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STATE OF CALIFORNIA

BOARD OF EQUALIZATION

In the Matter of the Petition for
Reassessment of the 2022 Unitary Value for:

**APPEALS ATTORNEY'S
HEARING SUMMARY FOR
ORAL HEARING ON
PROPERTY TAX PETITION**

**SOUTHERN CALIFORNIA EDISON
COMPANY (0148)**

Appeal No.: SAU 22-006

Petitioner

Representing the Parties:

For the Petitioners:

Mardiros H. Dakessian, Attorney
Dakessian Law, LTD.

Charles Moll, Attorney
McDermott Will & Emery

For the Respondent:

Richard Moon, Attorney V
Attorney for State-Assessed Properties Division

David Lujan, Tax Counsel
Attorney for State-Assessed Properties Division

Jack McCool, Chief
State-Assessed Properties Division

Appeals Attorney:

Sonya Yim, Tax Counsel IV

PROPOSED VALUES

	Value	Penalty	Total
2022 Board-Adopted Unitary Value	\$34,274,700,000	\$0	\$34,274,700,000
Petitioner's Requested Unitary Value	\$26,996,100,000	\$0	\$26,996,100,000
Respondent's Appeal Recommendation	\$34,274,700,000	\$0	\$34,274,700,000

ISSUES

1. **Whether Petitioner Has Shown that the State-Assessed Properties Division (SAPD or Respondent) Has Failed to Reconcile the Historical Cost Less Depreciation (HCLD) Value Indicator and the Capitalized Earning Ability (CEA) Indicator of Value.**
2. **Whether Petitioner Has Shown that Respondent Erred in Placing 75 Percent Reliance on the HCLD Value Indicator and 25 Percent Reliance on the CEA Indicator of Value.**
3. **Whether Petitioner Has Shown that Respondent Must Adjust the Board-Adopted Value for SCE's Liabilities for the 2017/2018 Wildfires and Mudslides.**
4. **Whether Petitioner Has Shown that Respondent Improperly Assessed \$1.6 Billion of Wildfire Mitigation Capital Expenditures.**
5. **Whether Petitioner Has Shown that Respondent Erred in its Treatment of Wildfire Insurance Fund-Related Contributions.**

Appeals Attorney's Recommendation and Note¹

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 34 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

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.

1 the General Rate Case (GRC) ² In establishing rates for utilities, the CPUC considers the utilities'
2 rate base. Rate base is the value of property on which a public utility is permitted by the Commission
3 to earn a specified rate of return. In general, the rate base consists of the cost of property as
4 used by the utility in providing service.

5 Petitioner's 2022 Board-adopted value is based on 75 percent reliance on the Historical Cost
6 Less Book Depreciation (HCLD)³ value indicator (\$36,406,485,637) and 25 percent reliance on the
7 Capitalized Earning Ability⁴ (CEA) value indicator (\$27,879,526,303).

8 On appeal, Petitioner contends that their 2022 Board-adopted unitary value is overstated and is
9 requesting a revised unitary value of \$26,996,100,000.

10 In the briefing and evidence submitted, Petitioner and the State-Assessed Properties Division
11 (SAPD or Respondent) each discussed general information relevant to the context of the four specific
12 issues raised within the briefings, including information related to SCE's past, current, and future
13 financial and economic situation, along with the risks associated with wildfires, the context of the
14 Board's valuation, and the state of the regulated electric generation industry as a whole. The Appeals
15 Attorney will first provide a summary of these general concerns to provide context to the consideration
16 of the specific issues raised within this Petition. Then, the five specific issues will be addressed under
17 headings: Issue 1 through Issue 5.

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

20 **General Concerns Raised by the Parties**

21 As a prefatory matter, each party provided remarks on the overall reasonableness of SCE's
22 2022 Board-adopted unitary value. Petitioner contends that the mere magnitude of the \$8 billion
23

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

26 ³ The HCLD value indicator is a form of the cost approach to value. The Historical Cost Less Depreciation (HCLD) value
27 indicator derivation includes the historical or original acquisition cost of all property less nontaxable items and property
28 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.

1 discrepancy between the HCLD and CEA value indicators is unacceptable from an appraisal
2 standpoint, which in short, allegedly supports their claim that SAPD's appraisal is unlawful and
3 improper. (Petition for Reassessment and Claim for Refund ("Petition"), pp. 2-3.) However,
4 Respondent points out that Petitioner's requested 2022 value of \$26.9 billion is \$4.3 billion less than
5 the 2021 Board-adopted value, despite \$4.6 billion⁵ of asset additions this year. (SAPD Analysis, p. 4)
6 The Appeals Attorney notes the Appraisal Data Report (ADR) is included as Exhibit 2 of the SAPD
7 Analysis; the ADR summarizes Petitioner's 2021 calendar year asset additions and retirements and
8 provides a high-level comparison of the 2022 assessment with Petitioner's 2021 assessment.

9 Then, Petitioner raises four general concerns⁶, asserting these are the various business risks and
10 other factors affecting SCE's 2022 unitary value: 1) the context of increasing catastrophic wildfires in
11 California; 2) California's use of "inverse condemnation"⁷ which "imposes strict liability...based on
12 the presumption that a utility has the ability and is the appropriate agency to recover such costs from
13 customers" (Petition, p. 4) and uncertainty as to whether the CPUC will allow liability to be recovered
14 in the rate base⁸; 3) the challenges and cost prohibitive nature of obtaining insurance coverage due to
15 wildfire risk arising from its ordinary operations; 4) Wildfire Mitigation Plans and the Wildfire
16 Insurance Fund, including specifically California's Senate Bill (SB) 901⁹ (Ch. 626, Stats. 2018) and
17 the Wildfire Insurance Fund created by Assembly Bill (AB) 1054 (Ch. 79, Stats 2019), which
18

19
20 ⁵ Respondent notes the cited approximate \$4.6 billion in additions is the net amount after taking into account asset
21 retirements during calendar year 2021, and is exclusive of approximately \$2 billion in construction work in progress.
(SAPD Analysis, p. 4)

22 ⁶ See Petition, pp. 3-7.

23 ⁷ Inverse condemnation is a legal concept that entitles property owners to just compensation if their property is damaged by
24 a public use. This liability rule applies to all government agencies, as well as utilities. After a wildfire, inverse
25 condemnation is the way that victims of fires (residents, businesses, and local agencies) recover their costs. See League of
26 California Cities "Inverse Condemnation Fact Sheet" <https://www.counties.org/post/inverse-condemnation-fact-sheet>.

27 ⁸ Petitioner cites 2017 CPUC ruling for San Diego Gas & Electric company (SDG&E), which held SDG&E liable for
28 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 SB 901 established, among other provisions, 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.

1 statutorily required Petitioner to make an initial contribution of \$2.4 billion, and 10 annual
2 contributions of \$95 million each, and Petitioner's statutory requirement to maintain reasonable
3 insurance coverage, which must be exhausted prior to Wildfire Insurance Fund reimbursement
4 becoming available to Petitioner.¹⁰ (Petition, pp. 3-7; see also Petition, Exhibit A¹¹.)

5 However, Respondent notes that the broad risks cited do not acknowledge the adjustments
6 already within Petitioner's 2022 unitary value, which total approximately \$2.59 billion. (SAPD
7 Analysis, p. 2.) Respondent highlights four specific adjustments which have already been included in
8 SCE's 2021 Board-adopted value:

- 9 • AB 1054¹² requires SCE to pay an additional \$95 million per year for 10 years
10 into the wildfire fund. Staff has made an adjustment to account for this requirement
11 which resulted in an approximately \$136 million value reduction.
- 12 • SCE has requested a .85% wildfire risk premium be added to its capitalization
13 rate. Staff has made an adjustment to account for this request, which resulted in an
14 approximately \$416 million value reduction.
- 15 • AB 1054 requires SCE to make \$1.6 billion in capital expenditures over a three
16 year period for fire risk mitigation purposes. The assembly bill precludes SCE from
17 earning an equity return on these capital expenditures. As of the 2022 lien date, SCE
18 has made \$1.6 billion in capital expenditures for this purpose. Staff has made an
19 adjustment to account for SCE's inability to earn an equity return on these
20 expenditures, which resulted in an approximately \$513 million value reduction.
- 21 • Staff made an obsolescence adjustment to the HCLD indicator to acknowledge
22 additional obsolescence resulting from the .85% equity risk premium addition to the
23 capitalization rate. This adjustment resulted in an approximately \$1.528 billion value
24 reduction.

