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BOARD OF EQUALIZATION

STATE OF CALIFORNIA

In the Matter of the Petition for Reassessment of the 2021 Unitary Value for: **SOUTHERN CALIFORNIA EDISON COMPANY (0148)** Petitioner	**APPEALS ATTORNEY'S HEARING SUMMARY FOR ORAL HEARING ON PROPERTY TAX PETITION** Appeal No.: SAU 21-007

Representing the Parties:

For the Petitioners:	Mardiros H. Dakessian, Attorney Dakessian Law, LTD.
For the Respondent:	Richard Moon, Attorney V Attorney for State-Assessed Properties Division
	Jack McCool, Chief State-Assessed Properties Division
Appeals Attorney:	Sarah J. Garrett, Tax Counsel III (Specialist)

PROPOSED VALUES

	Value	Penalty	Total
2021 Board-Adopted Unitary Value	$31,322,100,000	$0	$31,322,100,000
Petitioner's Requested Unitary Value	$25,640,227,493	$0	$25,640,227,493
Respondent's Appeal Recommendation	$31,322,100,000	$0	$31,322,100,000

ISSUES

1. **Whether Petitioner Has Shown that the State-Assessed Properties Division (SAPD or 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.**
2. **Whether Petitioner Has Shown that Respondent Must Adjust the Board-Adopted Value for SCE's $3.6 Billion Accrual for Liabilities for the 2017/2018 Wildfires and Mudslides.**
3. **Whether Petitioner Has Shown that Respondent Improperly Assessed $1.3 Billion of Wildfire Mitigation Capital Expenditures.**
4. **Whether Petitioner Has Shown that Respondent Erred in its Treatment of Wildfire Insurance Fund-Related Contributions.**

Appeals Attorney's Recommendation and Note[1]

The Appeals Attorney recommends that the Board deny the petition for reassessment, based on the evidence and argument submitted to the record to date.

This appeal involves an amount in controversy that is $500,000, or more, in tax and thus is governed by Rev. and Tax. Code (R&TC) section 40. Please see Staff Comment on page 39 for additional detail.

Background Information

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. Petitioner's service area encompasses 50,000 square miles, which includes 103,000 miles of distribution and transmission lines, serving a population of approximately 15 million people.

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'

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[1] Unless the Board holds otherwise, the Board shall take official notice of: Petitioner's property statement filed with the Board and any attachments thereto; any reports to regulatory agencies such as the U.S. Securities and Exchange Commission and the California Public Utilities Commission (CPUC), and any annual reports to shareholders; the Appraisal Data Report (ADR) prepared by the State-Assessed Properties Division (SAPD) together with any workpapers; the Notice of Unitary Value; and any correspondence between SAPD and Petitioner.

[2] The Commission's Rules of Practice and Procedure Article 2 and Appendix A of the Commission decision (D07-07-004) set the rules and procedures for GRC review process.

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 2021 Board-adopted value is based on 75 percent reliance on the Historical Cost Less Book Depreciation (HCLD)[3] value indicator ($33,112,164,913) and 25 percent reliance on the Capitalized Earning Ability[4] (CEA) value indicator ($25,951,717,915).

On appeal, Petitioner contends that their 2021 Board-adopted unitary value is overstated and is requesting a revised unitary value of $25,640,227,493.

In the briefing and evidence submitted, Petitioner and the State-Assessed Properties Division (SAPD or Respondent) each discussed general information relevant to the context of the four specific issues raised within the briefings, including information related to SCE's past, current, and future financial and economic situation, along with the risks associated with wildfires, the context of the Board's valuation, and the state of the regulated electric generation industry as a whole. The Appeals Attorney will first provide a summary of these general concerns to provide context to the consideration of the specific issues raised within this Petition. Then, the four specific issues will be addressed under headings: Issue 1 through Issue 4.

At the Appeals Conference, the parties did not reach agreement on any of the four issues raised and affirmed they were pursuing a full hearing before the Board.

General Concerns Raised by the Parties

As a prefatory matter, each party provides remarks on the overall reasonableness of SCE's 2021 Board-adopted unitary value. Petitioner contends that the mere magnitude of the $7 billion discrepancy between the HCLD and CEA value indicators is unacceptable from an appraisal standpoint, which in short, allegedly supports their claim that SAPD's appraisal is unlawful and

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[3] The HCLD value indicator is a form of the cost approach to value. The Historical Cost Less Depreciation (HCLD) value indicator derivation includes the historical or original acquisition cost of all property less nontaxable items and property assessed elsewhere. This results in the taxable historical cost. The taxable historical cost is then reduced for the assessee's regulatory accounting depreciation of the taxable property. This results in the assessable HCLD. The value of any possessory interest and/or noncapitalized leased properties are added to arrive at the final HCLD value indicator. HCLD is one of the more important indicators of value for closely regulated public utilities. See Cal. Bd. Of Equaliz. *Unitary Valuation Methods (UVM)* (2003), pp. 1-4.

[4] The CEA value indicator is a form of the income approach to value. The income approach to value may be generally described as any method that converts future anticipated income into present value. The conversion process is commonly known as income capitalization. See Cal. Bd. Of Equaliz. *UVM*, (2003), pp. 35-37.

improper. (Petition for Reassessment and Claim for Refund "Petition", pp. 2-3.) However, Respondent points out that Petitioner's requested 2021 value of $25.6 billion is $3 billion less than the 2020 Board-adopted value, despite $5 billion[5] of asset additions in calendar year 2020 now reflected in the 2021 Board-adopted unitary value. (SAPD Analysis, p. 4) The Appeals Attorney notes the Appraisal Data Report (ADR) is included as Exhibit 2 of the SAPD Analysis; the ADR summarizes Petitioner's 2020 calendar year asset additions and retirements and provides a high-level comparison of the 2021 assessment with Petitioner's 2020 assessment.

Then, Petitioner raises 7 concerns[6], asserting these are the various business risks and other factors affecting SCE's 2021 unitary value: 1) the context of increasing catastrophic wildfires in California; 2) California's use of "inverse condemnation[7]" which "imposes strict liability…based on the presumption that a utility has the ability and is the appropriate agency to recover such costs from customers"; 3) uncertainty as to whether the CPUC will allow liability to be recovered in the rate base[8]; 4) California's Senate Bill (SB) 901[9] (Ch. 626, Stats. 2018.), which among other provisions, established CPUC's reasonableness review of utility activities to determine whether, or not, cost recovery through the rate base is allowable when the wildfire is caused by the utility's equipment, without altering California's application of inverse condemnation; 5) increasing financial and credit instability due to Moody's downgrades of California's investor-owned utilities ("IOUs"); 6) the

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[5] Respondent notes the cited approximate $5 billion in additions is the net amount after taking into account asset retirements during calendar year 2020.

[6] See Petition, pp. 3-9.

[7] Inverse condemnation is a legal concept that entitles property owners to just compensation if their property is damaged by a public use. This liability rule applies to all government agencies, as well as utilities. After a wildfire, inverse condemnation is the way that victims of fires (residents, businesses, and local agencies) recover their costs. See League of California Cities "Inverse Condemnation Fact Sheet" https://www.counties.org/sites/main/files/file-attachments/inverse_condemnation_fact_sheet_league__csac.pdf

[8] Petitioner cites 2017 CPUC ruling for San Diego Gas & Electric company (SDG&E), which held SDG&E liable for damages due to finding SDG&E had not taken reasonable actions prior to 2007 and thus not properly invoked inverse condemnation to allow cost sharing through utility rates. (CPUC, App. No. 15-09-010 and Decision 17-11-033.)

However, the courts have expressed skepticism regarding the uncertainty of recoverability that Petitioner cites; in *Pac. Bell v. So. Cal. Edison Co.* (2012) 208 Cal. App. 4th 1400, the Court noted in response to Edison's argument that the loss-spreading rationale should not apply to an investor-owned public utility due to lacking the taxing authority to raise rates without the approval of the CPUC, "Edison has not pointed to any evidence to support its implication that the Commission [CPUC] would not allow Edison adjustments to pass on damages liability during its periodic reviews." (*Id*. at 1407.) However, it should be noted the legal standards applicable to CPUC's consideration of rate base recoverability in this case has since changed.

[9] Petitioner notes SB 901 creates a framework for potential cost socialization or recovery debt financing but does not remove the standard of inverse condemnation. However, the Appeals Attorney notes, while SB 901 certainly established the reasonableness standard CPUC now uses to evaluate whether recovery of costs should be granted through the rate base, the risk, or likelihood of recovery, is directly affected by the utility's own risk mitigation efforts.

challenges and cost prohibitive nature of obtaining insurance coverage due to wildfire risk arising from its ordinary operations; and 7) the Wildfire Insurance Fund created by Assembly Bill (AB) 1054 (Ch. 79, Stats 2019), which statutorily required Petitioner to make an initial contribution of $2.4 billion, and 10 annual contributions of $95 million each, and Petitioner's statutory requirement to maintain reasonable insurance coverage, which must be exhausted prior to Wildfire Insurance Fund reimbursement becoming available to Petitioner.[10] (Petition, pp. 3-9; see also Petition, Exhibit A[11].)

However, Respondent notes that the broad risks cited do not acknowledge the adjustments already within Petitioner's 2021 unitary value, which total approximately $2.3 billion. (SAPD Analysis, pp. 2-3.) Respondent highlights four specific adjustments which have already been included in SCE's 2021 Board-adopted value:

- AB 1054[12] requires SCE to pay an additional $95 million per year for 10 years into the wildfire fund. Staff has made an adjustment to account for this requirement which resulted in an approximately $148 million value reduction.

