. 2, 5). Third, the Commissioner argues that the Board erred in applying a *de novo* review standard instead of an abuse of discretion standard, which the Commissioner argues is required by R.C. § 5727.11(A) (Propositions of Law Nos. 4, 6). Lastly, in finally reaching the merits, the Commissioner argues that the Board erred in its determination of the true value of Ohio Bell's property (Propositions of Law Nos. 7, 8). The Commissioner is wrong on all counts.

First, Ohio law is well-settled that the Board, as the first *independent* reviewer of the valuation issue presented, is not restricted to a review of the evidence that was presented to the Commissioner, but may indeed consider new evidence, as submitted by either party. Moreover, although the Board's review is limited to issues raised in the notice of appeal, there is no requirement that the evidence to be used to support the taxpayer's position be specified in that notice. Further, the Board reviews valuation determinations made by the Tax Commissioner *de novo*, and not for an abuse of discretion.

As discussed below, the fatal flaw running throughout the Commissioner's Propositions of Law 1 through 6 is his confusion of Ohio Bell's *claim* with Ohio Bell's *evidence*. A taxpayer's claim must be presented to the Tax Commissioner and specified in a notice of appeal filed with the Board; a taxpayer's evidence in support of its claim may be presented at any time prior to the Board's close of its hearing record. Ohio Bell's claim in this case is that the Tax Commissioner's application of the statutory valuation method failed to result in the assessment of Ohio Bell's taxable public utility property at its "true value in money" as mandated by Article XII, Section 2, of the Ohio Constitution and R.C. § 5727.10. While Ohio Bell presented more evidence of true value to the Board than it presented to the Tax Commissioner, the record is clear that Ohio Bell has never wavered from its "true value" claim.

As to the Tax Commissioner's last two propositions of law challenging the actual value as found by the Board, the Commissioner travels far from the record in promoting his "independent expert appraisal witness" that, in fact, was not independent, did not perform an appraisal, and did not offer an opinion of value. Supp. 695 (H.T. IV at 110, ln. 2-10); Supp. 703 (H.T. IV at 142, ln. 1-8). The Board correctly relied upon the competent and probative evidence of the true value of Ohio Bell's taxable public utility property in the form of an independent appraisal from "an expert with considerable experience in valuing public utility property" — Thomas K. Tegarden, MAI, CAE. *See* Appx. 25-26. As the Board determined, the appraisal methodology used by Mr. Tegarden is more accurate in determining true value than the statutory method used by the Tax Commissioner to estimate value. Appx. 26-27. The Tax Commissioner elected not to present *any* evidence that the default statutory method in R.C. § 5727.11 produces a reasonable result (indeed, his sole witness was critical of this method) and elected not to present any evidence of an alternate valuation method for valuing Ohio Bell's property.

Accordingly, this Court should affirm the Board's decision on the true value of Ohio Bell's taxable public utility property for the 2003 tax year.

II. STATEMENT OF FACTS

A. Ohio Bell's Wireline Telephone Business Declines As Regulatory and Technological Changes Bring Increased Competition and Risk

Ohio Bell is a "telephone company" as defined in R.C. §5727.01(D)(2). Supp. 421. Ohio Bell provides telecommunications services, primarily local wireline telephone service, to homes and businesses in the state of Ohio. Supp. 442 (H.T. I at 45, ln. 22 to 46, ln. 1), 910. As of the tax date – December 31, 2002, Ohio Bell was a second tier-subsubsidiary of SBC Communications, which reported the results of its business operations in five business segments – wireline, wireless, directory, international, and other. Supp. 442 (H.T. I at 45, ln. 15-21), 910, 912.

Ohio Bell's provision of traditional voice service is a "mature business, characterized by slowing demand and intense price competition." Supp. 904. Yet the business risk and uncertainty faced by Ohio Bell is a fairly recent development. The number of access lines used by its residential customers grew at a fairly consistent rate from 1984-1995 when Ohio Bell lacked significant competitors in the local exchange market. Supp. 1054.¹ The development of competition in the early 1990s in certain areas of Ohio Bell's business prompted the Public Utilities Commission of Ohio ("PUCO") to replace rate-of-return regulation of Ohio Bell's pricing with limited price cap regulation of certain noncore services, although, in exchange, Ohio Bell agreed, among other things, to a decrease of \$92,300,000 in its jurisdictional base period revenues and to substantial network investment. *In the Matter of the Application of Ameritech*

¹ Citations to Supplement page numbers 1017 and above are to the Second Supplement filed by Appellee on July 30, 2008.

Ohio for Approval of an Alternative Form of Regulation, PUCO Case No. 93-487-TP-ALT, 1994 Ohio PUC LEXIS 956 at *15-18, *28 (Opinion and Order Nov. 23, 1994). Less than two years later, the United States Congress' adoption of the Telecommunications Act of 1996 ("Telecom Act"), 47 U.S.C. 151 *et seq.*, "profoundly changed the telecommunications environment" by creating "a pro-competitive national policy for the telecommunications industry." *In the Matter of the Application of MCI Metro Access Transmission Services, Inc. for a Certificate of Public Convenience and Necessity*, PUCO Case No. 94-2012-TP-ACE, 1996 Ohio PUC LEXIS 609, at *9 (Entry on Rehearing Sept. 26, 1996).

Yet even after the Telecom Act encouraged competition in the local exchange market, Ohio Bell's access line count continued to grow for a few more years as it sold second lines to customers and competitors ramped up. Supp. 1055, 1059-60. Ohio Bell's access lines peaked in 2000, however, and "two years of carnage" from intense competition in 2001 and 2002 resulted in steep line loss (both business and residential customers) for Ohio Bell that continued through 2003 and 2004. Supp. 575-76 (H.T. II at 494, ln. 7 to 495, ln. 23), 905-06, 935, 1022, 1039-45, 1055, 1056, 1059-63. Regulatory changes and technological improvements had radically and permanently altered the local exchange business. Supp. 1060-62; *see* Supp. 576 (H.T. II at 495, ln. 6-23). Ohio Bell lost business to wireline competitors known as competitive local exchange carriers or CLECs (more than 145 CLECs were certified to operate in Ohio as of 2001), to wireless providers, and to cable modem service providers. Supp. 576 (H.T. II at 495, ln. 6-19), 1023; *see In the Matter of the Commission Ordered Investigation of an Elective Alternative Regulatory Framework for Incumbent Local Exchange Companies*, PUCO Case No. 00-1532-TP-COI, 2001 Ohio PUC LEXIS 912, at *50-60 (Opinion and Order Dec. 6, 2001). One analyst argued in early 2003 that the network assets of traditional telephone companies were being

rendered worthless as more modern wireless and Internet Protocol-based networks supplanted them. Supp. 908.

This intense competition resulted in a significant decrease in Ohio Bell's revenues for local telephone service. Access lines are the primary driver of revenue for Ohio Bell. Supp. 534 (H.T. II at 330, ln. 3-5). Local service revenues increased steadily from \$1,366,721,311 in 1997 to \$1,445,617,226 in 2000. Supp. 781-84. However, these revenues fell to \$1,381,742,323 in 2001 and fell again to \$1,299,189,418 in 2002. Supp. 779-80. This decrease was primarily related to access lines lost by Ohio Bell when business and residential customers switched their service away from Ohio Bell. Supp. 534-35 (H.T. II at 330, ln. 14 to 331, ln. 3). The decrease in revenues was not a surprise to Ohio Bell or telecommunications industry investors, given the competitive business environment, and it continued after 2002. Supp. 535 (H.T. II at 331, ln. 20-23), 575-76 (H.T. at 494, ln. 19 to 495, ln. 5), 1056, 1059; *see* Supp. 904-09. Competitors with new technologies were "eating the lunch" of the incumbent local exchange companies such as Ohio Bell. Supp. 576 (H.T. II at 495, ln. 17). By the end of 2004, Ohio Bell had 25% fewer total access lines than it did in 2000; remarkably, its residential access line count was the lowest it had been since 1972. Supp. 935, 1039-45, 1057.

B. The Department of Taxation Uses the Statutory Default Method to Value Ohio Bell's Taxable Public Utility Property for Tax Year 2003.

While Ohio Bell was struggling to respond to these unprecedented and tumultuous market conditions, it filed its 2003 Annual Report with the Ohio Department of Taxation. *See* Supp. 1 *et seq.* The Report shows a total value of Ohio Bell's taxable public utility property of \$2,416,838,541. Supp. 17. The Department made one adjustment: it added in the value of property listed by Ohio Bell as intangibles in account 2690 to estimate a value of \$2,466,085,652. Supp. 190, 443 (H.T. I at 50, ln. 1-10).

