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7 **STATE OF CALIFORNIA**
8 **BOARD OF EQUALIZATION**

10 In the Matter of the Consolidated Petitions for
11 Reassessment of the 2013 Unitary Values for:

) **APPEALS DIVISION’S**
) **HEARING SUMMARY FOR**
) **ORAL HEARING ON**
) **PROPERTY TAX PETITIONS**

13 **GWF ENERGY LLC – HANFORD (1122)**

) Appeal No.: SAU 13-029
) Case ID No.: 743424

15 **GWF ENERGY LLC – HENRIETTA (1123)**

) Appeal No.: SAU 13-030
) Case ID No.: 743425

17 **GWF ENERGY LLC – TRACY (1124)**

) Appeal No.: SAU 13-031
) Case ID No.: 743427

19 Petitioners
20 _____

21 **Representing the Parties:**

22 For the Petitioners:

Paul Bellon, Director
Duff & Phelps

24 For the Respondent:

Susan Galbraith, Tax Counsel
Attorney for State-Assessed Properties Division

Kurt A. Beck, Senior Specialist Property Auditor Appraiser
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27 Counsel for Appeals Division:

Dana R. Brown, Tax Counsel III (Specialist)

PROPOSED VALUES**GWF Energy LLC - Hanford (1122)**

	Value	Penalty	Total
2013 Board-Adopted Unitary Value	\$41,100,000	\$0	\$41,100,000
Petitioner's Requested Unitary Value	\$13,000,000	\$0	\$13,000,000
Respondent's Appeal Recommendation	\$41,000,000	\$0	\$41,000,000

GWF Energy LLC - Henrietta (1123)

	Value	Penalty	Total
2013 Board-Adopted Unitary Value	\$35,800,000	\$0	\$35,800,000
Petitioner's Requested Unitary Value	\$16,500,000	\$0	\$16,500,000
Respondent's Appeal Recommendation	\$35,800,000	\$0	\$35,800,000

GWF Energy LLC – Tracy (1124)

	Value	Penalty	Total
2013 Board-Adopted Unitary Value	\$266,400,000	\$0	\$266,400,000
Petitioner's Requested Unitary Value	\$196,500,000	\$0	\$196,500,000
Respondent's Appeal Recommendation	\$266,400,000	\$0	\$266,400,000

ISSUE

Whether Petitioners Have Shown that Respondent Erred by Disallowing Petitioners' Purchase Price Allocation of Nontaxable Intangible Value to their Power Purchase Agreements.

Appeals Division's Recommendation¹

The Appeals Division recommends that the Board deny the petitions for reassessment because petitioners have not met their burden of proof to establish that respondent erred by failing to remove intangible value attributable to their power purchase agreements in the determination of their unitary values.

Background Information

On December 13, 2012, GWF Energy Holdings LLC acquired petitioners GWF Energy LLC – Hanford (Hanford), GWF Energy LLC – Henrietta (Henrietta), and GWF Energy LLC – Tracy (Tracy)

¹ Unless the Board otherwise holds, the Board shall take official notice of: the property statement filed with the Board, together with any attachments, including without limitation any reports to regulatory agencies such as the U.S. Securities and Exchange Commission and the California Public Utilities Commission, 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 power generation facilities from affiliates of Harbert Power, LLC. The total purchase consideration
2 amounted to \$631 million.

3 Petitioners Hanford and Henrietta are both peaking power² facilities located in Kings County.
4 The Hanford facility is located in Hanford, California, and the Henrietta facility is located
5 approximately 20 miles southwest of Hanford, California. The Hanford and Henrietta facilities each
6 consist of two gas turbine generators. Petitioner Tracy facility is a combined cycle facility located in
7 Tracy in San Joaquin County. The Tracy facility ceased production as a peaking facility in or around
8 October 2010 and also has two gas turbine generators.

9 The 2013 Board-adopted unitary values for petitioners Hanford and Henrietta were determined
10 by placing 60 percent reliance on the Replacement Cost Less Depreciation (ReplCLD) value indicator,
11 and 40 percent on the Capitalized Earning Approach (CEA) value indicator for the Hanford and
12 Henrietta facilities. The 2013 Board-adopted unitary value for petitioner Tracy's facility was
13 determined by placing 100 percent reliance on the ReplCLD value indicator.

