

**CALIFORNIA STATE BOARD OF EQUALIZATION**

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

In the Matter of the Petition for  
Reassessment of the 2020 Unitary Value for: )

**SOUTHERN CALIFORNIA EDISON  
COMPANY (0148)** )

Petitioner )

Appeal No.: SAU 20-015  
Case ID No.: 1064117

Oral Hearing Date:  
December 16, 2020<sup>1</sup>

Representing the Parties:

For the Petitioner:

Mardiros H. Dakessian, Attorney  
Dakessian Law, LTD.

For the Respondent:

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

Jack McCool, Chief  
State-Assessed Properties Division

Appeals Attorney:

Sarah J. Garrett, Tax Counsel III (Specialist)

**VALUES AT ISSUE**

	<b>Value</b>	<b>Penalty</b>	<b>Total</b>
2020 Board-Adopted Unitary Value	\$29,802,900,000	\$0	\$29,802,900,000
Petitioner's Requested Unitary Value	\$24,410,636,422	\$0	\$24,410,636,422
Petitioner's Revised Requested Unitary Value	\$22,900,000,000	\$0	\$22,900,000,000
Respondent's Appeal Recommendation	\$29,802,900,000	\$0	\$29,802,900,000
Respondent's Revised Appeal Recommendation	\$28,485,345,150	\$0	\$28,485,345,150

<sup>1</sup> At the oral hearing, the Board granted the petition for reassessment, in part, and reduced the 2020 Board-adopted unitary value from \$29,802,900,000 to \$28,485,345,150 by a majority vote of the Members, with Chairman Vazquez, Vice Chair Schaefer, and Controller Yee voting aye, and Member Gaines voting no.

## **Factual Background**

Southern California Edison Company (SCE or Petitioner), a wholly owned subsidiary of Edison International, is a public utility subject to rate regulation by the California Public Utilities Commission (Commission or CPUC). SCE is primarily engaged in the business of supplying electric energy in central, coastal, and southern California, excluding the City of Los Angeles and certain other cities.

The CPUC establishes rates for utilities under its jurisdiction in a rate-setting procedure called the General Rate Case (GRC).<sup>2</sup> In establishing rates for utilities, the CPUC considers the utilities' rate base. Rate base is the value of property on which a public utility is permitted by the Commission to earn a specified rate of return. In general, the rate base consists of the cost of property as used by the utility in providing service.

Petitioner's 2020 Board-adopted value is based on 75 percent reliance on the Historical Cost Less Book Depreciation (HCLD)<sup>3</sup> value indicator (\$31,980,069,007) and 25 percent reliance on the Capitalized Earning Ability<sup>4</sup> (CEA) value indicator (\$23,271,463,581). The CEA value indicator calculation is based on a perpetual life premise, where the capital investment necessary to maintain a perpetual income flow is deducted from expected revenues, reflecting the annual capital replacement allowance.

## **General Contentions and Background Raised by the Parties**

Petitioner and Respondent each discussed general information they found relevant and raised a variety of concerns within their filings and at the Oral Hearing; this included: information related to SCE's past, current, and future financial and economic situation; the risks associated with wildfires; the context of the Board's valuation; and the state of the regulated gas and electric industry as a whole. The specific issues Petitioner raised with its 2020 Board-adopted value are addressed under headings Legal Issues 1 through 6. A summary of these general contentions is provided first to provide factual context to the Board's consideration of this Petition.

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<sup>2</sup> The Commission's Rules of Practice and Procedure Article 2 and Appendix A of the Commission decision (D.) 07-07-004 set the rules and procedures for GRC review process.

<sup>3</sup> The HCLD value indicator is a form of the cost approach to value.

<sup>4</sup> The CEA value indicator is a form of the income approach to value.

1 First, Petitioner contends that the mere magnitude of the \$4.2 billion increase from its 2019  
2 Board-adopted unitary value to the 2020 Board-adopted unitary value represents not only the highest  
3 recent increase of assessed value, but also generally demonstrates that economic and other uncertainties  
4 were not fully considered by the Board. However, Respondent points out that in 2019, Petitioner added  
5 over \$6 billion in new assets (including Construction Work in Progress (CWIP) and only had \$700  
6 million in retirements, equating to a net increase of over \$5 billion in taxable assets acquired by  
7 Petitioner since its 2019 assessment, easily supporting the \$4.2 billion increase that Petitioner claims is  
8 inappropriate. (SAPD Analysis, Exhibit 2: Appraisal Data Report.)

9 Second, Petitioner asserts Respondent did not account for or fully appreciate the increased  
10 business risk resulting from increasing wildfires, asserting three general justifications for a lower  
11 assessed value: 1) the wildfires of 2017 and 2018 being unprecedented in size and amount of damage;  
12 2) the risk of inverse condemnation, and California's application of inverse condemnation with strict  
13 liability to utilities; and 3) the credit rating agencies, which investors use to assess risk, perceiving  
14 increased risk from wildfires in California. Respondent contends increased risk is only one of many  
15 factors that affects appraisal, and that Respondent has already made multiple adjustments to account  
16 for wildfire risk, as detailed in the 2020 appraisal narrative. Then, Respondent highlights 3 specific  
17 adjustments:

- 18 • Assembly Bill 1054 (Ch. 79, Stats. 2019) (AB 1054)<sup>5</sup> requires SCE to pay an additional \$95  
19 million per year for 10 years into the wildfire fund. Respondent made an adjustment to  
20 account for this requirement, which resulted in an approximately \$156 million value  
21 reduction.
- 22 • SCE has requested a 0.85% wildfire risk premium be added to its capitalization rate.  
23 Respondent made an adjustment to account for this request, which resulted in an  
24 approximately \$325 million value reduction.
- 25 • SCE made \$400 million in capital expenditures for fire risk mitigation as of the 2020 lien  
26 date, as required by AB 1054. AB 1054 precludes SCE from earning an equity return on  
27 these capital expenditures. Respondent made an adjustment to account for this expenditure,  
28 which resulted in an approximately \$128 million value reduction.

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<sup>5</sup> AB 1054 created a \$21 billion fund funded by contributions from investor-owned utilities, including Petitioner, and from ratepayers. This fund is available to pay certain wildfire claims made against specific regional electric generation corporations, like Petitioner. At the time of passage, the Legislature estimated Petitioner would be allocated almost 1/3 of the total fund.

1 Together, Respondent notes these adjustments resulted in a \$609 million reduction to Petitioner's  
2 unitary value, as already reflected in the 2020 Board-adopted value. In its Reply, Petitioner renews its  
3 risk contentions and notes if the AB 1054 wildfire mitigation fund is depleted, Petitioner is at risk of  
4 being liable for the excess.

5 Finally, Respondent notes Petitioner has raised the same arguments it made recently before the  
6 CPUC to request an increase on its allowed return on equity (ROE).<sup>6</sup> In the CPUC proceeding,  
7 Respondent notes Petitioner recognized AB 1054 significantly reduced its risk of liability and  
8 voluntarily reduced its request of the CPUC from a 6.3 percent increase in ROE to a 0.85 percent  
9 increase.<sup>7</sup> However, CPUC rejected even the revised request, leaving Petitioner's ROE unchanged at its  
10 original 10.30 percent, stating:

11 After considering the evidence on market conditions, trends, creditworthiness, interest rate  
12 forecasts, quantitative financial models, additional risk factors including business risk [which  
13 includes wildfire risk], and interest coverage presented by the parties and applying our informed  
14 judgment ... We find that SCE's authorized test year 2020 ROE should be 10.30%. This ROE is  
15 reasonably sufficient to assure confidence in the financial soundness of the utility and to  
maintain investment grade credit ratings while balancing the interests between shareholders and  
ratepayers. We further observe that the 10.30% authorized ROE is significantly higher than the  
9.60%<sup>[fn omitted]</sup> average ROEs granted to United States electric utilities during 2018.