R.C. § 5727.11 establishes a default procedure for assessing public utility property that uses “cost as capitalized on the public utility’s books and records less composite annual allowances as prescribed by the commissioner.” A public utility, however, has more than one set of books. Ohio Bell maintains a set of books for external reporting or financial reporting (“FR”) purposes that are kept in accordance with Generally Accepted Accounting Principles or GAAP. Supp. 528 (H.T. II at 303, ln. 4-16). A regulatory set of books, known as the management reporting or MR books, is compiled in accordance with Federal Communications Commission (“FCC”) rules. Supp. at 528 (H.T. II at 303, ln. 17-21), 571 (H.T. II at 475, ln. 2-6). The primary difference between these books is that depreciation on the FR books is determined on a useful life basis while depreciation on the MR books follows FCC prescribed rates. Supp. 528 (H.T. II at 304, ln. 2-10). The books that are most relevant to the investor are the FR books. Supp. 571 (H.T. II at 475, ln. 17-20). However, the cost and balance sheet data reported on Ohio Bell’s 2003 Annual Report are from the MR books. Supp. 442 (H.T. I at 47, ln. 2 to 48, ln. 1).

C. Ohio Bell Petitions for Reassessment Because the Estimate of Value Derived From the Statutory Method Does Not Reflect the True Value in Money of Ohio Bell’s Taxable Property.

Ohio Bell timely filed its Petition for Reassessment of its taxable public utility property for the 2003 tax year on December 5, 2003. Supp. 193-95. Of relevance herein,² the Petition specified as an error:

2. *The cost less depreciation method utilized by the Tax Commissioner does not reflect the true value in money of SBC Ohio’s taxable property as required by Ohio law.*

² Ohio Bell has not pursued its first assignment of error, which dealt with treatment of computer software as an intangible. See Supp. 438 (H.T. I at 31, ln. 9-15).

The Tax Commissioner's determination of the true value of all taxable property of SBC Ohio does not reflect its true value in money as required by Ohio law. The Tax Commissioner's determination is erroneous, unjust and unreasonable because, inter alia, it overstates both costs and service lives and utilizes a method that does not reasonably reflect true value. Correction of the Tax Commissioner's errors results in a total reduction in true value of \$919,726,091 and a reduction in taxable value of \$351,611,285.

Supp. 194. In support of this assignment of error, Ohio Bell submitted a detailed RCNLD (replacement cost new, less depreciation) valuation study to the Tax Commissioner as evidence that the statutory method did not reasonably reflect true value. Supp. 314-420; *see* Supp. 443-44 (H.T. I at 52, ln. 3 to 53, ln. 7). The RCNLD study fixed the true value of Ohio Bell's taxable property at \$1,546,359,561 (Supp. 323), which is a reduction of \$919,726,091 from the Tax Commissioner's estimated value (Supp. 190).

The Tax Commissioner's own consultant, Mr. Brent Eyre, testified that an RCNLD study is a meaningful indicator of value for utilities such as Ohio Bell that are not "rate base" regulated. Supp. 696 (H.T. IV at 115, ln. 12-22); *see* Supp. 631 (H.T. III at 75, ln. 8-18), 934. He also testified that Ohio's statutory method for estimating value, which does not use FR books and places limits on the amount of depreciation that can be deducted from an asset, is not the cost approach he would use and constrains an appraiser from determining fair market value of utility assets. Supp. 695 (H.T. IV at 111, ln. 21 to 112, ln. 19), 696 (H.T. IV at 113, ln. 25 to 115, ln. 3). However, in a Final Determination issued December 13, 2004, the Tax Commissioner determined that he would not deviate from the statutory method of estimating fair value. Supp. 427.

D. Ohio Bell Submits to the Board of Tax Appeals Competent Evidence Reflecting True Value of Its Public Utility Property.

Ohio Bell timely appealed to the BTA on February 11, 2005, from the Tax Commissioner's Final Determination for the 2003 tax year. Ohio Bell retained Tegarden &

Associates to prepare an appraisal of Ohio Bell's taxable property. The appraisal report was co-signed by Thomas K. Tegarden and Diane M. Ange, RM, CAE, and Mr. Tegarden testified in support of the report at hearing on September 20 and 21, 2006.³

Mr. Tegarden's nearly forty years of experience as a professional appraiser is remarkable. *See* Supp. 565-67 (H.T. II at 453, ln. 16 to 462, ln. 3), 971-74. He has maintained the highest designation bestowed by the Appraisal Institute for the past twenty-five years and has been performing independent appraisals of public utility properties for at least as long. Supp. 566 (H.T. II at 455, ln. 8 to 456, ln. 14). Mr. Tegarden's and Ms. Ange's specialty is the appraisal of public utility properties, including telephone companies. Supp. 569 (H.T. II at 467, ln. 4-22). Mr. Tegarden has continuously performed appraisals of "just about all" of the large telephone companies starting with Southwestern Bell in 1983 for Dallas County, Texas. Supp. 566 (H.T. II at 457, ln. 2-14). Since 1988, he and Ms. Ange have written the basic appraisal course for local assessors in the United States and abroad with the support of the International Association of Assessing Officers, and he also has taught appraisal courses across the country for state assessors and tax administrators. Supp. 566-67 (H.T. II at 457, ln. 15 to 459, ln. 16). Importantly, Mr. Tegarden's appraisals of public utility property are performed for cities, counties, states and taxpayers, and he uses the same tried-and-true appraisal methodologies regardless of the interest of his client. Supp. 566 (H.T. II at 456, ln. 11-23).

Mr. Tegarden's report, which considered the cost, income and sales comparison approaches to value to determine the fair market value of Ohio Bell's public utility property, was

³ Because Mr. Tegarden testified in support of the report, this brief generally will refer to the report as Mr. Tegarden's report. However, Ms. Ange's signature on the report represents that both she and Mr. Tegarden take full responsibility for the entire report. Supp. 567 (H.T. II at 462, ln. 20-24). Ms. Ange's extensive qualifications are found at pages 975-78 of the Supplement.

produced to the Tax Commissioner pursuant to an agreed schedule on March 31, 2006. On September 7, 2006, Ohio Bell produced to the Tax Commissioner a revised report, which had been updated by Mr. Tegarden to accurately reflect a corrected 2002 income statement provided to him by Ohio Bell. See Supp. 620 (H.T. III at 29, ln. 3 to 30, ln. 10), 892-1011. As explained in detail in the report, the fair market value of *all* of Ohio Bell's operating property (tangible and intangible) as of the 2003 tax date was \$2,475,000,000. Supp. 968. He removed the value of tax-exempt property from this unit value to reach an appraised true value of Ohio Bell's *taxable* public utility property of \$1,702,157,675. See Supp. 448 (H.T. I at 71, ln. 14 to 72, ln. 7), 895. The unit valuation method employed by Mr. Tegarden is a commonly accepted method for valuing public utility property. Supp. 568 (H.T. II at 463, ln. 22 through 464, ln. 10). Indeed, the Tax Commissioner's consulting witness was familiar with the unit valuation method and had used it in the past. Supp. 671 (H.T. IV at 13, ln. 1-3).

Based on all evidence presented to the BTA as to the unreasonableness of the Tax Commissioner's use of the statutory method and the actual fair market value of Ohio Bell's public utility property, Ohio Bell sought an order from the BTA finding that the true value of Ohio Bell's taxable public utility property for tax year 2003 was \$1,702,157,675, a decrease of \$763,927,977 from the Tax Commissioner's estimate of \$2,466,085,652.⁴

E. The Board of Tax Appeals Rejects the Tax Commissioner's Technical Objections and Adopts the Expert Appraisal Testimony Offered by Ohio Bell.

The Board rejected the Tax Commissioner's argument that the Board ignore the Tegarden appraisal "on the basis that the decision to deviate from the valuation methodology set forth in

⁴ The decrease sought was \$155,798,114 less than was sought by the taxpayer in its Petition for Reassessment. See Supp. 194.

R.C. 5727.11 is exclusively his.” Appx. 14. As the Board explained, citing several Ohio Supreme Court decisions in support, “we conclude that the obligation of this Board remains in this appeal to ascertain whether the evidence presented supports a value different from that previously determined by the Tax Commissioner.” Appx. 15. The Board then examined in detail the valuation evidence presented by Ohio Bell, noted the considerable change occurring in the telecommunications industry during the past decade, and found “Tegarden’s appraisal to be competent and probative evidence of the value of appellant’s personal property and that as a result of such evidence appellant has rebutted the presumption of correctness which must be accorded the commissioner’s findings.” Appx. 26-27. The Board reversed the final determination of the Tax Commissioner and ordered that the true value of Ohio Bell’s taxable public utility property for tax year 2003 be established at \$1,702,157,675.

III. DISCUSSION

APPELLEE’S PROPOSITION OF LAW NO 1:

The Board of Tax Appeals May Consider Evidence That Was Not Presented To the Tax Commissioner for Administrative Review Provided the Evidence Relates to the Claim or Claims Asserted by the Taxpayer.

