CALIFORNIA STATE BOARD OF EQUALIZATION

SUMMARY DECISION UNDER REVENUE AND TAXATION CODE SECTION 40

In the Matter of the Petition for Reassessment of the 2021 Unitary Value for: **SOUTHERN CALIFORNIA EDISION COMPANY (0148)** Petitioner	Appeal No.: SAU 21-007 Oral Hearing Date: December 14, 2021[1]

Representing the Parties:

For the Petitioner: Madiros 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)

VALUES AT ISSUE

	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
2021 Board-Adopted Unitary Value, Corrected[2]	$31,125,300,000	$0	$31,125,300,000
Respondent's Revised Appeal Recommendation	$31,125,300,000	$0	$31,125,300,000

[1] At the oral hearing, the Board denied the petition for reassessment and affirmed the 2021 Board-adopted unitary value, as corrected by the September 21, 2021 Board roll correction, by a majority vote of the Members, with Chairman Vazquez, Vice-Chair Schaefer, Member Cohen, and Controller Yee voting aye, and Member Gaines voting no.

[2] The Board's roll correction on September 21, 2021 corrected Petitioner's 2021 unitary value of $31,322,100,000 to $31,125,300,000.

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Factual Background

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

The CPUC establishes rates for utilities under its jurisdiction in a rate-setting procedure called the General Rate Case (GRC).[3] In establishing rates for utilities, the CPUC considers the utilities' rate base, which 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.

The State-Assessed Properties Division (SAPD or Respondent) calculated Petitioner's 2021 Board-adopted value, by placing 75 percent reliance on the Historical Cost Less Book Depreciation (HCLD)[4] value indicator and 25 percent reliance on the Capitalized Earning Ability[5] (CEA) value indicator. The CEA value indicator calculation is based on a perpetual life premise, where the capital investment necessary to maintain a perpetual income flow is deducted from expected revenues, reflecting the annual capital replacement allowance.

General Contentions and Background Raised by the Parties

Petitioner and Respondent each discussed general information they found relevant and raised a variety of concerns within their filings and at the Oral Hearing; this included: information related to SCE's past, current, and future financial and economic situation; the risks associated with wildfires; the context of the Board's valuation; and the state of the regulated gas and electric industry as a whole. The

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[3] 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.

[4] 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.

[5] 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.

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specific issues Petitioner raised with its 2021 Board-adopted value are addressed under headings Legal Issues 1 through 4. A summary of these general contentions is provided first to provide factual context to the Board's disposition of this Petition.

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 improper. 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[6] of asset additions in calendar year 2020 now reflected in the 2021 Board-adopted unitary value.

Next, Petitioner raises seven 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 challenges and cost prohibitive nature of obtaining insurance coverage due to wildfire risk arising from its ordinary operations; and 7) the Wildfire Insurance Fund

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

[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 to a 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.)

[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.

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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, along with Petitioner's statutory requirement to maintain reasonable insurance coverage, which must be exhausted prior to Wildfire Insurance Fund reimbursement becoming available to Petitioner. 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 Issues 1-4*).

Respondent notes that the risks cited are only one of many factors that affect appraisal, and that Respondent has already made multiple adjustments within Petitioner's 2021 unitary value to account for wildfire risk, which total approximately $2.3 billion. Respondent highlights four specific adjustments which have already been included in SCE's 2021 Board-adopted value:

- AB 1054[10] 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.

(See SAPD Analysis, Exhibit B, Appraisal Data Report.)

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[10] 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 and other fund participants.

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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.[11] 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[12] (ROE) allowed. (CPUC Decision 19-12-056 (Dec. 19, 2019), pp. 40-41.) In the CPUC case,[13] 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*.[14]

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."* (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, as they voluntarily significantly reduced their 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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[11] California State Board of Equalization, Appeal SAU 20-015, decided December 16, 2020.
[12] 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.]
[13] 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].
[14] *Id.* at pp. 40-41, emphasis added by Respondent.

