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STATE OF CALIFORNIA
BOARD OF EQUALIZATION

In the Matter of the Petition for
Reassessment of the 2011 Unitary Value for:

Trans Bay Cable LLC (119)

Petitioner

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

) Appeal No.: SAU 11-021
) Case ID No.: 577086
)

Representing the Parties:

For the Petitioner:

John Messenger, Attorney
Marty Dakessian, Attorney
Michael D. Hornstein, General Counsel
Donna Burke, Chief Financial Officer

For the Respondent:

Mary Anne B. Tooke
Tax Counsel
Attorney for State-Assessed Properties Division

Don Jackson
Principal Property Appraiser
State-Assessed Properties Division

Counsel for Appeals Division:

Anthony S. Epolite, Tax Counsel IV

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PROPOSED VALUES

	Value	Penalty	Total
2011 Board-Adopted Unitary Value	\$511,000,000	\$20,000,000	\$531,000,000
Petitioner's Requested Unitary Value	\$511,000,000	0	\$511,000,000
Respondent's Recommendation on Appeal	\$511,000,000	\$20,000,000	\$531,000,000

ISSUE

Whether petitioner has presented evidence sufficient to abate the 10-percent penalty imposed for petitioner's failure to timely file a property statement.

Appeals Division's Recommendation¹

The Appeals Division recommends that the Board deny the petition for abatement of the 10-percent late filing penalty because petitioner has not presented evidence demonstrating that the untimely filing was due to reasonable cause and occurred despite the exercise of ordinary care and in the absence of willful neglect.

BACKGROUND INFORMATION

Trans Bay Cable LLC (petitioner) is an energy transmission company which owns and operates a 53-mile long transmission line that runs from the City of Pittsburg (City), and under San Francisco Bay, to San Francisco, to transmit electricity to San Francisco.

The only issue before the Board in this appeal is the assessment of a late filing penalty relating to the late filing of petitioner's 2011 property statement.

Summary of Appeals Conference

At the October 11, 2011 appeals conference, petitioner argued (as discussed in detail below) that it tried to be diligent in its filing of property statements, including working with staff of respondent State-Assessed Properties Division (SAPD) relating to escape assessments for prior assessment years. Petitioner states that it only employed 10 people on November 23, 2010, when the project went

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.

operational, and has only 14 employees currently. Petitioner contends that, after its accounting department employee returned from an absence, the property statement was filed within 12 days of her return.

Petitioner states, as detailed below, that it negotiated with the City and other City agencies for the purchase of the construction assets, but that on November 21 or 22, 2010, the City and its joint powers authority (JPA) decided not to exercise their option to purchase the construction assets. Petitioner states that it only contemplated operating as a construction company and had not planned on actually operating the project as its owner. Petitioner also contends that, up to the time of the City's decision not to exercise the option in November 2010, it (petitioner) was involved in a refinancing of the project which consumed petitioner's time and efforts.

Petitioner argues that the magnitude of the penalty is out of proportion to the error that occurred. Petitioner contends that, going forward, such an oversight will not occur as petitioner now has a calendar to assure that it is in compliance with government filing deadlines.

Respondent argues that it informed petitioner twice of its filing requirements and that the property statement was filed six weeks late. Respondent states that petitioner did not request an extension for the filing of the property statement, such that an abatement of the penalty is not appropriate under the circumstances. Respondent also notes that, if petitioner had not misplaced documents sent to it by SAPD relating to the filing of the 2011 property statement (as detailed below), the late filing would not have occurred.

Subsequent to the appeals conference, petitioner submitted (in response to the Appeals Division's request) a narrative regarding (1) petitioner's discussions and negotiations with the City in 2010 relating to the exercise of the option, including the timing of the JPA's decision not to exercise the option and the project's operational date, and (2) petitioner's refinancing of the project during 2010. Petitioner included the Settlement Agreement and Mutual Release between itself and the various entities of the City as part of this submission. This submission is summarized below.

At the conference, the Appeals Division confirmed the following with the parties. First, petitioner filed timely property statements for 2008, 2009, and 2010. Second, SAPD (respondent) confirmed that it sent a letter to petitioner dated March 16, 2011 (as discussed below), inquiring about

the filing of petitioner's property statement. However, respondent states that it did not mean to imply (as it asserts below in Respondent's Contentions) that the letter was acknowledged by petitioner as of any particular date.