25 (SAPD Analysis, pp. 2-3; see also SAPD Analysis, Exhibit B, Appraisal Data Report. See also
26 Appraisal Narrative, 2022 Lien Date, for Southern California Edison Company, submitted as SAPD's
27 oral hearing Exhibit E.)

28 ¹⁰ Petitioner also notes that maintaining \$1 billion of insurance coverage has become increasingly expensive, citing \$450 million in costs for FY 2021-2022, and estimates that cost increasing, which questions their ability to obtain a reasonable amount of wildfire insurance, at a reasonable cost. (Petition, p. 6-7.)

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.

1 Then, Respondent contends, these, among other arguments regarding a general increase in
2 business risk due to wildfires, are the same arguments Petitioner made—and the Board rejected—for
3 the last two years.¹³ Further, Respondent notes these are also the same arguments the CPUC rejected in
4 SCE’s request for a wildfire risk premium adjustment to increase the return on equity¹⁴ (ROE) allowed
5 in 2019. (SAPD Analysis, p. 3; citing CPUC Decision 19-12-056 (Dec. 19, 2019), pp. 40-41.) In the
6 CPUC case,¹⁵ the CPUC stated:

7 After considering the evidence on market conditions, trends, creditworthiness, interest rate
8 forecasts, quantitative financial models, additional risk factors including business risk [which
9 includes wildfire risk], and interest coverage presented by the parties and applying our
10 informed judgment ... We find that SCE’s authorized test year 2020 ROE should be 10.30%.
11 *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

12 Further, Respondent notes that CPUC’s final conclusion was that “*We find that the passage of AB 1054
13 and other investor supportive policies in California have mitigated wildfire exposure faced by
14 California’s utilities.*” (SAPD Analysis, p. 3 citing CPUC Decision 19-12-056, at p. 37; emphasis
15 added by Respondent.) The CPUC also stated “[b]ased on the above financial, business, and regulatory
16 risks discussion, we conclude the ROE ranges adopted in the proceedings...adequately compensate the
17 utilities for these risks.” (*Id.*, at p. 40.) Respondent notes that Petitioner also recognized its significant
18 reduction of risk of liability and as Petitioner voluntarily significantly reduced its ROE increase request
19 in the CPUC case following the passage of AB 1054. (SAPD Analysis, p. 3 citing CPUC Decision 19-
20 12-056, at p. 28.)

23 ¹³ California State Board of Equalization, Appeal SAU 20-015, decided December 16, 2020, and Appeal SAU 21-007,
24 decided December 14, 2021. The Appeals Attorney notes each petition year is decided de novo by the Board.

25 ¹⁴ A utility’s Rate of Return, or Cost of Capital, is the weighted average cost of debt, preferred equity, and common stock, a
26 utility has issued to finance its investments. Return on Equity (ROE) is the return to common equity. The CPUC attempts
27 to set the authorized ROE at a level that is adequate to enable the utility to attract investors to finance the replacement and
28 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. 21, 2022.]

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. 21, 2022].

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

1 In addition, Respondent notes that similar to SCE's 2021 unitary value, and even though the
2 CPUC denied Petitioner's increased ROE request based on its conclusion that mitigation measures and
3 AB 1054 had sufficiently addressed wildfire risk, SAPD has again allowed an increased equity risk
4 premium of .85 percent to Petitioner's 2022 overall capitalization rate. (SAPD Analysis, p. 4.) This
5 equity risk premium resulted in an approximately \$1.9 billion value reduction, which was allowed to
6 acknowledge risk that might not be captured in the other adjustments allowed for the Petitioner. (*Ibid.*)

7 In the Reply to SAPD's Analysis, Petitioner contends that despite SAPD's claims of multiple
8 and generous adjustments that the Board should not conflate the wildfire risk premium adjustment
9 discussion with the specific issues raised in SCE's petition (discussed *infra*). (Petitioner's Resp to
10 SAPD Analysis ("Reply"), pp. 2-4.)

11 While these general risks and factors are relevant to the context of this appeal, the Appeals
12 Attorney notes no general concern raised proves *ipso facto* that Respondent erred in the calculation of
13 SCE's 2022 Board-adopted unitary value. Petitioner is providing a general assertion that Respondent
14 did not consider, or fully consider, the risk Petitioner faces as a part of its 2022 assessment, which it
15 contends is visible due to the value differential between the HCLD and CEA approaches. However,
16 Respondent confirms it has considered many factors in its assessment,¹⁷ and also highlights certain
17 adjustments¹⁸ within SCE's 2022 valuation that reflect increased wildfire risk, including the allowance
18 of a 0.85% wildfire risk premium added to the capitalization rate.¹⁹ Further, the Appeals Attorney
19 notes that Petitioner maintains the burden of showing that Respondent's underlying assessment is
20 incorrect or illegal. (*ITT World Communications v. Santa Clara* (1980) 101 Cal.App.3d 246; see also
21 Cal. Code Regs., tit. 18, § 5541, subd. (a).) This requires specificity and verifiable evidence or error.
22 Accordingly, to the extent that Petitioner is using these general risks and factors to assert specific
23 errors exist within Respondent's calculations supporting the assessment at issue, Petitioner maintains
24 the burden of providing evidence and proving the existence of such alleged specific errors within
25
26
27

28 ¹⁷ Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.)

¹⁸ Detailed in SCE's 2022 Appraisal Data Report Narrative, included as SAPD Analysis, Exhibit B, and SAPD's Appraisal, included as SAPD's oral hearing Exhibit E.

¹⁹ Note, this risk premium is above what the CPUC was willing to entertain for Petitioner; discussed *supra* at p. 6. See also California Public Utilities Commission Decision D1912056 referenced in ftn. 15.

Respondent's calculation of the 2022 Board-adopted unitary value in the following five 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.

ISSUES 1 AND 2

Whether Petitioner Has Shown that Respondent Has Failed to Reconcile the Historical Cost Less Depreciation (HCLD) Value Indicator and the Capitalized Earning Ability (CEA) Indicator of Value and/or Otherwise 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 2022 unitary value by placing 25 percent reliance on the HCLD value indicator and 75 percent reliance on the CEA value indicator.²⁰ (Petition, p. 10.)

Petitioner asserts Respondent has not reconciled the \$8 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. 8-9.) 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 in an analytical manner based on verified market data, which, in Petitioner's opinion, is contrary to the guidance within Assessors' Handbook (AH), section 501, *Basic Appraisal* (AH 501). (*Id.* pp. 8-9.) Petitioner also asserts that the disparity in value indicators signals the existence of substantial obsolescence or impairment, as AH 502, *Advanced Appraisal*, warns is possible. (*Id.* p. 9-10.)

Petitioner asserts Respondent has improperly weighted the HCLD value indicator as 75 percent and the

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.

1 CEA approach at 25 percent.

2 Petitioner asserts that Respondent has arbitrarily weighted the value indicators, which is
3 underscored by the admission that it is the same reliance used to value Petitioner's property in each of
4 the past 10 years, despite recent changes in circumstances and increasing risks and costs related to the
5 ownership of Petitioner's property. (*Id.* at p. 10.) Petitioner recommends that the Board instead weigh
6 the two value indicators as 75 percent income approach and 25 percent cost approach. (*Ibid.*)

7 Petitioner further asserts that Property Tax Rule²¹ 8 indicates the income approach must be
8 granted additional weight. (*Id.* at p. 11.) Petitioner asserts that the rate base determined by the CPUC is
9 intended to achieve a fair balance between what rate payers bear and what utility shareholders earn,
10 and not to establish the fair market value of the utility's property. (*Id.* at p. 11.) Petitioner further
11 argues that the HCLD indicator calculated by SAPD is unreliable when Respondent includes assets not
12 included in the rate base and does not recognize impairments due to regulatory restrictions placed on
13 certain assets (i.e., the inability to earn a return), and as such, additional reliance placed on the income
14 indicator captures the economic impairment due to wildfire risks and increased regulatory restrictions.
15 (*Id.* at p. 11-13.) Petitioner cites that the Ernst & Young, LLP (EY) report²² it commissioned in the
16 SAU 20-015 appeal for lien date 2020, supports this view and reconciles the two approaches
17 appropriately, in its opinion, and considers Petitioner's perceived flaws with Respondent's approach.²³
18 (*Id.* at p. 12-13.)

