STATE BOARD OF EQUALIZATION
PROPERTY TAX APPEAL

CALIFORNIA STATE BOARD OF EQUALIZATION

SUMMARY DECISION UNDER REVENUE AND TAXATION CODE SECTION 40

In the Matter of the Petition for Reassessment of the 2015 Unitary Value for: **Verizon California, Inc. (0201)** Petitioner	Appeal No.: SAU 15-016 Case ID No.: 903737 Nonappearance Hearing Date: December 16, 2015

Representing the Parties:

For the Petitioner: Peter W. Michaels, Attorney at Law

For the Respondent: Leslie Ang, Tax Counsel
Attorney for State-Assessed Properties Division

Richard Reisinger, Business Taxes Administrator III
State-Assessed Properties Division

Counsel for Appeals Division: Louis A. Ambrose, Tax Counsel IV

VALUES AT ISSUE

	Value	Penalty	Total
2015 Board-Adopted Unitary Value	$2,715,200,000	$0	$2,715,200,000
Petitioner's Requested Unitary Value	$1,907,066,960	$0	$1,907,066,960
Respondent's Recommendation On Appeal	$2,715,200,000	$0	$2,715,200,000

FACTUAL BACKGROUND

Verizon California, Inc. (petitioner) is the second largest incumbent local exchange carrier in the State of California. Petitioner is regulated by the California Public Utilities Commission (CPUC) and is designated as a telephone service provider of last resort (POLR). Petitioner submitted a "Fair Market Value Appraisal, as of January 1, 2015, prepared by Deloitte Advisory Services (Deloitte Study) on March 1, 2015, in collaboration with CostQuest Associates (CostQuest) and Technologies Futures, Inc. (TFI). The 2015 Board-adopted unitary value of $2,715,200,000 was based on a 100-percent reliance on the Replacement Cost Less Depreciation (ReplCLD) value indicator.

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LEGAL ISSUE 1

Whether petitioner has established that the 2015 Board-adopted unitary value is excessive due to the State-Assessed Properties Division's (respondent) reliance on the BCRI Valuation Services (BCRI) percent-good factors.

FINDINGS OF FACT AND RELATED CONTENTIONS

Petitioner maintains that respondent has not disclosed the factual or methodological bases, or the assumptions and calculations upon which the BCRI percent-good factors were determined or upon which the TFI factors and petitioner's depreciation estimates were rejected.

Respondent states that BCRI specializes in the appraisal of telecommunications properties for property tax purposes and that the BCRI factors are currently being used in connection with the refund actions brought by petitioner. Respondent determined that the BCRI percent-good factors represent the most accurate and reliable information available with respect to telecommunications property because the BCRI percent-good factors are based on market evidence of actual replacements of technology, whereas the TFI percent-good factors are "more heavily based" on a methodology that relies on forecasts about hypothetical changes in telecommunications technology. Respondent also states it used the same factors to assess all POLR companies valued with the ReplCLD value indicator.

APPLICABLE LAW AND APPRAISAL PRINCIPLES

Burden of Proof

Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.) Petitioner has the burden of proof as to all issues of fact. (Cal. Code Regs., tit. 18, § 5541, subd. (a).)

Percent-good Factors

Percent-good factors are used to determine the remaining value of a property as a basis for adjusting the replacement cost new (RCN) into an indicator of fair market value and are complements of physical deterioration and functional obsolescence. The factors used for a given property type are derived from the expected economic life of that property type and are based on service life studies which survey industry participants that own specific types of property. The factors can measure some, but not all, economic obsolescence, including increased competition, unexpected technological innovation, legal limitations on use, and environmental factors. (*Unitary Valuation Methods*

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(March 2003) (UVM), p. 30.) The four other variables that have an effect on percent-good factors are: the rate of return, the method of calculation, the survivor curve, and the presence of an income adjustment factor. Petitioner has the burden of establishing the existence of any additional or extraordinary obsolescence. (See Property Tax Rule 6, subds. (d) & (e)[1]; Assessors' Handbook section 502, *Advanced Appraisal* (December 1998) (AH 502), pp. 20-21; UVM, p. 30.)

