

1 THE POWER OF TEN

2 Early in my career I wondered what it would be like to undertake a really large and
3 important project. At a conference dinner I once found myself seated with an appraiser who just
4 completed appraising the Panama Canal. I sat in awe of the accomplishment.

5 There was another more experienced machinery and equipment appraiser in Miami. He
6 occasionally hired me to assist him when there was more legwork than he wanted to do. At a
7 luncheon of the American Society of Appraisers shortly after he returned from Seattle, he came
8 to regale me with tales of how — with the assistance of his wife — they just finished appraising
9 Boeing's main manufacturing plant.

10 It was a complete mystery to me how they could have done it. On jobs I did with them,
11 they were usually more than half in the bag, literally high functioning drunks. I didn't have much
12 of a clue about the really big jobs, and no one was sharing their secrets.

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14 My introduction would be unexpected and under fire. Arriving at the room where my
15 hearings as a special master were usually held in the morning was always filled with expectation.
16 What type of businesses were going to be represented, and who the individual taxpayers were,
17 was kept a mystery until I was seated. This morning that expectation was heightened when I saw
18 a crowd milling around the entrance to my room. I got to the door and peered in to make sure I
19 hadn't gotten off the elevator on the wrong floor. It was standing room only. Television cameras
20 lined the wall. Sure that I had made a mistake, I started to turn back when I saw my regular court
21 reporter waving to get my attention. After taking my seat at the head table I could make out the
22 County Property Appraiser, an elected official, the head of the personal property division, the

23 county attorney and the attorney for the Property Appraisal Adjustment Board. Where there were
24 usually two seats for the appellant and his lawyer there were now two rows of seats occupied,
25 and the court reporter gave the thumbs up while pointing to her wrist to vouch for the
26 authenticity of their Rolexes. This wasn't going to be an ordinary day. Bewildered, I looked to
27 the court reporter, "What's going on?"

28 "You have one case, AT&T. For some reason they are making a big deal of it."

29 I got up and walked over to Steve, the PAAB attorney, and asked him the same question.

30 With a studied nonchalance — decried by his best suit — he said, "Don't sweat it. Since
31 the break-up, AT&T has been pleading loss of value to its assets. No one expects it to be
32 resolved here. You're only a stepping stone on the way up to the U.S. Supreme Court. Every
33 taxing jurisdiction, and AT&T, wants to know what the arguments are going to be. When it's
34 finally resolved the precedent will likely stick for a long time. This is their first appeal, and just a
35 formality. Enjoy your fifteen minutes of fame."

36 * * *

37 In 1982 AT&T was the largest company in the world. It had a virtual monopoly on
38 telecommunication, both service and equipment. Its assets included not only most telephones in
39 existence, but phone books, land lines, undersea cables and satellites. A long distance call within
40 the USA could easily cost a 1982 dollar a minute. As the result of an antitrust lawsuit AT&T
41 was being broken up, and losing control over the local Bell Telephone companies. That breakup
42 was called the *divestiture*.

43 Large national companies were not taxed like ordinary businesses. How would you
44 apportion things in motion, underseas cables and satellites? It was relatively easy to determine

45 the income generated in any taxing jurisdiction, and the value of the company's assets was taken
46 to be in proportion to the income. My job that day would be to adjudicate the value of all of
47 AT&T tangible assets. With no hyperbole — the conclusion would be the largest appraised
48 value in the world, ever — hundreds, if not thousands of times the value of Boeing or the
49 Panama Canal.

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51 The property appraiser representative — with his boss, his boss's boss, and his boss's
52 boss's boss looking on — presented their case. It was the same as it would have been for my
53 antique shop. They used the cost approach. In the cost approach historical cost was taken from
54 the company's federal income tax returns. A correction for inflation was made, and depreciated
55 value was calculated using standardized factors taken from tables. Those factors took into
56 account the useful life of the property and its age. The only step in the process requiring human
57 input was to select a useful life for the property in question. The useful life of telephone
58 company equipment was traditionally taken to be ten years. It was based on a study of equipment
59 retirements made at the beginning of the twentieth century, and was a convenient round number.
60 The assessment was a simple calculation left to computers. The hardest part of doing it manually
61 was keeping track of all the zeros.

62 When AT&T's turn came, their approach was just as simple as the property appraiser's.
63 AT&T was using the income approach. In the income approach you divide the income generated
64 by an asset by a capitalization rate. The capitalization rate is simply the ratio of income to asset
65 value — and is a function of interest rates, risk and depreciation. Like with the cost approach
66 and useful life, the capitalization rate — again by tradition and without serious inquiry — was a

67 round number, in those years ten percent. When applied to the projected income, it yielded an
68 amount about half that of the property appraiser's valuation. It was a complete mystery to me
69 why they needed two rows of suits posing as authorities to convey that information.

70 Typically, all there was to resolving similar disputes was to decide which approach was
71 the most valid, and let the winner take all — or failing to see the merits of one over the other —
72 split the baby. I had some experience with fiddling around the depreciation tables trying to make
73 sense of how they were being applied to computers. Computers had just come into their own and
74 the prices were plummeting. The computer program that the property appraiser was using could
75 not handle negative inflation, and the results it yielded had been the subject of numerous appeals.
76 The Property Appraiser's solution was to avoid considering negative inflation, and to make up
77 for it by adjusting the useful life of computer assets to as little as two years. It was a "rubber
78 glove for a leaky pen" kind of solution, but the best that they could do without modifying the
79 computer program used at the time. I made a study of how sensitive the depreciation factors
80 were to changes in useful life to be prepared for cases I had to hear. Small changes in useful life
81 could make enormous changes in depreciation factors.

82 At the same time interest rates in the US were falling from their 1981 all time high.
83 Interest rates were an erstwhile consideration in calculating capitalization rates, and a change of
84 one percentage point could change the value of the asset by ten percent.

85 It occurred to me that the fact that both sides were basing their approaches on arbitrary
86 premises — comically obvious by the common values of ten — could be used to drive a
87 compromise in hopes of their avoiding embarrassment. I called for two blackboards and chalk to
88 be brought in. After a lecture on the sensitivity of valuations to changes in capitalization rates

89 and useful lives, I took some time to remind the property appraiser that telecommunications were
90 increasingly dependant on computer technology since the time of Alexander Graham Bell. I
91 similarly reminded AT&T that interest rates were plummeting after their 1981 peak. I sent them
92 to the boards to chip away at their now arbitrary looking ten years and ten percent. After a
93 couple of iterations of seemingly inconsequential changes, I suggested there was not enough
94 difference in their values to argue about. Neither the property appraiser nor AT&T wanted to
95 spend a lot of time talking on the record about how ill considered their valuation approaches
96 were. A junk man putting a price on a piece of carnival glass would have used more critical
97 thought than these empty suits valuing the assets of the largest company in the history of the
98 world.

99 "Do you want to see how I feel about your valuation approaches in my opinion?"

100 The case was settled in little more than an hour, and what might have turned into a whole
101 new legal industry was avoided.

102 * * *

103 I had the rest of the day off to glow in my fifteen minutes of fame, buy myself a fancy
104 lunch, and poke around downtown Miami — alone. Big jobs were no longer a mystery. Just like
105 painting: small job, small brush; big job, big brush. I would always be cautious of using round
106 numbers in appraisals.