Contentions

Petitioner's Contentions

Petitioner asserts that the late filing of its 2011 property statement on April 12, 2011, was due to reasonable cause and occurred notwithstanding the exercise of ordinary care and in the absence of willful neglect. Petitioner contends that it has an unblemished history of filing timely property statements and of working cooperatively with staff and that a confluence of several events affected the filing of the property statement. (Petition, p. 1.)

Petitioner states that it developed, built, managed, and owned a transmission system project (project) during its construction and that it anticipated that the JPA would exercise its option to purchase the project upon its completion and thereafter own and operate the project. Petitioner states that it further anticipated that it would retain certain transmission system rights in the project from the commencement of, and after, the commercial operation date of the project. Accordingly, petitioner contemplated that once the project's construction was completed and operational, the JPA would make property tax filings with the Board.² (Petition, pp. 1-2.)

Petitioner states that the project became operational on November 23, 2010, and that, pursuant to an agreement between it and the JPA dated November 22, 2010, the JPA did not acquire ownership of the project as originally contemplated; petitioner, instead, became the owner of the operating project. As a result, petitioner contends that it had to deal with a vast transformation of itself from a construction company to an entity with organizational responsibilities and was faced with a multitude of issues, responsibilities, and complexities that were not originally contemplated, including operational demands, expanded accounting responsibilities, financing obligations, regulatory compliance mandates, and taxation responsibilities. Petitioner states that it made significant organizational changes and hiring

² Petitioner attaches a June 27, 2007 letter from the Tax and Fee Programs Division of the Board's Legal Department as the basis for its assertion that, after the exercise of the option by Pittsburg JPA, petitioner would no longer have any property tax responsibilities relating to the subject property. (Petition, p. 2; Exhibit A.)

decisions, including the retention of a new accounting firm, experienced with regulated utilities, and the hiring of a chief financial officer. Petitioner describes itself as a small start-up company in early 2011 with a myriad of obligations and with few internal policies and procedures in place. (Petition, pp. 2-3.)

Petitioner asserts that it timely filed its 2010 property statement and that, despite its complete filing in 2010 and in prior years, the Board failed to include certain properties in the assessment that had been reported on the property statements. Petitioner contends that its employee worked with Board staff to correct the Board's processing errors, errors which resulted in escape assessments and an \$8 million increase in assessed value. (Petition, p. 3.)

Petitioner contends that, during this period of time (while its employee was working with Board staff), it received a December 31, 2010 letter from the Board regarding the filing of the 2011 property statement and the March 1, 2011 deadline for the property statement. Petitioner alleges that the letter was mistakenly filed away with the documentation relating to the escape assessments for the prior years and was not acted upon. Petitioner contends that, without this misfiling, it would have filed its property statement or timely requested an extension to file its property statement. Petitioner also asserts that the March 16, 2011 follow-up letter from Board staff arrived while petitioner's employee was on vacation and that its employee immediately called Board staff, upon her return, on March 28, 2011, to request assistance. (Petition, p. 4.)

Petitioner asserts that in prior years, during the project's construction, the bulk of its property was reported on the property statement as an aggregate of construction in progress. However, with the conversion from a construction company to an operating company, petitioner alleges that it had to identify and record assets in over 200 asset classes, a complex and time-consuming process, and that its final audit report was delayed and not issued until June 16, 2011, because of these complexities. Nevertheless, petitioner points out that its employee filed the 2011 property statement within days of her telephone conversation with Board staff. Petitioner contends that, despite the haste in filing the property statement, petitioner filed a complete property, resulting in an overstatement in its value by over \$1 million. (Petition, pp. 4-5.)

In conclusion, petitioner asserts that the delayed filing of its property statement was due to reasonable cause and occurred notwithstanding the exercise of due care and the absence of willful

neglect. Petitioner contends that it has a record of timely filing its property statements and working cooperatively with Board staff, even to its own detriment (i.e., resulting in escape assessments).

Petitioner asserts that the change in its operations, and the related changes in its responsibilities, all occurred within a four-month period of time, leading to the unintentional and understandable delay in its filing. Based upon the above, petitioner requests that the penalty be abated. (Petition, pp. 5-6.)

