

1 **CALIFORNIA STATE BOARD OF EQUALIZATION**

2 **SUMMARY DECISION UNDER REVENUE AND TAXATION CODE SECTION 40**

3  
4 In the Matter of the Petition for )  
Reassessment of the 2016 Unitary Value for: )

5 )  
6 **LA PALOMA GENERATING** )  
7 **COMPANY, LLC (1112)** )

8 Petitioner )

Appeal No.: SAU 16-012

Case ID No.: 961716

9 Oral Hearing date:  
December 14, 2016<sup>1</sup>

10  
11 Representing the Parties:

12 For the Petitioner:

C. Stephen Davis, Attorney at Law  
Antreas E. Ghazarossian, Representative

13  
14 For the Respondent:

Richard Moon, Tax Counsel IV  
Attorney for State-Assessed Properties Division

Sonya Yim, Tax Counsel III (Specialist)  
Attorney for State-Assessed Properties Division

17  
18 Richard D. Reisinger, Chief  
State-Assessed Properties Division

19  
20 Counsel for Appeals Division:

Dana R. Brown, Tax Counsel III (Supervisor)

21 VALUES AT ISSUE

	<u>Value</u>	<u>Penalty</u>	<u>Total</u>
22 2016 Board-Adopted Unitary Value	\$168,800,000	\$0	\$168,800,000
23 Petitioner's Requested Unitary Value	\$73,347,569	\$0	\$73,347,569
24 Respondent's Appeal Recommendation	\$168,800,000	\$0	\$168,800,000
25 Respondent's Revised Recommendation	\$136,100,000	\$0	\$136,100,000

26  
27  
28 <sup>1</sup> At the oral hearing, by majority vote of the members, the Board granted the petition for reassessment, in part, and reduced the 2016 Board-adopted unitary value of \$168,800,000 to \$136,100,000. Chairwoman Ma, Member Horton, and Controller Yee voted to grant the petition for reassessment, in part, and reduce the 2016 Board-adopted unitary value of \$168,800,000 to \$136,100,000, Member Runner and Member Harkey voting no.

1 FACTUAL BACKGROUND

2 La Paloma Generating Company LLC (petitioner) was formed in 1998, and is based in Houston,  
3 Texas. Petitioner is a wholly-owned subsidiary of La Paloma Acquisition Company, LLC. Petitioner  
4 owns and operates a 1,048-megawatt (MW) combined-cycle, natural gas-fired power generation facility  
5 near McKittrick in Kern County, California that has been operating since March 2003. Petitioner’s  
6 facility has four equal-sized ABB GT24-B combustion generation units, coupled with Alstom KA24-1  
7 combined-cycle power units and natural gas and electric transmission facilities. The 2016 Board-  
8 adopted unitary value of \$168,800,000 for petitioner’s facility is based on 60-percent reliance on the  
9 Replacement Cost Less Depreciation (ReplCLD) value indicator and 40-percent reliance on the  
10 Capitalized Earnings Approach (CEA) value indicator (income approach).

11 LEGAL ISSUE 1

12 Whether petitioner has shown that the ReplCLD value indicator fails to account for all obsolescence in  
13 the determination of petitioner’s 2016 Board-adopted unitary value.

14 FINDINGS OF FACT AND RELATED CONTENTIONS

15 Petitioner contends that its 2016 Board-adopted unitary value should be adjusted for additional  
16 obsolescence because low energy prices and a lack of demand for its power generation for a number of  
17 years which have resulted in a lower than expected return on its investment. Petitioner also asserts that  
18 the 2016 Board-adopted unitary value is based primarily on a cost approach valuation methodology that  
19 does not take into consideration the full extent of obsolescence impacting petitioner’s facility.  
20 Petitioner maintains that the cost approach should either be disregarded or adjusted to the CEA value  
21 indicator to account for all obsolescence as required by Revenue and Taxation Code section 51,  
22 subdivision (a)(2) and Property Tax Rule 6.

23 Petitioner argues that a “material differential between the income and cost indicators is strong  
24 evidence of economic obsolescence requiring that the income shortfall method of quantifying economic  
25 obsolescence be utilized.” Petitioner cites *SBE Guidelines for Substantiating Additional Obsolescence*  
26 *for Personal Properties and Fixtures* (2010) LTA No. 2010/030, p.19 for its assertion that “[t]he  
27 relationship between replacement cost new and the cash flows the hypothetical replacement is capable  
28 of generating – compare the replacement cost new to the income indicator of value for the same

1 property the difference is economic obsolescence.” Petitioner concludes that respondent should place  
2 100-percent reliance on the CEA value indicator because the ReplCLD value indicator does not fully  
3 account for all obsolescence impacting petitioner’s property.