14 Contentions

15 Petitioners' Contentions

16 Petitioners provide an appraisal report prepared by Duff & Phelps (D&P report) attached as an
17 exhibit to their petition. Section 5 of the D&P report, titled "Valuation of the Intangible Assets",
18 identifies the intangible assets as petitioners' 10-year "tolling agreements"³ with Pacific, Gas and
19 Electric Company (PG&E). Under the tolling agreements, petitioners sell electricity to PG&E in return
20 for payments of stated amounts under specified terms. The D&P report describes the steps of its
21 discounted cash flow analysis used to value the tolling agreements. The "fair value" of the tolling
22 agreement for each petitioner is stated as follows: Tracy - \$305 million, Hanford - \$35 million and
23 Henrietta - \$35 million. (Petition, Attachment pp. 30-32.)

24 Based on the D&P study, petitioners contend that their power purchase agreements are
25 intangible assets and that the values of those intangible assets are erroneously included in petitioners'

27 ² A "peaker" is a facility where the generating equipment is operated during the hours of highest seasonal demand as
28 required or dispatched by the California Independent System Operator.

³ The tolling agreements are also referred to as power purchase agreements in this hearing summary.

1 2013 Board-adopted unitary values. Petitioners assert that their unitary values should be determined by
2 calculating the value difference between the revenues generated with their power purchase agreements
3 in place and the revenues that would be generated in an “open market” if they did not operate with their
4 power purchase agreements.

5 Respondent’s Contentions

6 Respondent contends that 60 percent reliance on the ReplCLD value indicator, and 40 percent
7 reliance on the CEA value indicator is consistent with the methodology used for other peaking facilities
8 similarly-situated to the Hanford and Henrietta facilities. (Respondent’s Reply Brief (Hanford and
9 Henrietta), pp. 2-3.) Respondent also contends that 100 percent reliance on the ReplCLD value
10 indicator is consistent with the methodology used for combined cycle facilities similarly-situated to the
11 Tracy facility. (Resp. Reply Br. (Tracy), pp. 3-4.) Additionally, respondent states that petitioners’
12 estimates of value were based solely on an income approach to value, while respondent used both the
13 ReplCLD approach and an income approach to calculate the plants’ unitary values. Respondent further
14 states that the ReplCLD value indicator is based on a cost per megawatt factor, after updating the cost
15 per megawatt based on industry specific information. Respondent asserts that industry representatives
16 and respondent believe these sources are conservative in calculating costs per megawatt as they include
17 only the actual cost of purchasing the turbines and related facility equipment. (Resp. Reply Br. (Tracy),
18 pp. 3-4.)

19 Respondent calculated a ReplCLD value indicator based on a cost per-megawatt (MW) factor
20 after updating the cost per-MW based on industry-specific information from sources such as Gas
21 Turbine World and the Bureau of Labor Statistics. (Resp. Reply Br. (Hanford and Henrietta), p. 3.)
22 After adjusting for physical obsolescence and using respondent’s value for assessable land, respondent
23 calculated ReplCLD value indicators, weighted at 60 percent, for petitioners’ Hanford and Henrietta
24 facilities as follows: \$45,221,169 (approximately \$492,000 per-MW) for the Hanford facility and
25 \$35,760,737 (approximately \$365,000 per-MW) for the Henrietta facility. (Resp. Reply Br. (Hanford
26 and Henrietta), p. 3.) Respondent calculated the CEA value indicators, weighted at 40 percent, for
27 petitioners’ Hanford and Henrietta facilities from projected generation revenue, fuel costs, and
28 operating expenses petitioners provided as follows: \$34,997,809 for the Hanford facility and,

1 \$35,805,115 for the Henrietta facility. Respondent calculated the RepICLD value indicator, weighted
2 at 100 percent, for the Tracy facility at \$266,400,000 (approximately \$800,000 per-MW). (Resp. Reply
3 Br. (Hanford and Henrietta), p. 3.)