19 Petitioner further contends that Respondent acknowledges a limited understanding of
20 "regulatory lag"²⁴ but continues to argue that the CEA indicator should be given less reliance in
21 Petitioner's overall value, contrary to Rule 8. (*Id.* at p. 13.)

22 Petitioner asserts the changes that have taken place during the last 10 years in terms of wildfires
23

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

25 ²² Petitioner has included a draft copy of the Ernst & Young, LLP (EY) Valuation Analysis, November 9, 2020 (EY Report)
26 as Petition, Appendix B). However, it should be noted this report was prepared for lien date 2020, **not lien date 2022**, i.e.
27 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.

28 ²³ Petitioner does not, however, acknowledge that the draft 2020 EY Report does not provide its conclusion as to the
relative weight placed on each of the two approaches to value, and merely states more relative weight was placed on the
income approach. (Petition, Appendix B, p. 34.)

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.

1 and shifts in the business environment and regulatory restrictions, coupled with Respondent's failure to
2 reconcile the \$8 billion difference in the HCLD and CEA approaches have rendered Respondent's
3 appraisal completely disconnected from what a willing buyer would pay. (*Ibid.*)

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

13 **Respondent's Contentions**

14 Respondent has conducted its appraisal by calculating and reconciling the HCLD and CEA
15 value indicators, consistent with relevant law and appraisal guidance.²⁵ Respondent notes significant
16 differences in the two value approaches can and may occur, as stated in Assessors' Handbook, section
17 501 (AH 501) *Basic Appraisal*, without compromising the validity of the underlying value approach,
18 quoting:

19 The reconciliation of value indicators from the separate approaches to value and the
20 resulting final value estimate is the next step in the appraisal process. *Theoretically*, the
21 approaches to value should produce identical value indicators. *In practice, however,*
22 *this is rarely the case, and significant differences may occur.* To produce a final value
23 estimate, the appraiser reconciles the indicators from each approach utilized. Value
24 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.

25 (SAPD Analysis, p. 4; citing AH 501, p. 62, emphases added.) Specifically, Respondent notes that
26 when analyzing and reconciling value indicators to arrive at a final value estimate, the criteria
27 described in AH 502 should be considered:
28

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

1 The final value estimate is an appraiser's *opinion of value*. There is no mathematical formula or
2 statistical technique to which the appraiser can ultimately refer in order to reach the final value
3 estimate. It is an opinion that should be based on the appraiser's application of generally
4 accepted appraisal methods and procedures. It is generally inappropriate to use the arithmetic
5 mean of the value indicators as the final value estimate. Simply calculating an average implies
6 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.

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

8 Respondent notes the HCLD approach is a reliable indicator of market value for closely
9 regulated public utilities, like Petitioner, as HCLD, with some modification, approximates the rate base
10 that regulators use in establishing revenue requirements.²⁶ (SAPD Analysis, p. 5; citing *Unitary*
11 *Valuation Methods (UVM)* (2003), p. 1.) Further, HCLD is,

12 **one of the more important indicators of value for closely regulated public utilities.** The
13 general practice of the California Public Utilities Commission (CPUC) and most other
14 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.

15 (SAPD Analysis, p. 5-6; citing *UVM*, p. 1. Emphasis added.)

16 Respondent also notes that Property Tax Rule 8, subdivision (a), indicates the CEA value
17 indicator is appropriate to use when the property has "an established income stream..." and here,
18 Petitioner has an established income stream. (SAPD Analysis, p. 6.)

19 Respondent states that consistent with the relevant HCLD and CEA value indicator
20 considerations, and Petitioner being a utility, rate regulated by the CPUC, Respondent considered
21 HCLD to be the most reliable indicator of value, placing 75 percent reliance on the indicator. (SAPD
22 Analysis, p. 6.) Respondent notes that due to Petitioner's significant growth in actual and planned
23 capital expenditures to replace and expand distribution and transmission infrastructure, and to
24 construct and replace generation assets, Petitioner is experiencing "regulatory lag." (*Ibid.*)
25 Accordingly, in Respondent's opinion, it is appropriate to weight the CEA value indicator 25 percent
26 to account for regulatory lag in rate adjustment for items on which Petitioner is not currently earning a
27 return. (*Ibid.*)

28 _____
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, p. 5.)

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 \$2.59 billion downward adjustment Respondent has already 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 it is unclear how Petitioner arrived at its requested weighting of the CEA and HCLD indicators. (*Ibid.*) Respondent points out that in 2020, 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.*) Then in 2021, Petitioner requested a 35 percent weighting of the CEA value indicator based on the same arguments, with no explanation for the change. (*Id.* at p. 6-7.) Now, in 2022, Petitioner requests a 75 percent weighting of the CEA value indicator based on the same arguments and presumptive risk analysis developed in 2020, without explanation for the change. (*Id.* at p. 7.) Respondent concludes while Petitioner criticizes SAPD's reasoning, Petitioner has not provided a 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. 9, 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 depreciation as the rate base, the amount invested in the property or the amount invested less depreciation computed by the method employed by the regulatory agency.” HCLD, with some modification, approximates the rate base that regulators use in establishing revenue requirements. (See *UVM*, p. 1.) HCLD reflects the market value contribution of all taxable property including the depreciated historical cost of plant in service, possessory interests, construction work in progress, and materials and supplies. (AH 502, p. 146.) HCLD is, one of the more important indicators of value for closely regulated public utilities. The general practice of the California Public Utilities Commission (CPUC) and most other regulatory agencies is to use historical or original cost less depreciation (with various adjustments) as the rate base. The regulatory agencies establish a rate base and a rate of return; utilities are permitted to earn at this established rate on the rate base.

(UVM (2003), p. 1.) 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

1 Board's replacement cost new trend factors and "percent" good factors. Obsolescence may occur when
2 property is outmoded (functional obsolescence) or when some event has substantially diminished the
3 future earning power of the property (economic obsolescence). (See Assessors' Handbook section 501,
4 *Basic Appraisal* (January 2002), pp. 80-83.) Functional obsolescence is the loss of value in a property
5 caused by the property's loss of capacity to perform the function for which it was intended. (*Id.* at p.
6 81.) Economic obsolescence is the diminished utility of a property due to adverse factors external to
7 the property being appraised and is incurable by the property owner. (*Id.* at p. 82.) The existence of any
8 additional or extraordinary obsolescence must be supported with verifiable documentation and
9 evidence, consistent with Board Guidelines. (See Property Tax Rule 6, subds. (d) & (e); Assessors'
10 Handbook section 502, *Advanced Appraisal* (Reprinted January 2015) (AH 502), pp. 20-21; *Unitary*
11 *Valuation Methods*, (2003), p. 30; and Cal. Bd. of Equalization, *Guidelines for Substantiating*
12 *Additional Obsolescence*, at p. 1.)

13 **Income Approach to Value**

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

25 **Reconciliation of Value Indicators**

26 Property Tax Rule 3 requires that, in estimating value, the assessor shall consider one or more
27 of the approaches to value "as may be appropriate for the property being appraised," which includes
28 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

1 to the type of property being appraised and the available data. (AH 502, p. 109.) In addition, the
2 validity of a value indicator will depend upon the accuracy of data and adjustments made to the
3 approach. That is, the accuracy of a value indicator depends on the amount of available comparable
4 data, the number and type of adjustments, and the dollar amount of adjustments. Finally, if a large
5 amount of comparable data is available for a given approach, the appraiser may have more confidence
6 in that approach. For example, if income, expense, and capitalization rate data can be obtained from
7 many properties comparable to the subject, the appraiser may attribute significant accuracy to the
8 income approach. The greatest reliance should be placed on that approach or combination of
9 approaches that best measures the type of benefits the subject property yields. The final value estimate
10 reflects the relative weight that the appraiser assigned, either implicitly or explicitly, to each approach.
11 (AH 502, p. 112.)