The Tax Commissioner’s Propositions of Law Nos. 1, 2, 3 and 5 are variations on the same theme: namely, that the BTA could not consider Ohio Bell’s appeal because Ohio Bell did not rely on Mr. Tegarden’s appraisal evidence either in its petition for reassessment or its notice of appeal filed with the BTA. However, the Tax Commissioner is mistakenly confounding the *claim* made by a taxpayer with the *evidence* used by the taxpayer in support of that claim. To bestow jurisdiction upon the BTA, the taxpayer’s claim must be identified in its petition for reassessment and notice of appeal. In contrast, there is no requirement that a taxpayer submit

any evidence to the Tax Commissioner. Because Ohio Bell consistently specified its claim during the Tax Commissioner's administrative review and in its Notice of Appeal to the BTA, the BTA properly considered the evidence Ohio Bell submitted in support of its claim.

It is, of course, incumbent upon a taxpayer challenging a finding of the Tax Commissioner to establish a right to the relief requested. See *Belgrade Gardens, Inc. v. Kosydar* (1974), 38 Ohio St. 2d 135; *Ohio Fast Freight v. Porterfield* (1972), 29 Ohio St. 2d 69; *Midwest Transfer Co. v. Porterfield* (1968), 13 Ohio St. 2d 138; *National Tube v. Glander* (1952), 157 Ohio St. 407. Accordingly, the taxpayer has the burden of proving to the BTA that the Tax Commissioner's formula does not reflect the true value of the property. *CC Leasing Corporation v. Limbach* (1986), 23 Ohio St. 3d 204, 207-08; *Alcoa v. Kosydar* (1978), 54 Ohio St. 2d 477.

However, this Court has made clear on several occasions that the Board may consider *new* evidence that was not presented to the Commissioner in making its *de novo* determination of value under R.C. § 5727.11(A). See *Higbee Co. v. Evatt* (1942), 140 Ohio St. 325, 332 ("The hearing before the Board of Tax Appeals is *de novo*. New evidence may be introduced and the burden of proof is upon the taxpayer"). "The BTA is statutorily authorized to conduct full administrative appeals in which the parties are entitled to produce evidence in addition to that considered by the Tax Commissioner. . . . The BTA may investigate to ascertain further facts and make its own findings independent of those of the Tax Commissioner." *Key Serv. Corp. v. Zaino* (2002), 95 Ohio St. 3d 11, 16, 2002-Ohio-1488 (internal citation omitted). See also *Bloch v. Glander* (1949), 151 Ohio St. 381, syllabus ¶ 1.

Indeed, R.C. § 5717.02 provides the procedures for appealing the determination of the Commissioner to the Board. That section provides that the Board *shall* consider new evidence not considered by the Commissioner, at the request of either party:

Upon the filing of a notice of appeal, the tax commissioner . . . shall certify to the board a transcript of the record of the proceedings before the commissioner . . . together with all evidence considered by the commissioner . . . in connection therewith. . . . The board may order the appeal to be heard upon the record and the evidence certified to it by the commissioner . . . , **but upon the application of any interested party the board shall order the hearing of additional evidence**, and it may make such investigation concerning the appeal as it considers proper.

(Emphasis added). Further, the Board has acknowledged its ability to hear additional evidence not brought before the Commissioner. See *Moore's Dream House v. Lindley* (BTA Aug. 5, 1981), Case No. 80-A-597, 1981 Ohio Tax Lexis 228, at *5 ("New evidence may be introduced and the burden of proof is upon the taxpayer."). See generally *Orange City School Dist. Bd. of Edn. v. Cuyahoga Cty. Bd. of Revision* (1996), 74 Ohio St. 3d 415 (Board has discretion in admitting evidence, weighing it, and granting credibility to testimony).

In *Moore's Dream House*, the Board allowed the taxpayer in a personal property tax case to introduce evidence of corporate income tax returns that were not presented to the Tax Commissioner. The Commissioner had assessed the taxpayer's property based on the taxpayer's failure to provide income tax returns, as required by statute, for three years. The taxpayer produced copies of the missing tax returns before the Board, and the Board considered them, noting its mandate to hear new evidence. See *id.* at *5 (citing *Higbee Co. v. Evatt* (1942), 140 Ohio St. 325).⁵ Similarly, the Board did not err in considering all evidence presented by Ohio

⁵ See also *Panhandle Eastern Pipeline Co. v. Tracy* (BTA June 30, 1995), Case No. 93-P-595, 1995 Ohio Tax LEXIS 842, at *17 (Board notes that lack of new evidence on appeal was parties' choice, thereby limiting Board's review to evidence already submitted in the record of proceedings before the Tax Commissioner); *Argyris v. Tracy* (BTA Nov. 20, 1998), Case No. 97-M-534, 1998 Ohio Tax LEXIS 1466, at *10 ("The hearing before this Board is another opportunity to present competent and probative evidence of error on the part of the Tax Commissioner").

Bell in support of its “true value” claim, including the expert appraisal report and testimony of Mr. Tegarden.

The Tax Commissioner argues to this Court that Ohio Bell “effectively” claimed on appeal to the BTA that the Commissioner’s use of the statutory valuation method was unreasonable because he failed to adopt Ohio Bell’s “unit valuation/income approach methodology.” T.C. Brief at 18. Of course, the question for this Court is not what Ohio Bell “effectively” did from the viewpoint of the Tax Commissioner but what Ohio Bell actually did. What Ohio Bell did is quite clear – it argued to the Tax Commissioner and to the Board that the statutory method failed to result in the assessment of Ohio Bell’s taxable public utility property at its “true value in money” as mandated by Ohio law. In support of this claim on appeal to the BTA, both the RCNLD study and the expert appraisal report were part of the record, and both demonstrated that the statutory method as applied to Ohio Bell’s public utility property violated the Ohio Constitution’s mandate that property be assessed at its true value in money. However, Ohio Bell chose on appeal to rely on the more conservative, and more traditional, appraisal performed by Mr. Tegarden. *See* Appx. 7-8. The Board did not err in considering that evidence.

Although the Commissioner presumes that the internal review of a petition for reassessment under R.C. § 5727.47 is the equivalent of a judicial or quasi-judicial proceeding, it clearly is not as it lacks an unbiased arbiter and any requirement for an evidentiary hearing. Indeed, although a hearing may be held at the option of the taxpayer, R.C. § 5727.47(D), the Commissioner may issue his final determination without considering any additional evidence. Ohio law requires only that the taxpayer state its objections to the Commissioner’s assessment. As nothing more is required, Ohio Bell satisfied all legal requirements by clearly stating its objections to the statutory valuation method in its petition for reassessment.

In this case, Ohio Bell waived hearing and submitted the RCNLD study in support of its objections, and the Commissioner determined that the cost study was not a more accurate gauge of the true value of Ohio Bell's property than the statutory formula. Supp. 427. On appeal to the Board, its jurisdiction was defined by Ohio Bell's objections and its assignments of error, not by the evidence that was or was not submitted to the Commissioner. The appeal to the Board was Ohio Bell's first opportunity to present evidence to a neutral arbiter, and it was Ohio Bell's first opportunity to exchange information with the Commissioner under the procedural protections of a quasi-judicial proceeding. Ohio law simply does not prevent Ohio Bell from submitting additional evidence to the Board in support of its claim that the statutory valuation method is unreasonable.

The decisions of this Court and of the Board make clear that a taxpayer may submit new evidence, including the testimony of a new witness, to the Board. The taxpayer may obtain a new appraisal or valuation study subsequent to the hearing before the Commissioner, and may present evidence as to its reliability and results before the Board. The taxpayer is not bound to the same valuation methods and studies that it presented to the Commissioner. Accordingly, this Court should affirm the decision of the Board reversing the Commissioner's determination with respect to the true value of Ohio Bell's taxable public utility property for the 2003 tax year.

APPELLEE'S PROPOSITION OF LAW NO. 2:

In Order to Vest the Board of Tax Appeals With Jurisdiction, a Taxpayer Need Only Specify the Challenged Issue in his Notice of Appeal. He Need Not, However, Specify the Evidence That He Intends to Introduce in Opposition to the Tax Commissioner's Decision on That Issue.

The Tax Commissioner's Second Proposition of Law, which is briefly revisited in its Fifth Proposition of Law, is that the BTA lacked jurisdiction to consider Ohio Bell's appeal because Ohio Bell did not assert in its Notice of Appeal any error with regard to the Tax

Commissioner's consideration of Ohio Bell's appraisal evidence. This is, of course, an improper back-door attack on the Board's clear authority to consider new evidence and is an argument lacking any support in Ohio law.

According to the Commissioner, the evidence submitted to him during his administrative review defines and limits the scope of any claim later appealed to the Board. If this were true, it would eliminate the Board's authority to conduct a *de novo* review through a full administrative appeal and consideration of additional evidence. See *Key Serv.*, 95 Ohio St. 3d 11 at 16; *Higbee*, 140 Ohio St. 325, 332; And, if this were true, the Board's rules requiring the disclosure of the identity of experts and written valuation reports seven days prior to hearing would be rendered meaningless. See O.A.C. 5717-1-11(A)(5). The Commissioner's argument is contrary to both Ohio law and the Board's own rules.