4 Respondent states that petitioners appear to attribute an intangible component to the tolling
5 agreements by calculating the value difference between having a tolling agreement in place and the
6 revenues that might be generated in a hypothetical “open market” scenario where tolling agreements do
7 not exist, using a discounted cash flow (DCF) model.⁴ Respondent asserts that petitioners compare
8 their revenues with revenues from facilities operating in an open market even though petitioners’
9 facilities were not built with the expectation of operating without tolling agreements. According to
10 respondent, this reasoning mistakenly assumes that revenues under the tolling agreements are not
11 market revenues whereas, “the contract *is* the market, and thus, there is no separate intangible value that
12 can be calculated in this manner.” (Resp. Reply Br. (Hanford, Henrietta, and Tracy), p. 2.)

13 Respondent states that a contract between a power generating facility and a utility company is
14 common and that most facilities enter into contracts, ranging from 10 to 15 years depending on such
15 factors as location and system needs, prior to being constructed. Respondent asserts that contracts
16 provide a predictable, reliable and stable cash flow for the contract term. Moreover, respondent
17 contends that petitioners operate in a market where most new power plants contract with a utility to
18 provide power generation for a number of years, and thus the market on which a comparison of value
19 must be made is reflected in the contract terms. Thus, respondent concludes that petitioners’ agreement
20 with PG&E to provide electricity on terms different than those available without such an agreement
21 does not necessarily create a nontaxable intangible asset and petitioners have cited no statutory,
22 regulatory, or judicial authority for this premise. (Resp. Reply Br. (Hanford, Henrietta, and Tracy),
23 p. 3.)

24 **Appeals Conference**

25 At the appeals conference, respondent asserted that the court of appeals’ holding in *Freeport-*
26 *McMoran Resource Partners v. County of Lake* (1993) 12 Cal.App.4th 634 (*Freeport-McMoran*),
27

28 ⁴ A DCF model is an income approach to value method.

1 applies to the facts here and, based on that decision, respondent generally uses revenue generated from
2 power purchase agreements when calculating an income approach to value as it did in this instance. In
3 contrast, petitioners argued that the California Supreme Court's recent holding in *Elk Hills Power, LLC*
4 *v. State Board of Equalization* (2013) 57 Cal.4th 593 (*Elk Hills*), however, more appropriately applies
5 here. Petitioners argue that the court's holding in *Elk Hills* supports a finding that petitioners' power
6 purchase agreements are intangible assets and that respondent erroneously included the revenues
7 generated from those power purchase agreements in petitioners' 2013 Board-adopted unitary values.

8 Applicable Law and Appraisal Principles

9 Burden of Proof

10 Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.)
11 Therefore, the petitioner has the burden of showing that the assessment is incorrect or illegal.
12 (*ITT World Communications v. Santa Clara* (1980) 101 Cal.App.3d 246; see also Cal. Code Regs.,
13 tit. 18, § 5080 subd. (a).)

14 Reconciliation of Value Indicators

15 Property Tax Rule 3 requires that, in estimating value, the assessor shall consider one or more
16 of the approaches to value "as may be appropriate for the property being appraised," which includes the
17 comparative sales approach, the replacement or reproduction cost approach (e.g., ReplCLD valuation
18 methodology), or the income approach. The appropriateness of an approach is often related to the type
19 of property being appraised and the available data. (Assessors' Handbook section 502, *Advanced*
20 *Appraisal* (December 1998) (AH 502), p. 109.) In addition, the validity of a value indicator will
21 depend upon the accuracy of data and adjustments made to the approach. That is, the accuracy of a
22 value indicator depends on the amount of available comparable data, the number and type of
23 adjustments, and the dollar amount of the adjustments. Finally, if a large amount of comparable data is
24 available for a given approach, the appraiser may have more confidence in that approach. For example,
25 if income, expense, and capitalization rate data can be obtained from many properties comparable to the
26 subject, the appraiser may attribute significant accuracy to the income approach. The greatest reliance
27 should be placed on that approach or combination of approaches that best measures the type of benefits
28 the subject property yields. The final value estimate reflects the relative weight that the appraiser

1 assigned, either implicitly or explicitly, to each approach. (AH 502, p. 112.)