ANALYSIS AND DISPOSITION

Petitioner merely asserts that the TFI percent-good factors are reliable but does not provide any evidence or argument to support its position and, thus, fails to meet its burden of proof to overcome the presumption that respondent properly relied on the BCRI percent-good factors.

LEGAL ISSUE 2

Whether petitioner has shown that respondent did not properly value petitioner's poles.

FINDINGS OF FACT AND RELATED CONTENTIONS

Petitioner contends that the per-pole RCN grossly overstates typical pole investment costs incurred by petitioner in California and states that its 100-percent-owned poles are "primarily 30[-]foot poles" that typically cost $988.40 per pole. Petitioner itemizes the RCN as follows: material and labor, $721.59, pole anchor, materials, and labor, $81.52, and loading costs, $185.29.

Respondent states that it used the pole costs from petitioner's 2014 valuation study, which was the best information available at the time, and adjusted for the average pole cost inflation for the past four years to determine its 2015 RCN for 100-percent-owned poles. Respondent contends that petitioner does not rely on either the methodology accepted in previous years or the methodology used by the Deloitte Study but rather appears to use another "unexplained" methodology and fails to provide any evidence or to cite any authority to support its RCN for 100-percent-owned poles.

APPLICABLE LAW

Burden of Proof

Please see Applicable Law and Appraisal Principles under Legal Issue 1 above.

ANALYSIS AND DISPOSITION

The Deloitte Study states that the 100-percent-owned and joint-owned poles were valued by

[1] All references to Property Tax Rules are to sections of title 18 of the California Code of Regulations.

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utilizing industry cost information and attached to the Deloitte Study is a "100[-percent-]owned pole RCNLD Summary," which states an average amount per pole of $638.04 but does not explain how the industry cost information was used to develop the Replacement Cost New Less Depreciation (RCNLD) value indicator for the poles. The Deloitte Study also does not support petitioner's claimed cost of $988.40 per 30-foot pole whereas respondent used costs from petitioner's own 2014 valuation study and adjusted for cost inflation to develop its RCN for the 100-percent-owned poles. Consequently, petitioner has not provided evidence sufficient to meet its burden of proof on this issue.

LEGAL ISSUE 3

Whether petitioner has shown that the 2015 Board-adopted unitary value fails to reflect all economic obsolescence.

FINDINGS OF FACT AND RELATED CONTENTIONS

Petitioner states that respondent's calculation is based on "in-service switched vs. total switched lines" and that switch line counts are "driven by switch network equipment, which is not an accurate reflection of underutilized fiber and copper plant." Petitioner contends that access line counts are a more accurate measure of fiber and copper cable utilization, as each access line represents a direct connection between the central office and the end user. Petitioner also contends that respondent's economic obsolescence calculation is based on an incorrect scale factor of 0.320, "further minimizing" the recognition of economic obsolescence. Petitioner states that the Board's "normalized scale factor" was estimated by CostQuest as of the valuation date and asserts that the scale factors for the 2014 and 2015 CostQuest analyses should have been used as inputs to calculate economic obsolescence.

Respondent states that petitioner's claim of additional economic obsolescence arising from inutility assumes that regulatory requirements result in economic obsolescence in property used to provide POLR service to non-Verizon customers. Respondent contends that petitioner failed to provide any evidence of economic obsolescence due to inutility and that any company operating as a POLR within petitioner's service area would have to comply with the same regulatory requirements.

APPLICABLE LAW AND APPRAISAL PRINCIPLES

Full Economic Costs

Full economic costs for appraisal purposes are "the payments that must be made to secure the

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supply of all the necessary agents of production." (Assessors' Handbook section 501, *Basic Appraisal* (January 2002) (AH 501), p. 75.)

