STATE OF CALIFORNIA

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July 22, 1993

No. 93/40

TO COUNTY ASSESSORS:

PHILLIPS PETROLEUM COMPANY v. COUNTY OF LAKE
(1993) 15 CAL.APP. 4th 180

The First Appellate District Court of Appeal recently issued a decision on the setting of base year values for geothermal mineral interests, and other matters. The decision was filed April 27, 1993.

This letter is a summary of the events leading to the court case, the court's decision on the county's method of setting base year values for geothermal interests, and the court's decision related to attorneys' fees. This case is of particular interest to assessors and the geothermal industry because draft Rule 473, Geothermal Properties, is scheduled for public hearing by the Board on July 29, 1993. The Board requested the court to publish its decision so the findings could be considered in designing Rule 473.

BACKGROUND

On June 30, 1976, Aminoil acquired, from Signal Oil and Gas Company, the rights as lessee for a geothermal lease in The Geysers Geothermal Field. At the time of acquisition, the property was in the development stage; 81 percent of the necessary steam wells had been drilled and completed.

Construction of the power plant began in the fall of 1977. The remaining wells were drilled and completed, and the first delivery of steam to the plant began on March 6, 1980. On October 6, 1984, Phillips Petroleum became the successor to the Aminoil lease.

The dispute between Aminoil/Phillips and Lake County concerned the county's method of assessing the geothermal mineral interests during the 1978-80 development stage and the county's method of determining the base year value for those interests. Phillips challenged the assessments for the period 1978 through 1985.

The county viewed the ongoing drilling of wells during the development stage as "new construction." The assessor annually reappraised the geothermal interests, including both the geothermal rights and the system used to recover the geothermal energy, such as wells, wellheads, pipelines, and the like, at market value until the commencement of commercial operations in 1980. The county assigned 1981 as the base year for these interests.

Phillips contended that these interests should have been assigned a base value as of the time they were first acquired by Aminoil. Phillips also

contended that the concept of "new construction" triggering reappraisal under the law is inapplicable to the mineral interests themselves and is limited to the physical or tangible components of the project including the land, improvements, and the system used to recover the minerals such as pipelines and wells.

ISSUES

The principal issues facing the court were:

1. Must the interest of a lessee under a geothermal lease having proved reserves be assigned a base year value at the time such interests were acquired after March 1, 1975?

2. May such an interest be reappraised annually at full market value as new construction in progress as the facilities to develop the resource are constructed?

DECISION

The appeals court affirmed the judgment of the trial court, finding that:

1. The interest of a lessee under a geothermal lease having proved reserves must be assigned a base year value at the time such interests were acquired after March 1, 1975. This decision is inconsistent with portions of proposed Rule 473. Staff believes the decision is based on a misunderstanding of Rule 469.

2. Such an interest may not be reappraised annually at full market value as "new construction in progress" as the facilities to develop the resource are constructed. This portion of the decision is consistent with the views set forth in Letter To Assessors 87/100, dated December 15, 1987 in Question and Answer 11.

ATTORNEY FEES

Phillips requested attorney fees based on Sections 538 and 5152 of the Revenue and Taxation Code. Briefly, Section 538 provides that if an assessor believes a constitutional provision, statute, or regulation is unconstitutional or invalid, the assessor shall bring an action for declaratory relief instead of making the assessment he or she believes would be correct. Section 5152 provides for attorney fees if the assessor does not follow the Section 538 procedures and the court rules in favor of the taxpayer. In Prudential Insurance Company v. City and County of San Francisco, (1987) 191 Cal.App. 3d 1142, the court awarded attorney fees because the assessor purposely disregarded Rule 4.

The court upheld the trial court's findings that attorney fees were not to be awarded. The court stated:

> "Sections 5152 and 538 require a cognitive decision on the part of the assessor that a particular provision, rule or regulation is unconstitutional or invalid either on its face or as applied to the circumstances in the case. In such a situation, it is reasonable to put the onus on the assessor to test his or her theory by filing an action for declaratory relief. On the other hand, when it is simply a matter of the assessor misreading or misunderstanding the applicability of a provision in general, it is not reasonable to require such action or to award fees. To rule otherwise would require an assessor in most every instance to either file a declaratory relief action or risk liability for attorney fees if an assessment proved erroneous. This would place an undue burden on our counties and was certainly not intended by the Legislature."

The court went on to recite that although it (the court) relied on Rule 468 to reach its decision, neither Rule 468 nor any other regulation addressed geothermal interests, and there was no indication in the record that the assessor believed Rule 468 was unconstitutional or invalid.

The court addressed several other issues, such as the calculation of interest, that were specific to the case. The court's findings on those issues were not certified for publication.

As stated earlier in this letter, proposed Rule 473, Geothermal Properties, is scheduled for public hearing by the Board on July 29, 1993. The hearing is scheduled to start at 1:30 p.m. in the Board hearing room at 450 N Street, Sacramento. We anticipate the hearing will include discussion of the Phillips case, including the effect of the case, if any, on the proposed rule.

Sincerely,

Verne Walton

Verne Walton, Chief
Assessment Standards Division

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