2 **ReplCLD Value Indicator**

3 Property Tax Rule 6, subdivision (a) provides, in part: “The reproduction or replacement cost
4 approach to value . . . is preferred when neither reliable sales data . . . nor reliable income data are
5 available” In general, the ReplCLD valuation methodology is estimated by applying trend
6 factors—price level changes, including the application of “current prices to the labor and material
7 components of a substitute property capable of yielding the same services and amenities, with
8 appropriate additions as specified” (Property Tax Rule 6, subd. (d).) Then, the resulting adjusted
9 cost amount is “reduced by the amount that such cost is estimated to exceed the current value of the
10 reproducible property by reason of physical deterioration, misplacement, over- or under-improvement,
11 and other forms of depreciation or obsolescence. The percentage that the remainder represents of the
12 reproduction or replacement cost is the property’s percent good.” (Property Tax Rule 6, subd. (e).)

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 to
18 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 duration
20 of the estimated stream and upon the capitalization rate at which future income is discounted to its
21 present worth.” Subdivision (c) provides that “the amount to be capitalized is the net return which a
22 reasonably well-informed owner and reasonably well informed buyers may anticipate on the valuation
23 date that the taxable property existing on that date will yield under prudent management and subject to
24 legally enforceable restrictions as such persons may foresee as of that date.”

25 **Revenue and Taxation Code section 110**

26 Revenue and Taxation Code section 110, subdivisions (a) and (b) define “full cash value” or
27 “fair market value” for California property tax assessment purposes. Subdivisions (d) and (e) set forth
28 the limitations on taxation of intangible value and provide in part that:

1 (d) Except as provided in subdivision (e), for purposes of determining the "full cash
2 value" or "fair market value" of any taxable property, all of the following shall apply:

3 (1) The value of intangible assets and rights relating to the going concern value of a
4 business using taxable property shall not enhance or be reflected in the value of the
5 taxable property.

6 (2) If the principle of unit valuation is used to value properties that are operated as a unit
7 and the unit includes intangible assets and rights, then the fair market value of the taxable
8 property contained within the unit shall be determined by removing from the value of the
9 unit the fair market value of the intangible assets and rights contained within the unit.

* * *

10 (e) Taxable property may be assessed and valued by assuming the presence of intangible
11 assets or rights necessary to put the taxable property to beneficial or productive use.

12 **Freeport McMoran**

13 The court of appeal in *Freeport-McMoran* examined whether intangible value is properly
14 assigned to a power purchase agreement (SO4 contract) in determining a power plant's unitary value.
15 In *Freeport-McMoran*, the appellant owned geothermal power plants in Lake County and argued that
16 the respondent county overvalued its property by basing its assessment on capitalization of the income
17 stream of power purchase agreements with PG&E at rates above the market rates. The court found that
18 the evidence showed that the power plant would only be offered for sale in conjunction with the SO4
19 contract because "the contract is integral to the economic viability of the plant" and "a prospective
20 purchaser would be willing to pay more for a plant with an SO4 contract than for a plant without one
21 because the SO4 contract guarantees a higher income." (*Id.* at 644.) Thus, the court held that the
22 proper market for valuation of appellant's power plants was a market consisting of existing facilities
23 with similar power purchase agreements. (*Id.* at 645.)

24 The court also rejected the appellant's argument that the income generated from appellant's
25 power purchase agreements was nontaxable intangible property. The court followed the decision in
26 *County of Stanislaus v. Assessment Appeals Bd.* (1989) 213 Cal. App. 3d 1445, which involved taxation
27 of a cable television franchise consisting of the right to use public streets for cables and the right to
28 charge fees to subscribers for use of the cable facilities. In *County of Stanislaus*, the court held that the
latter component, the intangible right to do business, was necessary to put the possessory interest to its
beneficial or productive use and, therefore, should be considered in valuing the possessory interest. By
the same reasoning, the *Freeport-McMoran* court concluded that the SO4 contracts were not

1 nontaxable intangibles because they were the means “by which appellant’s properties are put to
2 beneficial use and must be considered in assessing the properties’ ‘full value.’” (*Id.* at 645-646.)