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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, which resulted in an approximately $1.8 billion value reduction and was allowed to acknowledge risk that might not be captured in the other adjustments allowed for Petitioner.

Applicable Law and Appraisal Principles

Burden of Proof

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

Analysis and Disposition of General Contentions

Respondent is presumed to have correctly determined the value of the property at issue and Petitioner bears the burden of proving otherwise. Here, Petitioner asserts that the mere magnitude of its assessed value increase from 2020 is objectively unreasonable and, therefore, proves that economic and other uncertainties were not fully considered by the Board. Additionally, Petitioner asserts the existence of additional business risk from wildfires was not fully reflected in the Board adopted value. However, Respondent contends risk is only one of many factors that affects appraisal and that the cited risk has already been adjusted for, as reflected in the 2021 appraisal narrative. Further, Respondent points out that Petitioner's 2020 calendar year asset additions support the year over year valuation increase. While Respondent raises Petitioner's prior CPUC proceeding as evidence that such risk was viewed as adequately captured in the rate base, we note that such a finding has relevance to the instant proceeding, particularly as it relates to the determination of the rate base utilized by Respondent in the development of the HCLD value indicator; however, we also note that Petitioner's specific factual contentions and legal issues have been fully considered by the Board, herein, as a case of first impression.

While these general risks and factors are relevant to the context of this appeal, we find that no general concern raised proves *ipso facto* that Respondent erred in the calculation of SCE's 2021 Board-adopted unitary value. Further, we also find that to the extent that Petitioner introduced these facts and contentions to provide context to the specific legal issues raised in this petition, Petitioner bears the

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burden of proof to show error within Respondent's calculation of the 2021 Board-adopted unitary value with regard to each specific legal issue raised before the Board.

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

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

Petitioner asserts that the Board must revise its 2021 unitary value by instead placing 65 percent reliance on the HCLD value indicator and 35 percent reliance on the CEA value indicator. To support this argument, Petitioner advances two primary contentions: 1) that Respondent's appraisal is flawed because the two value approaches utilized produced widely varying results; and 2) that this difference confirms the existence of uncaptured obsolescence within Respondent's appraisal.

First, due to this disparity and as Respondent's analysis does not explicitly state reconciliation occurred, Petitioner asserts Respondent must have decided to simply weigh the indicators 75 percent (HCLD) and 25 percent (CEA), without any reason for doing so and contrary to the guidance within Assessors' Handbook (AH), Section 501, *Basic Appraisal* (AH 501). Further, that changes within the past 10 years, including climate, the utility industry as a whole, and to Petitioner specifically, require a re-weighting of the two value indicators. Overall, Petitioner believes the rate base determined by the CPUC is very reliable but asserts that the HCLD indicator 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 (*See* Issue 3). As such, Petitioner contends additional reliance placed on the income indicator captures the economic impairment due to wildfire risks and inverse condemnation. Further, Petitioner cites that the EY Report[15] it commissioned for lien date 2020 supports this view and reconciles the two approaches, unlike Respondent's appraisal 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.

[15] Petitioner has included a draft copy of the Ernst & Young, LLP (EY) 2020 Valuation Analysis in support of the 2021 appeal. (Dated November 9, 2020 (EY Report) as Petition, Appendix B).

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Petitioner alternatively asserts the $7 billion difference in value indicators reflects that the HCLD approach has not fully captured all economic and functional obsolescence. In support of this argument, Petitioner contends that while Respondent concedes "regulatory lag" exists and that SCE is not earning a return on certain capital expenditures, instead of quantifying that impact analytically, Respondent has not explained why the 25 percent weighting of the CEA value indicator accurately captures the impact of regulatory lag.[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, and, as such, increased reliance on the income approach is justified. 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. Petitioner asserts that its argument that the difference between the two value indicators is attributed to economic obsolescence is supported by AH, section 502, *Advanced Appraisal* (AH 502), which states a "CEA indicator which is much lower than an HCLD may indicate that obsolescence exists in the property." (AH 502, p. 146.)