16 (*CPUC Decision 19-12-056*, pp. 40-41.) Further, Respondent notes that the CPUC's final conclusion  
17 was that "*We find that the passage of AB 1054 and other investor supportive policies in California have*  
18 *mitigated wildfire exposure faced by California's utilities.*" (*CPUC Decision 19-12-056*, at p. 37;  
19 *emphasis added* by Respondent.) The CPUC also stated "Based on the above financial, business, and  
20 regulatory risks discussion, we conclude the ROE ranges adopted in the proceedings...adequately  
21 compensate the utilities for these risks." (*Id.* at p. 40.) While Respondent notes that Petitioner's request  
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23  
24 <sup>6</sup> A utility's Rate of Return, or Cost of Capital, is the weighted average cost of debt, preferred equity, and common stock, a  
25 utility has issued to finance its investments. Return on Equity (ROE) is the return to common equity. The CPUC attempts to  
26 set the authorized ROE at a level that is adequate to enable the utility to attract investors to finance the replacement and  
expansion of its facilities so it can fulfill its public utility service obligation. In practice, this level is determined by  
estimating market returns on investments for other companies with similar levels of risk. In general, a higher ROE allows  
greater earnings and would be appropriate to reflect increased risks and uncertainties. See generally:

27 <<https://www.cpuc.ca.gov/General.aspx?id=10457>> and

28 <[https://www.cpuc.ca.gov/uploadedFiles/CPUC\\_Public\\_Website/Content/About\\_Us/Organization/Divisions/  
Policy\\_and\\_Planning/PPD\\_Work/PPDReturnonEquityDCFmethodology\\_2.pdf](https://www.cpuc.ca.gov/uploadedFiles/CPUC_Public_Website/Content/About_Us/Organization/Divisions/Policy_and_Planning/PPD_Work/PPDReturnonEquityDCFmethodology_2.pdf)> [As of Nov. 30, 2020.]

<sup>7</sup> California Public Utilities Commission Decision 19-12-056 (*CPUC Decision 19-12-056*) (Dec. 19, 2019), p. 28 available at  
<<https://docs.cpuc.ca.gov/DecisionsSearchForm.aspx>> [as of Nov. 30, 2020].

1 was already denied by the CPUC, the 2020 Board-adopted value reflects Respondent's allowance of  
2 an increased equity risk premium of 0.85 percent to Petitioner's overall capitalization rate to  
3 acknowledge risk that might not be captured in other adjustments allowed for Petitioner.

#### 4 Applicable Law and Appraisal Principles

##### 5 Burden of Proof

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

##### 15 Analysis and Disposition of General Contentions

16 Respondent is presumed to have correctly determined the value of the property at issue and  
17 Petitioner bears the burden of proving otherwise. Here, Petitioner asserts that the mere magnitude of its  
18 assessed value increase from 2019 is objectively unreasonable and proves that economic and other  
19 uncertainties were not fully considered by the Board; however, Respondent points out Petitioner's 2019  
20 calendar year asset additions support the year over year valuation increase. Additionally, Petitioner  
21 asserts the existence of additional business risk from wildfires was not fully reflected in the Board-  
22 adopted value; however, Respondent contends risk is only one of many factors that affects appraisal and  
23 that the cited wildfire risk has already been adjusted for, as described in the 2020 appraisal narrative.  
24 While Respondent raises Petitioner's prior CPUC proceeding as evidence that such risk was viewed as  
25 adequately captured in the rate base, we note that such a finding has relevance to the instant proceeding,  
26 particularly as it relates to the determination of the rate base utilized by Respondent in the development  
27 of the HCLD value indicator; however, we also note that Petitioner's specific factual contentions and  
28 legal issues have been fully considered by the Board, herein, as a case of first impression. With respect

1 to these general contentions and background details raised by the parties, we find that Petitioner has not  
2 raised any specific contention herein to prove that Respondent erred in the calculation of the 2020  
3 Board-adopted value. Further, we also find that to the extent that Petitioner introduced these facts and  
4 contentions to provide context to the specific legal issues raised in this petition, Petitioner bears the  
5 burden of proof to show error within Respondent's calculation of the 2020 Board-adopted unitary value  
6 with regard to each specific legal issue raised before the Board.

7  
8 **Legal Issue 1: Whether Petitioner Has Shown that Respondent Erred in Placing 75 Percent**  
9 **Reliance on the Historical Cost Less Depreciation (HCLD) Value Indicator and 25 Percent**  
10 **Reliance on the Capitalized Earning Ability (CEA) Indicator of Value.**

11 **Findings of Fact and Related Contentions**

12 Petitioner asserts an equal weighting would result in a more consistent and reasonable value. To  
13 support this argument, Petitioner contends Respondent's appraisal is flawed because the two value  
14 approaches utilized produced widely varying results. Due to this disparity and as Respondent's analysis  
15 does not explicitly state reconciliation occurred, Petitioner asserts Respondent must have decided to  
16 simply weigh the indicators, without any reason for doing so. Petitioner argues that the difference  
17 between the two value indicators shows that the HCLD value indicator is less reliable and proves the  
18 existence of additional obsolescence impacting Petitioner's property<sup>8</sup> and, thus, supporting additional  
19 weight for the CEA value indicator approach.

20 Respondent contends the HCLD and CEA value indicators were reconciled, consistent with  
21 relevant appraisal guidance and law. Respondent notes that significant differences in the two value  
22 approaches can and may occur without compromising the validity of the underlying value approach.  
23 (Assessors' Handbook, section 501 (AH 501) *Basic Appraisal*, p. 62 and Assessors' Handbook, section  
24 502 (AH 502) *Advanced Appraisal*, p. 111.) Further, Respondent notes the HCLD approach is one of  
25 the more important indicators of market value for closely regulated public utilities, like Petitioner, as  
26 HCLD, with some modification, approximates the rate base that regulators use in establishing revenue  
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28 \_\_\_\_\_  
<sup>8</sup> See Issue 6; Petitioner's additional obsolescence argument is discussed therein.

1 requirements. (*Unitary Valuation Methods (UVM)* (2003), p. 1.) Respondent also notes that Property  
2 Tax Rule<sup>9</sup> 8, subdivision (a), indicates the CEA value indicator is appropriate to use when the property  
3 has “an established income stream...,” like Petitioner. Additionally, Respondent notes that due to  
4 Petitioner’s significant growth in actual and planned capital expenditures to replace and expand  
5 distribution and transmission infrastructure, and to construct and replace generation assets, Petitioner is  
6 experiencing “regulatory lag.”<sup>10</sup> Respondent also notes that the 75/25 percent reliance on the HCLD and  
7 CEA indicators is the same reliance used to value Petitioner’s property in each of the past 10 years, as  
8 well as the same reliance placed on the value indicators of other investor-owned, rate regulated utilities.  
9 Accordingly, Respondent considered HCLD to be the most reliable indicator of value, placing 75  
10 percent reliance on the indicator, and found it appropriate to weight the CEA value indicator at 25  
11 percent, to account for the regulatory lag in adjustment to the rate base.

