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[1]

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

	Value	Penalty	Total
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

[1] 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).[2] 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)[3] value indicator ($31,980,069,007) and 25 percent reliance on the Capitalized Earning Ability[4] (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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[2] 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.
[3] The HCLD value indicator is a form of the cost approach to value.
[4] The CEA value indicator is a form of the income approach to value.

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

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

- Assembly Bill 1054 (Ch. 79, Stats. 2019) (AB 1054)[5] requires SCE to pay an additional $95 million per year for 10 years into the wildfire fund. Respondent made an adjustment to account for this requirement, which resulted in an approximately $156 million value reduction.

- SCE has requested a 0.85% wildfire risk premium be added to its capitalization rate. Respondent made an adjustment to account for this request, which resulted in an approximately $325 million value reduction.

- SCE made $400 million in capital expenditures for fire risk mitigation as of the 2020 lien date, as required by AB 1054. AB 1054 precludes SCE from earning an equity return on these capital expenditures. Respondent made an adjustment to account for this expenditure, which resulted in an approximately $128 million value reduction.

[5] 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.

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

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

> After considering the evidence on market conditions, trends, creditworthiness, interest rate forecasts, quantitative financial models, additional risk factors including business risk [which includes wildfire risk], and interest coverage presented by the parties and applying our informed judgment ... We find that SCE's authorized test year 2020 ROE should be 10.30%. This ROE is 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%[fn omitted] average ROEs granted to United States electric utilities during 2018.

(CPUC Decision 19-12-056, pp. 40-41.) Further, Respondent notes that the CPUC's final conclusion was that "*We find that the passage of AB 1054 and other investor supportive policies in California have mitigated wildfire exposure faced by California's utilities.*" (CPUC Decision 19-12-056, at p. 37; *emphasis added* by Respondent.) The CPUC also stated "Based on the above financial, business, and regulatory risks discussion, we conclude the ROE ranges adopted in the proceedings…adequately compensate the utilities for these risks." (*Id.* at p. 40.) While Respondent notes that Petitioner's request

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[6] A utility's Rate of Return, or Cost of Capital, is the weighted average cost of debt, preferred equity, and common stock, a utility has issued to finance its investments. Return on Equity (ROE) is the return to common equity. The CPUC attempts to 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: <https://www.cpuc.ca.gov/General.aspx?id=10457> and <https://www.cpuc.ca.gov/uploadedFiles/CPUC_Public_Website/Content/About_Us/Organization/Divisions/Policy_and_Pla nning/PPD_Work/PPDReturnonEquityDCFmethodology_2.pdf > [As of Nov. 30, 2020.]

[7] 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].

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

Applicable Law and Appraisal Principles

Burden of Proof

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

Analysis and Disposition of General Contentions

Respondent is presumed to have correctly determined the value of the property at issue and Petitioner bears the burden of proving otherwise. Here, Petitioner asserts that the mere magnitude of its assessed value increase from 2019 is objectively unreasonable and proves that economic and other uncertainties were not fully considered by the Board; however, Respondent points out Petitioner's 2019 calendar year asset additions support the year over year valuation increase. Additionally, Petitioner asserts the existence of additional business risk from wildfires was not fully reflected in the Board-adopted value; however, Respondent contends risk is only one of many factors that affects appraisal and that the cited wildfire risk has already been adjusted for, as described in the 2020 appraisal narrative. While Respondent raises Petitioner's prior CPUC proceeding as evidence that such risk was viewed as adequately captured in the rate base, we note that such a finding has relevance to the instant proceeding, particularly as it relates to the determination of the rate base utilized by Respondent in the development of the HCLD value indicator; however, we also note that Petitioner's specific factual contentions and legal issues have been fully considered by the Board, herein, as a case of first impression. With respect to these general contentions and background details raised by the parties, we find that Petitioner has not raised any specific contention herein to prove that Respondent erred in the calculation of the 2020 Board-adopted value. Further, we also find that to the extent that Petitioner introduced these facts and contentions to provide context to the specific legal issues raised in this petition, Petitioner bears the burden of proof to show error within Respondent's calculation of the 2020 Board-adopted unitary value with regard to each specific legal issue raised before the Board.

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

<u>Findings of Fact and Related Contentions</u>

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

Respondent contends the HCLD and CEA value indicators were reconciled, consistent with relevant appraisal guidance and law. Respondent notes that significant differences in the two value approaches can and may occur without compromising the validity of the underlying value approach. (Assessors' Handbook, section 501 (AH 501) *Basic Appraisal*, p. 62 and Assessors' Handbook, section 502 (AH 502) *Advanced Appraisal,* p. 111.) Further, Respondent notes the HCLD approach is one of the more important indicators of market value for closely regulated public utilities, like Petitioner, as HCLD, with some modification, approximates the rate base that regulators use in establishing revenue

[8] See Issue 6; Petitioner's additional obsolescence argument is discussed therein.