Respondent's Contentions

Respondent asserts that petitioner was properly notified of its reporting responsibilities and had adequate time to file its property statement timely. Respondent acknowledges that petitioner anticipated that the project would be purchased and that, instead, petitioner was faced with a multitude of issues and responsibilities in November 2010 that were not originally contemplated when it retained ownership of the operating project. Respondent also acknowledges that petitioner's 2009 and 2010 property statements only reported construction work in progress and that petitioner did not anticipate the filing of a 2011 property statement. Nevertheless, respondent states that petitioner was required to file a 2011 property statement and that, on December 15, 2010, petitioner was mailed a copy of the 2011 newsletter reminding it of its filing obligation and that, on December 31, 2010, petitioner was mailed a 2011 property statement. (Respondent's Opening Brief, p. 2.)

Respondent also contends that, on March 15, 2011, a letter was mailed to petitioner stating that its 2011 property statement had not been filed and that petitioner acknowledged the receipt of this letter on March 16, 2011. Respondent states that petitioner acknowledged the receipt of the 2011 property statement reporting forms but stated that it failed to file the statement on time because it had misplaced the forms with its 2010 information. In response to petitioner's assertion that it would have filed an extension if the forms had not been misplaced, respondent states no extension was filed. (Respondent's Opening Brief, p. 2.)

In response to petitioner's assertion that it filed a property statement within days of March 28, 2011, when it became aware of its failure to do so, respondent asserts that the property statement was not filed until April 13, 2011, two weeks later. Furthermore, respondent contends that, even after the property statement was received, staff worked with petitioner to complete the tax rate area information relating to the location of petitioner's transmission lines. As to petitioner's assertion that petitioner was

working with staff to correct staff's processing errors, respondent argues that these errors related to escape assessments for prior years and had no bearing on petitioner's filing of its 2011 property statement. And, finally, respondent asserts that petitioner's filing of its 2011 property statement, 43 days late, was not due to reasonable cause and did not occur notwithstanding the exercise of ordinary care and the absence of willful neglect as required by R&TC section 830, subdivision (f). (Respondent's Opening Brief, p. 3.)

Petitioner's Reply Brief

Petitioner asserts that respondent incorrectly states that petitioner acknowledged the receipt of Board staff's letter on March 16, 2011. Instead, petitioner claims that the letter itself was dated March 16, 2011 and, since it was delivered via regular mail, could not have also been received and acknowledged on March 16, 2011. Petitioner argues that respondent's misstatement is material because it bears on petitioner's extraordinary efforts of responding once it became aware of the missed filing. (Petitioner's Reply Brief, p. 1.)

Petitioner also claims that, as a small company, it only has an accounting staff of six individuals and reiterates that its accounting manager, responsible for its property tax filing, was on vacation until March 28, 2011. Petitioner also claims that a key member of its accounting staff was unavailable during this period of time as well, on maternity leave, and that petitioner quickly hired staff to assist with the classification of its assets. Petitioner asserts that once it became aware of its error, it elevated the filing of its property statement to the highest priority, moving resources from other projects and submitting the filing as expeditiously as possible. (Petitioner's Reply Brief, pp. 1-2.)

Petitioner's Post-Conference Submission

At the appeals conference, the Appeals Division requested that petitioner provide additional evidence relating to (1) its discussions and negotiations with the JPA in 2010 relating to the exercise of the option, including the timing of the JPA's decision not to exercise the option and the project's operational date, and (2) petitioner's refinancing of the project during 2010.

Petitioner states that, under various agreements entered into by the City, the JPA, and petitioner, the City was granted the option to designate the JPA or another designee to own petitioner's project assets as of the date the project was placed into service and to have the overall responsibility for the

management, administration, supervision, operation, and maintenance of the transmission facilities that constitute the project. Through its adoption of a purchase and sale agreement on November 6, 2006, the JPA notified petitioner that it was exercising its option to acquire the project assets. (Petitioner's Post-Conference Submission, p. 1.)

Shortly before commercial operation began, however, the parties determined that it was in the parties' best interests, and in the best interest of the California Independent System Operator-controlled transmission system, to restructure the parties' relationship so that petitioner would continue to own or lease all of the assets at, and after, the time the project was placed into service and to retain all of the management, administration, supervision, operation, and maintenance responsibilities. As a consequence, the parties entered into a settlement agreement on November 22, 2010, one day prior to the date the project achieved commercial operation and was placed into service. (Petitioner's Post-Conference Submission, p. 1.)