- SCE has requested a .85% wildfire risk premium be added to its capitalization rate. Staff has made an adjustment to account for this request, which resulted in an approximately $397 million value reduction.

- AB 1054 requires SCE to make $1.6 billion in capital expenditures over a three year period for fire risk mitigation purposes. The assembly bill precludes SCE from earning an equity return on these capital expenditures. As of the 2021 lien date, SCE has made $1.3 billion in capital expenditures for this purpose. Staff has made an adjustment to account for SCE's inability to earn an equity return on these expenditures, which resulted in an approximately $387 million value reduction.

- Staff made an obsolescence adjustment to the HCLD indicator to acknowledge additional obsolescence resulting from the .85% equity risk premium addition to the capitalization rate. This adjustment resulted in an approximately $1.42 billion value reduction.

(SAPD Analysis, pp. 2-3; See also SAPD Analysis, Exhibit B, Appraisal Data Report.)

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[10] Petitioner also notes that maintaining $1 billion of insurance coverage has become increasingly expensive, citing $450 million in costs for FY 2020-2021, and estimates that cost increasing, which questions their ability to obtain a reasonable amount of wildfire insurance, at a reasonable cost. (Petition, p. 9.)

[11] Petitioner quotes a 2018 study: *The California Wildfires* (attached as Petition, Exhibit A.)

[12] Assembly Bill 1054 (Ch. 79, Stats. 2019) (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 Petitioner.

Then, Respondent contends, these, among other arguments regarding a general increase in business risk due to wildfires, are the same arguments Petitioner made—and the Board rejected last year.[13] Further, Respondent notes these are also the same arguments the CPUC rejected in SCE's request for a wildfire risk premium adjustment to increase the return on equity[14] (ROE) allowed. (SAPD Analysis, p. 3; citing CPUC Decision 19-12-056 (Dec. 19, 2019), pp. 40-41.) In the CPUC case,[15] the CPUC stated:

> 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*.[16]

Further, Respondent notes that CPUC's final conclusion was that "*We find that the passage of AB 1054 and other investor supportive polices in California have mitigated wildfire exposure faced by California's utilities."* (SAPD Analysis, p. 3 citing CPUC Decision 19-12-056, at p. 37; emphasis added by Respondent.) The CPUC also stated "[b]ased 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.) Respondent notes that Petitioner also recognized its significant reduction of risk of liability and as they voluntarily significantly reduced its ROE increase request in the CPUC case following the passage of AB 1054. (*Id.*, at p. 28.)

In addition, Respondent notes that similar to SCE's 2020 unitary value, and even though the CPUC denied Petitioner's increased ROE request based on its conclusion that mitigation measures and

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[13] California State Board of Equalization, Appeal SAU 20-015, decided December 16, 2020.

[14] 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/industries-and-topics/electrical-energy/electric-costs/cost-of-capital> and <https://www.cpuc.ca.gov/industries-and-topics/electrical-energy/electric-costs/historical-electric-cost-data/rate-of-return> [As of Nov. 30, 2021.]

[15] California Public Utilities Commission Decision 19-12-056 (D1912056) (Dec. 19, 2019), p. 28 available at <https://docs.cpuc.ca.gov/DecisionsSearchForm.aspx> [as of Nov. 30, 2021].

[16] *Id.* at pp. 40-41, emphasis added by Respondent.

AB 1054 had sufficiently addressed wildfire risk, SAPD has again allowed an increased equity risk premium of .85 percent to Petitioner's 2021 overall capitalization rate. (SAPD Analysis, pp. 3-4.) This equity risk premium resulted in an approximately $1.8 billion value reduction, which was allowed to acknowledge risk that might not be captured in the other adjustments allowed for the Petitioner. (*Ibid.*)

In the Reply to SAPD's Analysis, Petitioner contends that despite SAPD's claims of multiple and generous adjustments that the Board should not conflate the wildfire risk premium adjustment discussion with the specific issues raised in SCE's petition (discussed *infra*). (Petitioner's Resp to SAPD Analysis "Reply", pp. 2-3.)

While these general risks and factors are relevant to the context of this appeal, the Appeals Attorney notes no general concern raised proves *ipso facto* that Respondent erred in the calculation of SCE's 2021 Board-adopted unitary value. Petitioner is providing a general assertion that Respondent did not consider, or fully consider, the risk Petitioner faces as a part of its 2021 assessment, which it contends is visible due to the value differential between the HCLD and CEA approaches. However, Respondent confirms it has considered many factors in its assessment,[17] and also highlights certain adjustments[18] within SCE's 2021 valuation that reflect increased wildfire risk, including the allowance of a 0.85% wildfire risk premium added to the capitalization rate.[19] Further, the Appeals Attorney notes Petitioner maintains the burden of showing that Respondent's underlying assessment is incorrect or illegal. (*ITT World Communications v. Santa Clara* (1980) 101 Cal.App.3d 246; see also Cal. Code Regs., tit. 18, § 5541, subd. (a).) This requires specificity and verifiable evidence or error. Accordingly, to the extent that Petitioner is using these general risks and factors to assert specific errors exist within Respondent's calculations supporting the assessment at issue, Petitioner maintains the burden of providing evidence and proving the existence of such alleged specific errors within Respondent's calculation of the 2021 Board-adopted unitary value in the following four specific issues raised.

At the hearing, the parties should be prepared to discuss these general contentions as they relate and provide context to the specific issues raised in this petition.

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[17] Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.)
[18] Detailed in SCE's 2021 Appraisal Data Report Narrative, included as SAPD Analysis, Exhibit B.
[19] Note, this risk premium is above what the CPUC was willing to entertain for Petitioner; discussed *supra* p. 6. See also California Public Utilities Commission Decision D1912056 referenced in ftn. 15.

STATE BOARD OF EQUALIZATION
PROPERTY TAX APPEAL

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.

Petitioner's Contentions

Based on the two contentions described below, Petitioner requests that the Board revise its 2021 unitary value by placing 65 percent reliance on the HCLD value indicator and 35 percent reliance on the CEA value indicator. [20] (Petition, p. 9.)

Petitioner asserts Respondent has not reconciled the $7 billion in value difference between the HCLD and CEA value indicators in violation of the Assessors' Handbook.

Petitioner asserts Respondent's appraisal is flawed as the two value approaches utilized produced widely varying results. (Petition, p. 12.) Petitioner alleges that due to this disparity, and as Respondent's analysis does not explicitly state the value approaches were reconciled, Respondent must have decided to simply weigh the HCLD value indicator as 75 percent and the CEA value indicator 25 percent, without any reconciliation or reason for doing so, which, in Petitioner's opinion, is contrary to the guidance within Assessors' Handbook (AH), section 501, *Basic Appraisal* (AH 501). (*Id.* pp. 11-12.) Petitioner also asserts that Respondent's failure to reconcile the value indicators is further underscored by the admission that it is the same reliance used to value Petitioner's property in each of the past 10 years. (*Id.* at p. 12.) Petitioner concludes the changes that have taken place during the last 10 years, including climate, the utility industry as a whole, and to Petitioner specifically, require a re-weighting of the two value indicators. (*Id.* at p. 12.)

Petitioner asserts the $7 billion difference between the HCLD and CEA value indicators is due to obsolescence.

Petitioner alternatively asserts $7 billion difference in value indicators reflects that the HCLD approach has not fully captured obsolescence. (*Id.* at pp. 12-13.) As described above, Petitioner contends Respondent has not reconciled the two indicators, nor provided analysis or market data to

[20] Petitioner asserts this adjustment would result in a reduction to its unitary value of $716,044,700. (Petition, p. 9.) However, the Appeals Attorney notes that this estimation is dependent upon success of Petitioner's other requested issues, and is currently indeterminable as to what value is attributable to this issue solely.

support the 75/25 weighting. (*Id.* at 13.) Additionally, Petitioner contends that Respondent undermines its own argument; specifically, while Respondent indicates HCLD is one of the more important indicators of value for closely regulated public utilities as the regulatory agencies establish the rate base and rate of return, Respondent also argues that certain assets must be included in the HCLD that are not included in the rate base and has improperly ignored regulatory restrictions on the rate of return (discussed in Issue 3). (*Ibid.*) Further, Petitioner asserts that Property Tax Rule[21] 8 indicates the income approach must be granted additional weight. (*Id*. at pp. 13-14.) Overall, Petitioner asserts that it believes the rate base determined by the CPUC is very reliable, but that the HCLD indicator calculated by SAPD, is unreliable when Respondent includes assets not included in the rate base and does not recognize impairments due to regulatory restrictions placed on certain assets (i.e., the inability to earn a return), and as such, additional reliance placed on the income indicator captures the economic impairment due to wildfire risks and inverse condemnation. (*Ibid.*) Petitioner cites that the EY report[22] it commissioned in the SAU 20-015 appeal for lien date 2020, supports this view and actually reconciles the two approaches, unlike Respondent's work and responses which "fails to address the significant change in the landscape of the utility industry, the functional and economic obsolescence, or the regulatory restrictions imposed on Petitioner's assets."[23] (*Id.* at pp. 14-15.)

Petitioner further contends that Respondent concedes "regulatory lag" exists and that SCE is not earning a return on certain capital expenditures, but instead of quantifying that impact, Respondent has not explained why the 25 percent weighting of the CEA value indicator accurately captures the impact of regulatory lag.[24] (*Id.* at p. 16.) Further, Petitioner argues that this regulatory lag results in an overvaluation of Petitioner's assets, as such assets should not be valued at cost if they cannot yet earn a return on them, and, as such, increased reliance on the income approach is justified. (*Ibid.*)

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[21] All references to "Property Tax Rule" or "Rule(s)" are to sections of title 18 of the California Code of Regulations.

