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December 16, 1993

No. 93/75

TO COUNTY ASSESSORS:

RECENT COURT DECISIONS RELATING TO INTANGIBLES

Here are four recent court decisions that relate to the issue of intangibles. Three of the cases dealt with the assessment of possessory interests. The fourth case involved the valuation of a geothermal power plant.

For your information, copies of the following decisions are enclosed:

1. County of Orange v. Orange County Assessment Appeals Board No. 1 (American Television and Communications Corporation) (13 Cal.App.4th 524)

2. Emil Shubat v. Sutter County Assessment Appeals Board No. 1 (Nor Cal Cablevision, Inc.) (13 Cal.App.4th 794, as modified February 24, 1993)

3. County of Los Angeles v. County of Los Angeles Assessment Appeals Board No. 1 (Dollar Rent A Car Systems, Inc.) (13 Cal.App.4th 102)

4. Freeport-McMoran Resource Partners v. County of Lake (12 Cal.App.4th 634; modified 13 Cal.App.4th 1066a)

If you have any questions concerning these decisions, please contact our Real Property Technical Services Unit at (916) 445-4982.

Sincerely,

Verne Walton

Verne Walton, Chief
Assessment Standards Division

VW:kmc
Enclosures

[No. G012151. Fourth Dist., Div. Three. Jan. 28, 1993.]

COUNTY OF ORANGE, Plaintiff and Appellant, v.
ORANGE COUNTY ASSESSMENT APPEALS BOARD NO. 1,
Defendant and Respondent;
AMERICAN TELEVISION AND COMMUNICATIONS
CORPORATION, Real Party in Interest and Respondent.

SUMMARY

The trial court denied a county's petition for a writ of mandamus seeking to set aside a decision of a county assessment appeals board adopting the position of a communications company concerning the property tax on its cable television system. (Superior Court of Orange County, No. 648275, Jonathan H. Cannon, Judge.)

The Court of Appeal affirmed. It held that, for purposes of determining the value of the cable television system, the trial court did not err in separating the company's property into land and land improvements, fixtures, and personal property, rather than considering all of the company's property as one appraisal unit for valuation purposes, since applicable law suggests there is no wrong in rationally dividing property into component parts for valuation purposes. Further, the court held, the trial court did not err as a matter of law in rejecting the comparable sales and income approaches in establishing the property's value. The court held that the selection of a particular method rests in the board's discretion and is constrained only by fairness and uniformity. The board determined that the income capitalization method using the annual franchise rent was appropriate for the company's possessory interest; it used the cost replacement approach to value the remainder of the property. The board found that neither the comparable sales approach nor the income approach was a reliable method for this property, and that the cost method was. When that is so, the court held, the cost method becomes preferable (Cal. Code Regs., tit. 18, § 6, subd. (a)). (Opinion by Wallin, J., with Moore, Acting P. J., and Sonenshine, J., concurring.)

HEADNOTES

Classified to California Digest of Official Reports

(1a, 1b) **Property Taxes § 42.2—Assessment—Valuation—Cable Television System—Separation of Property Into Components.**—A county assessment appeals board, for purposes of determining the value of a cable television system owned by a communications company, did not err in separating the company's property into land and land improvements, fixtures, and personal property, rather than considering all of the company's property as one appraisal unit for valuation purposes. Taken as a whole, neither Rev. & Tax. Code, § 51 (taxable value of real property), in general, nor Rev. & Tax. Code, § 51, subd. (e) ("real property" means that appraisal unit that persons in marketplace commonly buy and sell as unit, or which is normally valued separately), in particular, mandated appraisal of the property as a single unit. Applicable law suggests that there is no wrong in rationally dividing property into component parts for valuation purposes.

(2a, 2b) **Property Taxes § 42.2—Assessment—Valuation—Cable Television System—Valuation Approach—Appeal—Standard of Review.**—On appeal from a judgment denying a county's petition for a writ of mandate seeking to set aside the decision of a county assessment appeals board adopting the position of a communications company regarding the property tax on its cable television system, the appropriate standard of review was whether, as a matter of law, the board's valuation method was arbitrary, in excess of discretion, or in violation of the standards prescribed by law, where the county's attack was directed at the validity of that method. The Court of Appeal was required to look not to whether another approach might also have been valid or yielded a more precise reflection of the property's value, but whether the method chosen was contrary to law.