12 In the EY Report,<sup>11</sup> Petitioner renews the contention that the CEA value indicator should be  
13 provided additional weight in the reconciliation, noting the HCLD value indicator does not reflect all of  
14 the external market conditions impacting SCE. Petitioner further contends that Rule 8, subdivision (a),  
15 supports this additional weighting of the CEA value indicator, as SCE experiences restrictions on  
16 income from disallowance of operating and capital expenses from rate recovery and requires numerous  
17 forms of obsolescence adjustments that are derived from the CEA analysis. The EY Report concludes  
18 Petitioner’s revised opinion of value is based on our understanding of the strengths and weaknesses of  
19 each approach and ultimately a reflection of the approach they best believe reflects the impacts of the  
20 wildfires.

21 In its Supplemental Analysis, Respondent contends none of the factors noted by Petitioner in its  
22 filings provide a specific explanation as to why the CEA value indicator should receive more weight.  
23 Respondent notes the HCLD value indicator is based on the rate which the rate-regulating agency allows  
24 the company to earn considering all business risks and circumstances, including wildfires, and the  
25 CPUC has already reviewed Petitioner’s rate increase requests and based on the financial, business, and  
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27 <sup>9</sup> All references to “Property Tax Rule” or “Rule(s)” are to sections of title 18 of the California Code of Regulations.

28 <sup>10</sup> Regulatory lag is the time delay between Petitioner’s costs and any adjustment CPUC may make to the rate base to account for these costs.

<sup>11</sup> Immediately prior to the Appeals Conference, Petitioner submitted the EY Report with a revised opinion of value.

1 regulatory risks cited and “concluded that the ROE ranges adopted in the proceedings...adequately  
2 compensate the utilities for these risks.” (CPUC Decision 19-12-056, at p. 37.) Further, Respondent  
3 notes that Petitioner’s EY Report does not state a specific revised weighting request and did not provide  
4 a clear explanation after clarification was sought by staff. Accordingly, Respondent contends Petitioner  
5 must provide specific evidence and argument to support its assertion that a different weight should be  
6 used, including the specific weighting of the value indicators Petitioner is requesting.

7 At the Appeals Conference on November 12, 2020, Petitioner generally reaffirmed its view that  
8 additional weight should be placed on the CEA value indicator given the increased risks SCE faces,  
9 regulatory lag, and other factors affecting SCE, as described within its filings. After the conference,  
10 Petitioner elaborated that Petitioner’s reliance request gave “[m]ore weight to the CEA relative to what  
11 SAPD has historically considered...ultimately based on our appraisal judgment.” (Email, November 19,  
12 2020).

13 At the Oral Hearing, an EY representative testified that the EY Report placed approximately 65  
14 percent weight on the HCLD and 35 percent weight on the CEA value indicator.

### 15 Applicable Law and Appraisal Principles

#### 16 Burden of Proof

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

#### 26 Value Standard

27 Property Tax Rule 2, subdivision (a) states that “in addition to the meaning ascribed to them in  
28



1 the Revenue and Taxation Code, the words “full value,” “full cash value,” “cash value,” “actual value,”  
2 and “fair market value” mean the price at which a property, if exposed for sale in the open market with  
3 a reasonable time for the seller to find a purchaser, would transfer for cash or its equivalent under  
4 prevailing market conditions between parties who have knowledge of the uses to which the property  
5 may be put, both seeking to maximize their gains and neither being in a position to take advantage of  
6 the exigencies of the other.”

### 7 **HCLD Approach to Value**

8 Property Tax Rule 3, subdivision (d) provides the HCLD approach to value shall be considered  
9 “[i]f the income from the property is regulated by law and the regulatory agency uses historical cost or  
10 historical cost less depreciation as the rate base, the amount invested in the property or the amount  
11 invested less depreciation computed by the method employed by the regulatory agency.” HCLD, with  
12 some modification, approximates the rate base that regulators use in establishing revenue  
13 requirements. (See *UVM*, p. 1.) HCLD reflects the market value contribution of all taxable property  
14 including the depreciated historical cost of plant in service, possessory interests, construction work in  
15 progress, and materials and supplies. (AH 502, p. 146.) HCLD is,

16 one of the more important indicators of value for closely regulated public utilities. The general  
17 practice of the California Public Utilities Commission (CPUC) and most other regulatory  
18 agencies is to use historical or original cost less depreciation (with various adjustments) as the  
19 rate base. The regulatory agencies establish a rate base and a rate of return; utilities are  
20 permitted to earn at this established rate on the rate base.

20 (UVM (2003), p. 1.)

### 21 **Income Approach to Value**

22 Property Tax Rule 8, subdivision (a), states that “the income approach is used in conjunction  
23 with other approaches when the property under appraisal is typically purchased in anticipation of a  
24 money income and either has an established income stream or can be attributed a real or hypothetical  
25 income stream by comparison with other properties.” Subdivision (b) describes the income approach to  
26 value as the valuation method whereby, “an appraiser values an income property by computing the  
27 present worth of a future income stream. This present worth depends upon the size, shape, and duration  
28 of the estimated stream and upon the capitalization rate at which future income is discounted to its

1 present worth.” Subdivision (c) provides that “the amount to be capitalized is the net return which a  
2 reasonably well-informed owner and reasonably well informed buyers may anticipate on the valuation  
3 date that the taxable property existing on that date will yield under prudent management and subject to  
4 legally enforceable restrictions as such persons may foresee as of that date.”

### 5 **Reconciliation of Value Indicators**

6 Property Tax Rule 3 requires that, in estimating value, the assessor shall consider one or more of  
7 the approaches to value “as may be appropriate for the property being appraised,” which includes the  
8 comparative sales approach, the cost approach (e.g., HCLD valuation methodology), or the income  
9 approach (e.g., CEA valuation methodology). The appropriateness of an approach is often related to the  
10 type of property being appraised and the available data. (AH 502, p. 109.) In addition, the validity of a  
11 value indicator will depend upon the accuracy of data and adjustments made to the approach. That is, the  
12 accuracy of a value indicator depends on the amount of available comparable data, the number and type  
13 of adjustments, and the dollar amount of adjustments. Finally, if a large amount of comparable data is  
14 available for a given approach, the appraiser may have more confidence in that approach. For example, if  
15 income, expense, and capitalization rate data can be obtained from many properties comparable to the  
16 subject, the appraiser may attribute significant accuracy to the income approach. The greatest reliance  
17 should be placed on that approach or combination of approaches that best measures the type of benefits  
18 the subject property yields. The final value estimate reflects the relative weight that the appraiser  
19 assigned, either implicitly or explicitly, to each approach. (AH 502, p. 112.)