In the proceeding below, the Tax Commissioner raised this issue well in advance of hearing in a "Motion for Jurisdictional Ruling," and the Board, by order dated February 3, 2006, rejected the Commissioner's arguments. See Appx. 30-34. The Board determined that, "even if [Ohio Bell's] petition for reassessment and notice of appeal were to be viewed with the most critical eye, the commissioner and this board were clearly put on notice that [Ohio Bell] was objecting to the cost less depreciation method typically employed by the commissioner in valuing its public utility property." Appx. 32-33. As the Board correctly explained, "R.C. 5727.47 and 5717.02 contemplate that pleadings invoking review will provide the commissioner with *notice* of the errors claimed by a public utility, not necessarily all of the *evidence*, which it is reasonable to assume, will be gathered during the appellate process and ultimately offered in support thereof." Appx. 33 (emphasis in original). The Board relied on several of this Court's decisions, including *Key Servs.*, *Higbee* and *Bloch v. Glander*, in finding that the "Supreme

Court has expressly rejected the argument now advanced by the Tax Commissioner.” Appx. 33.
The Board did not err in doing so.

Here, there is no dispute that the issue of valuation was before the Commissioner and the Board. Thus, the Board was entitled to consider all evidence before it on that issue, regardless whether that evidence was presented first to the Commissioner. Accordingly, this Court should affirm the Board’s decision.

APPELLEE’S PROPOSITION OF LAW NO. 3:

**The Board of Tax Appeals Reviews Valuation Determinations
by the Tax Commissioner *De Novo*.**

The Fourth and Sixth Propositions of Law put forward by the Tax Commissioner argue that R.C. § 5727.11(A) bestows upon him sole discretion to determine whether or not to apply the standard statutory valuation method or to vary from that method and, thus, that the Board erred in applying a *de novo* review standard instead of an abuse of discretion standard. However, in enacting R.C. § 5727.11(A), the General Assembly did not eliminate the “true value” requirement of R.C. § 5727.10 and Ohio Const. Art. XII, § 2. In harmonizing these provisions, this Court and the Board have both determined that the rigid application of R.C. § 5727.11 must yield to other competent evidence reflecting true value. *Texas Eastern Trans. Corp. v. Tracy* (1997), 78 Ohio St. 3d 83, 86; *Texas Eastern Trans. Corp. v. Tracy* (BTA June 30, 1995), Case No. 93-P-594, 1995 Ohio Tax LEXIS 846, at *7-10. Under Ohio law, the taxpayer’s constitutionally-protected interest in having its public utility property assessed at its true value is protected by the Board’s *de novo* review of appeals taken from the Commissioner’s internal administrative determination.

A. The Standard of Review Employed by the Board is *De Novo*.

The decision of the Commissioner is reviewed by the Board of Tax Appeals *de novo*. *Key Serv.*, 95 Ohio St. 3d at 16; *Coventry Towers, Inc. v. Strongsville* (1985), 18 Ohio St. 3d 120, 122; *Pennsylvania Rd. Co. v. Porterfield* (1971), 25 Ohio St. 2d 223, 225; *Nestle v. Porterfield* (1971), 28 Ohio St. 2d 190, 193; *Bloch v. Glander*, 151 Ohio St. at 387; *Higbee*, 140 Ohio St. at 332. *See also Moore's Dream House*, 1981 Ohio Tax Lexis 228, at *5 ("The hearing before the Board of Tax Appeals is *de novo*."). The Board's task in considering a taxpayer's personal property valuation appeal is not to ask whether the Commissioner abused his discretion in applying the statutory valuation method. Instead, the Board's task is to determine whether the taxpayer has produced reliable, probative evidence that the standard formula applied by the Commissioner does not reflect the true value of the taxpayer's property, either because of special or unusual circumstances or because a rigid application of the formula would be inappropriate. *CC Leasing Corporation v. Limbach* (1986), 23 Ohio St. 3d 204, 207-08; *Alcoa v. Kosydar* (1978), 54 Ohio St. 2d 477, 480-81. The Board has reiterated that this standard of review is equally as applicable to public utility property complaints under R.C. § 5727.11 as it is to general business property complaints under R.C. § 5711.18. *Cincinnati Bell Tel. Co. vs. Zaino* (June 10, 2005), BTA Case Nos. 2003-K-765, 2003-K-1612, 2005 Ohio Tax LEXIS 753, at *28-30. Ohio Bell adhered to this standard in presenting reliable, probative evidence to the Board of the true value of its taxable public utility property.

In arguing that the Board should apply an "abuse of discretion" standard, the Commissioner has presented no decision from this Court or the Board indicating that the proper standard of review is anything other than *de novo*. Indeed, the Commissioner's Sixth Proposition of Law is based almost entirely on his analysis of Ohio's statutes permitting remission of

penalties and alternative allocation of local government funds, and the claimed similarity between language used by the General Assembly in those statutes and that used in R.C. § 5727.11(A). *See* T.C. Brief at 28-30. However, the Commissioner's strained analogies fail to take into account the Constitutional and statutory mandate here to assess property at its true value. While penalty remissions and local government fund allocations truly are discretionary, faithfully executing a clear mandate of the Ohio Constitution and R.C. § 5727.10 is not. The Commissioner has presented no evidence that he may exercise discretion in assessing public utility property at anything other than its true value as mandated by the Ohio Constitution.

Similarly, the Commissioner's reliance in its Fourth Proposition of Law upon this Court's decision in *Texas Eastern* is misplaced (*See* T.C. Brief at 24-25). If the Commissioner's "sole discretion" theory were correct, then this Court would have been required to remand *Texas Eastern's* appeal to the Board for further remand to the Commissioner so that the Commissioner could exercise his "sole discretion" in the first instance. The Commissioner erroneously argued in *Texas Eastern* that an alternative valuation method could not be used absent a showing of special and unusual circumstances. The Court held that competent evidence of true value must be considered when the statutory method does not yield true value, regardless of whether there are special and unusual circumstances. *Texas Eastern*, 78 Ohio St. 3d at 86. Under the Commissioner's "sole discretion" theory, the Court would then have been required to remand the question to the Commissioner so that he could decide, in his sole discretion, whether the statutory method yielded true value and whether the appraisal testimony submitted in that matter was competent evidence of true value. Yet no remand occurred. Instead, the Court affirmed the Board's *de novo* review.

The Commissioner's strained reliance on the penalty remission statutes and circular arguments serves only to highlight the fact that he cannot demonstrate the existence of any statutory language or case law that imposes an "abuse of discretion" standard of review on the Board in valuation cases. Indeed, all law is to the contrary.

B. Ohio Revised Code § 5727.11(A) Did Not Alter the Standard of Review to be Employed by the Board of Tax Appeals.

As stated above, in his Merit Brief, the Commissioner ignores the caselaw declaring the standard of review, and instead states that R.C. § 5727.11, which was enacted in 1989, imposed an "abuse of discretion" standard of review on the Board with respect to valuation decisions of the Commissioner. The Commissioner is wrong.

Section 5727.11(A) states that:

(A) Except as otherwise provided in this section, the true value of all taxable property, except property of a railroad company, required by section 5727.06 of the Revised Code to be assessed by the tax commissioner shall be determined by a method of valuation using cost as capitalized on the public utility's books and records less composite annual allowances as prescribed by the commissioner. If the commissioner finds that application of this method will not result in the determination of true value of the public utility's taxable property, the commissioner may use another method of valuation.

Accordingly, this section does not establish the standard of review to be employed by the Board on appeal, but simply sets forth the methods by which the Commissioner (and the Board) will make the determination on valuation. Contrary to the Commissioner's unfounded assertions in his Merit Brief, however, R.C. § 5727.11(A) does not alter the role of the Board in reviewing the Commissioner's decision or give that decision any special weight on appeal.

Indeed, R.C. § 5727.11(A) governs *only* the substantive means by which an internal administrative review of the valuation determination will take place and fails to address how the

Board should review that determination, including the weight to be afforded the Commissioner's decision and the nature of the evidence the Board may review. On appeal, the Board makes its own valuation determination in order to effectuate the constitutional and statutory mandate that personal property be assessed at its "true value in money." Accordingly, the Commissioner's reliance on R.C. § 5727.11(A) as a means to demonstrate that the Board is handcuffed by an "abuse of discretion" review on appeal is not at all supported by the language of that statute.

APPELLEE'S FOURTH PROPOSITION OF LAW:

The Decision of the Board of Tax Appeals Regarding the True Value of a Public Utility's Personal Property Shall Not be Overturned if the Public Utility Taxpayer Has Produced Competent and Probative Evidence of True Value to Rebut the Tax Commissioner's *Prima Facie* Determination of True Value.