Respondent has conducted its appraisal by calculating and reconciling the HCLD and CEA value indicators, consistent with relevant law and appraisal guidance.[17] 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, and is one of the more important indicators of value of closely regulated public utilities, like Petitioner. (*Unitary Valuation Methods* (*UVM*) (2003), p. 1.) Respondent also notes that Property Tax Rule[18] 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. Respondent states that consistent with the relevant HCLD and CEA value indicator considerations, Respondent considered HCLD to be the most reliable indicator of value, placing 75 percent reliance on the indicator. Respondent notes that due to Petitioner's significant growth in actual and planned capital

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[16] 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.
[17] Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.)
[18] All references to "Property Tax Rule" or "Rule(s)" are to sections of title 18 of the California Code of Regulations.

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expenditures to replace and expand distribution and transmission infrastructure, and to construct and replace generation assets, Petitioner is experiencing "regulatory lag." 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 return. Respondent also notes the 75 percent reliance on HCLD and 25 percent on CEA value indicator 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.

Further, Respondent notes significant differences in the two value approaches can and may occur without compromising the validity of the underlying value approach. (AH 501, p.62.) Specifically, Respondent notes that when analyzing and reconciling value indicators to arrive at a final value estimate, consistent with AH 502, that the criteria described in AH 502 should be considered:

> 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**.**

(AH 502, p. 111; Emphasis added by Respondent.)

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. Respondent concludes while Petitioner criticizes SAPD's analysis and reconciliation, Petitioner has not provided an alternative reasoned basis for a different reconciliation of the value indicators, i.e., in an "analytical manner" that is based on a "reasoned and defensible opinion of verified market data". (AH 502, p. 62.)

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*

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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.)

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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.)

Analysis and Disposition

Respondent is presumed to have correctly determined the value of the property at issue, and Petitioner bears the burden of proving otherwise. Here, Petitioner contends that because Respondent's calculated HCLD value indicator exceeds the CEA value indicator by $7 billion, Respondent's 2021 Board-adopted unitary value is unreconciled or 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 or, alternatively, that additional obsolescence is present. However, as Board guidance and Respondent note, significant differences may occur in validly calculated indicators. While Petitioner advances many arguments, 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, as well

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as consistency with Property Tax Rules 3, 6, and 8 and relevant Board guidance.

We concur with Respondent and find no error within in the reconciliation of Petitioner's 2021 unitary value. Further, based on the evidence and arguments submitted to the record, we find 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 must be granted additional weight. Finally, we note Petitioner's assertion that the difference in the HCLD and CEA value indicators being attributed to obsolescence is unsupported. Accordingly, we find Petitioner has not met their burden of proof as to this issue.

Legal 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.

Findings of Fact and Related 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. 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. 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" [19] by this net amount, after all received insurance and Federal Energy Regulatory Commission recoveries. Petitioner asserts 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 thus would be reflected in any buyer's valuation of the company.

To support their assertion, Petitioner advances a number of arguments. First, Petitioner contends the CPUC needs to sign off on any sale of a regulated public utility, and in such a transaction, the

[19] "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.

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CPUC is required to consider existing liabilities and their assumption by the buyer. (Pub. Util. Code, sections 851 and 854.) Second, Petitioner cites to PG&E's liabilities and ensuing bankruptcy as evidence of adverse impact of fire-related claims on the value of a California public utility.[20] Third, Petitioner contends that Respondent misinterprets the Court's conclusion in *ITT Communications vs. City and County of San Francisco,* 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"* by overemphasizing property and by arguing "firm value" is irrelevant to the valuation of property as a going concern. (*ITT Communications vs. City and County of San Francisco* (1985) 37 Cal.3d 859, at *864-865;* hereinafter "*ITT*".*)* Fourth, Petitioner asserts AH 502 supports Petitioner's position that losses, such as those at issue, were not intended to be excluded from deduction of income to be capitalized, and that instead only debt payments were meant to be excluded. (AH 502, p. 74.)