(3) **Property Taxes § 42—Assessment—Valuation—Standard of Review.**—If a party challenging a property tax assessment claims only that the assessment board erroneously applied a valid method of determining full cash value, the decision of the board is equivalent to the determination of a trial court, and the trial court in turn may review only the record presented to the board. The trial court may overturn the board's decision only when no substantial evidence supports it, in which case the actions of the board are deemed so arbitrary as to constitute a deprivation of property without due process. On the other hand, when the party challenges the validity of the valuation method

itself, the trial judge is faced with a question of law. The question is whether the challenged method of valuation is arbitrary, in excess of discretion, or in violation of the standards prescribed by law.

(4) **Property Taxes § 42.2—Assessment—Valuation—Cable Television System—Valuation Approach.**—A county assessment appeals board, for purposes of determining the value of a cable television system owned by a communications company, did not err as a matter of law in rejecting the comparable sales and income approaches in establishing the property's value. The three basic methods of valuation are the reproduction cost or cost replacement method, the market data or comparable sales method, and the income capitalization method. The selection of a particular method rests in the board's discretion and is constrained only by fairness and uniformity. The board determined that the income capitalization method using the annual franchise rent was appropriate for the company's possessory interest; it used the cost replacement approach to value the remainder of the property. The board found that neither the comparable sales approach nor the income approach was reliable, and that the cost method was. When that is so, the cost method becomes preferable (Cal. Code Regs., tit. 18, § 6, subd. (a)). The board's cost approach yielded a lower value than the other two approaches, but that was because the assessor's method had captured intangibles that were not subject to taxation.

[See **Cal.Jur.3d,** Property Taxes, § 77; 9 **Witkin,** Summary of Cal. Law (9th ed. 1989) Taxation, § 178 et seq.]

COUNSEL

Terry C. Andrus, County Counsel, and Thomas C. Agin, Deputy County Counsel, for Plaintiff and Appellant.

No appearance for Defendant and Respondent.

Shartsis, Friese & Ginsburg, Douglas Mo and Paul M. Gordon for Real Party in Interest and Respondent.

OPINION

WALLIN, J.—The County of Orange (County) appeals the judgment denying its petition for writ of mandamus seeking to set aside a decision of the

Orange County Assessment Appeals Board No. 1 (Board), which adopted the position of taxpayer American Television and Communications Corporation (American) concerning the property tax on American's cable television system. The County contends the Board erred as a matter of law by: (1) failing to consider the appropriate appraisal unit as a whole for valuation purposes; and (2) rejecting the comparable sales and income approaches in establishing the property's value. We affirm.

The Board heard several days of testimony and made certain findings. The trial court relied on that testimony in ruling on the petition for writ of mandamus. We summarize the Board's findings:

American owns and operates a cable television system which provides services for a fee to subscribers in the City of Orange and an abutting unincorporated area. To do so, it obtained requisite licenses, permits and approval to operate in that geographical area. It receives television signals and transmits them to the subscribers through a network of trunk and feeder cables, some of which are above and some of which are below ground.

American owns and uses taxable tangible property to carry on its business, including real property, distribution cables, buildings, cables, tower and antennas, local origination television equipment, furniture and fixtures, converters, and surplus and test equipment. American owned some of its taxable tangible property when it began operations in 1980 and acquired more later.

As part of the approval process, American entered into a franchise agreement with the City and County of Orange which included the right to use public property for its cable distribution network. That right constitutes a taxable possessory interest in public property. (Rev. & Tax. Code, § 107.7.)

For the lien dates in 1987, 1988, and 1989, the assessor calculated the full cash value of American's property at $30 million, $35 million, and $38 million, respectively,[1] and American challenged those values before the Board. To obtain the values the assessor used a "unitary approach," determining all of American's property should be valued as a single appraisal unit, applying a valuation approach, and allocating the total value among the various component parts of the appraisal unit.

To support his use of the "unity approach," the assessor presented evidence of two other methods. First, he presented a comparable sales approach, which involved taking purchase prices for other cable television

[1]Although the assessor determined those values, the amounts actually enrolled were considerably less due to the constraints of the California Constitution, article XIII A, popularly known as Proposition 13. The enrolled amounts were approximately $16 million, $18 million, and $19, million respectively.

systems in southern California, determining the price per subscriber, and multiplying that figure by the number of American's subscribers. The Board found that approach unreliable because it included the value of nontaxable intangible assets such as existing franchises or licenses to construct, a subscriber base, marketing and programming contracts, management and operating systems, an in—place work force, going concern value, and goodwill.