- A. A taxpayer may overcome the *prima facie* determination of value made by the Commissioner with direct evidence of value, by showing special or unusual circumstances, or with probative evidence showing that an alternative valuation method is more accurate.

Ohio Bell's personal property must be assessed at its true value in money. Ohio Const. Art. XII, § 2; R.C. § 5727.10. As with the "302 computation" used by the Commissioner to value the personal property of general business taxpayers, the computation set forth in R.C. § 5727.11 to value taxable public utility property is a "predetermined formula" used simply because it is impracticable for the Tax Commissioner to personally value all personal property in Ohio. *Cincinnati Bell*, 2005 Ohio Tax LEXIS 753, at *27 (citing *Snider v. Limbach* (1989), 44 Ohio St. 3d 200, 201). This predetermined formula is a *prima facie* means to determine true value; it must be rejected whenever it does not reflect true value either because of "special and unusual circumstances" or because rigid application would be inappropriate. *Cincinnati Bell*, 2005 Ohio Tax LEXIS 753, at *28 (citing *Wheeling Steel Corp. v. Evatt* (1944), 143 Ohio St.

71). Administrative convenience must yield to the Constitutional mandate to assess personal property at its true value.

As explained by the Ohio Supreme Court in *Texas Eastern Trans. Corp. v. Tracy* (1997), 78 Ohio St. 3d 83, 86 (“Texas Eastern II”) (emphasis in original; citations omitted), true value is paramount:

The ultimate goal imposed by R.C. 5727.10 clearly is to determine the *true value* of the property taxed. . . . If the statutory method does not yield true value, then another method of valuation may be used, whether or not there are special or unusual circumstances. Although a statute may provide a prima facie estimate or presumption of value, where rigid application of the statute would be inappropriate, the presumption of value must yield to other competent evidence reflecting true value.

A taxpayer contesting true value need not demonstrate special or unusual circumstances. *Id.* at 85. Instead, a taxpayer may show that changes in an industry, including technological improvements, deregulation and increased competition, render strict application of the statutory method unjust or unreasonable. *See, e.g., Alcoa, Inc. v. Zaino* (Oct. 22, 2004), BTA Case No. 1999-G-1401, 2004 Ohio Tax LEXIS 1672, at *20-22, 26-27. In the alternative, a taxpayer may rebut the presumption created by the statutory method by introducing evidence, such as a unit appraisal, that is more accurate than the statutory method imposed by the Tax Commissioner. *Texas Eastern II*, 78 Ohio St. 3d at 86.

B. Ohio Bell submitted sufficient evidence to allow the Board to examine whether an alternative valuation method was more accurate than the Commissioner’s estimate.

The Tax Commissioner mistakenly claims that Ohio Bell failed to introduce any evidence challenging the reasonableness of the statutory valuation method. T.C. Brief at 31. To the contrary, both Ohio Bell and the Tax Commissioner submitted abundant evidence demonstrating that the statutory method produced an unjust or unreasonable result in the case of Ohio Bell’s

public utility property. As detailed above in the Statement of Facts, technological and regulatory changes in the 1990s resulted in explosive growth of competitors, both within the wireline market and in substitute markets using alternative technologies such as wireless and cable, which, starting in 2001, resulted in a precipitous decline in Ohio Bell's access lines.⁶ Notably, according to the vintage records used to assess Ohio Bell's public utility property, more than twenty percent of Ohio Bell's plant was placed in service prior to 1994, well before Ohio Bell became subject to this competitive risk. *See* Supp. 190.⁷ Yet the Tax Commissioner's value was based on Ohio Bell's MR books, which reflect the old regulated industry, and not its FR books, which are relied upon by investors and reflect the current state of the telecommunications industry. Supp. 571 (H.T. II at 475, ln. 17 to 476 ln. 7). It is unjust and unreasonable to continue to rely upon the statutory method under these circumstances and, therefore, the Board's decision reversing that determination was correct.

Moreover, the parties agreed that a unit appraisal such as that relied upon by the taxpayer in *Texas Eastern* is competent evidence reflecting true value. Indeed, the Commissioner conceded recently in the Board's *Cincinnati Bell* case that, "where 'direct evidence' of value is offered, such as an appraisal like that relied upon in *Texas E. Transm.*, a public utility need not demonstrate the existence of special and unusual circumstances in order to deviate from booked

⁶ The industry changes identified by Ohio Bell were similar to those identified by Alcoa in its appeal to the Board, in which the Board found that "changes in the aerospace industry support appellant's contention that the rigid application of the 302 computation to that equipment would create an unjust or unreasonable result." *Alcoa*, 2004 Ohio Tax LEXIS 1672, at *26-27. The industry changes identified by Alcoa were a significant decrease in demand from customers, regulatory restructuring resulting in price reductions, new competitors entering the market, and competitors utilizing alternative technologies. *Id.* at *20-21. Each of these changes also was negatively affecting Ohio Bell's wireline business.

⁷ Under Ohio Rev. Code § 5727.11, telephone company property first subject to taxation for tax year 1995 or thereafter is assessed at a rate of 25%, while all other property is assessed at a rate of 88%.

costs less prescribed allowances.” *Cincinnati Bell*, 2005 Ohio Tax LEXIS 753, at *33. The unit appraisal in *Texas Eastern* was prepared by Mr. Tegarden using the same traditional appraisal methodologies as he used in preparing the unit appraisal introduced into evidence here. See *Texas Eastern II*, 78 Ohio St. 3d at 83-84; Supp. 567. Although the Commissioner has questioned whether Mr. Tegarden’s appraisal is more accurate than the Commissioner’s valuation estimate, the appraisal was sufficient evidence under *Texas Eastern II* to allow the Board to reach the valuation question.

C. A Preponderance of the Evidence Supported the Board’s Decision to Reverse the Commissioner’s Determination.

The Board in this case had before it the results of the statutory method and two independent opinions of value: the Tegarden appraisal and the RCNLD study prepared by AUS Consultants — Weber Fick & Wilson Division. Ohio Bell chose on appeal to rely on the more conservative appraisal performed by Mr. Tegarden, and, thus, sought a Board decision assigning a \$1.7 billion value to Ohio Bell’s taxable public utility property. The Commissioner seeks in his Merits Brief to counter Mr. Tegarden’s competent and probative evidence of value by arguing that the Commissioner’s consultant, Mr. Eyre, established an alternative valuation for Ohio Bell’s public utility property. See T.C. Brief at 31-32, 40-42. Yet, Mr. Eyre freely admitted at hearing that *he did not prepare an appraisal report, was retained only as a consultant to the Tax Commissioner, and has not rendered an opinion as to value.* Supp. 695 (H.T. IV at 110, ln. 2-10); Supp. 703 (H.T. IV at 142, ln. 1-8). Because Mr. Eyre was testifying as a consultant to the Tax Commissioner and not as an independent appraiser, the Board was free to disregard his testimony as not credible.

1. The Tax Commissioner's Defense of the Valuation Estimate Provided by the Statutory Method Is Irrelevant to the Issue of Whether Ohio Bell's Public Utility Property Was Assessed At Its True Value.

The Tax Commissioner claims in one sub-part of his Seventh Proposition of Law that the statutory method is the "best evidence" of the true value of property in that it most closely relates to the price which a willing buyer would pay and a willing seller would accept on the open market. T.C. Brief at 33-34. The Commissioner argues that the capitalized costs which are the starting point of the statutory method are tied to real market transactions, and he attempts to contrast this approach to the appraisal methodologies employed by Mr. Tegarden. The Commissioner ignores a few salient points.

First, the Tax Commissioner overlooks the undisputed fact that the MR books used by the Tax Commissioner are prepared solely to satisfy FCC rules and are not consistent with GAAP. Supp. 528 (H.T. II at 303, ln. 17 to 304, ln. 10). Any purchaser seeking to value Ohio Bell's public utility property would use the FR books, not the MR books used by the Tax Commissioner. See Supp. 529 (H.T. II at 308, ln. 11-15), 545-46 (H.T. II at 371-76), 560 (H.T. II at 434), 561 (H.T. II at 436), 571 (H.T. II at 475-77). Indeed, a cost approach using MR data does not reflect the market value of utility property because it is based on unsound figures that the investment community has specifically rejected. Supp. 571 (H.T. II at 477, ln. 19-25). The Commissioner's own testifying consultant agreed that FR books should be used instead of MR books. Supp. 695 (H.T. IV at 112, ln. 11-19). Thus, the costs utilized by the Commissioner are not the wonderful approximation of fair market value that he makes them out to be.