Generally, Petitioner asserts that SAPD's application of Property Tax Rule 8 and calculation of the CEA value indicator does not recognize public utility property as a going concern, as the disallowed claims and settlements are ordinary and necessary parts of SCE's operation as a going concern and have a significant impact on future expenses, and, thus, its function as a business entity. Petitioner asserts that Rule 8 requires the inclusion of anticipated income, and similarly anticipated operating expenses must be considered and deducted. Additionally, assuming for the sake of argument that these expenses were not ordinary in the "new normal" of year-round wildfires in California, Petitioner asserts Respondent provides no support for the exclusion of a non-ordinary expense anticipated to occur again in the future.[21] Petitioner also cites to the draft 2020 EY Report to support its position that future anticipated operating expenses have been recorded for accounting purposes as a liability on SCE's balance sheet, and, as such, must also be deducted for property tax purposes.

[20] 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.

[21] 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."

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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. At the time of the Reply brief, SCE claims to have incurred additional losses of $1.297 billion in 2021 related to these events. Additionally, Petitioner generally renews its contentions 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.

Respondent notes that consistent with the California Constitution Article XIII, section 1, the standard of value is fair market value. 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.

(*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>*.

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(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*. Further, Respondent notes this context is why firm value and the CPUC's consideration of liabilities in evaluating a proposed acquisition are not relevant to this issue.

Respondent goes on to note that Petitioner's equating a decline in "firm value" with 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*." 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, thus making a downward adjustment inappropriate.

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. 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.

(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. 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.

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. Further, Respondent notes it is undisputed that these particular liabilities are accrued for liability related to

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claims that resulted from wildfires and mudslides in 2017 and 2018, all of which occurred in the past and will not recur. Further, Respondent notes the mere fact that such expenses may be paid in the future, however, does not mean that such expenses qualify as deductible, ordinary expenses in the calculation of the CEA value indicator. 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.

Applicable Law and Appraisal Principles

Burden of Proof

See Issue 1, Applicable Law, pp. 9-10.

Value Standard

See Issue 1, Applicable Law, p. 10.

Income Approach to Value

See Issue 1, Applicable Law, p. 11.

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*.)

Analysis and Disposition

Respondent is presumed to have correctly determined the value of the property at issue, and Petitioner bears the burden of proving otherwise.

Here, Petitioner contends that Respondent's calculated unitary value inappropriately excludes Petitioner's $3.588 billion in liabilities related to the 2017/2018 wildfires and mudslides, contrary to relevant law and appraisal principals. 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, the expenses are ordinary and reoccurring, as liabilities have continued to accrue in calendar year 2021 related to the 2017/2018

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Wildfires/Mudslides. 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, which the likelihood of occurring again is unknown, even if the total liability from such past events are still being finalized as remaining claims are settled, litigated, or otherwise resolved.

We concur with Respondent that the disputed expenses are properly excluded from the CEA value indicator calculation, consistent with Property Tax Rule 8. Further, we find Petitioner has not shown any specific evidence or argument to prove that the claimed expenses must be deducted from the HCLD value indicator. We note that while Petitioner's arguments appear to rest on finding Respondent's property tax appraisal judgment flawed by inference or due to disparate income tax accounting treatment, we note that it is well settled that the burden of proof is on the Petitioner. Based on the foregoing, we find Petitioner has not met its burden of proof as to this issue.

Legal Issue 3: Whether Petitioner Has Shown that Respondent Improperly Assessed $1.3 Billion of Wildfire Mitigation Capital Expenditures.

Findings of Fact and Related Contentions

Petitioner contends that Respondent improperly assessed $1.3 billion of wildfire mitigation capital expenditures in its 2021 assessment of SCE,[22] 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. 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; instead, the $1.6 billion wildfire mitigation spend will be recovered through a securitizable dedicated-rate

[22] 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.

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component through a financial product known as securitization.[23] Petitioner asserts the 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 excluded from the rate base. Instead, Petitioner asserts the payments are associated with "Recovery Property,"[24] which secures the bonds and is used to pay the bondholders. Accordingly, Petitioner asserts a buyer would value the wildfire mitigation capital expenditures at zero, and Respondent should do the same and remove these costs from the HCLD value indicator.