Depreciation and the Replacement Cost Approach

In general, the ReplCLD value indicator recognizes three types of depreciation: physical deterioration, functional obsolescence, and external, or economic, obsolescence, through the application of the Board's replacement cost new trend factors and percent-good factors. Economic obsolescence is the diminished utility of a property due to adverse factors external to the property being appraised and is incurable by the property owner. (See AH 501, pp. 81-83.)

ANALYSIS AND DISPOSITION

POLR assets are required by the CPUC for the operation of petitioner's network as a POLR and any prospective purchaser of petitioner's unitary property would also be required to maintain these POLR assets and would assume those operational costs. In addition, petitioner has not provided any evidence to support its claim that respondent's scaling factor minimizes economic obsolescence and, therefore, petitioner has not met its burden of proof on this issue.

LEGAL ISSUE 4

Whether petitioner has shown that respondent erred in its determination that the TFI percent-good factors are less reliable than the BCRI percent-good factors.

FINDINGS OF FACT AND RELATED CONTENTIONS

The parties make the same contentions as set forth in Legal Issue 1 above.

APPLICABLE LAW AND APPRAISAL PRINCIPLES

Burden of Proof

Please see Applicable Law and Appraisal Principles under Legal Issue 1 above.

Percent-good Factors

Please see Applicable Law and Appraisal Principles under Legal Issue 1 above.

ANALYSIS AND DISPOSITION

As stated above in Legal Issue 1, petitioner does not provide any evidence to support its position and, thus, has not met its burden of proof.

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LEGAL ISSUE 5

Whether petitioner has shown that respondent erred by adding the value of leasehold improvements on property leased by petitioner.

FINDINGS OF FACT AND RELATED CONTENTIONS

Petitioner contends that the value of leased improvements was included in the Deloitte Study and that respondent has not presented any evidence to support its adjustment to the Deloitte Study for the value of the leased improvements. Respondent states that it added $4,858,032 for the value of leased buildings occupied 100 percent by petitioner and that it has used this methodology in prior years without objection from petitioner.

APPLICABLE LAW AND APPRAISAL PRINCIPLES

Burden of Proof

Please see Applicable Law and Appraisal Principles under Legal Issue 1 above.

ANALYSIS AND DISPOSITION

There is no evidence that the Deloitte Study performed an RCN analysis or use determination for leased buildings completely occupied by petitioner and, therefore, petitioner has failed to meet its burden of proving error in respondent's determination.

LEGAL ISSUE 6

Whether petitioner has established that a fixed wireless network is the most probable replacement model for rural service areas.

FINDINGS OF FACT AND RELATED CONTENTIONS

Petitioner contends that respondent erroneously assumed a fiber-to-the-premises (FTTp) architecture for all of petitioner's service areas which resulted in an excessive 2015 Board-adopted unitary value. Petitioner asserts that, currently, in rural areas where fiber is not deployed, cable providers and independent wireless Internet service providers are using fixed terrestrial wireless networks to offer Internet, video, and voice services. Petitioner maintains that fixed wireless provides cost advantages over copper wires which have higher capital network construction costs and maintenance expenses and that a fixed wireless network architecture provides the same or better utility and functionality than a copper-based network.

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Petitioner contends that there are no legal restrictions on serving its wireline customers through fixed wireless alternatives and that, prior to the 2015 lien date, the California Public Utilities Commission (CPUC) adopted an updated definition of "basic telephone service" designed to allow telecommunications providers to service their customers on a technology-neutral basis and that the CPUC acknowledged that, as long as the specified elements are met, "[a]ny carrier may use any technology to satisfy any obligation to provide basic service." Petitioner asserts that for two decades the CPUC has encouraged the deployment of alternative technology by POLRs and that, in 1993, the CPUC issued a report, which recommended including the promotion of "a technology-neutral infrastructure policy to the maximum extent possible." Petitioner notes that the report stated that telecommunications providers in California should be allowed to make their own investment decisions, including the type of technology employed. Petitioner also states that, in Decision 94-08-029, the CPUC affirmed that POLRs should be free to choose technologies and that the federal Telecommunications Act of 1996 (Act) provides that "each state with regulatory jurisdiction over telecommunications services shall encourage deployment of advanced telecommunications capability on a reasonable and timely basis." Petitioner also cites a CPUC decision affirming that the Act supports a technology-neutral policy. Petitioner states that fixed wireless service is already available in California by several providers and that petitioner plans to utilize fixed wireless in "areas that are more rural and sparsely populated." Finally, petitioner asserts that the Deloitte Study's RCN model includes all costs necessary to construct the network.