The assessor also presented the income approach, which involved multiplying American's net income by a capitalization rate. The Board rejected this approach for the same reason it rejected the comparable sales approach, it did not factor out the value of nontaxable intangible assets. The assessor did not present evidence as to how the property would be valued using a third accepted method of valuation, the replacement cost approach.

The Board accepted the testimony of American's three expert appraisers who identified American's taxable tangible property and opined as to its value. For all items except American's possessory interest, the property was divided into three categories: land and land improvements, fixtures, and personal property.[2]

As to the fixtures and personal property, the board considered all three methods of valuation and determined the replacement cost approach was the most reliable. It would not include nontaxable intangible value, and it best equalized assessments since the assessor had traditionally used that approach in valuing fixtures and personal property of similar businesses. The Board used the testimony and data from American's witnesses to calculate the appropriate replacement cost for these items.[3] It calculated the value for the undergrounding, which was categorized as land and land improvements, by taking its cost and assigning it an infinite life with no trending for the years in question.[4]

For the possessory interest in public property, the Board used the income capitalization method, which is presumptively correct under Revenue and Taxation Code section 107.7. It found American's franchise fees were the market rent which paid for the possessory interest and capitalized them at a

[2]The land and land improvements were comprised of the leasehold improvements and the undergrounding (the joint trench and back build); the fixtures were comprised of the cable distribution plant (except for the undergrounding), headend, tower, antenna, and earth station; and the personal property was comprised of the office furniture, computers, tools, cablecasting equipment, radios and test equipment, electronic ad equipment, converters, and supplies.

[3]These items totaled $6,695,366 in 1987, $6,404,988 in 1988, and $6,172,436 in 1989.

[4]The values were $2,401,080 for 1987, $2,671,931 for 1988, and $2,805,000 for 1989.

10 percent rate, yielding a $5 million value for each of the three years in question. The Board determined that American's total value for the years in question was greater than that enrolled, due to the effect of Proposition 13, and that the enrolled value should remain unchanged.[5] The assessor was ordered to change the assessed values for the years in question to those found by the Board.

I

(1a) The County argues the Board erred as a matter of law by failing to consider all of American's property as one appraisal unit for valuation purposes. In other words, the County claims the Board should not have separated the property into land and land improvements, fixtures, and personal property in determining the value of American's property. We conclude the Board acted properly, but first we must consider the applicable standard of review.

(2a) American asserts the Board's determination, and that of the trial court, must be upheld if substantial evidence supports the decision. *Bret Harte Inn, Inc.* v. *City and County of San Francisco* (1976) 16 Cal.3d 14 [127 Cal.Rptr. 154, 544 P.2d 1354], set out the proper standard. (3) "If the [petitioner] claims only that the [board] erroneously applied a valid method of determining full ca ': value, the decision of the board is equivalent to the determination of a trial court, and the trial court in turn may review only the record presented to the board. [Citations.] The trial court may overturn the board's decision only when no substantial evidence supports it, in which case the actions of the board are deemed so arbitrary as to constitute a deprivation of property without due process. [Citations.] On the other hand, when the [petitioner] challenges the validity of the valuation method itself, the trial judge is faced with a question of law. [Citations.] That question . . . is whether the challenged method of valuation is arbitrary, in excess of discretion, or in violation of the standards prescribed by law." (*Id.* at p. 23; see also *County of Stanislaus* v. *Assessment Appeals Bd.* (1989) 213 Cal.App.3d 1445, 1450 [262 Cal.Rptr. 439].)

(2b) The County's attack is directed at the Board's method of valuation, so we and the trial court look to see whether, as a matter of law, the method was arbitrary, in excess of discretion, or in violation of the standards prescribed by law. (*Bret Harte Inn, Inc.* v. *City and County of San Francisco*,

[5]The totals were $14,096,446 in 1987, $14,076,919 in 1988, and 13,977,436 in 1989. These amounts are less than amounts actually enrolled. At oral argument the County conceded the Board's ruling would actually lower the enrolled amounts to these levels.