[22] Petitioner has included a draft copy of the Ernst & Young, LLP (EY) Valuation Analysis, November 9, 2020 (EY Report) as Petition, Appendix B). However, it should be noted this report was prepared for lien date 2020, not lien date 2021, i.e. the subject of this appeal; thus, while referenced, the EY report is not an appraisal for the lien date at issue. Further, the EY report does not publish any conclusion as to what it believed to be the proper weighting, nor is this attached report the finalized copy.

[23] Petitioner does not, however, acknowledge that the draft 2020 EY Report does not provide the relative weight placed on each of the two approaches to value.

[24] Regulatory lag is the time delay between a utility's costs and any adjustment CPUC may make to the rate base to account for these costs. This process creates a lag between the time the assets are placed in service and the time the company begins to get a recover of and recovery on the assets.

Petitioner concludes that Respondent's failure to reconcile the $7 billion difference in the HCLD and CEA approaches renders the appraisal completely disconnected from what a willing buyer would pay. (*Ibid*.)

In its reply, Petitioner asserts that its argument that the difference between the two value indicators is attributed to economic obsolescence is supported by AH 502, *Advanced Appraisal*, which states a "CEA indicator which is much lower than an HCLD may indicate that obsolescence exists in the property." (Reply, p. 4.) Additionally, Petitioner reasserts that Respondent has not reconciled the indicators in an analytical manner and is distracting from that failure by requesting Petitioner "provide a reconciliation of value indicators in an analytical manner" based on "reasoned and defensible opinion of verified market data" (Reply, p. 4.) Petitioner concludes by reasserting SAPD's duty is to reconcile the indicators, and the difference between the two approaches suggests Respondent has not addressed all economic and functional obsolescence. (Reply, p. 5.)

Respondent's Contentions

Respondent has conducted its appraisal by calculating and reconciling the HCLD and CEA value indicators, consistent with relevant law and appraisal guidance.[25] Respondent notes significant differences in the two value approaches can and may occur, as stated in Assessors' Handbook, section 501 (AH 501) *Basic Appraisal,* without compromising the validity of the underlying value approach, quoting:

> The reconciliation of value indicators from the separate approaches to value and the resulting final value estimate is the next step in the appraisal process. *Theoretically*, the approaches to value should produce identical value indicators. *In practice, however, this is rarely the case, and significant differences may occur*. To produce a final value estimate, the appraiser reconciles the indicators from each approach utilized. Value indicators should be reconciled considering: (1) the appropriateness of the approach given the purpose of the appraisal; and (2) the adequacy and reliability of the data available to perform the appraisal. The appraiser should examine and reconcile all value indicators.

(SAPD Analysis, p. 5; citing AH 501, p.62, emphases added.) Specifically, Respondent notes that when analyzing and reconciling value indicators to arrive at a final value estimate, the criteria described in AH 502 should be considered:

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[25] Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.)

> The final value estimate is an appraiser's *opinion of value*. There is no mathematical formula or statistical technique to which the appraiser can ultimately refer in order to reach the final value estimate. It is an opinion that should be based on the appraiser's application of generally accepted appraisal methods and procedures. It is generally inappropriate to use the arithmetic mean of the value indicators as the final value estimate. Simply calculating an average implies that all the value indicators have equal validity. While this may occur in certain instances, it is usually not the case. Appraisers must follow Rule 3, noted above, and consider the appropriateness of the value approaches, the relative accuracy of the value indicators, and the quantity and quality of the data available when reconciling value indicators to reach the final value estimate.

(SAPD Analysis, pp. 4-5; citing AH 502, p. 111; Emphasis added by Respondent.)

Respondent notes the HCLD approach is a reliable indicator 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 requirements.[26] (SAPD Analysis, p. 5; citing *Unitary Valuation Methods* (*UVM*) (2003), p. 1.) Further, 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.

(SAPD Analysis, p. 6; citing *UVM,* p. 1. Emphasis added.)

Respondent also notes that Property Tax Rule 8, subdivision (a), indicates the CEA value indicator is appropriate to use when the property has "an established income stream…," and here, Petitioner has an established income stream.[27] (SAPD Analysis, p. 5.)

Respondent states that consistent with the relevant HCLD and CEA value indicator considerations, and Petitioner being a utility, rate regulated by the CPUC, Respondent considered HCLD to be the most reliable indicator of value, placing 75 percent reliance on the indicator. (SAPD Analysis, p. 6.) 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." (*Ibid.*) Accordingly, in Respondent's opinion, it is appropriate to weight the CEA value indicator 25 percent to account for regulatory lag in rate adjustment for items on which Petitioner is not currently earning a

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[26] Respondent also cites excerpts from AH 502, p. 146, which further support the use of the HCLD approach as relevant for public utility properties. (SAPD Analysis, pp. 5-6.)
[27] Petitioner acknowledges that it has an established income stream. (Reply, p. 5.)

return. (*Ibid.*)

Respondent also notes the 75/25 percent reliance on HCLD and CEA respectively is the same reliance used by SAPD to value Petitioner's property in each of the past 10 years, as well as the same reliance Respondent places on the value indicators of other investor-owned, rate-regulated utilities. (*Ibid.*) Respondent contends, while Petitioner sees this consistency as a flaw or indication that changes have not been reflected related to the climate, utility industry, and to Petitioner specifically, Respondent asserts Petitioner ignores the fact that a change in weighting is not the sole method by which significant value adjustments can be made to reflect such factors, such as the approximately $2.3 billion downward adjustment made to account for wildfire risk. (*Ibid.)*

Respondent also notes that Petitioner's assertion that the difference between the HCLD and CEA methods is entirely attributable to economic obsolescence is wholly unsubstantiated. *(Ibid.*) Further, Respondent notes last year Petitioner requested 50 percent weighting of the CEA value indicator in its original petition, before revealing at the hearing its revised opinion of value placed 35 percent reliance on the CEA indicator, with no explanation for the change. (*Ibid.*) Respondent concludes while Petitioner criticizes SAPD's reasoning, Petitioner has not provided as basis for the reconciliation of the value indicators it requests in this petition in an "analytical manner" that is based on a "reasoned and defensible opinion of verified market data". (*Ibid,* quoting Petition, p. 11, citing AH 502, p. 62.)

For these reasons, Respondent maintains no adjustment can be recommended as to this issue.

Applicable Law and Appraisal Principles

Burden of Proof

Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.) Therefore, Petitioner has the burden of showing that the assessment is incorrect or illegal. (*ITT World Communications v. Santa Clara* (1980) 101 Cal.App.3d 246; see also Cal. Code Regs., tit. 18, § 5541, subd. (a).)

Value Standard

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."

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 (2003), 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.)

Depreciation and the Cost Approach

In general, the cost approach recognizes three types of depreciation: physical deterioration, functional obsolescence, and external, or economic, obsolescence, through the application of the Board's replacement cost new trend factors and "percent" good factors. Obsolescence may occur when property is outmoded (functional obsolescence) or when some event has substantially diminished the future earning power of the property (economic obsolescence). (See Assessors' Handbook section 501, *Basic Appraisal* (January 2002), pp. 80-83.) Functional obsolescence is the loss of value in a property caused by the property's loss of capacity to perform the function for which it was intended. (Id. at p. 81.) Economic obsolescence is the diminished utility of a property due to adverse factors external to the property being appraised and is incurable by the property owner. (Id. at p. 82.) The existence of any additional or extraordinary obsolescence must be supported with verifiable documentation and evidence, consistent with Board Guidelines. (See Property Tax Rule 6, subds. (d) & (e); Assessors' Handbook section 502, *Advanced Appraisal* (Reprinted January 2015) (AH 502), pp. 20-21; *Unitary Valuation Methods*, (2003), p. 30; and Cal. Bd. of Equalization, *Guidelines for Substantiating Additional Obsolescence*, at p. 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 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 (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.)

Appeals Attorney's Analysis and Comments

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 because Respondent's calculated HCLD value indicator exceeds the CEA value indicator by $7 billion, Respondent's 2021 Board-adopted unitary value is flawed, as the various approaches to value must yield approximately the same results, and differences of such a magnitude indicate the value indicators were not reconciled. Further, Petitioner contends Respondent did not reconcile the two value indicators, as required by Property Tax Rule 3 and Board Guidance, but instead "decided to simply weight historical cost 75% and income only 25%" without reason. Petitioner appears to be asserting the Board should adopt the appraisal judgment of last year's EY Report or, alternatively, adjust the weighting of the indicators pursuant to its request, without putting forth any specific argument or evidence to support their request for additional weight to be placed on the CEA value indicator, despite bearing the burden of proof to show error or illegality.

Respondent contends that Board guidance clearly states that significant differences may occur in validly calculated indicators. (citing AH 501, p. 62.) Further, Respondent notes that the HCLD value indicator is a reliable indicator of value for closely regulated public utilities, like Petitioner, because HCLD, with some modification, approximates the rate base that regulators use in establishing revenue requirements. Accordingly, Respondent contends, in light of all available evidence, it was reasonable and appropriate to place 75 percent reliance on the HCLD value indicator, which reflects the consideration of many factors, including: Petitioner's "regulatory lag," Petitioner's established income stream, the relative reliance placed on the value indicators of other rate-base regulated utilities, and consistency with Property Tax Rules 3, 6, and 8, as well as relevant Board guidance. Further, Respondent contends Petitioner's allegation that the difference in the HCLD and CEA value indicators being attributed to obsolescence is wholly unsupported. Additionally, Respondent asserts that Petitioner already raised the additional risk concerns reiterated in the instant petition with the CPUC, which concluded no further adjustment to Petitioner's ROE was warranted. Accordingly, Respondent concludes Petitioner has provided no evidence or argument to support a revised weighting of the value indicators.