Respondent contends that a hypothetical fixed wireless network is not an appropriate replacement network model because it does not meet the criteria of the Board's *Guidelines for Substantiating Additional Obsolescence for State-Assessed Telecommunications Properties* (Guidelines), which provide that "the proposed replacement must be available, implementation should follow a realistic time frame, and include all associated costs." Respondent contends that the issue is whether petitioner may legally provide only fixed wireless structures in rural or remote areas as a POLR and states that petitioner has not provided any evidence to demonstrate that such a network would be consistent with petitioner's legal duty as a POLR or that it is currently providing or intends in the near future to provide fixed wireless service to its California customers. Respondent also notes that

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CPUC Decision No. 12-12-038 specifically states that "current wireless service plans − without wireline at least as a back up − are still not exclusively meeting most consumers' basic service needs." Respondent states that petitioner has attempted to offer wireless networks as a replacement for copper line networks to POLR customers outside of California but, upon being met with complaints related to wireless service, decided to implement a fiber-optic-based service instead.

APPLICABLE LAW AND APPRAISAL PRINCIPLES

ReplCLD Value Indicator

Property Tax Rule 6, subdivision (d) provides that, in general, the ReplCLD valuation methodology is estimated by applying the appropriate trend factors, including the application of "current prices to the labor and material components of a substitute property capable of yielding the same services and amenities, with appropriate additions . . . ." The RCN is an estimate of the current cost to replace a property with a new property *of equivalent utility*, which should include all economic costs necessary to put the property to productive and beneficial use. RCN should reflect the current cost a knowledgeable person or company would pay if it were necessary to replace the subject property with a new property of equivalent utility. (UVM, p. 23.) With respect to RCN trend factors that are the bases for converting the historical cost of property into current replacement cost levels, the UVM, at page 28, further provides:

> These factors measure the current cost of replacing the existing property with a substitute property having *equivalent utility*.
>
> In developing replacement cost index factors, staff currently relies on two sources: (1) studies submitted by industry participants and (2) studies performed by the Policy Planning and Standards Division (PPSD) of the Property Taxes Department. The PPSD studies at present pertain only to general purpose computer equipment and peripherals.

Economic Principle of Substitution

The rationale for the use of the cost approach is based on the economic principle of substitution, which holds that a rational person will pay no more for a property than the cost of acquiring a satisfactory substitute, assuming no costly delay. If the condition of no costly delay is not satisfied, the cost of the delay must be added to the cost of a substitute property. If the delay in acquiring a substitute is too costly so that it would not be worthwhile to replace the property, then the cost of replacement

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cannot be said to represent the property's market value. (AH 502, p. 12.)

ANALYSIS AND DISPOSITION

Petitioner has not demonstrated that fixed wireless networks provide the same or a better utility and functionality than a copper wireline network. In addition, petitioner has not presented any evidence of an intention to deploy a fixed wireless network in rural and remote areas of California (e.g., an application with the CPUC to authorize such deployment). For the foregoing reasons, petitioner has not met its burden of proof on this issue.

LEGAL ISSUE 7

Whether petitioner has shown that respondent improperly adjusted components of the CostQuest RCN Analysis.