Further, Petitioner states that the wildfire-related capital expenditures are not eligible for an equity rate of return and are excluded from SCE's 2021 General Rate Case. 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. Petitioner states the Recovery Bond will be repaid to the bondholders directly via the collection of a special surcharge to ratepayers. In other words, Petitioner asserts the SPE is a separate legal entity, that exists to issue recovery bonds, and whose property would not be included in SCE's bankruptcy estate.[25] Petitioner asserts this structure provides no opportunity for recovery, through depreciation of or a return on the capital expenditures at issue. Petitioner concludes without this recovery or return, due to the securitized financing structure, these assets should not be included in the HCLD value indicator.

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[23] 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." 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.

[24] 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.

[25] Petition quotes from CPUC, Decision D2011007.

Additionally, Petitioner argues that these expenditures should be treated like Contributions in Aid of Construction[26] (CIAC), because similarly: the bondholders are making a contribution in aid of construction; prospective purchasers would not pay for such property; the contributions are not included in the rate base; and, in Petitioner's opinion, the expenditures should not be added to value indicators derived using these approaches (e.g., the HCLD value indicator). (AH, section 542, *Assessment of Water Companies and Water Rights* (2000), pp 14-15.)

Petitioner maintains Respondent's partial adjustment to exclude the equity portion attributable to these expenditures improperly leaves a portion of the wildfire-related capital expenditures that should be completely removed from the HCLD value within SCE's 2021 unitary value.

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 Construction-Work-In-Progress's exclusion from the rate base but taxability for property tax purposes. (AH 502, pp. 146-147.) 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.

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. 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. 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.

[26] 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.

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Further, Respondent notes SAPD has recognized that there is an impact to these capital expenditures being excluded from the rate base and has already made a proper adjustment in Petitioner's 2021 Board-adopted value. Respondent notes when making capital expenditures, firms expect both a "return of" their invested capital as well as a "return on" their invested capital. 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. (AH 502, p. 62.) 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 indicator to account for this by calculating the present value of the income using a discount rate that excludes the equity portion of the capitalization rate. The excluded equity portion represents the return *on* the investment, and properly leaves in the rate for return *of* the investment. 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.

Respondent states the financing mechanism used to purchase the assets is not relevant to the taxable value of such assets for property tax purposes. 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 a return on these expenditures through the rate base.

Further, Respondent contends Petitioner's analogy to CIAC fails because the capital expenditures at issue here were not donated to them, given to them, nor otherwise purchased for them with government grants.

Applicable Law and Appraisal Principles

Burden of Proof

See Issue 1, Applicable Law, pp. 9-10.

Value Standard

See Issue 1, Applicable Law, p. 10.

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HCLD Approach to Value

See Issue 1, Applicable Law, p. 10.

Analysis and Disposition

Respondent is presumed to have correctly determined the value of the property at issue, and Petitioner bears the burden of proving otherwise.

Here, Petitioner contends that Respondent 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 SPE, who will collect bond repayments directly from rate payers, providing no benefit to Petitioner. However, Respondent contends it has already adjusted the HCLD value indicator appropriately for these expenditures: by 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 receives the benefit of.

Here, we find that while Petitioner focuses on the alternative financing (securitization) structure as a basis for exempting the expenditures from property taxation, Petitioner cites no authority to support the disputed property is exempt from property taxation under the California Constitution. Further, we concur with Respondent, that neither AB 1054, nor any other provision of law identified supports the exemption of these assets from property taxation. Further, Petitioner provides no evidence or argument to show that Respondent erred in the calculation of the existing adjustment to the HCLD value indicator attributable to these assets. Additionally, while Petitioner requests analogous treatment of the disputed expenditures as CIAC, as Respondent points out, that comparison is flawed, as the capital expenditures at issue were not donated or given to SCE, nor otherwise purchased for them with government grants. Accordingly, we find that Petitioner has not met their burden of proof as to this issue.