### 20 **Analysis and Disposition**

21 Respondent is presumed to have correctly determined the value of the property at issue and  
22 Petitioner bears the burden of proving otherwise. Here, Petitioner is a rate-regulated public utility with  
23 an established income stream and thus reliance on both the HCLD and CEA value indicators is  
24 appropriate, as provided by Property Tax Rules 3, 6, and 8. Further, the application of reconciliation  
25 methodology and the determination of a final opinion of value are explicitly contemplated and described  
26 in Property Tax Rule 3 and AH 501 and 502. While Petitioner claims Respondent’s appraisal is flawed  
27 or unreconciled, the requested opinion of value within the EY study does not even disclose what reliance  
28 Petitioner is requesting be placed on each value indicator; as such, it is not a valid starting point

1 regarding the reconciliation of the two value indicators. Further, we find that Petitioner has provided  
2 no evidence or argument to support a revised weighting of the value indicators; specifically, Petitioner  
3 has not met its burden of proving that the HCLD indicator is impaired, nor that its CEA value indicator  
4 must be granted additional weight. Based on the foregoing, we conclude Petitioner has not met its  
5 burden of proof to overcome the presumption that Respondent correctly relied upon and reconciled  
6 both the HCLD and CEA value indicators, consistent with Property Tax Rules 3, 6, and 8.

7  
8 **Legal Issue 2: Whether Petitioner Has Shown that Respondent Must Adjust the Board-Adopted**  
9 **Value for SCE’s \$4.5 Billion Accrual for Liabilities for the 2017/2018 Wildfires and Mudslides**

10 **Findings of Fact and Related Contentions**

11 Petitioner asserts the Board-adopted value does not account for SCE’s \$4.5 billion accrual for  
12 liabilities for the 2017/2018 wildfires and mudslides, erroneously disregarding costs for estimated  
13 claims and settlements prior to the enactment of AB 1054. Petitioner argues that a \$1.825 billion  
14 adjustment must be made to the HCLD and CEA value indicators to reflect its wildfire-related claims  
15 liability related to 2017/2018, as such liability reduces its “firm value”<sup>12</sup> and is reflected on its year end  
16 2018 and 2019 audited financial statements. (Petition, Exhibits B and C.)

17 Respondent notes it performs its valuation duties by calculating and reconciling different  
18 indicators of value, where Respondent’s final appraisal value reflects the value of all taxable property,  
19 owned or used by Petitioner, as a unit. Respondent further states that consistent with Cal. Const.  
20 Article XIII, section 1, the standard of value in property tax assessment is fair market value, not “firm  
21 value.” Additionally, for state-assessed properties, the California Supreme Court has stated:

22 From our review of the relevant constitutional and statutory provisions, we conclude that unit  
23 taxation is properly characterized not as the taxation of real property or personal property or  
24 even a combination of both, but rather as the taxation of *property as a going concern*. First, what  
25 the Board assesses is the value of the public utility *property* as a going concern; it considers the  
26 earnings of the *property* as a whole, and does not consider, less still assess, the value of any  
27 single real or personal asset.

28 <sup>12</sup> “Firm value” is an economic measure reflecting the market value of a business, which reflects a sum of claims on the  
company by all claimants, i.e. both equity and non-equity claims. Consistent with this definition, Petitioner contends that its  
firm value is impaired by the existence of claims on the company, i.e. the liability from lawsuits. (Petition, p. 16).

1 (*ITT Communications vs. City of San Francisco* (1985) 37 Cal.3d 859, 864-865, emphases added.)  
2 Respondent claims that it does not calculate “Firm Value” and that this concept is irrelevant to the  
3 valuation of taxable property as an ongoing concern.

4 With respect to the specific adjustment Petitioner requests, Respondent states Petitioner lists a  
5 \$4.5 billion long term liability, “Wildfire-related claims,” on its Balance Sheet as of December 31,  
6 2019<sup>13</sup> and shows a “Wildfire-related claims, net of insurance recoveries” expense of \$255 million for  
7 year-ended December 31, 2019.<sup>14</sup> Respondent notes Petitioner requests an adjustment of \$1.825 billion,  
8 which appears to be the after-tax, wildfire-related expense for 2018.<sup>15</sup> However, it is unclear why  
9 Petitioner is asserting a reduction in “firm value” necessarily results in a reduction to its taxable value,  
10 because whether or not the CPUC considered these past liabilities in determining Petitioner’s “Firm  
11 Value” is not determinative for California Unitary Property Assessment. Under Property Tax Rule 8,  
12 subdivision (c) debt payments are explicitly excluded as an allowable expense. (See also AH 502, pp.  
13 73-74.); further, the allowance of such expenses would be inconsistent with a capitalized earning  
14 approach which seeks to convert the *future* income stream into present worth. (Rule 8, subd. (a).)  
15 Accordingly, Respondent contends no adjustment for these liabilities is appropriate, as they are past  
16 expenses and not anticipated to occur again in the future.

17 In its Reply, Petitioner refutes that its wildfire-related expenses are past expenses and not  
18 anticipated to occur again in the future. First, Petitioner asserts the \$1.825 billion adjustment requested  
19 represents a future, anticipated operating expense to cover liabilities beyond all expected insurance  
20 recoveries. Petitioner further contends it is not a financing liability, nor a contractual liability, but  
21 instead an estimated amount of necessary operating expense above and beyond insurance recoveries,  
22 which negatively impacts its going concern value. Second, Petitioner asserts that Rule 8 requires the  
23 inclusion of anticipated income, and similarly anticipated operating expenses must be considered and  
24 deducted. Third, if assuming for the sake of argument that this is a non-ordinary expense, Respondent  
25

26 <sup>13</sup> Petitioner’s Consolidated Balance Sheet, Attached to SAPD’s Analysis, Exhibit 3.

27 <sup>14</sup> Petitioner’s Consolidated Statement of Income, Attached to SAPD’s Analysis, Exhibit 4.

28 <sup>15</sup> Southern California Edison Annual Report, p. 110-112, attached as Exhibit 5. Petition, Exhibit B appears to apply \$1.825 billion as a reduction to both the cost and income indicators, then weights each indicator 50 percent to arrive at a total unitary value reduction of the same \$1.825 billion. Respondent notes that it is unclear how this calculation was determined or why this methodology was chosen.

1 provides no support for the exclusion of a non-ordinary expense anticipated in the future.<sup>16</sup> Fourth,  
2 Petitioner contends there is no material difference between “firm value,” “fair market value,” “full cash  
3 value,” or “going concern value.” In conclusion, Petitioner states that while the initial liability claim  
4 accrual may normally be a “historical” expense accrual from an accounting standpoint, that the liability  
5 is still an ongoing cash cost to SCE as claims are settled and paid, and as such it must be accounted for,  
6 as any willing buyer would account for it.

7 In Petitioner’s EY Report, Petitioner asserts the appropriate adjustment is instead \$2.1 billion,  
8 based on the present value of settlement payments estimated in 2021 based on SCE management’s and  
9 EY’s understanding, and it should be deducted from both the HCLD and CEA value indicators. (EY  
10 Report, Exhibit 3, p. 54-55.) The EY Report asserts the \$2.1 billion is not a liability, but an accrual of a  
11 future expense merely recognized as a liability for accounting purposes. As such, Petitioner contends  
12 the expense does not align with any of the non-allowable operating expenses described in AH 502.