Based on the evidence and arguments submitted to the record to date, the Appeals Attorney finds that Petitioner has not shown specific evidence or argument to prove that its HCLD indicator is impaired, nor has Petitioner shown that its CEA value indicator should be granted additional weight. Petitioner's contention instead appears to rest on its request that the Board find Respondent's appraisal judgment and valuation approach flawed, without Petitioner providing any specific evidence, and that the Board should instead adopt the appraisal judgment of the draft 2020 EY Report or Petitioner's unsupported claims in the instant petition. However, it is well settled that the burden of proof is on the Petitioner, and that such treatment would be not only unsupported under relevant law and appraisal principles, but also inequitable in comparison to other rate-regulated electric-generating utility assessees that are also assessed by this Board.

At the hearing, the parties should be prepared to discuss the issue; further, Petitioner should be prepared to explain: why, specifically, as a rate-base regulated utility, it believes Respondent's HCLD indicator is less reliable, despite HLCD being considered to be one of the more important indicators of value for closely regulated utilities, based on verifiable evidence or relevant legal and appraisal principles; why, specifically, it believes its CEA value should be granted more relative reliance in comparison to the HCLD value indicator and what verifiable evidence or relevant legal and appraisal principles support that request; and why Petitioner's value indicators should be weighted differently compared to other similarly situated investor-owned, rate-regulated utilities.

ISSUE 2

Whether Petitioner Has Shown that Respondent Must Adjust the Board-Adopted Value for SCE's $3.6 Billion Accrual for Liabilities for the 2017/2018 Wildfires and Mudslides.

Petitioner's Contentions

Petitioner asserts the Board-adopted value does not account for SCE's $3.6 billion accrual for liabilities for the 2017/2018 wildfires and mudslides, erroneously disregarding costs for estimated claims and settlements pre-AB 1054. (Petition, p. 17.) Petitioner argues that Respondent has improperly made no adjustments to reflect the expected losses in SCE's 2019, 2020, and 2021 unitary assessments, despite valuation of a going concern requiring consideration of forecasted future expenses, whether or not they originate from prior events. (*Id.* at pp. 17-20.) To address this issue, Petitioner requests an adjustment of $3.588 billion because its estimated "Wildfire-related claims" net liability/payments for years 2021-2023 will reduce its "firm value"[28] by this net amount, after all received insurance and FERC recoveries. (Petition, pp. 17-19.) Petitioner supports this request by asserting that any potential purchaser of the company would recognize that these damage claims will adversely impact the purchaser's anticipated returns on the investment, and as such the damage claims would be reflected in any buyer's valuation of the company. (*Id.,* at p. 21.)

To support their assertion, Petitioner advances a number of arguments:

Petitioner cites to the context of the CPUC needing to sign off on any sale of a regulated public utility, and in such a transaction, the CPUC is required to consider existing liabilities and their assumption by the buyer. (*Ibid.*, citing Pub. Util. Code, sections 851 and 854.) For these reasons, Petitioner asserts Respondent's disallowance of these liabilities in 2019, 2020 and 2021 is erroneous, and must be rectified in this petition. (Petition, pp. 21-22.)

As evidence of the adverse impact of fire-related claims upon the value of a California public utility, Petitioner then cites to PG&E's liabilities and ensuing bankruptcy.[29] (*Id.,* at 22.)

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[28] "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, pp. 20-21.)

[29] Petitioner does not, however, acknowledge the context of PG&E's culpability in the 2018 wildfire tied to a badly maintained and ageing transmission tower, which resulted in an estimated $16.5 billion of damages and tragic loss of life, $4 billion of such damages that were not covered by insurance, and a PG&E guilty plea to more than 80 counts of involuntary manslaughter in relation to the cited devaluation events. See generally https://www.latimes.com/local/lanow/la-me-ln-camp-fire-insured-losses-20190111-story.html citing Munich RE's reinsurance report on the fire.

Additionally, Petitioner contends that Respondent's citation in their 2020 SAPD analysis, reflects an incorrect understanding and interpretation. (*Ibid,* citing *ITT Communications vs. City and County of San Francisco* (1985) 37 Cal.3d 859; hereinafter "*ITT*".) Specifically, Petitioner asserts the Court's conclusion stating in part "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"* is misinterpreted by SAPD by overemphasizing property and by arguing "firm value" is irrelevant to the valuation of property as a going concern. (Petition, pp. 22-23, citing *ITT* at *864-865.)* Petitioner instead argues that the Court's logic supports the Petitioner's argument that utility property as a whole must be considered as a going concern, reflecting the interrelation and operation of the utility as a unit.[30] (Petition, pp. 23-24, citing *ITT* at 863.)

Additionally, Petitioner asserts Respondent's citation to Property Tax Rule 8 is improper, and cites AH 502 to support Petitioner's position that losses, such as those at issue here, were not intended to be excluded from deduction of income to be capitalized. (Petition, p. 24, citing AH 502, p. 74.) Petitioner asserts this disregard of these claims and settlements contravenes law, Assessors' Handbooks, and appraisal theory, and that instead only debt payments were meant to be excluded. (Petition, p. 24.) Petitioner then argues that SAPD's citation and application of Property Tax Rule 8 does not recognize public utility property as a going concern, as such claims and settlements have a significant impact on future expenses, and thus, its function as a business entity. (*Id.,* at pp. 24-25.) Petitioner contends such expenses are ordinary and necessary parts of SCE's operation as a going concern, and even if they were not ordinary in the "new normal" of year-round wildfires in California, Respondent does not provide citation to support excluding a non-ordinary expense that is anticipated in the future. (*Id.,* at 25.) Petitioner asserts that Rule 8 requires the inclusion of anticipatied income, and similarly anticipated operating expenses must be considered and deducted. (*Ibid.*) Additionally, assuming for the sake of argument that this is a non-ordinary expense, Petitioner asserts Respondent provides no support for the exclusion of a non-ordinary expense anticipated in the future.[31] Petitioner

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[30] Therein the Court quoted a law review article. Bertane, Public Utility Property, 20 UCLA L. Rev. at pp. 426-428, 433.

[31] In support, Petitioner cites a general statement from AH 502 to support this position. 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 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 if and until the wildfire mitigation fund is exhausted.

also cites to the draft 2020 EY Report to support its position that future anticipated operating expenses have been recorded for accounting purposes and recorded as a liability on SCE's balance sheet, and as such must be deducted for property tax purposes. (*Id.,* at 26.)

Petitioner appears to apply the requested $3.588 billion as a reduction to both the HCLD and CEA indicators, then deducts $3,588,000,000 from the overall AV.[32] (*Id.,* at p 9; See also Petition, Exhibit B.)

In its Reply, Petitioner does not dispute that the liabilities at issue stem from 2017 and 2018 events, but asserts that SAPD is wrong that these claims and settlements will neither continue to increase, nor be paid in the foreseeable future. (Reply, p. 5.) In 2021 thus far, SCE claims to have incurred additional losses related to these events of $1.297 billion.[33] *(Id.,* pp. 5-6.) Additionally, Petitioner generally renews its contentions as to this issue, and notes that AB 1054's remedies do not address the losses/settlements related to the 2017 and 2018 Wildfire/Mudslide events, as it only covers wildfires occurring on or after July 2019. (Reply, p. 6.) Petitioner concludes by reasserting that while the initial liability stems from past events, that does not change that it is resulting in ongoing expenses to SCE as claims are settled and paid, and such expenses would be considered by any willing buyer, and thus, must be allowed. (*Ibid.*)

Respondent's Contentions

Respondent notes Petitioner lists "Wildfire-related claims" as both a current and long-term liability on its Balance Sheet as of December 31, 2020, and requests that $3.6 billion of that liability be deducted from their 2021 Board-adopted value as such liabilities reduced its firm value. (SAPD Analysis, p. 7.) In general, Respondent notes that it is unclear, however, why Petitioner equates a reduction in firm value with a reduction to its taxable unitary value, nor why Petitioner equates the valuation of its property as a going concern with the value of its business as a going concern, as none of the authorities Petitioner cites supports that proposition. (*Ibid.)*

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[32] As discussed in Issue 1, in Petitioner's 2021 request is to place 65 percent reliance on the HCLD approach and 35 percent on CEA approach. Accordingly, the overall request for Issue 2 is a $3,588,000,000 adjustment to each approach.

[33] See ftn. 31. The appeals attorney notes while cases stemming from the 2017 and 2018 incidents may still be active at this time, the statute of limitations for filing any new claims has likely expired in most cases. See, e.g. https://www.sce.com/ar/customer-service/request-support/claims where SCE acknowledges on their website that "The Statute of Limitations on filing a claim is 3 years for property damage, and 2 years for bodily injury."

Respondent notes that consistent with the California Constitution Article XIII, section 1, the standard of value is fair market value. (SAPD Analysis, p. 7.) Further, 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.