Second, the Commissioner has stated elsewhere that an appraisal of the type provided by Mr. Tegarden is itself direct evidence of value. See *Cincinnati Bell*, 2005 Ohio Tax LEXIS 753, at *33. The Commissioner was correct then, but wrong now in relying upon a limited cost approach that is not tailored to Ohio Bell's circumstances. Remarkably, the Commissioner's

own witness agreed that Ohio's statutory method for estimating value, which does not use FR books and places limits on the amount of depreciation that can be deducted from an asset, is not the cost approach he would use and constrains an appraiser from determining fair market value of utility assets. Supp. 695 (H.T. IV at 112, ln. 11-19), 696 (H.T. II at 113 ln. 25 to 115 ln. 3). As explained in Mr. Tegarden's appraisal report, his appraisal determines the market value of Ohio Bell's property by analyzing each of three approaches to value using the same methods that any investor would adopt to determine the fair market value of Ohio Bell's property. See Supp. 900, 915-19, 927-28.

Third, the Tax Commissioner's positive spin placed on his "on-going study of the telecommunications industry" is not supported by any evidence in the record below. The "Guidelines" booklet referenced by the Tax Commissioner contains depreciation schedules that may have been somewhat appropriate when adopted in January 1999, but which were not updated to reflect the rapid changes in the wireline telephone business that resulted in Ohio Bell's rapid line loss beginning in 2001. See Supp. 730. There is no evidence in the record of the "on-going study" described in the Tax Commissioner's Merits Brief. Instead, the only evidence presented was that the statutory method is based on a snap shot in time that does not accurately value Ohio Bell's public utility property.

2. Speculation Based on Ohio Bell's Reported Annual Additions and Retirements Is Not Reliable, Probative Evidence of True Value Given Ohio Bell's Status as a Public Utility.

The Tax Commissioner speculates in the next sub-part of his Seventh Proposition of Law as to the true value of Ohio Bell's personal property by referencing Ohio Bell's "regular investment in Ohio plant property over the years" as compared to its "modest" retirements. T.C. Brief at 35-38. This history, suggests the Commissioner, is evidence that Ohio Bell is earning a reasonable rate of return on its investment. *Id.* at 37. Interestingly, the Commissioner failed to

cite to any testimony or other evidence in the record that would support the conclusions he asks the Court to draw here. His unsupported speculation is not the type of direct evidence of value that may be relied upon by the Board, and the Board properly rejected the Commissioner's invitation to engage in a reading of tea leaves.

The Commissioner's theory, moreover, fails to take into account Ohio Bell's obligation under Ohio law as a public utility and telephone company to provide adequate service to all persons in Ohio who request its service. *See* R.C. §§ 4905.22, 4905.26. At all relevant times, Minimum Telephone Service Standards ("MTSS") adopted by the Public Utilities Commission of Ohio (the "PUCO") pursuant to R.C. § 4905.231 regulated Ohio Bell's provision of service to its customers. *See* O.A.C. Chapter 4901:1-5. In order to ensure that a certain level of service is provided to telephone customers, the PUCO may order a telephone company to make whatever repairs or additions are necessary to its plant "in order to promote the convenience or welfare of the public or of employees, or in order to secure adequate service or facilities." R.C. § 4905.38.

Ohio Bell's interactions with the PUCO in the years prior to the relevant tax date here starkly reveal that Ohio Bell was being pushed hard by the PUCO to maintain its capital investment in its network. In fact, the PUCO determined by opinion and order issued July 20, 2000 that Ohio Bell, using its trade name of Ameritech Ohio, was providing inadequate service to its customers because of its violations of the PUCO's MTSS and various Commission orders. Opinion and Order, *In the Matter of the Commission-Ordered Investigation of Ameritech Ohio Relative to Its Compliance with Certain Provisions of the Minimum Telephone Service Standards Set Forth in Chapter 4901:1-5, Ohio Administrative Code*, PUCO Case No. 99-938-TP-COI, 2000 Ohio PUC LEXIS 678 (July 20, 2000) ("July 2000 Order"). According to the results of an audit ordered by the PUCO in the July 2000 Order, "virtually all of the indicators examined by

[the auditor] evidenced deterioration in the condition and performance of Ameritech's outside plant." Second Supplemental Opinion and Order, *In the Matter of the Commission-Ordered Investigation of Ameritech Ohio Relative to Its Compliance with Certain Provisions of the Minimum Telephone Service Standards Set Forth in Chapter 4901:1-5, Ohio Administrative Code*, PUCO Case No. 99-938-TP-COI, 2002 Ohio PUC LEXIS 101, at *12 (January 31, 2002) ("January 2002 Order"). The PUCO's January 2002 Order reminded Ohio Bell that it "has the legal obligation to provide adequate service to its customers and is required to make the appropriate expenditures to meet its obligation regardless of its number of employees." *Id.* at *19. Put another way, Ohio Bell was legally obligated to provide adequate service to all possible customers, even if many of those customers were terminating their wireline service and switching to cellular or Voice over Internet Protocol ("VoIP") service.

The Tax Commissioner's basic premise is that Ohio Bell, like any other profit maximizing company, makes capital investment with an expectation that it will earn a reasonable return on that investment. However, public utilities do not always function under the same rules as unregulated companies. The PUCO's July 2000 Order and January 2002 Order make clear that Ohio Bell's level of capital investment during that time period was dictated by PUCO staffers and by its obligation to maintain its network regardless of the number of customers taking service. Thus, a myopic focus on Schedules B and C of Ohio Bell's return offers no evidence that the statutory formula fairly represents the true value of Ohio Bell's taxable property. If anything, it suggests that Mr. Tegarden properly gave more weight to the income approach than to the cost approach to value.

3. The Lack of Documentation of a FAS 144 Impairment Analysis Is Not Probative Evidence of the True Value of Ohio Bell's Public Utility Assets.

The Tax Commissioner also argues in his Seventh Proposition of Law that Ohio Bell's lack of documentation of an impairment analysis under Financial Accounting Standard ("FAS") 144 means: (1) that no documents ever existed; (2) that no impairment analysis was ever performed; and (3) that none of Ohio Bell's fixed assets was ever determined by Ohio Bell or SBC's internal or external auditor and in-house management personnel to have experienced a triggering event. T.C. Brief at 39-40. He further argues that the lack of documentary evidence of a "triggering event" under FAS 144 is "powerful" evidence that no "significant adverse" events occurred between 1988 and 2006 regarding Ohio Bell's taxable public utility property. *Id.* at 39. However, the Commissioner's reliance upon FAS 144 is not supported by the evidence presented or by the terms of FAS 144 itself.

First, the Commissioner is confusing the FAS 144 impairment standard with an obsolescence determination. In *Alcoa Inc. v. Zaino* (Oct. 22, 2004), BTA Case No. 1999-G-1401, 2004 Ohio Tax LEXIS 1672, at *31-32, the taxpayer introduced into evidence an impairment analysis conducted under FAS 121 (the predecessor to FAS 144) intended to determine whether the undiscounted cash flows expected to be generated from the personal property at issue exceeded the carrying value of the assets. Although there was no impairment under FAS 121, the Board noted that this analysis had "no bearing on the appraisal value" presented by the taxpayer. *Id.* at *32. The FAS 121/144 test, which looks at undiscounted cash flow, is a severe test, and the *lack* of impairment under FAS 121/144 is not probative evidence of the true value of assets.

Second, instead of introducing at hearing any evidence regarding Ohio Bell's accounting practices or the potential applicability of FAS 144 to the issues before the Board, the

Commissioner simply accepted Ohio Bell's stipulation that, from 1998 to the present, "Ohio Bell does not have documents that are responsive to the request with regard to – I think it asks about impairment or potential impairment." Supp. 537 (H.T. II at 339, ln. 22-25). Based solely on this stipulation the Commissioner speculates, and asks this Board to conclude, that no documentation ever existed and that no triggering events ever occurred. However, the Commissioner presented no evidence to the Board to support his speculation.

Indeed, in examining Ohio Bell's controller, the Commissioner learned that an impairment analysis would not be conducted at the operating company level but on a consolidated basis at the SBC corporate accounting level. Supp. 537-38 (H.T. II at 342-43). This is true because Ohio Bell's assets are part of an asset group – the telecommunications network – that is "integrally related to the overall telecommunications business of SBC." Supp. 538 (H.T. II at 344, ln. 19-24). Thus, in applying FAS 144, SBC would ask if the carrying amount of its telecommunications network is not recoverable from its undiscounted cash flows. Supp. 1081, 1082 (defining asset group and impairment). SBC cannot pick and choose which parts of its network to operate but, instead, is required by state laws to operate its entire network as a public utility and to provide service to all. Thus, as explained in FAS 144 at p. 50 ¶ B45 (Supp. 1123), it cannot record an impairment on individual aspects of its network plant unless the entire network is impaired. What the Commissioner's "no documents" argument thus suggests, at most, is that SBC's outside auditors believe that the carrying amount of SBC's telecommunications network exceeds the sum of undiscounted cash flows expected to result

from its use and disposition. This is not, as claimed by the Commissioner, “powerful” evidence of anything having any relevance to this appeal.⁸

Third, the Commissioner mistakenly argues that the lack of an impairment analysis is evidence that Ohio Bell’s and SBC’s financial accounting auditors and in-house management/accounting personnel have a different opinion as to the value of Ohio Bell’s assets than does Mr. Tegarden. The Commissioner once again is ignoring the difference between the MR books used by him and the FCC and the Financial Reporting (“FR”) books used by everyone else, including SBC’s auditors, Ohio Bell’s and SBC’s management, the SEC, the investing public, Mr. Tegarden and Mr. Eyre. *See* Supp. 529 (H.T. II at 308), 545-46 (H.T. II at 371-76), 560 (H.T. II at 434), 561 (H.T. II at 436), 571 (H.T. II at 475-77), 695 (H.T. IV at 112, ln. 11-19). The Commissioner presented no evidence to the Board that FAS 144 has any application to the MR books. Indeed, the undisputed evidence before the Board demonstrated that the FR books relied upon by Ohio Bell, the investment community and Mr. Tegarden are probative evidence of a true value of Ohio Bell’s taxable public utility property of \$1.7 billion.