supra, 16 Cal.3d at p. 23.)[6] In this regard we look not to whether another approach might also have been valid or yielded a more precise reflection of the property's value, but whether the method chosen was contrary to law. (*Trailer Train Co.* v. *State Bd. of Equalization*, *supra*, 180 Cal.App.3d at p. 585 [selection of a particular method of valuation from among valid methods rests in the board's discretion]; see also, *Union Pacific Railroad Co.* v. *State Bd. of Equalization* (1991) 231 Cal.App.3d 983, 992 [282 Cal.Rptr. 745] [inappropriate application of an otherwise valid valuation method could be considered a factual question].) "The law requires only that an assessor adopt and use a reasonable method—neither a trial court, nor this court, can reject a method found by the board to be reasonable merely because, in [its] nonexpert opinion, another method might have been better." (*Texaco, Inc.* v. *County of Los Angeles* (1982) 136 Cal.App.3d 60, 63 [186 Cal.Rptr. 16], fn. omitted.)

(1b) Relying on Revenue and Taxation Code section 51, subdivision (e), the County says the Board erred as a matter of law by failing to value American as one unit, "the whole system itself." That subdivision is of no avail. It states, "For purposes of subdivisions (a) and (b), 'real property' means that appraisal unit which persons in the marketplace commonly buy and sell as a unit, or which are normally valued separately."

Subdivisions (a) and (b) deal with the determination of a property's value as the lesser of its full cash value and its base year value (1975) enhanced by an inflation factor. Those subdivisions say nothing about the propriety of dividing the appraisal unit into components to determine its value. Further, subdivision (e) states, albeit ungrammatically, that an "appraisal unit" can be that "which are [*sic*] normally valued separately." Taken as a whole, neither section 51 in general, or subdivision (e) in particular, mandates appraisal of the property as a single unit.

Rule 22(b) of the Orange County Assessment Appeals Board and Assessment Hearing Officer Rules is similarly of no avail. That rule provides that

[6]We reach this conclusion recognizing there is often a fine line between a challenge to an application of a valuation method and a challenge to the method itself. (*Trailer Train Co.* v. *State Bd. of Equalization* (1986) 180 Cal.App.3d 565, 582 [225 Cal.Rptr. 717]; see also *People* v. *Louis* (1986) 42 Cal.3d 969, 984-988 [232 Cal.Rptr. 110, 728 P.2d 180] [discussing mixed questions of law and fact].) Here, the Board opted to value American's property in separate sub-units and to apply the cost method of valuation, after determining the ssessor's approach to valuation improperly captured intangible asset value. That determination involved at least a mixed question of law and fact and, based upon the Board's expertise, should be adopted by the courts in reviewing the propriety of the method selected. (See *Shell Western E & P, Inc.* v. *County of Lake* (1990) 224 Cal.App.3d 974, 979 [272 Cal.Rptr. 313] [assessment appeals boards have special expertise in property valuation and their factual determinations are entitled to deference].)

in considering a reduction in assessed value, the Board must "make determination of the full value of the whole property." Nothing in the rule says how the Board must make that determination, let alone that it may not value components separately. It does provide the Board may "adjust the value of the parts," a task seemingly impossible unless the parts have been separately valued. And, contrary to the County's assertion that "the most appropriate unit for valuation is the whole system itself," the testimony before the Board established that the cable distribution plant of cable television companies is valued separately, usually using the cost approach.

Further support exists for the concept that the components of taxable property may be separated for valuation purposes. Revenue and Taxation Code section 107.7 deals with valuation of cable television possessory interests and provides the preferred method of valuing that portion of a cable television company's property shall be capitalizing the annual rent. (Rev. & Tax. Code, § 107.7, subd. (b)(1).) It says nothing about changing the preferable methods for valuing other types of taxable property. (Cal. Code Regs., tit. 18, §§ 4, 6 & 8 [stating the preferred methods under other circumstances].) To apply the preferred methods both to the possessory interest and to other aspects of the property when the preferred methods differed would require separating the two facets of the property for valuation purposes, as was done here.[7]

Title 18, section 461, subdivision (d) of the California Code of Regulations states that where there are declines in value (here, the fixture portion of the cable distribution plant), "Land and improvements constitute an appraisal unit . . . [and] fixtures and other machinery and equipment classified as

[7]The Legislature's observation in enacting Revenue and Taxation Code section 107.7 that "[p]ossessory interests of cable television systems do not sell by themselves" does not alter the analysis. (Stats. 1988, ch. 1630, § 1(d).) The section codified the holding in *Cox Cable San Diego, Inc.* v. *County of San Diego* (1986) 185 Cal.App.3d 368 [229 Cal.Rptr. 839] that possessory interests of cable television companies constitute taxable property. (*County of Stanislaus* v. *Assessment Appeals Bd.*, *supra*, 213 Cal.App.3d at p. 1452, fn. 3.) The Legislature's observation in the enabling legislation merely justifies use of the income capitalization method so the value of such property can be captured and assessed. (See *id.* at p. 1455.)