(*Ibid.* quoting *ITT,* (1985) 37 Cal.3d at 864-865, emphases added by Respondent.) Respondent notes this is explained for purposes of California property tax purposes by AH 502 as follows:

> "Going concern value" is a term that has been used in a variety of contexts, and more than one definition of the term can be found in the appraisal literature. Also, there are different meanings for California property tax purposes and more than one meaning even within California property tax law.
>
> ¶ ...
>
> Outside the property tax arena, going concern appraisals are commonly conducted for hotels and motels, restaurants, bowling alleys, industrial enterprises, shopping centers, retail stores, and similar business operations using real property. Generally, the real property is considered an integral part of the business operation. Without an allocation among the various elements contributing value to the business operation, however, *such an appraisal is not appropriate for California property tax purposes*....
>
> Where the unit principle of valuation is used, it has been said that the assessable property is valued as a going concern. *This means only that the taxable property of the business should be valued as if put to beneficial or productive use.* *<u>It does not mean that the entire value of the business can be assessed or that the going concern value is assessable</u>*.

(*Ibid.,* Quoting AH 502, p. 157, emphases added by Respondent.) Accordingly, Respondent notes their appraised value reflects the total market value of all taxable *property* as a unit owned or used by Petitioner, not the "firm value," which can be thought of as an estimate of the price a potential buyer might be willing to pay for the entire *business*. (Petition, p. 8.) Respondent contends the entire business or firm value, by itself, is not relevant to California unitary property taxation. (*Ibid.*)

Respondent also remarks that this context is why the CPUC's consideration of liabilities in evaluating a proposed acquisition is irrelevant, because CPUC is instead evaluating the *entire business*. (*Ibid.*)

Respondent goes on to note that Petitioner's equating of "firm value" with the value of the entire company, requiring a decline in the unitary value of taxable property when firm value declines, is reasoning that ignores the fundamental difference between the value of "*the entire company*" and the unitary value of "*the company's taxable property*." (*Ibid.* Emphases added by Respondent.) Instead, because Petitioner's "Wildfire-related claims" are for the settlement or potential settlements of litigation arising out of wildfires and mudslides that occurred in 2017 and 2018, Respondent notes it does not reduce the value of Petitioner's taxable property, making a downward adjustment inappropriate. (*Ibid.*)

Additionally, Respondent contends petitioner's request for the same deduction to be made to the CEA value indicator is also not appropriate for the same reasons. (*Ibid.*) Respondent notes the premise of the CEA value indicator calculation is to convert (or capitalize) a *future* income stream into present worth (Rule 8, subd. (a).), and 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 such legally enforceable restrictions as such persons may foresee as of that date.

(SAPD Analysis, p. 8; citing Rule 8, subd. (c), emphasis added.) Thus, Respondent contends it is clear that neither past nor non-ordinary expenses may be deducted from the future income stream to be capitalized. (*Id.,* at p. 9.) Accordingly, as Respondent notes the costs for which Petitioner seeks a reduction are both past expenses and expenses which are not anticipated to be incurred again in the future, Respondent concludes no adjustment for these liabilities is appropriate. (*Ibid.*)

Respondent also notes that Petitioner's argument that wildfire liabilities should now be considered ordinary expenses and that they will occur in the future, may or may not actually be true, but regardless, it is only these particular liabilities from these past events that are at issue. (*Ibid.)* Further, Respondent notes it is undisputed that these particular liabilities are accrued for liability related to claims that resulted from wildfires and mudslides in 2017 and 2018, all of which occurred in the past and will not recur. (*Ibid.)*

Finally, Respondent notes that while Petitioner appears to be arguing that since these past liabilities will actually be paid at some time in the future, they are deductible when calculating the CEA value indicator, the mere fact that they may be paid in the future, however, does not mean that such expenses qualify as deductible, ordinary expenses. (*Ibid.)*

Respondent also notes that to the extent Petitioner is arguing that this type of wildfire liability lawsuit settlements will occur in the future, Petitioner has stated a belief that much of that risk has been mitigated through AB 1054. (*Ibid.)*

For these reasons, Respondent maintains no adjustment can be recommended as to this issue.

Applicable Law and Appraisal Principles

Burden of Proof

Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.) Therefore, Petitioner has the burden of showing that the assessment is incorrect or illegal. (*ITT World Communications v. Santa Clara* (1980) 101 Cal.App.3d 246; see also Cal. Code Regs., tit. 18, § 5541, subd. (a).)

Value Standard

See Issue 1, Applicable Law, pp. 12-13.

Income Approach to Value

See Issue 1, Applicable Law, p. 14.

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." 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*.)

Appeals Attorney's Analysis and Comments

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's calculated unitary value inappropriately excludes Petitioner's $3.588 billion in liabilities related to the 2017/2018 wildfires and mudslides, and requests a corresponding reduction to each value indicator. Petitioner asserts such an adjustment is necessary as the liabilities reduce its firm value, or going concern as a business, and certainly would be considered by any prospective buyer or the CPUC in any proposed transaction. Further, Petitioner contends such an adjustment to the CEA value indicator calculation is necessary as such expenses are ordinary and reoccurring, as liabilities have continued to accrue in calendar year 2021 related to the 2017/2018 Wildfires/Mudslides. Petitioner further contends Respondent misinterprets Supreme Court Cases, Property Tax Rules, and Assessors' Handbooks, by denying Petitioner's requested adjustments to the HCLD and CEA value indicators.

However, as Respondent points out, Petitioner has provided no specific argument, evidence, or legal or appraisal authority to support its proposed deduction of the past and non-ordinary expenses related to its pre-AB 1054 liabilities for property tax purposes. In fact, as Respondent points out, such a deduction would be directly contrary to Property Tax Rule 8 and relevant Board guidance. Further, no legal or appraisal support is provided with respect to the proposed deduction to the HCLD or CEA value indicators, as such expenses are undisputedly related to past events, that are unlikely to occur in the future, even if the total liability from such past events are still being finalized as remaining claims are settled, litigated, or otherwise resolved.[34]

Accordingly, based on the evidence and arguments submitted to the record to date, the Appeals Attorney notes that Petitioner has not shown specific evidence or argument to prove that the claimed expenses must be deducted from both the CEA and HCLD value indicators, nor has Petitioner shown that such expenses are ordinary or ongoing.[35] Further, the Appeals Attorney notes such expenses are explicitly excluded from the CEA approach under Property Tax Rule 8, just as Respondent contends. Petitioner's argument appears to rest on the Board finding Respondent's appraisal judgment and approach to these wildfire liabilities as flawed, without providing any specific evidence or legal or

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[34] See ftns. 31 and 33.

[35] Even if one were to accept that it is "ordinary" for power generating companies to be regularly liable for causing or contributing to wildfire or mudslide incidents that cannot be recovered through the rate base, the California Legislature has designed AB 1054 to mitigate the likelihood wildfire expenses going forward, as long as the utility acts prudently such that the wildfire is covered.

appraisal support, and that the Board either adopt the appraisal judgment of the draft 2020 EY Report or otherwise grant Petitioner's unsupported request to deduct $3.588 billion from both the CEA and HCLD value indicators.[36] However, it is well settled that the burden of proof is on the Petitioner.

At the hearing, the parties should be prepared to discuss the issue; further, Petitioner should be prepared to explain: what legal and appraisal support exists to support the deduction of these liabilities expenses from the CEA and HCLD value approaches; and how Petitioner's requested adjustment can be reconciled with Property Tax Rule 8 and other Board issued guidance, as the Assessors Handbooks' cited in isolation do not supersede Property Tax Rule 8 or the Board's guidance in context.

ISSUE 3

Whether Petitioner Has Shown that Respondent Improperly Assessed $1.3 Billion of Wildfire Mitigation Capital Expenditures.

Petitioner's Contentions

Petitioner contends that Respondent improperly assessed $1.3 billion of wildfire mitigation capital expenditures in its 2021 assessment of SCE,[37] based on the incorrect assumption that these assets generate a cash flow from ratepayers, allowing SCE to realize a return on investment for these capital expenditures.[38] (Petition p. 28.) Petitioner contends that under AB 1054, SCE is required to make capital expenditures to the wildfire mitigation fund but is precluded from earning a rate of return on the capital expenditures. (*Ibid*.) Petitioner asserts this inclusion results in approximately $754,436,312 that should be removed from SCE's HCLD indicator.[39] (*Ibid. See also,* p. 9.)

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, under AB 1054, Petitioner states that the $1.6 billion wildfire mitigation spend will be recovered through a

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[36] See Petition p. 9 and Petition, Exhibit B; however, note that such claimed amounts mathematically tie to the requested revised reliance on the HCLD and CEA value indicators in issue 1, and the accuracy thereof is contingent upon the Board's determination of Issue 1.

[37] The $1.3 billion referenced appears to stem from the paid to date portion of Petitioner's total $1.6 billion in wildfire mitigation capital expenditures required under AB 1054. This amount results in Petitioner's request for a further $754 million adjustment to the HCLD, after taking into account the $545 million adjustment to the HCLD value indicator already reflected in SCE's 2021 Board-Adopted appraisal. Petitioner estimates this request for further adjustment to the HCLD value indicator would reduce their 2021 unitary value by an additional $490,383,603. However, this estimated amount ties to Petitioner's requested reliance on the HCLD and CEA value indicators in issue 1, and the accuracy thereof is contingent upon the Board's determination of Issue 1 (See Petition, p. 9 and Petition, Exhibit C.)

[38] Petitioner cites to correspondence with SAPD from the 2020 appeal year, regarding the wildfire-related mitigation spend.

[39] See ftn. 37.

securitizable dedicated-rate component through a financial product known as securitization.[40] (Petition, p. 29.) Petitioner asserts that this securitization structure provides no assessable value to a willing buyer/seller transaction, as there is no opportunity to recover the wildfire capital expenditures and they are statutorily excluded from the rate base. (Petition, pp. 29-30.) Instead, Petitioner asserts the payments are associated with "Recovery Property,"[41] which secures the bonds and is used to pay the bondholders. (*Id.,* at pp. 30-31.) Accordingly, Petitioner asserts a buyer would value the first $1.6 billion of wildfire mitigation capital expenditures ($1.3 billion as of 12/31/20) at zero, and Respondent should do the same and remove these costs from the HCLD value indicator. (Petition, p. 31.)