13 In its response, Respondent renews its position.

#### 14 **Applicable Law and Appraisal Principles**

15 See Burden of Proof and Value Standard sections in Legal Issue 1.

#### 16 **Income Approach to Value**

17 Property Tax Rule 8, subdivision (a), states that “the income approach is used in conjunction  
18 with other approaches when the property under appraisal is typically purchased in anticipation of a  
19 money income and either has an established income stream or can be attributed a real or hypothetical  
20 income stream by comparison with other properties.” Subdivision (b) describes the income approach to  
21 value as the valuation method whereby, “an appraiser values an income property by computing the  
22 present worth of a future income stream. This present worth depends upon the size, shape, and duration  
23 of the estimated stream and upon the capitalization rate at which future income is discounted to its  
24 present worth.” Subdivision (c) provides that “the amount to be capitalized is the net return which a  
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26 \_\_\_\_\_  
27 <sup>16</sup> In support, Petitioner cites a general statement from AH 502 to support this supposition. AH 502, p. 67, “Cost trends  
28 relating to the components of operating expenses should be studied to estimate the future level of operating expenses.”  
Petitioner also asserts such costs are anticipated to continue in the future but does not address the likelihood of such claims in  
the context of AB 1054, which is designed to reduce the likelihood of such expenses until the wildfire mitigation fund is  
exhausted.

1 reasonably well-informed owner and reasonably well informed buyers may anticipate on the valuation  
2 date that the taxable property existing on that date will yield under prudent management and subject to  
3 legally enforceable restrictions as such persons may foresee as of that date.” Net return is the difference  
4 between gross return and gross outgo. (Rule 8, subd. (c).) Amortization, depreciation, and debt  
5 retirement are explicitly excluded from gross outgo. (*Ibid.*)

### 6 Analysis and Disposition

7 Respondent is presumed to have correctly determined the value of the property at issue and  
8 Petitioner bears the burden of proving otherwise. Here, Petitioner asserts the requested \$2.1 billion  
9 adjustment represents future, anticipated operating expenses to cover wildfire related liabilities arising  
10 from the 2017/2018 wildfires, which must be reflected in both the HCLD and CEA value indicators.  
11 However, Respondent contends Petitioner has provided no specific argument, evidence, or legal  
12 appraisal authority to support the proposed deduction of non-ordinary expenses related to its pre-AB  
13 1054 liabilities for property tax purposes. Based on the facts and evidence submitted to the record, we  
14 find that Petitioner has not shown specific evidence or arguments to prove that the claimed liability  
15 expenses must be deducted from both the CEA and HCLD value indicators; specifically, we find  
16 allowing such expenses in the CEA approach would be directly contrary to Property Tax Rule 8 and  
17 Board guidance; further, no legal or appraisal support is provided to show that Respondent erred in  
18 disallowing the requested deduction to the HCLD value indicator. As Petitioner has provided no  
19 argument or evidence to show Respondent erred in the disallowance of these wildfire and mudslide  
20 related expenses, we find Petitioner has not met its burden of proof as to this issue.

### 21 22 **Legal Issue 3: Whether Petitioner Has Shown that Respondent Improperly Assessed \$400 Million** 23 **of Wildfire Mitigation Capital Expenditures.**

#### 24 Findings of Fact and Related Contentions

25 Petitioner contends that Respondent improperly assessed \$400 million of wildfire mitigation  
26 capital expenditures in its 2020 assessment of SCE, based on the incorrect assumption that these assets  
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28

1 generate a cash flow from ratepayers, allowing SCE to realize a return on investment.<sup>17</sup> Petitioner  
2 contends that under AB 1054, SCE is required to make capital expenditures to the wildfire mitigation  
3 fund, including the initial \$1.6 billion, which will not be included in SCE's rate base, nor will SCE be  
4 allowed to earn a return on the investment. Instead of the traditional approach of Petitioner financing  
5 infrastructure investments by adding the assets in its rate base and retaining the opportunity to earn a  
6 rate of return on its investment, Petitioner states that the \$1.6 billion wildfire mitigation spent will be  
7 recovered through a securitizable dedicated-rate component through a financial product known as  
8 securitization.<sup>18</sup> Petitioner asserts that this securitization structure provides no assessable value to a  
9 willing buyer/seller transaction, as there is no opportunity to earn an investment return on the assets.  
10 Accordingly, Petitioner asserts a buyer would value the first \$1.6 billion of wildfire mitigation capital  
11 expenditures (\$400 million as of 12/31/19) at zero, and as such, Respondent should do the same and  
12 remove these costs from the HCLD value indicator.

13 Respondent contends no adjustment is appropriate for this issue. Respondent notes when  
14 making capital expenditures, firms typically expect both a "return of" their invested capital as well as a  
15 "return on" their invested capital. (AH 502, p. 62.) Both components are captured in the capitalization  
16 rate, which provides explicitly or implicitly for both the return of and the return on capital. (*Ibid.*)  
17 Respondent contends that while Petitioner is not allowed to earn a *return on* the expenditure, Petitioner  
18 will earn a *return of* its capital expenditure through depreciation and the reimbursement of interest paid  
19 for debt service. As such, Respondent contends it made appropriate adjustments to the cost indicator to  
20 account for this by calculating the present value of the income using a discount rate that excludes the  
21 equity portion of the capitalization rate; the excluded equity portion represents the *return on* the  
22 investment, and properly leaves the rate for *return of* the investment. Respondent then removed the  
23 difference between this present value amount and the total \$400 million capital expenditure, resulting  
24 in an approximately \$171 million reduction to the HCLD value indicator, as already reflected in  
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26 \_\_\_\_\_  
27 <sup>17</sup> Petition, Exhibit D, correspondence with SAPD regarding the wildfire-related mitigation expenditures, and Petition,  
28 Exhibit E, reflecting the reduction in value attributable to AB 1054 capital expenditures.

<sup>18</sup> Petitioner later described this securitization process at the Appeals Conference. Petitioner noted that a special purpose  
entity was created, separate and apart from SCE, which lent SCE the funds and recovered the debt over time through  
securitized utility bond (re)payments collected directly from ratepayers.

1 Petitioner's 2020 Board-adopted unitary value. Therefore, Respondent concludes no further adjustment  
2 is warranted.

3 At the Appeals Conference, Petitioner described SCE as being in the process of creating a  
4 special purpose entity to securitize the \$400 million in capital expenditures required by AB 1054. An  
5 SCE employee explained, the special purpose entity will issue a recovery bond to finance the \$400  
6 million in capital expenditures. Petitioner's EY Report also explains that the \$400 million investment  
7 will be repaid by ratepayers via a surcharge called a "fixed recovery charge." Additionally, in a  
8 supplemental data request, Petitioner provided Petitioner's application and testimony from SCE's  
9 Application to the CPUC for authorization to securitize certain costs, explaining the structure of the  
10 securitization, bond transaction structure, capital structure of securitization, and the transaction's  
11 structure.

12 After a review of Petitioner's EY Report and supplemental evidence, Respondent contends while  
13 Petitioner's description of this financing mechanism illustrates a special purpose entity, separate from  
14 SCE, the financing structure is not relevant to the taxable value of the assets and the EY Report itself  
15 acknowledges that Petitioner will earn a return of its capital investment. Accordingly, Respondent  
16 reaffirms that the additional information has not changed its view that SAPD has already made  
17 appropriate adjustments to the cost indicator to account for the return of Petitioner's investment, while  
18 acknowledging Petitioner's return on this capital expenditure is impaired.