4 Respondent asserts that the ReplCLD value indicator sufficiently accounts for obsolescence in  
5 petitioner’s 2016 unitary valuation and that petitioner fails to identify or quantify the claimed additional  
6 obsolescence. Respondent argues that petitioner’s position that the 2016 Board-adopted unitary value  
7 should be adjusted to the CEA value indicator is not an acceptable methodology for determining  
8 obsolescence in the cost approach. Respondent notes that the ReplCLD value indicator of \$232,371,071  
9 for lien date 2016 reflects total adjustments of \$697,456,294 (or 77-percent) of the Replacement Cost  
10 New value of petitioner’s facility and that the 2016 Board-adopted value is only 40-percent of  
11 petitioner’s net book value. Respondent asserts that the obsolescence adjustments for petitioner’s  
12 property are sufficient, and petitioner has not shown that any further adjustments are warranted.

13 In its reply brief, petitioner argues that market conditions for gas-fired power generation  
14 facilities without power sales agreements, such as its facility, must “sell into the market” which has  
15 “catastrophic” economic consequences and that companies are not building such facilities due to  
16 adverse market conditions. Petitioner notes that it has filed a complaint with FERC seeking to compel  
17 CalISO to modify the tariff terms under which petitioner must operate.

18 In its reply brief, respondent asserts that its ReplCLD value indicator sufficiently accounts for  
19 obsolescence and that petitioner fails to identify or quantify the claimed additional obsolescence.  
20 Respondent argues that the fact that no similar facilities are being built does not preclude respondent’s  
21 use of the ReplCLD value indicator. Respondent notes that the ReplCLD value indicator is reliable here  
22 because in “nearly all cases” of the sales of electric generation facilities it has recently reviewed, the  
23 sales price was greater than the ReplCLD value indicator for the lien date preceding the sale date.

24 After an appeals conference, petitioner provided the following documents: profit and loss  
25 (P&L) statements for the first and second quarters of 2016, California Independent System Operator  
26 (CalISO) and merchant generator filings in a proceeding before the Federal Energy Regulatory  
27 Commission (FERC), and its updated cash flow analysis. Respondent reviewed the additional  
28 information and, based on the information related to the prevailing market conditions in California,

1 respondent calculated two adjustments to the ReplCLD value indicator totaling \$54,431,710, to reflect  
2 petitioner's anticipated reduced generation levels and the reduced spark spreads experienced by  
3 petitioner. After weighting of the value indicators, respondent recommends a \$32,700,000 adjustment  
4 for additional economic obsolescence resulting in a 2016 Board-adopted unitary value of \$136,100,000  
5 for petitioner's property.

## 6 APPLICABLE LAW

### 7 Burden of Proof

8 Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.)  
9 The Board has promulgated the Rules for Tax Appeals (RTA) to govern the administrative and  
10 appellate review processes for all of the tax and fee programs administered by the Board. (Cal. Code  
11 Regs., tit. 18, § 5000.) Of relevance here, RTA 5541, subdivision (a), places the burden of proof upon  
12 the taxpayer as to all issues of fact except as otherwise specifically provided by law. Courts have long  
13 presumed that the Board assesses all property correctly, placing on the taxpayer the burden of proving  
14 that an assessment is incorrect. (*Trailer Train Co. v. State Bd. of Equalization* (1986) 180 Cal.App.3d  
15 565, 584.) Therefore, petitioner bears the burden of showing that the assessment is illegal.  
16 (*ITT World Communications v. Santa Clara County* (1980) 101 Cal.App.3d 246.)

### 17 Depreciation and the Replacement Cost Approach

18 In general, the ReplCLD value indicator recognizes three types of depreciation: physical  
19 deterioration, functional obsolescence, and external or economic obsolescence, through application of  
20 the Board's replacement cost new trend factors and "percent" good factors. Obsolescence may occur  
21 when property is outmoded (functional obsolescence) or when some event has substantially diminished  
22 the future earning power of the property (economic obsolescence). (*See Assessors' Handbook* section  
23 501, *Basic Appraisal* (January 2002), pp. 81-83.) Functional obsolescence is the loss of value in a  
24 property caused by the property's loss of capacity to perform the function for which it was intended.  
25 (*Id.* at p. 81.) Economic obsolescence is the diminished utility of a property due to adverse factors  
26 external to the property being appraised and is incurable by the property owner. (*Id.* at p. 82.)