The County reasoned at oral argument that because the possessory interest is worth nothing without cable in place along the right-of-way, the value of the cable was wedded to the possessory interest and should not have been valued separately. But the preferred method of capitalizing that portion of the franchise fee attributable to the possessory interest takes the County's reasoning into account. A cable television company would not "rent" the right-of-way unless it intended to use it. Thus, capitalizing that portion of the franchise fee reflects the value to the cable company of having the right-of-way with cable in place.

improvements constitute a separate appraisal unit." The rule contemplates a division in the appraisal unit for valuation purposes.[8]

Other sources rebut the County's claim that a taxpayer's property cannot be separated for valuation purposes. Title 18, section 3 of the California Code of Regulations provides than an assessor "shall consider one *or more*" of the three acceptable valuation approaches. (Italics added.) Similarly, title 18, section 324 provides the board "shall determine whether the method*(s)* used was *(were)* properly applied," and "[t]he findings shall also include a statement of the method *or methods* of valuation used . . . ." (Cal. Code Regs., tit. 18, § 324, subds. (a) and (e), italics added.) One way to use multiple methods would be when value is best calculated by breaking down the property into component parts.

To summarize, applicable law suggests there is no wrong in rationally dividing property into component parts for valuation purposes. (Compare *McDonnell Douglas Corp.* v. *County of Los Angeles* (1990) 219 Cal.App.3d 715, 726 [268 Cal.Rptr. 294] [separate *parcels* were properly valued as economic unit; the assessor was not required to value each parcel subject to its individual restrictions].) The County has provided no authority to the contrary. The Board was within its discretion to separate the property as it did.

II

(4) The County urges the Board erred as a matter of law by rejecting the comparable sales and income approaches in establishing the property's value. Using the same review standards discussed above, we conclude it did not.

The three basic methods of valuation are the reproduction cost or cost replacement method, the market data or comparable sales method, and the income capitalization method. (*Pacific Mutual Life Ins. Co.* v. *County of Orange* (1985) 187 Cal.App.3d 1141, 1147 [232 Cal.Rptr. 233].) The selection of a particular method of valuation from among the valid methods rests in the Board's discretion. (*Trailer Train Co.* v. *State Bd. of Equalization*, *supra*, 180 Cal.App.3d at p. 585.) It is constrained only by fairness and uniformity. (*ITT World Communications, Inc.* v. *County of Santa Clara* (1980) 101 Cal.App.3d 246, 252 [162 Cal.Rptr. 186].)

[8]By engaging in this reasoning, we do not hold fixtures must always be valued apart from the land and land improvements. We merely provide an example which helps refute the County's assertion that the converse is true.

Here, the Board determined the income capitalization method using the annual franchise rent was appropriate for American's possessory interest. It was the preferred method (Rev. & Tax. Code, § 107.7, subd. (b)(1)), and the County does not contend it was improper.

The County does attack the Board's use of the cost replacement approach to value the remainder of the property, contending we held in *Pacific Mutual Life Ins. Co.* v. *County of Orange, supra,* 187 Cal.App.3d 1141 that the income capitalization approach was "a preferred method for valuing all income producing real property . . . ." Not so. All we held there was that the cost reproduction approach was not appropriate where it was "designed solely to capture the specific utility of property to a particular owner . . . ." (*Id.* at p. 1149.)

Several cases have upheld the validity of the cost replacement approach for tangible taxable property. (*Bret Harte Inn, Inc.* v. *City and County of San Francisco, supra,* 16 Cal.3d at pp. 21-23, 25 [cost approach is not inherently arbitrary although it was in that instance]; *May Department Stores Co.* v. *County of Los Angeles* (1987) 196 Cal.App.3d 755, 769-772 [242 Cal.Rptr. 162]; *Xerox Corp.* v. *Orange* (1977) 66 Cal.App.3d 746, 753 [136 Cal.Rptr. 583]; *Midstate Theatres, Inc.* v. *County of Stanislaus* (1976) 55 Cal.App.3d 864, 882 [128 Cal.Rptr. 54]; *Guild Wineries & Distilleries* v. *County of Fresno* (1975) 51 Cal.App.3d 182, 188-189 [124 Cal.Rptr. 96] [single open market sale does not bar use of replacement cost approach]; *Western Title Guaranty Co.* v. *County of Stanislaus* (1974) 41 Cal.App.3d 733, 739-741 [116 Cal.Rptr. 351].) The County argues the other two methods were preferable. The comparable sales method is preferable "when reliable market data are available." (Cal. Code Regs., tit. 18, § 4.) The income method is preferable "when reliable sales data are not available and the cost approaches are unreliable." (Cal. Code Regs., tit. 18, § 8, subd. (a).)