### 19 Applicable Law and Appraisal Principles

20 See Burden of Proof and HCLD sections in Legal Issue 1.

### 21 Analysis and Disposition

22 Respondent is presumed to have correctly determined the value of the property at issue and  
23 Petitioner bears the burden of proving otherwise. Here, Petitioner contends that the \$400 million of  
24 wildfire mitigation capital expenditure is in a securitization structure that does not allow for a *return on*  
25 the investment and therefore should be excluded from its assessment. However, Respondent contends  
26 appropriate adjustments were already made to the HCLD indicator to account for this by calculating the  
27 present value of the amount using a discount rate that excludes the equity portion of the capitalization  
28 rate; this excluded equity portion represents the *return on* the investment and properly leaves the rate for



1 *return of* the investment within the assessment. Based on the evidence and arguments submitted to the  
2 record, we find that Petitioner has not shown specific evidence or argument to prove error within  
3 Respondent’s adjustment to the HCLD value indicator calculation, which removes the value attributable  
4 to Petitioner’s *return on* the investment and leaves the rate for *return of* its capital expenditure, as  
5 Petitioner will receive the benefit of the *return of* its capital expenditure through depreciation and  
6 reimbursement of interest paid for debt service through the securitization structure. Further, Petitioner  
7 has provided no legal or appraisal guidance to show that the HCLD value indicator must be adjusted to  
8 remove the value attributable to the *return of* its capital expenditure. Accordingly, we find that Petitioner  
9 has not met its burden of proof as to this issue.

10  
11 **Legal Issue 4: Whether Petitioner Has Shown that Respondent Erred in Its Treatment of Wildfire**  
12 **Insurance Fund Related Contributions.**

13 **Findings of Fact and Related Contentions**

14 Petitioner asserts Respondent erred in its treatment of the Wildfire Insurance Fund-related  
15 contribution by only allowing an annual operating expense of \$95 million, and by ignoring the initial  
16 contribution of \$2.4 billion to the fund, which should properly be included in the income indicator as part  
17 of SCE’s annualized operating cost for wildfire insurance. (Petition, Exhibit F) Petitioner notes SCE  
18 made the initial contribution of \$2.4 billion to the Wildfire Fund on September 19, 2019 and will make  
19 10 annual contributions of approximately \$95 million per year to the fund, consistent with Cal. Public  
20 Utilities Code, section 3292, subdivision (a). Petitioner notes the Wildfire Insurance Fund contributions  
21 are being treated similarly to prepaid insurance: such assets are amortized over ten years at \$323 million  
22 per year and reflected as an expense in the “Operation and Maintenance” section of its income  
23 statement.<sup>19</sup> Accordingly, Petitioner contends Wildfire Insurance Fund contributions are equivalent to  
24 the payment of insurance premiums, and that a potential purchaser would be willing to

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26 <sup>19</sup> Petitioner notes the Wildfire Insurance Fund does not have a defined life and will terminate when the administrator  
27 determines the fund has been exhausted. Management estimates that the wildfire fund will provide insurance coverage for 10  
28 years, but could vary depending upon several factors, including future occurrence and magnitude of wildfires; the  
involvement of SCE or other electric corporations in the ignition of wildfires; the probable future outcome of CPUC cost  
recovery proceedings for wildfire claims; the participation of PG&E in the fund, and the use of the contributions by the  
administrator of the fund.

1 pay more for a utility that had prepaid this annual contribution, as compared to a utility that had not  
2 done so.

3 Further, Petitioner contends if AB 1054 had required ten annual payments of the same amount  
4 (\$323 million) instead of an initial payment of \$2.4 billion, the full annual payment amount would be  
5 deducted from the income indicator to reflect annual operating costs. Petitioner also disputes  
6 Respondent's characterization of the prepaid expense as an excludable amortization or depreciation  
7 expense, asserting depreciation is irrelevant because the annual cost reflects amortization of a prepaid  
8 asset, not depreciation of a capital asset. (Citing *State Assessment Manual* (SAM), p. 74 for the  
9 definition of "Amortization.") Additionally, Petitioner adds its prior year wildfire insurance expenses  
10 further support that the annual expense of \$323 million for insurance premiums in the income indicator  
11 is reasonable. Finally, Petitioner alleges that Respondent is treating state assessees inconsistently, as  
12 such contribution expenses were allowed for another state assessee. Accordingly, Petitioner contends  
13 that the \$323 million annualized insurance expense should be an allowable adjustment reflected in the  
14 CEA model, absent a drastic change to wildfire projections in California or a change to insurance  
15 markets.

16 Respondent contends that consistent with Property Tax Rule 8 and Board issued appraisal  
17 guidance, Respondent appropriately did not allow the \$2.4 billion initial contribution as an expense in  
18 the CEA value indicator. (Citing *UVM*, pp. 35-37 and AH 502, p. 74.) Respondent notes Petitioner  
19 admits the Wildfire Insurance Fund-related initial contribution is both a past, and non-reoccurring  
20 expense and that it is being amortized over a 10-year period. Respondent contends Petitioner does not  
21 explain how this amortized, non-ordinary expense becomes a deductible, ordinary, cash expense.  
22 Further, Respondent notes while Petitioner has cited SAM for the definition of "amortization,"  
23 Petitioner's cited definition does not explain or support Petitioner's requested treatment of amortized  
24 costs within the CEA indicator of value. Instead, Respondent asserts the treatment of amortized costs is  
25 provided in Rule 8 and AH 502, which support Respondent's underlying assessment.

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1           Additionally, Respondent states that the California Supreme Court has made it clear that  
2 amortized costs are not deducted from anticipated income to be capitalized.<sup>20</sup> (*De Luz Homes v. County*  
3 *of San Diego (De Luz)* (1955) 45 Cal.2d. 546.) Respondent concludes that as the \$2.4 billion initial  
4 contribution is a past expense that need not be paid again, the initial contribution is not deductible from  
5 Petitioner’s future income stream to be capitalized. However, Respondent notes that Petitioner’s  
6 required annual contributions to the Wildfire Insurance Fund are allowable, ordinary expenses expected  
7 to be paid for a 10-year term. Accordingly, Respondent allowed this deduction for annual contribution  
8 payments by taking the present value of nine future payments (each of \$95 million), which resulted in a  
9 \$624 million reduction to the CEA value indicator and was already reflected in Petitioner’s 2020  
10 Board-adopted value. Finally, Respondent confirms that it has treated state-assessees equally, based on  
11 a consistent application of the same principles to all utilities contributing to the fund.

12           In its Reply, Petitioner contends while *De Luz* precludes a deduction for depreciation of  
13 property, it does not preclude a deduction for operating and maintenance expenses, which Petitioner  
14 contends the Wildfire Insurance Fund Contributions are. Further, Petitioner contends the annual  
15 Wildfire Insurance Fund Contributions are not “past, non-recurring expense[s]” as wildfires are here to  
16 stay and only getting progressively worse. Additionally, Petitioner notes its audited financial  
17 statements show that these prepaid insurance expenses are being reflected as operating expenses over a  
18 10-year period (\$323 million per year), and as such, any prudent buyer would consider such expenses  
19 as regular and reoccurring.

20           In the EY Report, Petitioner renews its contentions in support of the request to allow for a  
21 revised deduction of \$340 million from its annualized operating expenses in the CEA value indicator  
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23 <sup>20</sup> Respondent includes selected excerpts to support its summary of *De Luz*. In determining what costs would be considered  
24 in valuing a leasehold interest under a capitalization of income method, the Court stated that:

25           ...anticipated net earnings equal expected gross income less necessary expenditures for maintenance, operation, and  
26 taxes.[fn omitted] *No deduction is made for the cost of the lease to the present lessee, i.e., his charges for rent and*  
27 *amortization of improvements*, for to a prospective assignee the value of a leasehold is measured solely by  
28 anticipated gross income less *expected necessary expenditures*.