27 The percent good factors, the basis for adjusting the RCN into an indicator of fair market value,  
28 are used to determine the remaining value of a property and are complements of physical deterioration

1 and functional obsolescence. The factors used for a given property type are based on the expected  
2 economic life of that property type which is based on a service life study that surveys industry  
3 participants who own that type of property. (*Unitary Valuation Methods* (March 2003) (UVM), p. 30.)

4 In addition to economic life, there are four other variables that have an effect on percent good  
5 factors. These variables are: the rate of return, the method of calculation, the survivor curve, and the  
6 presence of an income adjustment factor. In the State-Assessed Properties Division these variables are  
7 determined as follows: rate of return annually established by Property Tax Department, single-life  
8 calculation method, R3 survivor curve and the use of an income adjustment factor reflecting a  
9 10-percent decline over average life. Petitioner has the burden of establishing the existence of any  
10 additional or extraordinary obsolescence. (*See* Property Tax Rule 6, subs. (d) & (e); Cal. Bd. of  
11 Equalization, Assessors' Handbook § 502, *Advanced Appraisal* (December 1998) (AH 502), p. 20-21;  
12 UVM, p. 30.)

### 13 ANALYSIS AND DISPOSITION

14 Respondent is presumed to have correctly determined the value of the property at issue, and  
15 petitioner bears the burden of proving otherwise. Here, respondent calculated a total of \$265,071,071  
16 (\$232,371,071 + \$32,700,000) in adjustments to the ReplCLD value indicator for petitioner's property.  
17 We do not find petitioner's argument that it has been experiencing low energy prices and lower-than-  
18 anticipated electricity demand sufficient to warrant respondent not placing any reliance on the  
19 ReplCLD value indicator. Additionally, we find that petitioner has failed to identify and quantify any  
20 additional obsolescence which it asserts respondent has not recognized in accordance with Rule 8.  
21 Accordingly, we find that petitioner has not presented sufficient evidence to meet its burden of proof to  
22 show that any further adjustments for additional obsolescence are warranted.

### 23 LEGAL ISSUE 2

24 Whether petitioner has shown that respondent failed to place proper reliance on the value indicators in the  
25 determination of petitioner's 2016 Board-adopted unitary value.

### 26 FINDINGS OF FACT AND RELATED CONTENTIONS

27 Petitioner contends that 60-percent reliance on the ReplCLD value indicator does not fully  
28 account for all of the obsolescence and that 100-percent reliance should be placed on the CEA value

1 indicator. Petitioner asserts that a two-year or three-year “weighted average” of its actual income  
2 should be used to develop petitioner’s capitalized income because using its “actual performance” would  
3 make the CEA value indicator more reliable. Petitioner states that its forecasts are based on the “best  
4 available information” at the time, but can be subject to change several months later due to changes in  
5 various factors including weather and market conditions. Petitioner contends that this volatility is not a  
6 reason for respondent to deem its forecasts to be unreliable because no market participant can  
7 accurately predict the future with “the degree of precision [respondent] seems to require.”

8         Additionally, with respect to respondent’s assertion that certain electric generation plants have  
9 recently sold at prices higher than petitioner’s unitary value, petitioner contends that no two sales  
10 transactions of power generation facilities are alike and, therefore, sales of power generation facilities  
11 must be closely examined when valuing petitioner’s property. Petitioner states that its facility is unique  
12 in the manner in which it gets power to the grid, in the cost it pays to place its power on the grid, and in  
13 the amount of power that is demanded to be put on the grid by CalISO. Petitioner asserts that its  
14 property has suffered obsolescence to such a degree that the RepICLD value approach is unreliable and  
15 cites, as an example, the fact that its facility suffers from a material amount of physical depreciation  
16 because its power generators are approximately halfway through their lives. Petitioner also asserts that  
17 the facility is uniquely located in relation to the power grid, and that there is a lower demand for  
18 electricity. For those reasons, petitioner contends that respondent should place 100-percent reliance on  
19 the CEA value indicator in determining petitioner’s 2016 unitary valuation.