Then, Petitioner points out that the analysis in the draft 2020 EY report supports Petitioner's assertions. (Petition, p 31-32.)

Next, Petitioner reasserts that the full $1.575 billion in wildfire-related capital expenditures are not eligible for an equity rate of return and excluded from SCE's 2021 General Rate Case with the CPUC, i.e., such expenditures are not included in either SCE's rate base or SCE's revenue requirements. (Petition, p. 32.) Petitioner states it will seek approval for revenue requirements to fund the repayment of the Recovery Bond through a separate application requesting a financing order, which will allow a Special Purpose Entity (SPE) to issue a Recovery Bond to finance the fire risk mitigation plan capital expenditures. (*Ibid.*) Petitioner states the Recovery Bond will be repaid to the bondholders directly via the collection of a special surcharge to ratepayers. (*Ibid.*) In other words, the

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[40] Petitioner cites to a National Regulatory Research Institute definition of securitization: "a special form of financing that is specifically designed to lower a utility's borrowing costs, which in turn lowers the amount of money customers will have to repay." And "a newly created property right authorized by the legislation and approved by the PUC is assigned to a limited purpose entity that pledges the property right as a collateral for the securitized utility bonds sold to other investors. ***The utility is considered repaid for the investment, and any related rate base or other regulatory asset is removed from the utility's books.*** Customers stop paying the utility's cost of capital with respect to that item, and instead begin paying the special charge which repays the bondholders." Petition p. 29, quoting *Managing Electricity Rates Amidst Increasing Capital Expenditures: Is Securitization the Right Tool? An Update*, NRRI Insights, January 2019. See https://pubs.naruc.org/pub/34058ED0-1866-DAAC-99FB-B8BC5BCC625C. The Appeals Attorney notes the publication cited addresses the securitization concept at a high level and is not specific to CPUC treatment.

[41] Pub. Util. Code § 850(b) (11)(A) provides that "Recovery property" means the property right created pursuant to this article, including, without limitation, the right, title, and interest of the electrical corporation or its transferee: (i) In and to the fixed recovery charges established pursuant to a financing order, including all rights to obtain adjustments to the fixed recovery charges in accordance with Pub. Util. Code § 850.1 and the financing order. . . (C) "Recovery property" shall constitute a current property right, notwithstanding the fact that the value of the property right will depend on consumers using electricity or, in those instances where consumers are customers of the electrical corporation, the electrical corporation performing certain services.

SPE is a separate legal entity, that exists to issue recovery bonds, and whose property would not be included in SCE's bankruptcy estate.[42] (*Id.,* at p. 33.) Petitioner asserts this structure provides no opportunity for recovery, through depreciation of or a return on the capital expenditures at issue. (*Id.,* at p. 34.)

Petitioner also provides a comparison of the SPE Recovery property funding, compared to the typical capital expenditure funding, which in SCE's 2020 Cost of Capital filing with CPUC, reflected a ratio of 43% debt, 5% preferred equity, and 52% common equity. (*Ibid.*) Petitioner explains, this authorized funding structure in the rate base authorizes an equity return and debt return, whereas the SPE securitization provides a benefit to the rate payers, by passing on a minimized debt rate due to lower costs through the bond structure. (*Id.,* at pp. 34-35.) Petitioner concludes the difference in financing structure shows that SCE does not recover a debt return on these capital expenditures. (*Id.,* at p. 35.)

Petitioner argues SAPD's differentiation between the return of and return on capital is inconsistent with AH 502, which Petitioner asserts requires both to be present to be properly included in the capitalization rate. (*Ibid.*)

Petitioner then argues the $754 million investment should be acknowledged as a no-return investment and acknowledged instead as economic obsolescence.[43] (*Ibid.*)

Petitioner also argues that Respondent incorrectly argues over the taxable value of the assets, when SCE is limited by AB 1054 and the CPUC's regulations regarding Recovery Bonds and the financing structure should inform value, as the value depends upon the interrelation and operation of the utility as an entire unit. (*Id.*, at p. 36, referencing *ITT*.)

Additionally, Petitioner argues that treatment of these expenditures should be akin to Contributions in Aid of Construction[44] (CIAC). (*Id.* at 37.) Petitioner argues that like CIAC, the bondholders are marking a contribution in aid of construction, prospective purchasers would not pay for such CIAC property as it is unable to provide a return on or recovery of the investment, its

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[42] Petition quotes from CPUC, Decision D2011007.
[43] It is unclear, however, how such assets would be suffering from economic obsolescence under appraisal principles and relevant guidance, and Petitioner does not expand upon this point.
[44] CIAC is defined as "Property which was donated or given to a utility. Customers, usually developers, contribute property to utilities in order to induce them to connect to or provide service to their projects." AH 542, *Assessment of Water Companies and Water Rights* (2000), p. 95.

typically not included in the rate base, and (in Petitioner's opinion) it is not added to value indicators derived using these approaches (e.g., the HCLD value indicator). (*Ibid.* Citing AH 542, *Assessment of Water Companies and Water Rights* (2000), pp 14-15.) Petitioner then references CPUC Decision 10-10-018, which similarly addresses contributions of public funding sources in an investor owned water utility property, arguing for analogous treatment of SCE's expenditures. (Petition, pp. 37-38.). Petitioner contends Respondent's responses to Petitioner's CIAC argument, misses the mark by focusing on whether the property in question is taxable or exempt; instead, Petitioner asserts the question is whether such expenditures are part of the rate base and thus should be included in the HCLD. (*Id.,* at p. 38; See also Reply, p. 7.)

Petitioner maintains Respondent's partial adjustment to exclude the equity portion attributable to these expenditures improperly leaves $1.3 billion in wildfire-related capital expenditures that should be completely removed from the HCLD within SCE's 2021 unitary value. (*Id.,* at 40.)

In their Reply, Petitioner contends SAPD's explanation excerpted from AH 502, "The HCLD for property tax appraisal purposes, therefore, differs from the rate base as established by the regulatory agency. Some items included in the rate base are not included in the HCLD and some items included in the rate base are included in the HCLD," is misleading, and in context is only meant to acknowledge CWIP's exclusion from the rate base but taxability for property tax purposes. (Reply pp. 7-8, quoting AH 502, pp. 146-147.) Petitioner also contends SAPD misunderstands the concept of "return of" capital in a regulatory context. (*Id.*, p. 7.) Petitioner then argues that SAPD ignores basic valuation principles, as Petitioner contends assets, to have value under a CEA approach, must produce income, or, under the HCLD approach, must be included in the rate base. (*Id.*, pp. 9-10.) Additionally, Petitioner generally renews several of its arguments, reaffirming the wildfire mitigation investments are not included in their rate base and are akin to CIAC. (*Id.*, pp. 8-9.)

Respondent's Contentions

Respondent contends no adjustment is appropriate for this issue. Respondent notes Petitioner essentially argues that because these costs are not included in rate base, these assets have no value and must be excluded entirely from the HCLD value indicator. (SAPD Analysis, p. 10.) However, Respondent explains whether or not property is included in the rate base of a regulated utility is not solely determinative of whether it has "value" for property tax purposes and must or must not be included in HCLD. (*Ibid.*) Respondent cites AH 502, which states:

> The HCLD for property tax appraisal purposes therefore, differs from the rate base as established by the regulatory agency. Some items included in rate base are not included in the HCLD, and some items not included in the rate base are included in the HCLD.

(*Ibid.,* citing AH 502, p. 146-147.) Therefore, Respondent contends it is false that all costs excluded from rate base must be excluded from HCLD. (*Ibid.*)

Specifically, Respondent notes the wildfire mitigation capital expenditures have value, as Petitioner spent $1.3 billion to purchase those assets and had they not, Petitioner (or any potential purchaser) would not be compliant with AB 1054. (*Ibid.*)

Respondent notes SAPD has recognized that there is an impact to these capital expenditures being excluded from the rate base and has made a proper adjustment in Petitioner's 2021 Board-adopted value.[45] Respondent notes when making capital expenditures, firms expect both a "return of" their invested capital as well as a "return on" their invested capital. (SAPD Analysis, p. 10.) Respondent notes a "return of" capital accounts for a recovery of the investment while a "return on" capital accounts for a reward for making an investment. (*Ibid.,* citing AH 502, p. 62.) Both of these 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 because AB 1054 prohibits Petitioner from earning a return on equity but does not prohibit earning a "return of" or a debt return on its capital expenditure, SAPD made appropriate adjustments to the HCLD 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. (SAPD Analysis, p.10.) The excluded equity portion represents the return *on* the investment, and properly leaves in the rate for return *of* the investment. (*Ibid.*) Respondent then removed the difference between this present value amount and the total $1.3 billion capital expenditure, resulting in an approximately $545 million reduction to the HCLD value indicator, which was already reflected in Petitioner's 2021 Board-adopted unitary value. (*Ibid.*)

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[45] $545 million was deducted from the HCLD indicator of value and resulted in a $387 million reduction to the overall 2021value. See SAPD Analysis, p. 9, ftn. 8.