12 **Appeals Attorney's Analysis and Comments**

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

15 Here, Petitioner contends that because Respondent's calculated HCLD value indicator exceeds
16 the CEA value indicator by \$8 billion, Respondent's 2022 Board-adopted unitary value is flawed, as
17 the various approaches to value must yield approximately the same results, and differences of such a
18 magnitude indicate the value indicators were not reconciled. Further, Petitioner contends Respondent
19 did not reconcile the two value indicators, as required by Property Tax Rule 3 and Board Guidance, but
20 instead "simply states that the final value estimate is an appraiser's opinion of value." (Petition, p. 9.)
21 Petitioner appears to be asserting the Board should adopt the appraisal judgment of the 2020 draft EY
22 Report or, alternatively, adjust the weighting of the indicators pursuant to its request, without putting
23 forth any specific argument or evidence to support their request for additional weight to be placed on
24 the CEA value indicator, despite bearing the burden of proof to show error or illegality.

25 Respondent contends that Board guidance clearly states that significant differences may occur
26 in validly calculated indicators. (SAPD Analysis, p. 4, citing AH 501, p. 62.) Further, Respondent
27 notes that the HCLD value indicator is a reliable indicator of value for closely regulated public
28 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

1 available evidence, it was reasonable and appropriate to place 75 percent reliance on the HCLD value
2 indicator, which reflects the consideration of many factors, including: Petitioner's "regulatory lag,"
3 Petitioner's established income stream, the relative reliance placed on the value indicators of other
4 rate-base regulated utilities, and consistency with Property Tax Rules 3, 6, and 8, as well as relevant
5 Board guidance. Further, Respondent contends Petitioner's allegation that the difference in the HCLD
6 and CEA value indicators being attributed to obsolescence is wholly unsupported. Accordingly,
7 Respondent concludes Petitioner has provided no evidence or argument to support a revised weighting
8 of the value indicators.

9 Based on the evidence and arguments submitted to the record to date, the Appeals Attorney
10 finds that Petitioner has not provided specific evidence or argument to prove that its HCLD indicator is
11 impaired, nor has Petitioner shown that its CEA value indicator should be granted additional weight.
12 Petitioner's contention instead appears to rest on its request that the Board find Respondent's appraisal
13 judgment and valuation approach flawed, without Petitioner providing any specific evidence, and that
14 the Board should instead adopt the appraisal judgment of the draft 2020 EY Report or Petitioner's
15 unsupported claims in the instant petition.²⁷ However, it is well settled that the burden of proof is on
16 the Petitioner, and that such treatment would be not only unsupported under relevant law and appraisal
17 principles, but also inequitable in comparison to other rate-regulated electric-generating utility
18 assessees that are also assessed by this Board.

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

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²⁷ Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.)

ISSUE 3**Whether Petitioner Has Shown that Respondent Must Adjust the Board-Adopted Value for SCE's \$1.635 Billion Accrual for Liabilities for the 2017/2018 Wildfires and Mudslides.****Petitioner's Contentions**

Petitioner asserts the 2022 Board-adopted value does not account for SCE's accrual for liabilities for the 2017/2018 wildfires and mudslides, erroneously disregarding costs for estimated claims and settlements pre-AB 1054, just as Respondent has done in its 2019, 2020, and 2021 assessments. (Petition, p. 13-14.) Petitioner argues that Respondent has improperly made no adjustments to reflect the expected losses in SCE's unitary assessments, despite valuation of a going concern requiring consideration of forecasted future expenses, as a potential buyer would become responsible for those liabilities and factor those obligations into the purchase price. (*Id.* at pp. 14-16.) On this basis, Petitioner requests an adjustment of \$1.635 billion from both the HCLD and CEA values to account for these operating expenses above and beyond insurance recoveries. (*Id.* at p. 16; Petition, Exhibit B.)

Petitioner asserts that Respondent ignores Petitioner's wildfire-related expenses as past expenses that are not anticipated to be incurred again in the future. (*Id.* at p. 16.) Petitioner refutes this by stating that its request for an adjustment of \$1.635 billion represents quantifiable operating expenses which negatively impact the going concern value of its property, rather than a contractual or financing liability. (*Ibid.*) 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.²⁸ (*Id.* at p. 16-17.) Petitioner further asserts that Rule 8 and AH 502 require the inclusion of anticipated income and operating expenses, and that Respondent cites no authority to exclude a non-ordinary expense that is anticipated in the future. (*Id.* at p. 16-17.)

²⁸ In support, Petitioner cites a general statement from AH 502 to support this position. AH 502, p. 67 states, "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.

1 In its Reply, Petitioner does not dispute that the liabilities at issue stem from 2017 and 2018
2 events, but asserts that SAPD is wrong that these claims and settlements will neither continue to
3 increase, nor be paid in the foreseeable future. (Reply, p. 5-6.) In the current year, SCE claims to have
4 incurred additional losses related to these events of \$1.3 billion. (*Id.*, p. 6.) Additionally, Petitioner
5 generally renews its contentions as to this issue, and notes that AB 1054's remedies do not address the
6 losses/settlements related to the 2017 and 2018 Wildfire/Mudslide events, as it only covers wildfires
7 occurring on or after July 2019. (Reply, p. 6-7.) Petitioner concludes by reasserting that while the
8 initial liability stems from past events, that does not change that it is resulting in ongoing expenses to
9 SCE as claims are settled and paid, and such expenses would be considered by any willing buyer, and
10 thus, must be allowed. (*Id.* at p. 7.)

11 **Respondent's Contentions**

12 Respondent notes Petitioner claims that SAPD has erroneously disregarded \$1.635 billion of
13 accrued liability related to "Wildfire-related claims" dating back to 2017 and 2018, and requests that
14 adjustments be made to both the HCLD and CEA value indicators because a knowledgeable buyer
15 would take these liabilities into account when valuing those assets. (SAPD Analysis, p. 7.) In general,
16 Respondent notes that it is unclear, however, why these liabilities, which arguably reduce the value of
17 Petitioner's *business* as a going concern, necessarily results in a reduction to the value of its *property*
18 as a going concern or its taxable unitary value, nor why Petitioner equates the valuation of its *property*
19 as a going concern with the value of its *business* as a going concern, as none of the authorities
20 Petitioner cites supports that proposition. (*Id.* at p. 7-8, emphases added by Respondent.)

21 Respondent notes that consistent with the California Constitution Article XIII, section 1, the
22 standard of value is fair market value. (SAPD Analysis, p. 7.) Further, for state-assessed properties,
23 the California Supreme Court has stated:

24 From our review of the relevant constitutional and statutory provisions, we conclude that unit
25 taxation is properly characterized not as the taxation of real property or personal property or
26 even a combination of both, but rather as the taxation of *property as a going concern*. First,
27 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.

28 (*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:

1 "Going concern value" is a term that has been used in a variety of contexts, and more
2 than one definition of the term can be found in the appraisal literature. Also, there are
3 different meanings for California property tax purposes and more than one meaning even
4 within California property tax law.