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

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

Petitioner asserts Respondent erred in its treatment of the Wildfire Insurance Fund-related contributions by only allowing an annual operating expense of $95 million, instead of the $323 million annualized expense for wildfire insurance. Petitioner notes the initial contribution of $2.4 billion was made to the Wildfire Fund on September 9, 2019, and that SCE 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.[27] Petitioner advances several arguments in support of this claim.

First, 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[28] at $323 million per year and reflected as an expense in the "Operation and Maintenance" section of its income statement.

Second, Petitioner contends Wildfire Insurance Fund contributions are equivalent to the payment of insurance premiums, and, as such, a potential purchaser would be willing to pay more for a utility that had prepaid this annual contribution, due to the increased estimated insurance premiums the purchaser would have to make absent these fund contributions.

Then, Petitioner 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. Additionally, Petitioner argues that SAPD is mischaracterizing the prepaid expense as an 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, which is inconsistent with Respondent's acceptance of other

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

[28] 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. Edison International's 2020 Form 10k, indicates an updated expectation of the fund lasting 15 years. See https://edison.gcs-web.com/static-files/567555d2-14b6-4a44-b749-e0a30e8febb0 (as of November 30, 2021.)

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annualized prepaid expenses related to insurance.

Next, 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, arguing that the broader context indicates the exclusion of depreciation and amortization costs only relate to the recovery of capital expenditures, not annualized expenses like prepaid property insurance.

Then, Petitioner claims that Respondent's treatment of the fund contributions is nonuniform in its application to all state assessees.

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 be guaranteed to occur.

Finally, Petitioner states that, consistent with GAAP, it has annualized these operating expenses over a 10-year period,[29] and the same treatment should be extended in the CEA calculation, by removing the corresponding amount of $336 million per year.

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 CEA value indicator. (*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 upon which the CEA indicator is premised. 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.

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[29]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.

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Respondent maintains the treatment of amortized costs in the CEA indicator of value is explained in Rule 8 and AH 502. Further, in *De Luz*, the California Supreme Court made clear that amortized costs are not deducted from the anticipated income to be capitalized. (*De Luz Homes, Inc. v. County of San Diego, supra*, p. 566.) 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.

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. 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.

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. 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.[30]

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 Petitioner will need to make another AB 1054-like initial contribution, something no one can know at this time.

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.). However, Respondent notes that in 2019, the CPUC stated that "arguments positing that the fund may be exhausted before 2035 are premature."

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[30] 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."

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

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. 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.

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.

Applicable Law and Appraisal Principles

Burden of Proof

See Issue 1, Applicable Law, p. 9.

Value Standard

See Issue 1, Applicable Law, p. 10.

Income Approach to Value

See Issue 1, Applicable Law, p. 11.

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:

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> 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>**Analysis and Disposition**</u>

Respondent is presumed to have correctly determined the value of the property at issue, and Petitioner bears the burden of proving otherwise.

Here, Petitioner contends that 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; 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 Respondent's CEA value indicator calculation as expenses. 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 case law, Property Tax Rule 8, and appraisal principals.

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We find that Petitioner has not shown specific evidence or argument to prove error within Respondent's CEA value indicator calculation, which deducts the present value of the eight future remaining annual payments of $95 million and was already reflected in Petitioner's 2021 Board-adopted value, consistent with relevant case law, Property Tax Rule 8, and relevant Board guidance in the calculation of the CEA approach. Therefore, we find that Petitioner has not met their burden of proof as to this issue.

Decision

Accordingly, the petition for reassessment is denied, and the 2021 Board-adopted unitary value, as corrected, of $31,125,300,000 is affirmed.*

Antonio Vazquez, Chairman

Mike Schaefer, Vice Chair

Malia Cohen, Member

Betty T. Yee, Controller

* The decision was rendered in Sacramento, California on December 14, 2021. This summary decision document was approved on February 23, 2022 in Sacramento, California.

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