FINDINGS OF FACT AND RELATED CONTENTIONS

Petitioner contends that the CostQuest RCN estimates include all costs necessary to construct a replacement property and develop the material cost for electronics and the material and labor costs for an outside plant, such as fiber optic cable based on costs incurred by petitioner "for the appropriate type build." Petitioner explains that the "in-plant factor is based on the cost of material booked to the electronics accounts in a period and compares to the total capitalized cost during the same period," which provides the additional costs that have been incurred by putting the material into use within the network.

Respondent asserts that the RCN value estimates were not adjusted and believes that petitioner may have misunderstood a statement in the appraisal narrative that the size and complexity of petitioner's network, for which there are limited comparable properties available in California, made it difficult to verify that the CostQuest RCN calculation includes all necessary cost components.

APPLICABLE LAW

Burden of Proof

Please see Applicable Law and Appraisal Principles under Legal Issue 1 above.

ANALYSIS AND DISPOSITION

Petitioner has provided no evidence that respondent made any adjustments to the CostQuest RCN estimates and, thus, petitioner has failed to meet its burden of proof on this issue.

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LEGAL ISSUE 8

Whether petitioner has shown that respondent improperly rejected petitioner's revised allocation of fiber optic cable and copper line in its RCN model.

FINDINGS OF FACT AND RELATED CONTENTIONS

Petitioner states that supporting documentation for the allocation of the RCN to the fixed asset accounts shows that, with the exception of the copper cable in the non-fiber-optic-service (non-FiOS) areas, all RCNs were assigned to their respective subject asset accounts. In the non-FiOS areas, petitioner states that the portion of the fixed wireless RCN that carries data from point to point has been allocated to the subject copper asset account even though fixed wireless is considered the replacement technology.

Respondent states that it accepted petitioner's fiber/copper RCN allocation based on petitioner's representations that the allocation did not include the copper within the FiOS footprint. Respondent states that petitioner subsequently asserted that its original copper/fiber RCN allocation was incorrect and submitted a revised allocation but provided no detail of the basis for the revisions. Respondent states that it determined that the revised fiber/copper RCN allocation was unreasonable and inconsistent with prior submissions.

APPLICABLE LAW

Burden of Proof

Please see Applicable Law and Appraisal Principles under Legal Issue 1.

ANALYSIS AND DISPOSITION

Petitioner's original RCN allocation accepted by respondent was based on evidence provided by petitioner and the revised RCN allocation was not substantiated, thus petitioner has not met its burden of proof.

LEGAL ISSUE 9

Whether petitioner has shown that the 2015 Board-adopted unitary value fails to account for additional claimed exempt software.

FINDINGS OF FACT AND RELATED CONTENTIONS

Petitioner contends that the 2015 Board-adopted unitary value fails to properly recognize the

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value of nontaxable custom application software. Respondent states that it accepted the amount of the nontaxable application software included in the Deloitte Study, which was taken into account in the determination of the 2015 Board-adopted unitary value.

APPLICABLE LAW AND APPRAISAL PRINCIPLES

Burden of Proof

Please see Applicable Law and Appraisal Principles under Legal Issue 1.

ANALYSIS AND DISPOSITION

Petitioner provides no evidence that the Board-adopted unitary value includes the value of nontaxable custom application software and thus has not met its burden of proof on this issue.

LEGAL ISSUE 10

Whether the 2015 Board-adopted unitary value properly accounts for legal restrictions on alternate uses of petitioner's fee-owned land interests.

FINDINGS OF FACT AND RELATED CONTENTIONS

Petitioner contends that the Board-adopted unitary value fails to account for land use restrictions and obsolescence due to the superadequacy of fee-owned land interests. Petitioner asserts that the Board-adopted unitary value fails to recognize the effect on the value of enforceable restrictions imposed by the CPUC which prohibit petitioner from disposing of or making alternate uses of its fee-owned land interests. Petitioner argues that it would be able to provide the same services to its customers without its "extensive land holdings" and could significantly reduce those holdings or move its central offices to less expensive locations but is prevented from doing so by regulatory restrictions.