¶ ... ¶

5 Outside the property tax arena, going concern appraisals are commonly conducted for
6 hotels and motels, restaurants, bowling alleys, industrial enterprises, shopping centers,
7 retail stores, and similar business operations using real property. Generally, the real
8 property is considered an integral part of the business operation. Without an allocation
9 among the various elements contributing value to the business operation, however, *such*
10 *an appraisal is not appropriate for California property tax purposes....*

11 Where the unit principle of valuation is used, it has been said that the assessable property
12 is valued as a going concern. *This means only that the taxable property of the business*
13 *should be valued as if put to beneficial or productive use. It does not mean that the entire*
14 *value of the business can be assessed or that the going concern value is assessable.*

15 (*Id.* at p. 7-8, quoting AH 502, p. 157, emphases added by Respondent.) Accordingly, Respondent
16 notes their appraised value reflects the total market value of all taxable *property* as a unit owned or
17 used by Petitioner, not the "firm value," which can be thought of as an estimate of the price a potential
18 buyer might be willing to pay for the entire *business*. (SAPD Analysis, p. 8.) Respondent contends the
19 entire business or firm value, by itself, is not relevant to California unitary property taxation. (*Ibid.*)

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

23 Respondent goes on to note that Petitioner's equating of "firm value" with the value of the
24 entire company, requiring a decline in the unitary value of taxable property when firm value declines,
25 is reasoning that ignores the fundamental difference between the value of "*the entire company*" and the
26 unitary value of "*the company's taxable property*." (*Ibid.* Emphases added by Respondent.) Instead,
27 because Petitioner's "Wildfire-related claims" are for the settlement or potential settlements of
28 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. (*Id.* at p. 8-9.) Respondent notes

1 the premise of the CEA value indicator calculation is to convert (or capitalize) a *future* income stream
2 into present worth (Rule 8, subd. (a).), and the amount to be capitalized is,

3 the net return which a reasonably well informed owner and reasonably well informed buyers
4 may *anticipate* on the valuation date that the taxable property existing on that date will yield
5 under prudent management and subject to such legally enforceable restrictions as such persons
may foresee as of that date.

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

11 Respondent also notes that Petitioner's argument that wildfire liabilities should now be
12 considered ordinary expenses and that they will occur in the future, may or may not actually be true,
13 but regardless, it is only these particular liabilities from these past events that are at issue.²⁹ (*Ibid.*)
14 Further, Respondent notes it is undisputed that these particular liabilities are accrued for liability
15 related to claims that resulted from wildfires and mudslides in 2017 and 2018, all of which occurred in
16 the past and will not recur. (*Ibid.*)

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

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

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

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28 ²⁹ Respondent also notes that 2021 was the third consecutive year without a catastrophic wildfire being associated with
Petitioner's infrastructure. (SAPD Analysis, p. 9, citing Public Safety Power Shutoffs – Information for High Risk Areas
Newsletter (April 2022) Southern California Edison.)
<<https://edisonintl.sharepoint.com/:b:/t/Public/MCRR/english/Efaq2EDHvMtAqHrYJbVuULUBiJrF3pVMBXuNmibYiHrLDg?e=ESGerI>> (as of October 3, 2022).)

1 **Applicable Law and Appraisal Principles**

2 **Burden of Proof**

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

7 **Value Standard**

8 See Issues 1 and 2, Applicable Law, p. 13.

9 **Income Approach to Value**

10 See Issues 1 and 2, Applicable Law, p. 14.

11 Subdivision (c) provides that “the amount to be capitalized is the net return which a reasonably
12 well-informed owner and reasonably well informed buyers may anticipate on the valuation date that
13 the taxable property existing on that date will yield under prudent management and subject to legally
14 enforceable restrictions as such persons may foresee as of that date.” Net return is the difference
15 between gross return and gross outgo. (Rule 8, subd. (c).) Amortization, depreciation, and debt
16 retirement are explicitly excluded from gross outgo. (*Ibid.*)

17 **Appeals Attorney’s Analysis and Comments**

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

20 Here, Petitioner contends that Respondent’s calculated unitary value inappropriately excludes
21 Petitioner’s \$1.635 billion in liabilities related to the 2017/2018 wildfires and mudslides, and requests
22 a corresponding reduction to each value indicator. Petitioner asserts such an adjustment is necessary as
23 the liabilities reduce its firm value, or going concern as a business, and certainly would be considered
24 by any prospective buyer or the CPUC in any proposed transaction. Further, Petitioner contends such
25 an adjustment to the CEA value indicator calculation is necessary as such expenses are ordinary and
26 reoccurring, as liabilities have continued to accrue in the current year related to the 2017/2018
27 Wildfires/Mudslides. Petitioner further contends Respondent misinterprets Property Tax Rules and
28 Assessors’ Handbooks by denying Petitioner’s requested adjustments to the HCLD and CEA value
 indicators.

1 However, as Respondent points out, Petitioner has provided no specific argument, evidence, or
2 legal or appraisal authority to support its proposed deduction of the past and non-ordinary expenses
3 related to its pre-AB 1054 liabilities for property tax purposes. For purposes of the HCLD approach,
4 Petitioner does not provide evidence or authority to support that such liabilities reduce Petitioner's
5 property value. Additionally, as Respondent points out, for purposes of the CEA approach, such a
6 deduction would be directly contrary to Property Tax Rule 8 and relevant Board guidance. Further, no
7 legal or appraisal support is provided with respect to the proposed deduction to the HCLD or CEA
8 value indicators, as such expenses are undisputedly related to past events, that are unlikely to occur in
9 the future, even if the total liability from such past events are still being finalized as remaining claims
10 are settled, litigated, or otherwise resolved.³⁰

11 Accordingly, based on the evidence and arguments submitted to the record to date, the Appeals
12 Attorney notes that Petitioner has not shown specific evidence or argument to prove that the claimed
13 expenses must be deducted from both the CEA and HCLD value indicators, nor has Petitioner shown
14 that such expenses represent ordinary and future, anticipated operating expenses.³¹ Further, the
15 Appeals Attorney notes such expenses are explicitly excluded from the CEA approach under Property
16 Tax Rule 8, just as Respondent contends. Additionally, even if wildfire liabilities should now be
17 considered ordinary expenses reasonably occurring in the future, it is undisputed that these particular
18 liabilities are a result of liability resulting from past wildfires and mudslides (in 2017 and 2018), which
19 are not appropriate to deduct from the future income stream to be capitalized. Petitioner's argument
20 appears to rest on the Board finding Respondent's appraisal judgment and approach to these wildfire
21 liabilities as flawed, without providing any specific evidence or legal or appraisal support, and that the
22 Board grant Petitioner's unsupported request to deduct \$1.635 billion from both the CEA and HCLD
23 value indicators.³² However, it is well settled that the burden of proof is on the Petitioner.

24 At the hearing, the parties should be prepared to discuss the issue; further, Petitioner should be
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26

27 ³⁰ See fn. 27.

28 ³¹ 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 of wildfire expenses going forward.

³² See Petition p. 16 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 Issues 1 and 2, and the accuracy thereof is contingent upon the Board's determination of Issues 1 and 2.

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

5 **ISSUE 4**

6 **Whether Petitioner Has Shown that Respondent Improperly Assessed \$1.6 Billion of Wildfire** 7 **Mitigation Capital Expenditures.**

8 **Petitioner's Contentions**

9 Petitioner contends that Respondent improperly assessed \$1.6 billion of wildfire mitigation
10 capital expenditures in its 2022 assessment of SCE,³³ based on the incorrect assumption that these
11 assets generate a cash flow from ratepayers, allowing SCE to realize a return on investment for these
12 capital expenditures. (Petition p. 17.) Petitioner contends that under AB 1054, SCE is required to
13 make capital expenditures to the wildfire mitigation fund but is precluded from earning either a rate of
14 return of or a return on the investment. (*Ibid.*) Petitioner asserts this inclusion results in approximately
15 \$1.228 billion that should be removed from SCE's HCLD indicator.³⁴ (*Ibid.*)

16 Petitioner further asserts that a potential buyer would not have the opportunity to recover the
17 wildfire mitigation capital expenditures, and thus conclude that the first \$1.6 billion of wildfire
18 mitigation capital expenditures have little or no value. (Petition, p. 17-18.) Petitioner cites the analysis
19 in the draft 2020 EY report to support that a prospective buyer would not pay for a \$1.6 billion capital
20 expenditure that produces no return. (Petition, p. 18.) Petitioner argues that Respondent's appraisal
21 assumes that the expenditures are being capitalized and included in the rate base, on which utilities are
22 permitted to earn a return, and concludes that if the capital expenditures are not included in
23 Petitioner's rate base, they must be removed from the HCLD value indicator. (Petition, p. 18.)