20         Respondent contends that 60-percent reliance on the RepICLD value indicator and 40-percent  
21 reliance on the CEA value indicator is appropriate for valuing petitioner’s facility. Respondent asserts  
22 that 100-percent reliance on the CEA value indicator is not appropriate because petitioner’s income  
23 projections for lien date 2016 are unreliable and suggest that petitioner’s assets are impaired when  
24 petitioner’s audited financial statements do not reflect impairment and petitioner has not provided the  
25 projected cash flows that its independent auditor would have used in testing its assets for impairment.  
26 Respondent states that it calculated the CEA value indicator based on petitioner’s actual 2015 appraisal  
27 income projected for the remaining economic life of the facility. Respondent asserts that the RepICLD  
28 value indicator is more reliable because it reflects current replacement cost of the latest technology,

1 with adjustments for depreciation and obsolescence. Respondent argues that petitioner’s inability to  
2 make short-term operating income projections with any degree of accuracy precludes respondent from  
3 placing greater reliance on the CEA value indicator.

4 Respondent contends that petitioner’s value is comparable to the Board-adopted values for  
5 similarly-situated companies on a per-MW basis. Respondent contends that petitioner has not provided  
6 sufficient evidence showing that the CEA value indicator is more reliable than the ReplCLD value  
7 indicator here, thus warranting any change in reliance on the value indicators.

8 In its reply, petitioner argues that respondent has weighted a valid value indicator for its facility  
9 with an invalid, incomplete indicator which is not an accepted appraisal practice. Petitioner contends  
10 that “maintaining the separateness or independence of action value methods is a general principle,  
11 which in turn must conform to accepted appraisal practice to test the economic feasibility of the cost  
12 indicator.” Lastly, petitioner argues that, contrary to respondent’s position, “testing the validity  
13 (economic feasibility) of the cost indicator by means of the income approach, and measuring the degree  
14 of obsolescence by means of the income shortfall, i.e., the extent to which the return on the RCNLD  
15 indicator is insufficient to render that cost value indicator to be feasible, is well established.”

16 In respondent’s reply, respondent renews its contention that its weighting of the value indicators  
17 is appropriate here. Respondent asserts that the cash flow statement petitioner provided on Schedule H  
18 of its property statement filing for lien date 2016 was unreliable because it implied petitioner’s assets  
19 should be impaired. Respondent again asserts that petitioner was requested, but failed, to submit the  
20 cash flow projections used by petitioner’s independent auditors in determining whether an impairment  
21 of assets should be recognized. Accordingly, respondent argues that petitioner’s inability to make short-  
22 term projections with any degree of accuracy does not support petitioner’s contention that respondent  
23 should place any greater reliance on the CEA value indicator.

#### 24 APPLICABLE LAW AND APPRAISAL PRINCIPLES

##### 25 Burden of Proof

26 Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.)  
27 The Board has promulgated the Rules for Tax Appeals (RTA) to govern the administrative and  
28 appellate review processes for all of the tax and fee programs administered by the Board. (Cal. Code

1 Regs., tit. 18, § 5000.) Of relevance here, RTA 5541, subdivision (a), places the burden of proof upon  
2 the taxpayer as to all issues of fact except as otherwise specifically provided by law. Courts have long  
3 presumed that the Board assesses all property correctly, placing on the taxpayer the burden of proving  
4 that an assessment is incorrect. (*Trailer Train Co. v. State Bd. of Equalization* (1986) 180 Cal.App.3d  
5 565, 584.) Therefore, petitioner bears the burden of showing that the assessment is illegal.  
6 (*ITT World Communications v. Santa Clara County* (1980) 101 Cal.App.3d 246.)

#### 7 Value Standard

8 Property Tax Rule 2, subdivision (a) states that “in addition to the meaning ascribed to them in  
9 the Revenue and Taxation Code, the words ‘full value,’ ‘full cash value,’ ‘cash value,’ ‘actual value,’  
10 and ‘fair market value’ mean the price at which a property, if exposed for sale in the open market with a  
11 reasonable time for the seller to find a purchaser, would transfer for cash or its equivalent under  
12 prevailing market conditions between parties who have knowledge of the uses to which the property  
13 may be put, both seeking to maximize their gains and neither being a position to take advantage of the  
14 exigencies of the other.”