(*De Luz Homes, Inc. v. County of San Diego, supra*, p. 566, emphasis added.) The Court concluded:

27           Furthermore, in determining the income to be capitalized to establish value for appraisal purposes, *no deduction*  
28 *can be made for amortization*. [Citation.] ‘[N]o concept of income which includes ... depreciation in capital value  
as a positive or negative item of income, is acceptable as a basis of valuation under the ‘capitalized income’  
method.’ [Citation.]

(*Ibid.*)

1 calculation to reflect for the annualized Wildfire Insurance Fund Contributions, and cites AH 502, in  
2 support of its claim:

3 The treatment of some operating expenses may vary depending on whether direct capitalization  
4 or yield capitalization (i.e., discounted cash flow analysis) is used. In direct capitalization,  
5 expenses are annualized, even though some expenditures may not actually occur on an annual  
6 basis. This is a slight deviation from the typical cash flow basis of real estate income and  
7 expense analysis. It is necessary because in direct capitalization only a single year's income is  
8 capitalized. For example, property insurance may be prepaid for three years, but the appraiser  
9 would annualize this expense in direct capitalization.

10 (AH 502, pp 71-72.) Further, Petitioner concludes it is reasonable to include the annualized expenses  
11 associated with the full contribution to the Wildfire Insurance Fund and that it is reasonable to  
12 capitalize this amount in the CEA expenses. (EY Report, Exhibit 2, pp. 52-53.)

13 In response to Petitioner's EY Report, Respondent contends that the cited text from AH 502 is  
14 misapplied, as the \$2.4 billion payment is not prepaid property insurance, but instead a single, one-  
15 time, required payment. Accordingly, Respondent maintains no adjustment should be made as to this  
16 issue.

### 17 **Applicable Law and Appraisal Principles**

18 See Burden of Proof, Value Standard, and Income Approach to Value in Legal Issue 1.

### 19 **The Income Approach: Amortization and Depreciation**

20 The income approach to value is generally described as any method that converts future  
21 anticipated income into present value. (UVM, p. 35.) It is premised on the assumption that investors  
22 will buy and sell property based on the income it is *expected* to yield. (*Ibid.*) The income that is  
23 converted into present value is appraisal income, or "net return" as defined by Rule 8. (UVM, pp. 35-  
24 37; Rule 8, subd. (c).) Net return is the difference between gross return and gross outgo. (Rule 8, subd.  
25 (c).) Amortization and depreciation are explicitly excluded from gross outgo. (*Ibid.*) AH 502 explains  
26 why this is the case:

27 The reference to depreciation and amortization in subdivision (c) [of Rule 8] refers to the  
28 accounting concept of depreciation (in this context, amortization is a synonym for depreciation).  
Accounting depreciation and amortization charges are non-cash expenses designed to spread, or  
match, the cost of a previously incurred cash expenditure over future accounting periods. There  
are at least two theoretical reasons for the exclusion of accounting depreciation charges as  
expenses. First, doing so incorporates the recognized cash flow concept of the amount of  
income to be capitalized. Second, accounting depreciation is a means of capital recovery based

1 on past expenditures. However, in real estate valuation the point is not to recover past  
2 expenditures, but rather to estimate the value that future income will be able to recover.

3 (AH 502, p. 74.) In other words, amortization and depreciation are not deducted when computing the  
4 future income stream to be capitalized because doing so would artificially lower that future income  
5 stream by subtracting non-cash expenses and would also cause the future income stream to no longer be  
6 a *future income* stream, as it would include past expenses. The California Supreme Court has confirmed  
7 this understanding in *De Luz*; the Court concluded:

8 Furthermore, **in determining the income to be capitalized** to establish value for appraisal  
9 purposes, ***no deduction can be made for amortization.*** [Citation.] ‘[N]o concept of income  
10 which includes ... depreciation in capital value as a positive or negative item of income, is  
11 acceptable as a basis of valuation under the ‘capitalized income’  
12 method.’ [Citation.]

13 (*De Luz Homes, Inc. v. County of San Diego, supra*, p. 566, emphasis added.)

#### 14 **Analysis and Disposition**

15 Respondent is presumed to have correctly determined the value of the property at issue and  
16 Petitioner bears the burden of proving otherwise. Here, Respondent has calculated and removed the  
17 present value of the 9 remaining, future Wildfire Insurance Fund payments from the CEA value  
18 indicator used within Petitioner’s 2020 Board-adopted value; however, Petitioner contends this  
19 adjustment understates the annualized and prepaid-expenses associated with the full contribution to the  
20 Wildfire Insurance Fund by ignoring the initial contributions. Instead, Petitioner contends all  
21 contributions should be annualized and deducted from the CEA value indicator calculation to represent  
22 an annual expense, akin to prepaid property insurance. Respondent contends the initial contributions to  
23 the AB 1054 fund are past, non-reoccurring expenses that Petitioner has amortized over a 10-year period  
24 and are not akin to prepaid property insurance; further, amortized expenses are explicitly disallowed  
25 from deduction in the CEA approach. Based on the evidence and arguments submitted to the record, we  
26 find that Petitioner has not shown specific evidence or argument to prove error within Respondent’s  
27 treatment of the prior Wildfire Insurance Fund payments. Further, we find Respondent’s treatment is  
28 consistent with *De Luz*, Property Tax Rule 8, and relevant Board guidance, which explicitly disallow  
amortized expenses from being deducted in the CEA approach. Accordingly, Petitioner has not met its  
burden of proving Respondent erred in the treatment of Petitioner’s Wildfire Insurance Fund payments.

1 **Legal Issue 5: Whether Petitioner Has Shown that Respondent Erred in Disallowing \$23 Million in**  
2 **Self-Insured Retention Expenses.**

3 **Findings of Fact and Related Contentions**

4 Petitioner asserts Respondent improperly disallowed \$23 million in self-insured retention<sup>21</sup>  
5 (SIR) expenses, as such expenses are ordinary operating expenses that must be deducted from its  
6 earnings. As of the 2020 lien date, Petitioner asserts it has incurred \$23 million in SIR expenses for  
7 fires that occurred in Southern California in 2019 and this SIR expense must be reflected in  
8 Respondent's value indicator calculations. (Petition, Exhibit G.)

9 Respondent initially contended SIR expenses are not ordinary in nature, and are not recurring  
10 future annual expenses, and thus are properly not deducted when calculating the CEA value indicator,  
11 under Rule 8.

12 In its Reply, Petitioner renewed its contention, insisting the SIR expenses are ordinary  
13 expenses associated with the wildfires that SCE incurs, or expects to incur, every year.

14 In the EY Report, Petitioner revised its requested adjustment to \$211 million, based on  
15 capitalizing the annual \$23 million SIR expense into perpetuity. (EY Study, Exhibit 4, pp.56-57.)

16 After the Appeals Conference on November 12, 2020, Petitioner provided additional detail  
17 about the SIR expenses, including evidence to support that the SIR expenses are recoverable within  
18 Petitioner's rates. After review of Petitioner's supplemental information, Respondent is satisfied that  
19 SIR expenses are recoverable in Petitioner's rates and, thus, can reasonably assume they are also  
20 included in SCE's revenues. Accordingly, Respondent is recommending the removal of \$23 million  
21 from Petitioner's revenues, resulting in an overall value reduction of \$52,774,025.