26 ³³ The \$1.228 billion referenced appears to stem from the paid to date portion of Petitioner's total \$1.6 billion in wildfire
27 mitigation capital expenditures required under AB 1054. This amount results in Petitioner's request for a further \$1.228
28 billion adjustment to the HCLD, after taking into account the \$684 million adjustment to the HCLD value indicator already
reflected in SCE's 2022 Board-Adopted appraisal. Petitioner estimates this request for further adjustment to the HCLD
value indicator would reduce their 2022 unitary value by an additional \$306,934,797. However, this estimated amount ties
to Petitioner's requested reliance on the HCLD and CEA value indicators in Issues 1 and 2, and the accuracy thereof is
contingent upon the Board's determination thereof (See Petition, p. 10-13 and Petition, Exhibit C.)

³⁴ See fn. 32.

1 Petitioner then argues that in the alternative, these capital expenditures are intangible assets
2 exempt from taxation, as such expenditures are statutorily required for Petitioner to continue to
3 operate, and thus confer intangible rights upon Edison and any future purchaser. (Petition, p. 19.)

4 Petitioner then adds that the property it spent \$1.6 billion replacing has been discarded and
5 even if Petitioner may have the right to continue to receive a return with respect to the formerly
6 owned property, since such property is no longer owned by Petitioner and the capital expenditure
7 assets replacing it are intangible or otherwise not assessable for property tax purposes in their opinion,
8 for those reasons, the disputed value must be removed from the HCLD value indicator. (Petition, p.
9 19.)

10 In their Reply, Petitioner contends SAPD's explanation excerpted from AH 502, "The HCLD
11 for property tax appraisal purposes, therefore, differs from the rate base as established by the
12 regulatory agency. Some items included in the rate base are not included in the HCLD and some items
13 included in the rate base are included in the HCLD," is misleading, and in context is only meant to
14 acknowledge Construction Work in Progress (CWIP)'s exclusion from the rate base but taxability for
15 property tax purposes. (Reply pp. 7-8, quoting AH 502, pp. 146-147.) Petitioner also contends SAPD
16 misunderstands the concept of "return of" capital in a regulatory context. (Reply, p. 8.) Specifically,
17 Petitioner contends that while SAPD argues that Petitioner is being paid back for its cost through a
18 special surcharge paid by ratepayers, CPUC D.20-11-007 requires that the special surcharges
19 collected from ratepayers will repay the bondholders of the Recovery Bond, such that Petitioner will
20 not recover either the return of or a return on the wildfire mitigation investments. (*Id.*, p. 9.)
21 Petitioner then argues that SAPD ignores basic valuation principles, as Petitioner contends assets, to
22 have value under a CEA approach, must produce income, or, under the HCLD approach, must be
23 included in the rate base. (*Id.*, pp. 9-10.) Finally, Petitioner generally renews several of its arguments,
24 reaffirming the wildfire mitigation investments are not included in their rate base, (*id.*, pp. 8-9), and
25 that as the expenditures were required under AB 1054, the intangible value of being compliant with
26 AB 1054 makes them intangible assets that are not assessable. (*Id.*, p. 9.)

27 **Respondent's Contentions**

28 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

1 must be excluded entirely from the HCLD value indicator. (SAPD Analysis, p. 10.) However,
2 Respondent explains whether or not property is included in the rate base of a regulated utility is not
3 solely determinative of whether it has “value” for property tax purposes and must or must not be
4 included in HCLD. (*Ibid.*) Respondent cites AH 502, which states:

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

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

10 Specifically, Respondent notes the wildfire mitigation capital expenditures have value, as
11 Petitioner spent \$1.6 billion to purchase those assets and had they not, Petitioner (or any potential
12 purchaser) would not be compliant with AB 1054. (*Ibid.*)

13 Respondent notes SAPD has recognized that there is an impact on value to these capital
14 expenditures being excluded from the rate base and has made a proper adjustment in Petitioner’s 2022
15 Board-adopted value.³⁵ (SAPD Analysis, p. 11.) Respondent notes when making capital expenditures,
16 firms expect both a “return of” their invested capital as well as a “return on” their invested capital.
17 (*Ibid.*) Respondent notes a “return of” capital accounts for a recovery of the investment while a “return
18 on” capital accounts for a reward for making an investment. (*Ibid.*, citing AH 502, p. 62.) Both of these
19 components are captured in the capitalization rate, which provides explicitly or implicitly for both the
20 return of and the return on capital. (*Ibid.*)

21 Respondent contends that because AB 1054 prohibits Petitioner from earning a return on
22 equity but does not prohibit earning a “return of” or a debt return on its capital expenditure, SAPD
23 made appropriate adjustments to the HCLD cost indicator to account for this, by calculating the
24 present value of the income using a discount rate that excludes the equity portion of the
25 capitalization rate. (SAPD Analysis, p.11.) The excluded equity portion represents the return *on* the
26 investment, and properly leaves in the rate for return *of* the investment. (*Ibid.*) Respondent then
27 removed the difference between this present value amount and the total \$1.6 billion capital
28

³⁵ \$684 million was deducted from the HCLD indicator of value and resulted in a \$513 million reduction to the overall 2021 value. See SAPD Analysis, p. 10, fn. 11.

1 expenditure, resulting in an approximately \$684 million reduction to the HCLD value indicator,
2 which was already reflected in Petitioner's 2022 Board-adopted unitary value. (*Ibid.*)

3 Respondent also contends that Petitioner's alternative arguments that the capital
4 expenditures are intangible assets exempt from taxation, and that the property Petitioner spent \$1.6
5 billion replacing has been discarded and is no longer owned by Petitioner, are each claimed
6 without evidence. (SAPD Analysis, p. 11.) Respondent asserts that these arguments ignore the fact
7 that \$1.6 billion dollars of tangible, depreciable equipment was purchased and is currently installed
8 as a part of Petitioner's physical infrastructure. (*Ibid.*) Respondent states that the equipment that
9 was actually replaced and discarded will be removed from the HCLD value indicator and therefore
10 has no unitary value, as is done with all equipment that is retired and removed from an assessee's
11 books and records. (*Ibid.*)

12 Therefore, Respondent recommends no adjustment as to this issue.

13 **Applicable Law and Appraisal Principles**

14 **Burden of Proof**

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

19 **Value Standard**

20 See Issues 1 and 2, Applicable Law, p. 13.

21 **HCLD Approach to Value**

22 See Issues 1 and 2, Applicable Law, p. 13.

23 **Appeals Attorney's Analysis and Comments**

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

26 Here, Petitioner contends that Respondent should deduct the entire \$1.6 billion wildfire capital
27 expenditures from its HCLD value indicator because Petitioner is not allowed to earn a rate of return
28 on the expenditures, and a prospective buyer would not pay for a \$1.6 billion capital expenditure that

1 produces zero return.³⁶ Petitioner also argues that if the capital expenditures are not included in the rate
2 base, it should be removed from the HCLD value indicator. However, Respondent explains that the
3 HCLD approach for property tax appraisal purposes differs from the rate base as established by the
4 regulatory agency, and that the capital expenditures have value as Petitioner spent \$1.6 billion to
5 purchase assets from which Petitioner will earn a return of the expenditures through depreciation and a
6 return on the expenditures through the reimbursement of interest paid for debt service. Respondent
7 additionally contends that since AB 1054 prohibits Petitioner from earning an equity return on this
8 capital expenditure but does not prohibit it from earning a return of or a debt return on its capital
9 expenditure, Respondent has already adjusted the HCLD value indicator appropriately for these
10 expenses: by calculating the present value of the income using a discount rate that excludes the equity
11 portion of the capitalization rate, reflecting that Petitioner will not receive a *return on* the investment,
12 but properly leaves the rate for *return of* its capital expenditure, which Petitioner will receive the
13 benefit of. Respondent noted this calculation resulted in an approximately \$684 million reduction to
14 the HCLD value indicator, which was already reflected in Petitioner's 2022 Board-adopted unitary
15 value.