#### 15 Reconciliation of Value Indicators

16 Property Tax Rule 3 requires that, in estimating value, the assessor shall consider one or more  
17 of the approaches to value “as may be appropriate for the property being appraised,” which includes the  
18 comparative sales approach, the replacement or reproduction cost approach (e.g., ReplCLD valuation  
19 methodology), or the income approach. The appropriateness of an approach is often related to the type  
20 of property being appraised and the available data. (AH 502, p. 109.) In addition, the validity of a  
21 value indicator will depend upon the accuracy of data and adjustments made to the approach. That is,  
22 the accuracy of a value indicator depends on the amount of available comparable data, the number and  
23 type of adjustments, and the dollar amount of adjustments. Finally, if a large amount of comparable  
24 data is available for a given approach, the appraiser may have more confidence in that approach. For  
25 example, if income, expense, and capitalization rate data can be obtained from many properties  
26 comparable to the subject, the appraiser may attribute significant accuracy to the income approach. The  
27 greatest reliance should be placed on that approach or combination of approaches that best measures the  
28 type of benefits the subject property yields. The final value estimate reflects the relative weight that the



1 appraiser assigned, either implicitly or explicitly, to each approach. (AH 502, p. 112.)

2 ReplCLD Value Indicator

3 Property Tax Rule 6,<sup>2</sup> subdivision (a) provides, in pertinent part, that: “The reproduction or  
4 replacement cost approach to value . . . is preferred when neither reliable sales data . . . nor reliable  
5 income data are available . . .” In general, the ReplCLD valuation methodology is estimated by  
6 applying the appropriate trend factors, including the application of “current prices to the labor and  
7 material components of a substitute property capable of yielding the same services and amenities, with  
8 appropriate additions . . .” (Property Tax Rule 6, subd. (d).) The resulting adjusted cost amount is  
9 “reduced by the amount that such cost is estimated to exceed the current value of the reproducible  
10 property by reason of physical deterioration, misplacement, over- or underimprovement, and other  
11 forms of depreciation or obsolescence. The percentage that the remainder represents of the  
12 reproduction or replacement cost is the property’s percent good.” (Property Tax Rule 6, subd. (e).)

13 Income Approach to Value

14 Property Tax Rule 8, subdivision (a) states that “the income approach is used in conjunction  
15 with other approaches when the property under appraisal is typically purchased in anticipation of a  
16 money income and either has an established income stream or can be attributed a real or hypothetical  
17 income stream by comparison with other properties.” Subdivision (b) describes the income approach to  
18 value as the valuation method whereby, “an appraiser values an income property by computing the  
19 present worth of a future income stream. This present worth depends upon the size, shape, and duration  
20 of the estimated stream and upon the capitalization rate at which future income is discounted to its  
21 present worth.” Subdivision (c) provides that “the amount to be capitalized is the net return which a  
22 reasonably well-informed owner and reasonably well-informed buyers may anticipate on the valuation  
23 date that the taxable property existing on that date will yield under prudent management and subject to  
24 legally enforceable restrictions as such persons may foresee as of that date.”

25 ANALYSIS AND DISPOSITION

26 Respondent is presumed to have determined correctly the value of the property at issue, and  
27 \_\_\_\_\_

28 <sup>2</sup> All references to Property Tax Rules are to sections of title 18 of the California Code of Regulations.

1 petitioner bears the burden of proving error. Here, petitioner argues that respondent should place  
2 100 percent reliance on the CEA value indicator and that its revenue and expenses forecasts are based  
3 on the best information available. While petitioner acknowledges that its forecasts can be subject to  
4 volatility due to various conditions such as weather and market conditions, it argues that this volatility  
5 is not a reason for respondent to deem its forecasts as unreliable because no market participant can  
6 accurately predict the future with “the degree of precision [respondent] seems to require.”

7       Property Tax Rule 8 provides that reliance on the income approach is appropriate when the  
8 property has an “established income stream or can be attributed a real or hypothetical income stream by  
9 comparison with other properties.” In the view of the Appeals Division, the factors and circumstances  
10 that affect electricity prices as described by petitioner and the volatility of petitioner’s income forecasts  
11 necessarily indicate a high degree of unpredictability in the level of future income. Therefore, we find  
12 that petitioner has not shown evidence of an established income stream for its facility. In addition,  
13 petitioner has not presented specific evidence to show that its property may be attributed a real or  
14 hypothetical income stream by comparison with other properties. We, therefore, find that petitioner has  
15 not presented sufficient evidence showing that respondent failed to place proper reliance on the value  
16 indicators in the determination of petitioner’s 2016 Board-adopted unitary value.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

DECISION

Accordingly, the petition for reassessment is granted, in part, reducing the 2016 Board-adopted unitary value from \$168,800,000 to \$136,100,000.\*

Fiona Ma \_\_\_\_\_, Chairwoman

George Runner \_\_\_\_\_, Member

Diane L. Harkey \_\_\_\_\_, Member

\* The decision was rendered in Sacramento, California on December 14, 2016. This summary decision document was approved on February 22, 2017, in Culver City, California.