Respondent also contends the financing mechanism used to purchase the assets is not relevant to the taxable value of such assets for property tax purposes. (*Ibid.*) Instead, Respondent notes as Petitioner acknowledges they are being paid back for their cost through the special surcharge paid by rate payers, it is taxable for property tax purposes, even if Petitioner does not also earn on these expenditures through the rate base. (*Ibid.*)

Further, Respondent contends Petitioner's analogy to CIAC and the CPUC Decision 10-10-018 both fail because the capital expenditures at issue here were not donated to them, given to them, nor otherwise purchased for them with government grants. *(Ibid.)*

Therefore, Respondent recommends no adjustment as to this issue.

Applicable Law and Appraisal Principles

Burden of Proof

Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.) Therefore, Petitioner has the burden of showing that the assessment is incorrect or illegal. (*ITT World Communications v. Santa Clara* (1980) 101 Cal.App.3d 246; see also Cal. Code Regs., tit. 18, § 5541, subd. (a).)

Value Standard

See Issue 1, Applicable Law, pp. 12-13.

HCLD Approach to Value

See Issue 1, Applicable Law, p. 13.

Appeals Attorney's Analysis and Comments

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 should deduct the entire $1.3 billion wildfire capital expenditures from its HCLD value indicator because Petitioner is not allowed to earn a rate of return on the expenditures and the expenditures will be securitized through an SCE, who will collect bond repayments directly from rate payers, providing no benefit to Petitioner.[46] However, Respondent contends it has already adjusted the HCLD value indicator appropriately for these expenses: by

[46] See ftn. 37.

calculating the present value of the income using a discount rate that excludes the equity portion of the capitalization rate, reflecting that Petitioner will not receive a *return on* the investment, but properly leaves the rate for *return of* its capital expenditure, which Petitioner will receive the benefit of. Respondent noted this calculation resulted in an approximately $545 million reduction to the HCLD value indicator, which was already reflected in Petitioner's 2021 Board-adopted unitary value.

Petitioner instead focuses on the securitization structure as a basis for exempting the expenditures from property taxation; however, Petitioner cites no authority supporting that such property is exempt from property tax under the California Constitution, nor proves that Respondent erred in their calculation of the existing adjustment to the HCLD attributable to these assets.

Petitioner also analogizes the disputed expenditures as akin to CIAC or the treatment of CIAC like property in the context of Water Utility appraisals or CPUC proceedings, but, as Respondent points out, that analogy is flawed, as the capital expenditures at issue were not donated to them, not given to them, nor otherwise purchased for them with government grants.

While the parties have clearly identified that the capital expenditures at issue were indeed required by AB 1054, Respondent has correctly identified that neither AB 1054, nor any other provision of law identified in the briefings, supports the exemption of these assets from property taxation. Petitioner is, in essence, asking the Board to provide an exemption from California Constitution, Article XIII, section 1 without providing any basis for the property tax exemption of such assets, arguing instead that the financing structure provides that basis on its face.[47]

Based on the evidence and arguments submitted to the record to date, the Appeals Attorney finds that Petitioner has not shown specific evidence or argument to prove error within Respondent's adjustment calculation, but instead Petitioner continues to assert the full $1.3 billion should be removed from the HCLD value indicator, which would result in a further $495 million adjustment to its unitary value.

At the hearing, the parties should be prepared to discuss the issue; further, Petitioner should be prepared to explain: what legal and appraisal support exists to show Respondent erred in its

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[47] Cal. Const. Art. XIII, section 1 states: "Unless otherwise provided by this Constitution or the laws of the United States [a]ll property is taxable and shall be assessed at the same percentage of fair market value." The appeals attorney notes exemption from property tax does not wholly correspond to income tax or accounting deductions and the California Constitution specifically requires a constitutional or statutory basis for any such exemption in property tax.

calculation; why, specifically, Petitioner asserts there is no assessable value attributable to the capital expenditures, despite Petitioner receiving a *return of* its capital expenditure via the securitization structure; and what legal and appraisal principles support the exemption of such assets for property tax purposes, such that the deduction of the full $1.3 billion from the HCLD approach is required under California property tax law.

ISSUE 4

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

Petitioner's 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, instead of the $323 million annualized expense, which accounts for the initial contribution to the fund of $2.4 billion which Respondent disallowed but should have been properly deducted in the income indicator to reflect SCE's annual operating expense for wildfire insurance. (Petition, p. 40-41.) Petitioner contends the proper treatment of these expenses would reduce the CEA value indicator by $2,534,421,051 and the overall unitary value by $887,397,368. [48] (Petition, p. 9 and Petition, Exhibit D.)

Petitioner then details their initial and annual contributions, noting SCE made the initial contribution of $2.4 billion to the Wildfire Fund on September 9, 2019, and will make 10 annual contributions of approximately $95 million per year to the fund, consistent with section 3292, subdivision (a) of the California Public Utilities Code.[49] (Petition, p. 41.)

Then, Petitioner notes the Wildfire Insurance Fund contributions are being treated similarly to prepaid insurance under Generally Accepted Accounting Principles (GAAP): such assets are amortized over ten years[50] at $323 million per year and reflected as an expense in the "Operation and Maintenance" section of its income statement. (Petition p. 41-42.)

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[48] Petitioner cites Petition, Exhibit D reflects the requested adjustment in value attributable to the disallowed expenses. However, the Appeals Attorney notes such a calculation is dependent upon the Board's consideration of Issue 1.

[49] Petitioner cites its 2019 Form 10k, at 113. See https://edison.gcs-web.com/static-files/9fa8a391-86e9-460f-84ad-eaa0d223288e (as of November 30, 2021.)

[50] 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 be depleted before then. However, see ftn. 52.

Next, Petitioner refutes SAPD's 2020 arguments that a prospective purchaser would not consider the $2.4 billion prepaid insurance in the company's value. (Petition, p. 42.) Instead, Petitioner contends Wildfire Insurance Fund contributions are equivalent to the payment of insurance premiums, and that a potential purchaser would be willing to pay more for a utility that had prepaid this annual contribution, as compared to a utility that had not done so, due to the increased estimated insurance premiums the purchaser would have to make absent these fund contributions. (Petition, pp. 41-42.)

Then, Petitioner further argues that SAPD is mischaracterizing the prepaid expense as excludable amortization or depreciation expense, as the expense at issue is more akin to annualizing or spreading a single expense over a period of years. (Petition, pp. 43-44.) Petitioner further contends this is inconsistent with Respondent's acceptance of other annualized prepaid expenses related to insurance, and results in a disadvantage to their CEA calculation because the estimated coverage period just happens to be longer than traditional insurance coverage. (*Id.* at 44.) Petitioner further contends this annualized Wildfire Insurance Fund cost is a close approximation of insurance premiums that are likely to continue for the foreseeable future, which is independently shown in its increasing 2018 and 2019 costs in excess of the premiums approved in SCE's 2018 GRC. (*Ibid.*)

Petitioner further contends that SAPD has incorrectly interpreted both Property Tax Rule 8 and *De Luz Homes, Inc. v. County of San Diego* ("*De Luz*") (1955) 45 Cal.2d 546. (*Id.,* at p. 44-45.) With respect to Rule 8, Petitioner asserts Respondent's reliance on AH 502 is incorrect, as Petitioner argues the broader context indicates the exclusion of depreciation and amortization relate to the recovery of capital expenditures. (*Id.,* at 46.) Similarly, Petitioner argues *De Luz* instead focuses on whether amortization deductions were allowable in reference to capital recovery through depreciation, rather than a blanket ban on amortization in a capitalized income method. (*Ibid.)* Petitioner cites to AH 502 to support its argument, wherein under a direct capitalization method, like the CEA, "expenses are annualized even though some expenditures may not actually occur on an annual basis" and prepaid property insurance is provided as an example. (Petition, p. 48, citing AH 502, pp. 71-72.) Similarly, Petitioner asserts its prepaid insurance should be annualized and capitalized on this basis, just as they previously asserted in their 2020 petition. (Petition, pp. 48-49.)

Petitioner also asserts that these prepaid insurance expenses would be viewed as relevant expenses to any prospective buyer, and also be considered regular and reoccurring in light of wildfire likelihood in California. (Petition, p. 49.)

Additionally, Petitioner notes that the draft 2020 EY report also supports this treatment as well as Petitioner's management as indicated by coverage in Edison International's 2020 Form 10k.[51] (Petition, pp. 49-52.)

Then, Petitioner references that Member Gaines comments in the Board hearing of their 2020 petition appeared to support this treatment of such expenses as annualized expenses removable from the CEA calculation. (Petition, pp. 52-53.)

Finally, Petitioner claims that Respondent's treatment of the fund contributions is nonuniform in its application to all state assessees, claiming that the initial contribution was allowed for another state assessee. (Petition, pp. 53-54.)

In their Reply, Petitioner renews the above arguments. (Reply, pp. 10-12.) Further, Petitioner argues that Respondent is attempting to disallow the deduction of the initial contribution by creating a requirement that a future AB 1054-like contribution will occur in the future, but Petitioner asserts it is not required that another similar prepayment is guaranteed to occur. (Reply p. 12.) Petitioner again states that, consistent with GAAP, it has annualized these operating expenses over a 10-year period,[52] and the same treatment should be extended in the CEA calculation, by removing the corresponding amount of $336 million per year, which adjusts Petitioner's unitary value downward by approximately $887 million. (Reply, p. 12.)

<u>Respondent's Contentions</u>

Respondent contends that consistent with Property Tax Rule 8 and Board issued appraisal guidance, Respondent appropriately disallowed the $2.4 billion initial contribution as an expense in the

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[51] Petitioner cites Edison International's 2020 Form 10k, at p. 42. See https://edison.gcs-web.com/static-files/567555d2-14b6-4a44-b749-e0a30e8feb0 (as of November 30, 2021.) Petitioner does not acknowledge, however, that the same 10k notes its expectation that the life of the fund last for 15 years from July 2019 and has amortized this amount over the same 15 year period. See *Id.* at p. 122.