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

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

In its Supplemental Analysis, Respondent contends none of the factors noted by Petitioner in its filings provide a specific explanation as to why the CEA value indicator should receive more weight. Respondent notes the HCLD value indicator is based on the rate which the rate-regulating agency allows the company to earn considering all business risks and circumstances, including wildfires, and the CPUC has already reviewed Petitioner's rate increase requests and based on the financial, business, and

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[9] All references to "Property Tax Rule" or "Rule(s)" are to sections of title 18 of the California Code of Regulations.
[10] 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.
[11] Immediately prior to the Appeals Conference, Petitioner submitted the EY Report with a revised opinion of value.

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

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

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

<u>Applicable Law and Appraisal Principles</u>

<u>Burden of Proof</u>

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

<u>Value Standard</u>

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

<u>HCLD Approach to Value</u>

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

> one of the more important indicators of value for closely regulated public utilities. The general practice of the California Public Utilities Commission (CPUC) and most other regulatory 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.

(UVM (2003), p. 1.)

<u>Income Approach to Value</u>

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

Reconciliation of Value Indicators

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

Analysis and Disposition

Respondent is presumed to have correctly determined the value of the property at issue and Petitioner bears the burden of proving otherwise. Here, Petitioner is a rate-regulated public utility with an established income stream and thus reliance on both the HCLD and CEA value indicators is appropriate, as provided by Property Tax Rules 3, 6, and 8. Further, the application of reconciliation methodology and the determination of a final opinion of value are explicitly contemplated and described in Property Tax Rule 3 and AH 501 and 502. While Petitioner claims Respondent's appraisal is flawed or unreconciled, the requested opinion of value within the EY study does not even disclose what reliance Petitioner is requesting be placed on each value indicator; as such, it is not a valid starting point regarding the reconciliation of the two value indicators. Further, we find that Petitioner has provided no evidence or argument to support a revised weighting of the value indicators; specifically, Petitioner has not met its burden of proving that the HCLD indicator is impaired, nor that its CEA value indicator must be granted additional weight. Based on the foregoing, we conclude Petitioner has not met its burden of proof to overcome the presumption that Respondent correctly relied upon and reconciled both the HCLD and CEA value indicators, consistent with Property Tax Rules 3, 6, and 8.

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

<u>Findings of Fact and Related Contentions</u>

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

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

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

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[12] "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).

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

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

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

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[13] Petitioner's Consolidated Balance Sheet, Attached to SAPD's Analysis, Exhibit 3.
[14] Petitioner's Consolidated Statement of Income, Attached to SAPD's Analysis, Exhibit 4.
[15] 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.

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

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

In its response, Respondent renews its position.

Applicable Law and Appraisal Principles

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

Income Approach to Value

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

[16] In support, Petitioner cites a general statement from AH 502 to support this supposition. AH 502, p. 67, "Cost trends 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.

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

Analysis and Disposition

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

Legal Issue 3: Whether Petitioner Has Shown that Respondent Improperly Assessed $400 Million of Wildfire Mitigation Capital Expenditures.

Findings of Fact and Related Contentions

Petitioner contends that Respondent improperly assessed $400 million of wildfire mitigation capital expenditures in its 2020 assessment of SCE, based on the incorrect assumption that these assets generate a cash flow from ratepayers, allowing SCE to realize a return on investment.[17] Petitioner contends that under AB 1054, SCE is required to make capital expenditures to the wildfire mitigation fund, including the initial $1.6 billion, which will not be included in SCE's rate base, nor will SCE be allowed to earn a return on the investment. Instead of the traditional approach of Petitioner financing infrastructure investments by adding the assets in its rate base and retaining the opportunity to earn a rate of return on its investment, Petitioner states that the $1.6 billion wildfire mitigation spent will be recovered through a securitizable dedicated-rate component through a financial product known as securitization.[18] Petitioner asserts that this securitization structure provides no assessable value to a willing buyer/seller transaction, as there is no opportunity to earn an investment return on the assets. Accordingly, Petitioner asserts a buyer would value the first $1.6 billion of wildfire mitigation capital expenditures ($400 million as of 12/31/19) at zero, and as such, Respondent should do the same and remove these costs from the HCLD value indicator.