16 Petitioner contends in the alternative that the capital expenditures, by being compliant with AB
17 1054, makes them intangible assets exempt from taxation, but provides no explanation, evidence, or
18 legal or appraisal basis or authority to support this contention.³⁷ Petitioner further contends that the
19 property Petitioner spent \$1.6 billion replacing has been discarded and is no longer owned by
20 Petitioner. However, Respondent states that the \$1.6 billion dollars of tangible, depreciable equipment
21 was purchased and is currently installed as part of Petitioner's physical infrastructure.

22 Based on the evidence and arguments submitted to the record to date, the Appeals Attorney
23 finds that Petitioner has not shown specific evidence or argument to prove error within Respondent's
24 calculation of the existing adjustment to the HCLD attributable to these assets, but instead Petitioner
25 continues to assert the full \$1.6 billion should be removed from the HCLD value indicator.

26
27
28 ³⁶ See fn. 32.

³⁷ 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.

1 At the hearing, the parties should be prepared to discuss the issue; further, Petitioner should be
2 prepared to explain: what legal and appraisal support exists to show Respondent erred in its
3 calculation; why, specifically, Petitioner asserts there is no assessable value attributable to the capital
4 expenditures, despite Petitioner receiving a *return of* its capital expenditure; and what legal and
5 appraisal principles support the exemption of such assets for property tax purposes, such that the
6 deduction of the full \$1.6 billion from the HCLD approach is required under California property tax
7 law.

8 **ISSUE 5**

9 **Whether Petitioner Has Shown that Respondent Erred in Its Treatment of Wildfire Insurance** 10 **Fund Related Contributions.**

11 **Petitioner's Contentions**

12 Petitioner notes that SCE made an initial contribution of \$2.4 billion to the Wildfire Insurance
13 Fund, which is intended to provide some insurance coverage in the event of a catastrophic wildfire
14 event, on September 9, 2019, and Petitioner will make 10 annual contributions of approximately \$95
15 million per year to the fund, consistent with section 3292, subdivision (a) of the California Public
16 Utilities Code.³⁸ (Petition, p. 19-20.) Petitioner asserts Respondent erred in its treatment of the
17 Wildfire Insurance Fund-related contribution by ignoring the initial contribution of \$2.4 billion,
18 instead arguing that the initial contribution and annual payments should be treated as insurance
19 premiums and spread ratably over Petitioner's estimated 15-year coverage period, yielding an annual
20 estimated insurance fund expense of \$215 million. (Petition, pp. 20-21.) Petitioner contends the
21 proper treatment of these expenses would reduce the CEA value indicator by \$1,431,010,928 and the
22 overall unitary value by \$1,073,258,196.³⁹ (Petition, pp. 19-22 and Petition, Exhibit D.)

23 Petitioner claims the Wildfire Insurance Fund contributions are being treated similarly to
24 prepaid insurance under Generally Accepted Accounting Principles (GAAP). (Petition, p. 20.) As no
25 period of coverage was provided in AB 1054, Petitioner is allocating the total expense ratably based
26 on its estimated fifteen-year period of coverage. (*Ibid.*)

27
28 ³⁸ Petitioner cites its 2019 Form 10k, at 113. See [https://edison.gcs-web.com/static-files/9fa8a391-86e9-460f-84ad-
eaa0d223288e](https://edison.gcs-web.com/static-files/9fa8a391-86e9-460f-84ad-
eaa0d223288e) (as of November 30, 2021.)

³⁹ Petitioner cites Petition, Exhibit D to reflect 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 Issues 1 & 2.

1 Next, Petitioner refutes SAPD’s arguments, presumably from the 2020 petition, that a
2 prospective purchaser would not consider the \$2.4 billion prepaid insurance in the company’s value.
3 (Petition, p. 20.) Instead, Petitioner contends Wildfire Insurance Fund contributions are equivalent to
4 the payment of insurance premiums, and that a potential purchaser would be willing to pay more for a
5 utility that had prepaid this annual contribution, as compared to a utility that had not done so, due to
6 the increased estimated insurance premiums the purchaser would have to make absent these fund
7 contributions. (Petition, pp. 20-21.)

8 Then, Petitioner argues that SAPD is mischaracterizing the prepaid expense as excludable
9 amortization or depreciation expense, as the expense at issue constitutes prepaid insurance or some
10 other intangible asset that will reduce future expenses, as the initial contribution was a legal
11 prerequisite that gave Petitioner the right to participate in the Fund, which is an intangible right. (*Id.*, p.
12 21.)

13 Additionally, Petitioner contends that AH 502 states that property insurance may be prepaid for
14 three years, though in Petitioner’s case the coverage is estimated at 15 years, and that an “appraiser
15 would annualize this expense in direct capitalization.” (*Ibid.*, citing AH 502, p. 71-72.)

16 Petitioner further contends that the \$215 million annual expense should be included in the CEA
17 value indicator because future insurance premiums are bound to increase consistent with the wildfire
18 risk conditions in California. (Petition, pp. 21-22.)

19 Petitioner additionally notes Respondent’s proper treatment of such expenses may actually
20 increase income in future years due to reduced future expenses, and that portion of the increased
21 income related to the initial contribution should be removed from the income approach as income from
22 an intangible asset. (*Id.*, p. 22.)

23 Finally, Petitioner claims that Respondent’s treatment of the fund contributions is nonuniform
24 in its application to all state assessees, claiming that the initial contribution was allowed for another
25 state assessee. (Petition, p. 22.)

26 In their Reply, Petitioner renews the above arguments. (Reply, pp. 10-12.) Petitioner further
27 contends that SAPD has incorrectly interpreted *De Luz Homes, Inc. v. County of San Diego* (“*De Luz*”)
28 (1955) 45 Cal.2d 546, explaining that while *De Luz* precludes a deduction for “depreciation of the
property,” it does not preclude a deduction for operating and maintenance expenses, and prepaid

1 insurance are such expenses. (*Id.*, at p. 10) Petitioner cites to AH 502 to support its argument, wherein
2 under a direct capitalization method, like the CEA, “expenses are annualized even though some
3 expenditures may not actually occur on an annual basis” and prepaid property insurance is provided as
4 an example. (Reply, p. 11, citing AH 502.)

5 Additionally, Petitioner references that Member Gaines’ comments in the Board hearing of
6 their 2020 petition appeared to support this treatment of such expenses as annualized expenses
7 removable from the CEA calculation. (Reply, pp. 10-11.)

8 Petitioner argues that while Respondent is attempting to create a requirement that another
9 future AB 1054-like contribution will occur, the guidance does not create a requirement that the
10 deduction of the prepaid insurance is only allowed when an identical payment is guaranteed to occur in
11 the future. (Reply, p. 11.) Petitioner also asserts that these prepaid insurance expenses would be
12 viewed as relevant expenses to any prospective buyer and be considered regular and reoccurring in
13 light of wildfire likelihood in California. (*Ibid.*) Additionally, Petitioner notes the requested treatment
14 is consistent with its audited financial statements. (*Ibid.*) Petitioner concludes that the adjustment of
15 approximately \$1.07 billion (CEA-adjusted present value of the annual expensing of \$215 million over
16 the remaining coverage period) for the prepaid insurance contribution of \$2.4 billion and the annual
17 contributions of \$95 million is reasonable and should be allowed. (*Ibid.*)

18 **Respondent’s Contentions**

19 Respondent contends that consistent with Property Tax Rule 8 and Board issued appraisal
20 guidance, Respondent appropriately disallowed the \$2.4 billion initial contribution as an expense in the
21 CEA value indicator. (SAPD Analysis, pp. 11-12; citing *UVM* pp. 35-37 and AH 502, p. 74.)
22 Respondent explains amortization and depreciation are not deducted when computing the future
23 income stream to be capitalized because doing so would artificially lower that future income stream by
24 subtracting non-cash expenses and would also cause the future income stream to no longer be a *future*
25 income stream (since it would then include past expenses); in other words, deducting either is contrary
26 to the principles on which the CEA indicator is premised. (SAPD Analysis, p. 12.) Thus, pursuant to
27 Property Tax Rule 8 and AH 502’s interpretation thereof, Respondent did not allow the \$2.4 billion
28 initial contribution as an expense in the CEA value indicator because the contribution was made in a
previous year. (*Ibid.*)

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 15-year period and 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.⁴⁰

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. (SAPD Analysis, p. 13.)