[52] While Petitioner requests this 10 year period in its Reply, this request does not correspond with its GAAP treatment beginning January 1, 2021, as indicated in its 2020 10-k. "During 2020 SCE amortized its contributions to the Wildfire Insurance Fund over 10 years, based on evaluation of the fund's expected life based on actual fire experience to December 31, 2020. SCE expects the life of the fund to be 15 years from July 12, 2019 which will be reflected prospectively in amortization expense from January 1, 2021" Edison International's 2020 Form 10k, at p. 112.

CEA value indicator. (SAPD Analysis, pp. 10-11; citing *UVM* pp. 35-37 and AH 502, p. 74.) Respondent explains 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 (since it would then include past expenses); in other words, deducting either is contrary to the principles on which the CEA indicator is premised. (SAPD Analysis, pp. 11-12.) Thus, pursuant to Property Tax Rule 8 and AH 502's interpretation thereof, Respondent did not allow the $2.4 billion initial contribution as an expense in the CEA value indicator because the contribution was made in a previous year. (*Id.,* at 12.)

Respondent contends Petitioner admits that the Wildfire Insurance Fund-related initial contribution is both a past, non-recurring expense and that it is being amortized over a 10-year period, yet insists the amortized amount should be deducted as an ordinary expense because it is "akin to 'annualizing' or 'spreading' a single expense over a period of years" (SAPD Analysis p. 12, quoting Petition, p. 44.) However, Respondent maintains the treatment of amortized costs in the CEA indicator of value is explained in Rule 8 and AH 502. (*Ibid.)* Further, in *De Luz*, the California Supreme Court made clear that amortized costs are not deducted from the anticipated income to be capitalized. [53]

While Respondent acknowledges the specific items which the *De Luz* Court considered were leasehold improvements, Respondent maintains the Court's logic applies to capitalized assets generally. (*Ibid.)*

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[53] Respondent includes selected excerpts to support its summary of *De Luz.* (SAPD Analysis, pp. 11-12.) 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*.)

Additionally, Respondent notes that the accounting treatment of the initial contribution is undisputed: an asset entitled "Wildfire Insurance Fund contributions" was created on Petitioner's balance sheet and a corresponding amortized portion is deducted on SCE's income statement. (SAPD Analysis, p. 13.) Thus, Respondent asserts that consistent with AH 502, *De Luz*, and generally accepted appraisal practice, the initial contribution's treatment for property tax valuation purposes should also be undisputed. (*Ibid.*)

Then, Respondent asserts Petitioner's contention that the expense be treated akin to prepaid insurance, ratably deducted over some coverage period, misses the issue, as the issue is not over whether the initial contribution is or is not prepaid insurance. (*Ibid.*) Respondent confirms that Petitioner's ordinary insurance expense was allowed, but instead asserts the issue is over whether the initial contribution is an ordinary, recurring expense and Petitioner has admitted that it is not in its 2020 10-k.[54] (*Ibid.*)

Next, Respondent contends Petitioner's argument that the amortized expense will be reoccurring due to the new reality of wildfires is also misframed; instead, Respondent asserts the issue is whether the Petitioner will need to make another AB 1054-like initial contribution, something no one can know at this time. (SAPD Analysis, p. 13.)

Respondent also notes that Petitioner itself does not know how long the AB 1054 fund will last, as in 2019, SCE estimated 10 years (SCE 2020 10-k, p. 65.), while in 2020, the estimate was increased to 15 years in its 2020 Form 10-k (SCE 2020 10-k, p. 122.). (SAPD Analysis, p. 13.) However, Respondent notes that in 2019, the CPUC stated that "arguments positing that the fund may be exhausted before 2035 are premature." (*Ibid;* quoting CPUC, Decision D1912056, p. 37.) Accordingly, Respondent concludes any deduction allowed of this initial contribution based on some likelihood that some future AB 1054-like contribution will have to be made is pure speculation. (SAPD Analysis, p. 13-14.) Respondent summarizes that because the $2.4 billion initial contribution is a past expense that need not be paid again, and because its deduction as amortization in future years is only for the

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[54] Edison International's 2020 Form 10k, pp. 3-4, where SCE lists various "non-core items" that "management does not consider representative of ongoing earnings" that includes a line item under this descriptor "Charges of $336 million ($242 million after-tax) recorded in 2020 and $152 million ($109 million after-tax) recorded in 2019 from the amortization of SCE's contributions to the Wildfire Insurance Fund."

purpose of computing accounting net income, the initial contribution is not deductible from the future income stream to be capitalized for property tax purposes. (*Id*., at 14.)

Respondent also reaffirms that while the initial contribution is not deductible, the required annual contributions to the Wildfire Insurance Fund are allowable, as they are ordinary expenses expected to be paid for a 10-year term. (*Ibid.*) Respondent notes this resulted in a $590 million reduction to the CEA value indicator, which has already been included in Petitioner's 2021 Board-adopted value. (*Ibid.*)

Finally, Respondent disputes inequitable treatment amongst state assessees occurred, as the allowance or disallowance of the initial contributions were based on a consistent application of the same principles to all utilities who contributed to the fund. (*Ibid.*)

For these reasons, Respondent recommends no adjustment as to this issue.

Applicable Law and Appraisal Principles

Burden of Proof

Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.) Therefore, Petitioner has the burden of showing that the assessment is incorrect or illegal. (*ITT World Communications v. Santa Clara* (1980) 101 Cal.App.3d 246; see also Cal. Code Regs., tit. 18, § 5541, subd. (a).)

Value Standard

See Issue 1, Applicable Law, p. 12.

Income Approach to Value

See Issue 1, Applicable Law, p. 12.

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; Emphases added.) 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 *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>**Appeals Attorney's Analysis and Comments**</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 Respondent's calculated present value deduction for the 8 remaining, future Wildfire Insurance Fund payments understates the annualized and prepaid-expenses associated with the full contribution to the wildfire insurance fund; instead, Petitioner asserts the initial contribution of $2.4 billion and the 10 annualized payments should be treated as prepaid, insurance expenses, and capitalized within the Respondent's CEA value indicator calculation as expenses, as such treatment is reasonable in its opinion.

However, Respondent notes Petitioner admits the initial contribution has been amortized, and contends amortized or past, non-ordinary expenses are not properly deducted from the CEA Value calculation, as a capitalized earning approach only correctly reflects future, ordinary expenses, not past expenses, consistent with relevant Property Tax Rule 8and appraisal principals.

Based on the evidence and arguments submitted to the record to date, the Appeals Attorney finds that Petitioner has not shown specific evidence or argument to prove error within Respondent's calculation, which deducts the present value of the eight future remaining annual payments of $95 million already reflected in Petitioner's 2021 Board-adopted value. Instead, Petitioner continues to assert the full $2.4 billion initial fund should be annualized and deducted as 10 ordinary, operating, prepaid insurance expenses ($336 million annualized as asserted in Petition) as it is "reasonable" and analogous to prepaid insurance payments. However, Petitioner fails to reconcile its request with Property Tax Rule 8 and relevant Board guidance, which explicitly disallows amortized expenses from being deducted in the CEA approach, as the CEA calculation is designed to capitalize future income.

Additionally, while Petitioner requests consistency with its accounting treatment, Petitioner has not acknowledged to the Board that it changed its own accounting treatment, as published in their 2020 Form 10-k, effective as of January 1, 2021, which changes the disputed funds to a 15 year amortization period going forward.

In general, the Appeals Attorney notes the difference between the parties in this issue seems to stem from Petitioner's disagreement that accounting principles and treatment do not have directly identical treatment under relevant property tax law and appraisal principles.

Also, Petitioner claims inequitable treatment and application of relevant law compared to other state assessees but provides no evidence thereof.

At the hearing, the parties should be prepared to discuss the issue; further, Petitioner should be prepared to explain: how Respondent specifically erred in its calculation and treatment of Petitioner's remaining Wildfire Insurance Fund annual payments in Petitioner's 2020 Board-adopted unitary value; why, specifically, Petitioner asserts the amortized, initial contribution, must be capitalized and reflected as an annualized ordinary expense, despite *De Luz,* Property Tax Rule 8, and relevant Board

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guidance; and what legal or appraisal principles, if any, support the allowance of past, amortized expenses in a capitalized earning approach to value, as Petitioner asserts.

Staff Comment: Rev. & Tax. Code, Section 40

As noted above, this matter is subject to R&TC section 40. The Board's decision on this petition is final. (Cal. Code Regs., tit. 18, § 5345, subd. (a)(1).) Thus, within 120 days from the date of the Board's vote to decide the appeal, a written opinion (i.e., Summary Decision or Formal Opinion) must be published on the Board's website. (Cal. Code Regs., tit. 18, § 5552, subds. (b), (f).)

Following the conclusion of this hearing, if the Board votes to decide the appeal, but does not specify whether a Summary Decision or a Formal Opinion should be prepared, staff will expeditiously prepare a nonprecedential Summary Decision and submit it to the Board for consideration at a subsequent meeting. (Cal. Code Regs., tit. 18, § 5551, subd. (b)(2).) Unless the Board directs otherwise, the proposed Summary Decision would not be confidential pending its consideration by the Board (Cal. Code Regs., tit. 18 § 5551, subd. (b)(5)); accordingly, it would be posted on the Public Agenda Notice for the meeting at which the Board will consider and vote on the Summary Decision.

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