4. Mr. Tegarden reasonably determined that the sales comparison approach and stock and debt approach were not useful in valuing Ohio Bell’s operating assets.

The Tax Commissioner also argues in his Seventh Proposition of Law that the Board should not have accepted Mr. Tegarden’s appraisal as probative evidence of true value because Mr. Tegarden “did not even attempt to undertake any sales comparison approach” and did not conduct a “stock and debt” approach to value. T.C. Brief at 40-43. However, the evidence

⁸ Even if SBC Communications had performed an impairment analysis and written down its assets at the corporate level, that impairment, according to *MCI Metro Access Transmission Services, LLC v. Wilkins* (April 13, 2007), BTA Case Nos. 2004-K-749; 2004-K-750, 2007 Ohio Tax LEXIS 524, at *22-24, would not be probative evidence of the Ohio assets.

before the Board was that Mr. Tegarden carefully considered each approach to value and then decided, in his professional judgment, which approaches were probative of value. As set forth in Mr. Tegarden's expert report and as he explained in his hearing testimony, neither a "sales comparison" nor a "stock and debt" approach produces a result under the particular circumstances here which is useful in valuing Ohio Bell's taxable public utility property. *See* Supp. 962-64, 568-69 (H.T. II at 466-67), 617-18 (H.T. III at 19-22).

Mr. Tegarden's report explained that actual sales data was not available that could be used as evidence of value of going-concern enterprises such as public utilities. Supp. 962, 568-69 (H.T. II at 466-67). Thus, in thirty-five years, he had never seen someone successfully do a sales comparison approach on public utility properties. Supp. 617 (H.T. III at 19, ln. 19-24). He also explained that some have attempted to use a "rather poor surrogate called the stock and debt approach" as a substitute for the traditional sales comparison approach. Supp. 962, 569 (H.T. II at 467, ln. 2-3). Although Mr. Tegarden considered this approach, he did not perform a stock and debt approach because Ohio Bell does not have traded stock, its parent company does not have traded stock, and the ultimate parent company has some 200 companies under its holding company umbrella that are reflected in the stock value. Supp. 570 (H.T. II at 473, ln. 7-14), 617-18 (H.T. III at 20-21), 967. Moreover, as explained in his report, stock prices are not particularly representative of the underlying value of the assets. Supp. 962-64, 618 (H.T. III at 21, ln. 12-22). For these reasons, when states do employ the stock-and-debt approach it is given very little weight. Supp. 711 (H.T. IV at 175-76). Indeed, Mr. Tegarden testified that Mr. Eyre's stock-and-debt examples did not change his opinion of value. Supp. 711 (H.T. IV at 174, ln. 11-19).

Although the Commissioner proposes the use of a rough estimation of value based on market-to-book ratios (T.C. Brief at 41), this approach has been rejected as not useful in valuing public utility property because it is polluted by intangibles:

In its report, RW Beck detailed several utility company sales to demonstrate that utility distribution facilities sold at an average sales price 1.8 times greater than book value. Hughes urges the point that because utility companies sell at more than book value, the modified cost approach is not a reliable indicator of value. The court disagrees. The assessment of personal property is limited to tangible property. A stock sale of a utility business, however, typically involves the sale of a going business with attendant good will with a work force in place. Understandably, no witness was able to report a comparable sale of tangible personal property only. And yet, to include, as a comparable, the unidentified worth of intangible assets, makes the comparison of little use. . . . [T]he sales price is not solely a function of the value of taxable personal property, but more generally of the anticipated revenues and profitability of companies, a determination flowing from many considerations which include but are not limited to the companies' tangible assets.

Yankee Gas Co. v. City of Meriden (Conn. Super. Ct. Apr. 20, 2001), 2001 Conn. Super. LEXIS 1119, at *62-63.

Indeed, because the Commissioner elected not to provide independent appraisal testimony but, instead, relied solely upon Mr. Eyre's criticisms of Mr. Tegarden's appraisal, the Board had no evidence before it to suggest that a "sales comparison" approach or "stock and debt" approach would be probative of value. Mr. Eyre suggested how these approaches could be performed by an appraiser. Yet Mr. Eyre refrained from offering his opinion as an appraiser that the results were probative of value. Because Mr. Eyre testified as a consultant, the ethics rules governing all appraisers prohibited him from offering his professional opinion as an appraiser that the "stock and debt" approach, or any other approach, was probative of the value of Ohio Bell's taxable public utility property. See Supp. 680 (H.T. IV at 50-52), 695 (H.T. IV at 110), 703 (H.T. IV at 141-42). Also, because Mr. Eyre was testifying as a consultant, he was unable to explain how he might reconcile the result of his cost approach of \$2,562,919,575 and his "stock

and debt” estimate of \$3,783,635,799. Supp. 751, 755. See Supp. 618 (H.T. III at 23) (results of valuation approaches should be relatively close, and wide disparity in values means at least one of approaches is not accurate). Given the evidence before the Board, Mr. Eyre’s “stock and debt” work papers are an excellent example of why, as Mr. Tegarden explained, the “stock and debt” approach is unreliable. See Supp. 618 (H.T. III at 21-24).

5. Mr. Tegarden’s Small Adjustment to the Cost Approach to Account for Economic Obsolescence Is An Accepted Appraisal Methodology.

The Tax Commissioner erroneously describes Mr. Tegarden’s cost approach as a “species” of income approach in a misguided attempt to argue that Mr. Tegarden performed only an income approach. T.C. Brief at 43-45. Notably, the Commissioner raised no objection to Mr. Tegarden’s cost approach other than the 2.83% adjustment he makes for external or economic obsolescence. See Supp. 695-96 (H.T. IV at 111-113). Yet, the Commissioner complains that this 2.83% obsolescence adjustment converts Mr. Tegarden’s cost approach into an income approach. However, Mr. Tegarden explained fully in his report and his hearing testimony both (i) why an appraiser *must* consider economic obsolescence when performing a cost approach to value and (ii) why the method he used was justified in this case. See Supp. 921-26, 573-77 (H.T. II at 484-501).

The Oregon case relied upon by the Commissioner at page 44 of his Brief is an anomaly that rejected basic appraisal methodology. The Court’s confusion in that case may have resulted from its mistaking the method used by Mr. Tegarden here – capitalizing the income loss resulting from the external obsolescence influence – with a similar method also used in some states. That alternative is explained in *Lacy Diversified Indus. v. Dep’t of Local Gov’t Fin.* (Ind. Tax Ct. 2003), 799 N.E.2d 1215, 1225, 2003 Ind. Tax LEXIS 109, at *21-24, which approved the following method to quantify economic obsolescence: determine the property’s market value

under the cost approach; determine the property's market value under the income capitalization approach; convert the difference (which typically represents obsolescence) to a percentage to be applied against the property's true tax value. Under this method, when the cost indicator of value is higher than the income indicator of value, the difference between the cost indicator and the income indicator is treated as economic obsolescence and used to adjust the cost indicator downward to the income indicator. Using this method would "always result in a value exactly the same as the income approach" as suggested by the Commissioner here and by the Oregon court in *United Tel. Co. v. Department of Revenue* (1989), 307 Ore. 428, 770 P.2d 43.

Yet Mr. Tegarden did not use that approach here. He used the approach authorized by the Appraisal Institute and in appraisal textbooks, as well as in Colorado, Wyoming, South Dakota, Tennessee and other states. Supp. 922-25, 577 (H.T. II at 500). He used the same approach in calculating economic obsolescence in *Panhandle Eastern Pipeline Co. v. Tracy* (June 30, 1995), BTA Case No. 93-P-595, 1995 Ohio Tax LEXIS 842, which the Board accepted over the Commissioner's objection that economic obsolescence was excessive. 1995 Ohio Tax LEXIS 842, at *20-21; Supp. 577 (H.T. II at 500). The Commissioner's continuing misrepresentation of Mr. Tegarden's appraisal methodology is specious and was properly rejected by the Board.