3 Finally, the court rejected the appellant’s argument that consideration of the value of a SO4
4 contract “improperly taxes appellant’s enterprise activity or business skill.” The court acknowledged
5 that under the income approach “income derived in large part from enterprise activity may not be
6 ascribed to the property.” However, the court held that the SO4 contract was the means by which
7 appellant sold its electricity, therefore, “the income generated by the SO4 contract is inextricably tied to
8 the beneficial use of the property and [is] properly considered in assessing its value.” The court further
9 found that there was no evidence the increased value of the SO4 contract over a market rate was due to
10 appellant’s enterprise activity. Thus, the court concluded that the higher price received under the SO4
11 contract was not “the result of appellant’s successful operation of its plants but of the regulatory
12 scheme that allowed appellant the benefit of a long-term fixed contract price.” (*Id.* at 646.)

13 **Elk Hills Power**

14 In *Elk Hills*, the California Supreme Court recently held that the Board directly assessed
15 intangible value by assessing the value of the taxpayer’s emission reduction credits (ERCs) in violation
16 of Revenue and Taxation Code section 110 when it added the replacement cost of the ERCs to the
17 power plant’s taxable value. Under the facts presented in that case, Elk Hills Power’s unitary value
18 was determined by reliance on the ReplCLD and CEA indicators of value and the court determined that
19 the Board improperly added a site-specific adjustment to account for the average replacement cost of
20 the plant’s ERCs as a separate line item in valuing the power plant. The court found that ERCs fall
21 within the class of intangibles described in section 110(d)(1) because they are intangible assets that
22 enable the day-to-day functioning of the power plant, and therefore, necessarily relate to the going
23 concern value of that business under either definition of going concern value. (*Id.* at 602.)

24 However, with respect to the CEA indicator of value, the Court reasoned that, “under an income
25 stream approach, not all intangible rights have a quantifiable fair market value that must be deducted”
26 (*Id.* at p. 617) and that, “[t]here was no credible showing that there is a separate stream of income
27 related to enterprise activity or even a separate stream of income at all that is attributable to the ERCs in
28 this case.” (*Id.* at p. 602.) Thus, the Court concluded that the Board correctly “estimated the amount of

1 income the property is expected to yield over its life and determined the present value of that amount,”
2 and “the Board was not required to deduct a value attributable to the ERCs under an income approach.”
3 (*Ibid.*)

4 Appeals Division’s Analysis and Comments

5 Respondent is presumed to have correctly determined the value of the property at issue, and
6 petitioners bear the burden of proving otherwise. The issue here is whether petitioners have shown that
7 respondent erred by disallowing petitioners’ allocations of nontaxable intangible value to their power
8 purchase agreements.

9 The Appeals Division notes that the court in *Freeport-McMoran* held that a S04 contract was
10 not a nontaxable intangible asset because it was necessary for the productive and beneficial use of the
11 taxpayer’s property which is consistent with Revenue and Taxation Code section 110, subdivision (e).
12 We also note that the court found that there was income generated by the SO4 contract as it was the
13 means by which appellant sold its electricity. In *Elk Hills*, however, the court found that there was no
14 credible evidence of a separate stream of income attributable to the ERCs. For that reason, the *Elk*
15 *Hills* court held this Board was not required to deduct intangible value attributable to the ERCs from
16 the income approach indicator. At the hearing, the parties should be prepared to discuss whether *Elk*
17 *Hills* may be inapposite to these appeals in view of the fact that a power purchase agreement generates
18 income while the court found in that decision that ERCs do not generate income.

19 Respondent asserts that most electricity generating plants enter into power purchase agreements
20 prior to construction as a basis for its position that such plants constitute the appropriate market for
21 valuation of petitioners’ facilities. At the hearing, the parties may wish to present evidence of the
22 numbers and types of electricity generating plants that operate with and without power purchase
23 agreements for which construction is planned or construction is underway and those that are currently
24 operating in California.

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