22 **Applicable Law and Appraisal Principles**

23 See Burden of Proof and Income Approach to Value in Legal Issue 1.

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27 <sup>21</sup> Petitioner notes SIR can be used in conjunction with a general liability policy to minimize insurance premiums, i.e. a  
28 company will pay for losses as they occur, rather than paying for them in advance via insurance premiums. SIRs are similar  
to an insurance deductible, in a sense. SIRs are determined by the company itself based on the amount of risk it wants to  
retain, which then becomes the SIR. If a loss is sustained less than the SIR, the company pays the entire amount of the loss  
rather than pursuing recovery via an insurance claim.

1 **Analysis and Disposition**

2 Respondent is presumed to have correctly determined the value of the property at issue and  
3 Petitioner bears the burden of proving otherwise. Here, Petitioner contends that Respondent improperly  
4 disallowed \$23 million in SIR expenses and that contends such expenses should be capitalized annually  
5 in perpetuity, resulting in a reduction of \$212 million. Based on Petitioner's supplemental information,  
6 Respondent has established that the SIR expenses are recoverable in Petitioner's rate and recommends  
7 removing the \$23 million from Petitioner's revenue. Accordingly, Respondent is recommending an  
8 overall value reduction of \$52,774,025 as to this issue. We find that Respondent's recommended  
9 adjustment is appropriate. Further, we find that Petitioner has neither provided evidence or argument to  
10 prove that further adjustment is required, nor proven that Respondent erred in the calculation of the  
11 recommended adjustment. Thus, we adopt Respondent's recommended adjustment and find no further  
12 adjustment is warranted as to this issue.

13  
14 **Legal Issue 6: Whether Petitioner Has Shown that Respondent Failed to Account for All**  
15 **Obsolescence Within the HCLD Value Indicator, After Respondent's Application of the Equity**  
16 **Risk Premium.**

17 **Findings of Fact and Related Contentions**

18 In Petitioner's EY Report, Petitioner requests a \$1.289 billion economic obsolescence  
19 adjustment to the HCLD value indicator. Petitioner asserts this will account for the fact that SAPD  
20 allowed a 0.85 percent equity risk premium adjustment to the capitalization rate used in the CEA value  
21 indicator calculation, which resulted in a reduction of Respondent's calculated CEA value of  
22 approximately \$1.3 billion. Petitioner appears to argue that the difference in the CEA value, i.e. before  
23 and after the equity risk premium adjustment is applied, is equal to the amount of economic  
24 obsolescence that should be adjusted for in the HCLD value indicator.

25 Respondent notes it did allow a 0.85 percent equity risk premium, over and above that allowed  
26 by the CPUC in determining the CPUC rate of return; the increased equity risk premium resulted in an  
27 increased capitalization rate to determine Petitioner's CEA value indicator. After review and  
28 consideration of Petitioner's request for a \$1.289 billion economic obsolescence adjustment to the

1 HCLD indicator to account for the equity risk premium adjustment applied within the increased  
2 capitalization rate, SAPD agrees additional economic obsolescence exists; however, Respondent does  
3 not agree with Petitioner’s proposed calculation, as it incorrectly equates the CEA adjustment to the  
4 HCLD adjustment. Instead, Respondent determined the recommended obsolescence adjustment  
5 percentage to the HCLD value indicator by comparing the effect on the HCLD of the CPUC-approved  
6 capitalization rate with the capitalization rate used by staff. Respondent asserts applying this percentage  
7 yields the level of economic obsolescence suffered by the assets, which resulted in a \$1.686 billion  
8 economic obsolescence adjustment to the HCLD indicator. Accordingly, Respondent recommends an  
9 overall unitary value reduction of \$1,264,780,825, reflecting its recommended economic obsolescence  
10 adjustment to the HCLD indicator.

### 11 **Applicable Law and Appraisal Principles**

12 See Burden of Proof and Value Standard in Legal Issue 1.

### 13 **HCLD Approach to Value**

14 Property Tax Rule 3, subdivision (d) provides the HCLD approach to value shall be considered  
15 “[i]f the income from the property is regulated by law and the regulatory agency uses historical cost or  
16 historical cost less depreciation as the rate base, the amount invested in the property or the amount  
17 invested less depreciation computed by the method employed by the regulatory agency.” HCLD, with  
18 some modification, approximates the rate base that regulators use in establishing revenue requirements.

19 (See *UVM*, p. 1.) HCLD reflects the market value contribution of all taxable property including the  
20 depreciated historical cost of plant in service, possessory interests, construction work in progress, and  
21 materials and supplies. (AH 502, p. 146.) HCLD is,

22 one of the more important indicators of value for closely regulated public utilities. The general  
23 practice of the California Public Utilities Commission (CPUC) and most other regulatory  
24 agencies is to use historical or original cost less depreciation (with various adjustments) as the  
rate base. The regulatory agencies establish a rate base and a rate of return; utilities are  
permitted to earn at this established rate on the rate base.

25 (UVM, p. 1.) Further, Board guidance states,

26 Appraisal depreciation in the form of obsolescence may be present in utility property and  
27 deducted from HCLD. Such deductions may be proper when the utility’s economic income has  
been impaired and the rate or tariff-setting regulators have recognized such impairment.

28 (UVM, p. 1.)



1 **Analysis and Disposition**

2 Respondent is presumed to have correctly determined the value of the property at issue and  
3 Petitioner bears the burden of proving otherwise. Here, Petitioner contends that Respondent has failed  
4 to fully adjust for economic obsolescence present in the HCLD value indicator, after Respondent's  
5 adjustment to the capitalization rate used in the CEA value approach to account for the 0.85 percent  
6 equity risk premium applied. Petitioner asserts the economic obsolescence present is equal to and  
7 proven by the difference in the CEA value approaches, calculated before and after the application of the  
8 equity risk premium adjustment. While Respondent acknowledges there is additional economic  
9 obsolescence present in the HCLD approach, Respondent contends this economic obsolescence is  
10 instead correctly quantified as the difference in HCLD value indicators, calculated by utilizing the  
11 CPUC-approved capitalization rate and the capitalization rate utilized by staff after the equity risk  
12 premium was applied. Based on this calculation, Respondent recommends an economic obsolescence  
13 adjustment to the HCLD value indicator of \$1.686 billion, resulting in a recommended overall value  
14 reduction of \$1,264,780,825. Based on the evidence and arguments submitted to the record to date, we  
15 find that Respondent's recommendation is reasonable and supported by the facts, evidence, and  
16 relevant legal and appraisal principals. Further, we find Petitioner has neither shown specific evidence  
17 or argument to prove error within Respondent's recommended economic obsolescence adjustment, nor  
18 shown any evidence or argument to prove further adjustment is required. Accordingly, we adopt  
19 Respondent's recommended adjustment as to this issue and find no further adjustment is warranted as  
20 to this issue.

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**Decision**

Accordingly, the petition for reassessment is granted, in part, and the 2020 Board-adopted unitary value is reduced from \$29,802,900,000 to \$28,485,345,150.\*

Antonio Vazquez \_\_\_\_\_, Chairman

Mike Schaefer \_\_\_\_\_, Vice Chair

Betty T. Yee \_\_\_\_\_, Controller

\* The decision was rendered in Sacramento, California on December 16, 2020. This summary decision document was approved on February 23, 2021, in Sacramento, California.