In the end, Mr. Tegarden produced a cost indicator of \$2,490,000, which accounts for a small amount of economic obsolescence, and then reconciled this with the result of his income approach of \$2,470,000. Mr. Tegarden gave most weight to the income approach and valued Ohio Bell's property at \$2,475,000. Because the Commissioner elected not to challenge Mr. Tegarden's reconciliation of his cost and income approaches to value, the Commissioner's objection to the small obsolescence adjustment made prior to that reconciliation is immaterial.

6. Mr. Tegarden's Income Approach Was Credible and Reasonable

The income approach is a commonly accepted methodology for determining market value of public utility properties, and Mr. Tegarden testified that it is considered the most relevant method for these types of properties. Supp. 570 (H.T. II at 472, ln. 8-17). The income approach is based on the principle of anticipation. Supp. 569 (H.T. II at 468, ln. 10-11). The appraiser anticipates a future net benefit (usually a future net income), determines the risk level of obtaining that future net income, than performs a capitalization or conversion process to convert that income into present value. Supp. 569 (H.T. II at 468, ln. 11-16); 927. Drawing upon his appraisal expertise and his detailed knowledge of the telecommunications industry, Mr. Tegarden determined that a reasonable estimate of net operating income for Ohio Bell was \$305,000,000 and that a reasonable and appropriate discount rate was 12.35 percent, which results in an income indicator of total value of \$2,470,000,000. Supp. 931-38, 577-79 (H.T. II at 501-08).

Although the Tax Commissioner generally objects in his Merits Brief to the Board's failure to consider Mr. Eyre's criticisms of Mr. Tegarden's income approach (see T.C. Brief at 45-46), the Board was free to determine that Mr. Eyre's testimony was not credible. As one example (others were discussed in briefing below), Mr. Eyre, who made clear that he was testifying as a consultant to the Tax Commissioner and not as an independent appraiser offering an opinion as to value, simply suggested that Mr. Tegarden's estimate of net operating income was "low." Supp. 671 (H.T. IV at 16, ln. 3-5), 679 (H.T. IV at 45, ln. 17), 703 (H.T. IV at 141 ln. 24 to 142, ln. 8). Mr. Eyre devoted "five or six days" in early September, 2006, to developing criticisms of Mr. Tegarden's appraisal at the Tax Commissioner's request, and he offered no opinion as to what an appropriate estimate of net operating income would be. Supp. 671 (H.T.

IV at 16, ln. 3-5), 695 (H.T. IV at 110, ln. 7-19). Instead, he speculated that Mr. Tegarden may not have performed an analysis of certain expense items on Ohio Bell's income statements for year 2001 and 2002, and that this may have resulted in Mr. Tegarden giving too much weight to the 2002 net operating income. Supp. 675-76 (H.T. IV at 29-35). Yet Mr. Eyre was not familiar with how Ohio Bell books expenses to its general ledger, and he had no understanding of the procedures and controls in place between SBC and Ohio Bell with regard to allocation of expenses. Supp. 702 (H.T. IV at 139, ln. 14-25). Mr. Eyre had no idea what Mr. Tegarden actually did, and his criticism of Ohio Bell's income statements was made without the benefit of an SBC employee's testimony regarding Ohio Bell's income statements. Supp. 702 (H.T. IV at 138, ln. 23 to 139, ln. 10). Thus, the Board was well within its discretion in rejecting Mr. Eyre's testimony and accepting Mr. Tegarden's appraisal opinion as credible and probative of value.

7. Mr. Tegarden Acted Reasonably In Deducting Tax-Exempt Items From The Unit Value Using A Widely-Accepted Methodology.

In his Eighth Proposition of Law, the Tax Commissioner questions Mr. Tegarden's appraisal of the unit value of Ohio Bell's public utility property because this unit value must be allocated between exempt and taxable properties. The Tax Commissioner must give this argument little weight because he failed to include it in his brief to the Board below. Regardless, the argument ignores that this allocation is based on the actual net book value of exempt items and is not an estimate, as suggested by the Tax Commissioner. *See* T.C. Brief at 46.

Mr. Tegarden appraised the operating properties of Ohio Bell using the "unit appraisal" concept. Supp. 899-900, 915, 568 (H.T. II at 463 ln. 2-21). A unit appraisal values an integrated property as a whole, with reference to the value of its components parts. Supp. 915. Approximately thirty-five states value telecommunications company property using the unit appraisal approach for ad valorem property tax purposes. Supp. 568 (H.T. II at 464, ln. 1-3). It

makes sense to value these properties as a unit, as Mr. Tegarden explained, because they are operated as a unit, managed as a unit, depreciated on the unitary basis, regulated as a unit, and report their financial operations as a unit. Supp. 568 (H.T. II at 464, ln. 4-10). Mr. Eyre, when asked to appraise public utility property, also performs unit appraisals. Supp. 671 (H.T. IV at 13, ln. 1-3).

Once the value of the operating entity as a whole is determined, the value of tax-exempt property must be deducted using a market-to-book ratio to determine the value of taxable public utility property. Supp. 619 (H.T. III at 25-28). The net book value of exempt items is deducted using the same basis as the unit appraisal. Supp. 619 (H.T. III at 26, ln. 11-18). Thus, if the appraisal is performed using FR data, the net book value of exempt items must also be determined on an FR basis. *Id.*; see also Supp. 444-45 (H.T. I at 56-57). The market-to-book ratio used by Mr. Tegarden adjusted the value of the total non-taxable items downward in order to have exempt items be on the same basis as the unit appraisal value.⁹ Supp. 894, 619 (H.T. III, at 27, ln. 23 through 28, ln. 2). Mr. Tegarden testified that this methodology is both common and reasonable. Supp. 619 (H.T. III at 28, ln. 8-22). Mr. Eyre also testified that this methodology is “very common” and unobjectionable. Supp. 672 (H.T. IV at 17, ln. 8-13). The Board did not err in accepting a methodology endorsed by all witnesses.

The Tax Commissioner also challenges the inclusion of the net book value on an FR basis of Ohio Bell’s “spare pairs” as an item to be removed from the appraised unit value. T.C. Brief at 46-48. The Commissioner’s challenge erroneously assumes that Mr. Tegarden’s unit

⁹ The adjustment here resulted in a reduction from the MR value of tax-exempt items of some \$23 million, thereby resulting in a corresponding increase in the value of the taxable public utility property.

value is wholly dependent upon income-generating assets only and, thus, must not include the value of dead and bad pairs. However, the evidence before the Board was to the contrary.

Mr. Tegarden appraised all of the operating properties (tangible and intangible) of Ohio Bell, including the spare pairs, and determined the *unit* value of these operating properties to be \$2,475,000,000 as of the applicable tax date. As explained in detail in Mr. Tegarden's report, this unit value was derived by reconciling a cost approach and an income approach to reach a final value estimate. Supp. 966-67. There is no indication that this unit value excluded the value of the wire and fiber in Ohio Bell's network that is not in use as of the tax date, either because it is reserved for future use and not currently connected to the network ("dead pairs") or because it has become damaged or worn out ("bad pairs"). See *United Tel. Co. of Ohio v. Tracy* (1999), 84 Ohio St. 3d 506 (defining "dead" and "bad" pairs). Indeed, because these assets are carried on Ohio Bell's books, they are included in the telecommunications plant-in-service used in the cost approach. See Supp. 59 (H.T. I at 59, lns. 2-7), 466 (H.T. I at 142-43), 785-87, 804-05 (showing FR accounts containing pairs and total net plant of \$8,154,858,282.29); Supp. 820-23 (tracking accounts from MR and FR balance sheets to show break-out of pairs, ROW and drawings by asset category and vintage). As the Board noted in its decision, the Commissioner's consultant agreed that it was proper to remove the value of these exempt items from a valuation using a cost approach if they were included in the plant-in-service account. Appx. 26, Supp. 701-02 (H.T. IV at 136-37).

The Commissioner's sole objection to Mr. Tegarden's adjustment for exempt items lacks an evidentiary basis and was properly rejected by the Board.

IV. CONCLUSION

The only competent and probative evidence of the true value of Ohio Bell's property was that offered by Mr. Tegarden, a recognized expert in the appraisal of public utility property.

Thus, the Board acted reasonably and lawfully in relying upon this evidence and finding that the true value of Ohio Bell's taxable public utility property for the 2003 tax year is \$1,702,157,675. As a result, this Court, which is not a trier of fact *de novo* in appeals taken from the Board, should reject the Tax Commissioner's arguments and find in favor of Ohio Bell.

Respectfully submitted,

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CERTIFICATE OF SERVICE

The foregoing Brief of Appellee has been served via first class U.S. mail, postage prepaid, upon Barton A. Hubbard, Assistant Attorney General, 30 East Broad Street, 25th Floor, Columbus, Ohio 43215-3428, attorney for Appellee, on this 30th day of July, 2008.

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