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 2022 10-K.⁴¹ (*Ibid.*)

⁴⁰ Respondent includes selected excerpts to support its summary of *De Luz*. (SAPD Analysis, p. 13.) 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.*)

⁴¹ SAPD Analysis, pp. 13-14, citing Edison International's 2022 Form 10-K, pp. 4-5, where SCE lists various "non-core items" that "management does not consider representative of ongoing earnings," which includes a line item under this

1 Next, Respondent contends Petitioner's argument that the amortized expense will be
2 reoccurring due to the new reality of wildfires is also misframed; instead, Respondent asserts the issue
3 is whether the Petitioner will need to make another AB 1054-like initial contribution, something no
4 one can know at this time. (SAPD Analysis, p. 14.)

5 Respondent also notes that Petitioner itself does not know how long the AB 1054 fund will last,
6 as in 2019, SCE estimated 10 years (SCE 2020 10-k, p. 65), while in 2020, the estimate was increased
7 to 15 years in its 2020 Form 10-k (SCE 2020 10-k, p. 122.). (SAPD Analysis, p. 14.) However,
8 Respondent notes that in 2019, the CPUC stated that "arguments positing that the fund may be
9 exhausted before 2035 are premature." (*Ibid.*; quoting CPUC, Decision D19-12-056, p. 37.) This has
10 been reinforced by the fact that as of January 6, 2022, no fund participant has used the fund yet (SAPD
11 Analysis, p. 14, ftn 13.) Accordingly, Respondent concludes any deduction allowed of this initial
12 contribution based on some likelihood that some future AB 1054-like contribution will have to be
13 made is pure speculation. (SAPD Analysis, p. 14.) Respondent summarizes that because the \$2.4
14 billion initial contribution is a past expense that need not be paid again, and because its deduction as
15 amortization in future years is only for the purpose of computing accounting net income, the initial
16 contribution is not deductible from the future income stream to be capitalized for property tax
17 purposes. (*Ibid.*)

18 Respondent also reaffirms that while the initial contribution is not deductible, the required
19 annual contributions to the Wildfire Insurance Fund are allowable, as they are ordinary expenses
20 expected to be paid for a 10-year term. (*Ibid.*) Respondent notes this resulted in a \$545 million
21 reduction to the CEA value indicator, which has already been included in Petitioner's 2022 Board-
22 adopted value. (SAPD Analysis, p. 14-15.)

23 Finally, Respondent disputes inequitable treatment amongst state assessees occurred, as the
24 allowance or disallowance of the initial contributions were based on a consistent application of the
25 same principles to all utilities who contributed to the fund. (SAPD Analysis, p. 15.) Respondent further
26 affirms that all other arguments made by Petitioner on this issue remain unpersuasive, particularly
27 those that attempt to liken the initial contribution to a deductible intangible asset. (*Ibid.*)

28 _____
descriptor stating, "Charges of \$215 million (\$155 million after-tax) recorded in 2021 and \$336 million (\$242 million after-
tax) recorded in 2020 from the amortization of SCE's contributions to the Wildfire Insurance Fund."

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

2 **Applicable Law and Appraisal Principles**

3 **Burden of Proof**

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

8 **Value Standard**

9 See Issues 1 and 2, Applicable Law, p. 13.

10 **Income Approach to Value**

11 See Issues 1 and 2, Applicable Law, p. 14.

12 **The Income Approach: Amortization and Depreciation**

13 The income approach to value is generally described as any method that converts future
14 anticipated income into present value. (UVM, p. 35.) It is premised on the assumption that investors
15 will buy and sell property based on the income it is *expected* to yield. (*Ibid.*) The income that is
16 converted into present value is appraisal income, or “net return” as defined by Rule 8. (UVM, pp. 35-
17 37; Rule 8, subd. (c).) Net return is the difference between gross return and gross outgo. (Rule 8,
18 subd. (c).) Amortization and depreciation are explicitly excluded from gross outgo. (*Ibid.*) AH 502
19 explains why this is the case:

20 The reference to depreciation and amortization in subdivision (c) [of Rule 8] refers to the
21 accounting concept of depreciation (in this context, **amortization is a synonym for**
22 **depreciation**). Accounting depreciation and **amortization** charges are **non-cash**
23 **expenses** designed to spread, or match, the cost of a **previously incurred** cash
24 expenditure over future accounting periods. There are at least two theoretical reasons for
25 the exclusion of accounting depreciation charges as expenses. First, doing so incorporates
26 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.

27 (AH 502, p. 74; Emphases added.) In other words, amortization and depreciation are not deducted
28 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

1 stream to no longer be a *future income* stream, as it would include past expenses. The *Supreme Court*
2 has confirmed this understanding in *De Luz*; the Court concluded,

3 Furthermore, ***in determining the income to be capitalized*** to establish value for appraisal
4 purposes, ***no deduction can be made for amortization***. [Citation.] ‘[N]o concept of income
5 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.]

6 (*De Luz Homes, Inc. v. County of San Diego, supra*, p. 566, emphasis added.)
7

8 **Appeals Attorney’s Analysis and Comments**

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

11 Here, Petitioner contends that Respondent’s calculated present value deduction for the
12 remaining, future Wildfire Insurance Fund payments understates the annualized and prepaid-expenses
13 associated with the full contribution to the wildfire insurance fund; instead, Petitioner asserts the initial
14 contribution of \$2.4 billion and the 10 annualized payments should be treated as prepaid insurance
15 expenses, and capitalized within the Respondent’s CEA value indicator calculation as expenses over a
16 15-year period, as such treatment is reasonable in its opinion, as well as consistent with its own
17 accounting treatment of such expenses.

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

22 Based on the evidence and arguments submitted to the record to date, the Appeals Attorney
23 finds that Petitioner has not shown specific evidence or argument to prove error within Respondent’s
24 calculation, which deducts the present value of the future remaining annual payments of \$95 million
25 already reflected in Petitioner’s 2022 Board-adopted value. Instead, Petitioner continues to assert the
26 full \$2.4 billion initial fund should be annualized and deducted as ordinary, operating, prepaid
27 insurance expenses (\$215 million annualized as asserted in Petition) as it is “reasonable” and
28 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

1 being deducted in the CEA approach, as the CEA calculation is designed to capitalize future income.

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

5 Additionally, Petitioner claims the expense at issue alternatively constitutes some other
6 intangible asset that will reduce future expenses, based presumably on the fact that the initial
7 contribution was a legal prerequisite that gave Petitioner the right to participate in the fund, but
8 Petitioner provides no explanation, evidence or legal or appraisal authority that supports the treatment
9 of such as an intangible or nontaxable right.

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

12 At the hearing, the parties should be prepared to discuss the issue; further, Petitioner should be
13 prepared to explain: how Respondent specifically erred in its calculation and treatment of Petitioner's
14 remaining Wildfire Insurance Fund annual payments in Petitioner's 2022 Board-adopted unitary value;
15 why, specifically, Petitioner asserts the amortized, initial contribution, must be capitalized and
16 reflected as an annualized ordinary expense, despite *De Luz*, Property Tax Rule 8, and relevant Board
17 guidance; and what legal or appraisal principles, if any, support the allowance of past, amortized
18 expenses in a capitalized earning approach to value, as Petitioner asserts.

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

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

24 Following the conclusion of this hearing, if the Board votes to decide the appeal, but does not
25 specify whether a Summary Decision or a Formal Opinion should be prepared, staff will expeditiously
26 prepare a nonprecedential Summary Decision and submit it to the Board for consideration at a
27 subsequent meeting. (Cal. Code Regs., tit. 18, § 5551, subd. (b)(2).) Unless the Board directs
28 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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