Respondent contends no adjustment is appropriate for this issue. Respondent notes when making capital expenditures, firms typically expect both a "return of" their invested capital as well as a "return on" their invested capital. (AH 502, p. 62.) Both components are captured in the capitalization rate, which provides explicitly or implicitly for both the return of and the return on capital. (*Ibid*.) Respondent contends that while Petitioner is not allowed to earn a *return on* the expenditure, Petitioner will earn a *return of* its capital expenditure through depreciation and the reimbursement of interest paid for debt service. As such, Respondent contends it made appropriate adjustments to the cost indicator to account for this by calculating the present value of the income using a discount rate that excludes the equity portion of the capitalization rate; the excluded equity portion represents the *return on* the investment, and properly leaves the rate for *return of* the investment. Respondent then removed the difference between this present value amount and the total $400 million capital expenditure, resulting in an approximately $171 million reduction to the HCLD value indicator, as already reflected in

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[17] Petition, Exhibit D, correspondence with SAPD regarding the wildfire-related mitigation expenditures, and Petition, Exhibit E, reflecting the reduction in value attributable to AB 1054 capital expenditures.

[18] 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.

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

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

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

<u>Applicable Law and Appraisal Principles</u>

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

<u>Analysis and Disposition</u>

Respondent is presumed to have correctly determined the value of the property at issue and Petitioner bears the burden of proving otherwise. Here, Petitioner contends that the $400 million of wildfire mitigation capital expenditure is in a securitization structure that does not allow for a *return on* the investment and therefore should be excluded from its assessment. However, Respondent contends appropriate adjustments were already made to the HCLD indicator to account for this by calculating the present value of the amount using a discount rate that excludes the equity portion of the capitalization rate; this excluded equity portion represents the *return on* the investment and properly leaves the rate for *return of* the investment within the assessment. Based on the evidence and arguments submitted to the record, we find that Petitioner has not shown specific evidence or argument to prove error within Respondent's adjustment to the HCLD value indicator calculation, which removes the value attributable to Petitioner's *return on* the investment and leaves the rate for *return of* its capital expenditure, as Petitioner will receive the benefit of the *return of* its capital expenditure through depreciation and reimbursement of interest paid for debt service through the securitization structure. Further, Petitioner has provided no legal or appraisal guidance to show that the HCLD value indicator must be adjusted to remove the value attributable to the *return of* its capital expenditure. Accordingly, we find that Petitioner has not met its burden of proof as to this issue.

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

Findings of Fact and Related Contentions

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

[19] Petitioner notes the Wildfire Insurance Fund does not have a defined life and will terminate when the administrator determines the fund has been exhausted. Management estimates that the wildfire fund will provide insurance coverage for 10 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.

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

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

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

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

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

In the EY Report, Petitioner renews its contentions in support of the request to allow for a revised deduction of $340 million from its annualized operating expenses in the CEA value indicator

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[20] Respondent includes selected excerpts to support its summary of *De Luz.* In determining what costs would be considered in valuing a leasehold interest under a capitalization of income method, the Court stated that:

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

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

> Furthermore, in determining the income to be capitalized to establish value for appraisal purposes, *no deduction 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*.)

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

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

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

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

Applicable Law and Appraisal Principles

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

The Income Approach: Amortization and Depreciation

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

> The reference to depreciation and amortization in subdivision (c) [of Rule 8] refers to the 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

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

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

> Furthermore, **in determining the income to be capitalized** to establish value for appraisal purposes, ***no deduction 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.]

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

<u>Analysis and Disposition</u>

Respondent is presumed to have correctly determined the value of the property at issue and Petitioner bears the burden of proving otherwise. Here, Respondent has calculated and removed the present value of the 9 remaining, future Wildfire Insurance Fund payments from the CEA value indicator used within Petitioner's 2020 Board-adopted value; however, Petitioner contends this adjustment understates the annualized and prepaid-expenses associated with the full contribution to the Wildfire Insurance Fund by ignoring the initial contributions. Instead, Petitioner contends all contributions should be annualized and deducted from the CEA value indicator calculation to represent an annual expense, akin to prepaid property insurance. Respondent contends the initial contributions to the AB 1054 fund are past, non-reoccurring expenses that Petitioner has amortized over a 10-year period and are not akin to prepaid property insurance; further, amortized expenses are explicitly disallowed from deduction in the CEA approach. Based on the evidence and arguments submitted to the record, we find that Petitioner has not shown specific evidence or argument to prove error within Respondent's treatment of the prior Wildfire Insurance Fund payments. Further, we find Respondent's treatment is 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.

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

<u>Findings of Fact and Related Contentions</u>

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

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

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

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

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

<u>Applicable Law and Appraisal Principles</u>

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

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[21] Petitioner notes SIR can be used in conjunction with a general liability policy to minimize insurance premiums, i.e. a 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.

Analysis and Disposition

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

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

Findings of Fact and Related Contentions

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

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

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

Applicable Law and Appraisal Principles

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

HCLD Approach to Value

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

> one of the more important indicators of value for closely regulated public utilities. The general practice of the California Public Utilities Commission (CPUC) and most other regulatory 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.

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

> Appraisal depreciation in the form of obsolescence may be present in utility property and 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.

(UVM, p. 1.)

Analysis and Disposition

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