Upon review of the Settlement Agreement and Mutual Release (Petitioner's Post-Conference Submission, Exhibit D), entered into by petitioner, the City, the JPA, and a City redevelopment agency, the JPA agreed to not exercise its option to purchase the project assets for the following reasons:

- During engineering tests conducted by, and on behalf of, petitioner in preparation for commercial operation, the project encountered unexpected technical difficulties which involved extensive remedial activities by petitioner's contractor relating to converter station technology. In order to enhance the project's reliability and operational stability, petitioner determined that it was necessary for its contractor to have an expanded role during the initial years of the project's commercial operation. The contractor's expanded role was not contemplated by the parties, or provided for, in the project agreements.
- Petitioner and the JPA differed in their understanding and application of certain terms of the project agreements, particularly various financial provisions of those agreements. Petitioner and the JPA were engaged in contractual dispute resolution proceedings in an effort to resolve these differences.
- The parties believed that it is in their mutual best interests to resolve the dispute between them by facilitating the expanded role of petitioner's contractor, as the parties agreed that such was necessary to insure the project's reliability and operational stability.

As for petitioner's refinancing issues, petitioner asserts that, at the same time that the project was placed into service, SteelRiver Infrastructure Fund, the fund that owns petitioner, formed Steel River Transmission Company as petitioner's direct owner and as the vehicle to provide equity and debt financing to petitioner. This debt financing took the place of financing that had been provided by a

German bank, as the German bank had ceased funding the construction project. This debt was provided to petitioner, via an intercompany loan agreement in the principal amount of \$268 million on November 23, 2010, the same day that the project was placed into commercial operation. (Petitioner's Post-Conference Submission, p. 1.)

Applicable Law and Appraisal Principles

Revenue and Taxation Code (R&TC) section 830, subdivision (a) provides that a state assessee is required annually to file a property statement with the Board by March 1, or by the extended due date, if an extension is requested prior to the filing deadline and granted by the Board. (Cal. Code Regs., tit. 18, § 901.) Subdivision (c)(1) of section 830 imposes a mandatory penalty in the amount of 10-percent of the assessed unitary value for untimely filing. Subdivision (f) provides that the Board may abate the penalty if the assessee files a timely petition for penalty abatement and establishes that the failure to timely file the property statement was due to reasonable cause and occurred notwithstanding the exercise of ordinary care and in the absence of willful neglect.

Evidence Code section 115 defines the "burden of proof" as "the obligation of a party to establish by evidence a requisite degree of belief concerning a fact in the mind of the trier of fact or the court." The burden of proof applicable in this case requires petitioner to establish the existence or nonexistence of a fact by a preponderance of the evidence.

Appeals Division's Analysis and Recommendation

Here, petitioner filed its 2011 property statement 43 days late and respondent properly imposed the 10-percent penalty. Thus, petitioner must establish that it failed to timely file the statement due to reasonable cause and notwithstanding the exercise of ordinary care and in the absence of willful neglect. The phrase "reasonable cause" as it is used in similar federal legislation has been construed to mean such cause as would prompt an ordinary, intelligent, and prudent businessperson to have acted under similar circumstances. (26 CFR § 301.6651-1(c); *Sanders v. Commissioner*, (10th Cir. 1955) 225 F.2d 629, *cert. denied*, 350 U.S. 967 (1956); *See also U.S. v. Boyle*, (1985) 469 U.S. 241, 245-246.)

Petitioner filed 2009 and 2010 property statements with the Board. In addition, in 2007, petitioner's representative, Reed Smith, received a letter from the Board's Legal Department regarding petitioner's and the City's property tax filing responsibilities. (See Petition, Exhibit A.) As such, it

appears to the Appeals Division staff that petitioner was aware of its filing responsibilities with the Board (including the March 1st deadline to file a property statement) because of the 2007 letter and as evidenced by its filing of property tax statements in previous years. In addition, after the JPA decided to not exercise its option, petitioner admits that it engaged an accounting firm, that was experienced with regulated utilities, to assist it with its operations.

It appears that petitioner was in discussions with the City and the JPA for several months in 2010 prior to the agreement reached in November 2010. As such, at the hearing, petitioner should be prepared to discuss any steps it may have taken prior to November 2010, in anticipation that the JPA would not exercise the option and that petitioner would become the operator of the project, including the hiring of staff and outside consultants. Petitioner should also be prepared to explain why the accounting firm that it engaged, which was experienced with regulated utilities, was not given the responsibility to assist petitioner with the filing of the 2011 property statement.