Respondent contends that petitioner does not identify any legal restrictions that affect its land and does not explain how such alleged land restrictions prevent it from putting its land to its highest and best use. Respondent also argues that petitioner has not provided information sufficient to demonstrate obsolescence due to the superadequacy of its land. Respondent also states that petitioner has not provided detailed descriptions of land that it believes has suffered additional economic obsolescence.

APPLICABLE LAW AND APPRAISAL PRINCIPLES

Public Utilities Code section 851

Section 851 provides, in relevant part, that a public utility (other than a common carrier by

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railroad) must secure approval from the CPUC before it may sell or otherwise dispose of "property necessary or useful in the performance of its duties to the public." However, section 851 further provides that:

> Nothing in this section shall prevent the sale, lease, encumbrance, or other disposition by any public utility of property that is not necessary or useful in the performance of its duties to the public, and any disposition of property by a public utility shall be conclusively presumed to be of property that is not useful or necessary in the performance of its duties to the public, as to any purchaser, lessee, or encumbrancer dealing with that property in good faith for value . . . .

ANALYSIS AND DISPOSITION

Section 851 expressly provides that the CPUC approval process is required for "property necessary or useful in the performance of its duties to the public"; and if, as petitioner alleges, the fee-owned land interests for which petitioner seeks an adjustment are superadequate, then petitioner does not meet this requirement. Once fee-owned land interests are disposed of, such interests are not subject to such restrictions in the hands of a good faith purchaser, lessee, or encumbrancer for value. Finally, petitioner has presented no evidence of superadequacy in any of its fee-owned land interests and, therefore, has not met its evidentiary burden on this issue.

LEGAL ISSUE 11

Whether petitioner has shown that the 2015 Board-adopted unitary value improperly includes value attributable to non-assessable, intangible costs of optional extended warranties.

FINDINGS OF FACT AND RELATED CONTENTIONS

Petitioner asserts that the replacement cost indicator on which the 2014 Board-adopted value is based improperly includes value attributable to non-assessable, intangible warranty costs "embedded" in petitioner's purchase price for certain telecommunications equipment. Respondent agrees with petitioner that costs for optional extended warranties should be excluded from petitioner's unitary value but states that petitioner has not submitted any evidence or other information to substantiate the existence of extended warranty costs, and has not provided detailed documentation supporting or quantifying these costs.

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APPLICABLE LAW AND APPRAISAL PRINCIPLES

Full Economic Cost

Property Tax Rule 10, subdivision (b) provides in relevant part that:

> Full economic cost does not include extended service plans or extended warranties, supplies or other assets or business services that may have been included in a purchase contract.

ANALYSIS AND DISPOSITION

Petitioner has not presented any evidence to show that it purchased optional extended warranties or to identify the specific property for which those extended warranties provide coverage. For the foregoing reasons, petitioner has failed to meet its burden of proof on this issue.

LEGAL ISSUE 12

Whether petitioner has shown that the 2015 Board-adopted unitary value improperly includes the value of nontaxable intangible assets and rights.

FINDINGS OF FACT AND RELATED CONTENTIONS

Petitioner contends that the 2015 Board-adopted unitary value includes value attributable to petitioner's nontaxable assets and rights because respondent relied on the BCRI percent-good factors and rejected CostQuest's RCN estimates. Respondent contends that petitioner fails to specify which intangible assets and rights were illegally assessed and how these alleged intangible assets and rights were included in the Board-adopted unitary value.

APPLICABLE LAW

Burden of Proof

Please see Applicable Law and Appraisal Principles under Legal Issue 1.

ANALYSIS AND DISPOSITION

Petitioner has not presented any evidence to show that the value of any intangible assets and rights were included in the 2015 Board-adopted unitary value. Therefore, petitioner has failed to meet its burden of proof on this issue.

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DECISION

Accordingly, the petition for reassessment is denied and the 2015 Board-adopted unitary value of $2,715,200,000 is affirmed.*

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

* The decision was rendered in Sacramento, California on December 16, 2015. This summary decision document was approved on February 23, 2016, in Culver City, California.

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