Here, the Board found that neither the comparable sales approach nor the income approach was reliable and that the cost method was. When that is so, the cost method becomes preferable. (Cal. Code Regs., tit. 18, § 6, subd. (a).)

The County seems to reason that because the cost approach yielded a lower value than the other two approaches, it did not yield an assessment at full value as required by law. (Rev. & Tax. Code, § 110.) But the Board correctly reasoned why the values differed. The assessor's method captured intangibles which are not subject to taxation such as existing franchises or licenses to construct, a subscriber base, marketing and programming contracts, management and operating systems, an in-place work force, going concern value, and goodwill.

The assessor and board *may* apply a method of assessment which reflects the value enhancement of tangible taxable property due to the presence of intangible property. (*County of Stanislaus* v. *Assessment Appeals Bd.*, *supra*, 213 Cal.App.3d at pp. 1454-1455.) The Board did so here when it applied the income capitalization method prescribed by Revenue and Taxation Code section 107.7 to value the possessory interest. (*Ibid.*) Any additional value must have been attributable to intangibles which enhanced the value of the *business*, not the *property*, e.g., in-place work force, going concern value, and goodwill.[9]

The Board's choice of the cost replacement method for fixtures and personal property was not arbitrary, an abuse of discretion, or contrary to law. (*Bret Harte Inn, Inc.* v. *City and County of San Francisco*, *supra*, 16 Cal.3d at p. 23.) The Board considered all three methods and selected the cost replacement method because it best expressed the value of American's property and was necessary to achieve fairness and uniformity by equalizing assessments. (*ITT World Communications, Inc.* v. *County of Santa Clara*, *supra*, 101 Cal.App.3d at p. 252.)

The judgment is affirmed.

Moore, Acting P. J., and Sonenshine, J., concurred.

[9]At oral argument, the County conceded there would be a problem if the assessor had enrolled the entire $38 million value he had calculated because it might have included impermissible *business* value intangibles such as good will. The County asserted this potential problem was avoided because the assessor only enrolled a value of $19 million, and reasoned that figure eliminated any business value intangibles.

But the $19 million figure was arrived at by taking the 1975 base value pursuant to Proposition 13 and adding new property acquisitions and the permissible inflation enhancement. It did not purport to have anything to do with scientifically eliminating business value intangibles from the total *property* value. Conversely, American presented expert testimony, which the Board accepted, affirmatively showing the value of the property apart from business value intangibles. Thus, the Board only had one analytically and procedurally proper valuation before it. The County admitted as much in oral argument when it reasoned that if the assessor erred, it was in assuming (as opposed to proving) that the $19 million reduction in the enrolled value accounted for all business value intangibles.

[No. C011938. Third Dist. Jan. 28, 1993.]

[As modified Feb. 24, 1993.]

EMIL G. SHUBAT, as Assessor, etc., Plaintiff and Appellant, v. SUTTER COUNTY ASSESSMENT APPEALS BOARD NO. 1, Defendant;
NOR CAL CABLEVISION, INC., et al., Real Parties in Interest and Respondents.

SUMMARY

After a corporation purchased the outstanding shares of entities involved in the cable television business, a county assessor reassessed the value of the local cable television service. The assessor allocated a portion of the total calculated value to tangible assets and the remainder to an intangible asset identified as the service's taxable possessory interest in the public rights-of-way. The service objected to the reassessment and filed an application for reduction. The assessment appeals board generally agreed with the assessor on the total value, but also determined that the value included certain nontaxable intangibles. The assessor filed a petition for a writ of administrative mandamus challenging the board's allocation of value to nontaxable intangibles. The trial court concluded the record supported the allocation and denied relief. (Superior Court of Sutter County, No. 40970, Terence J. Keeley, Judge.)

The Court of Appeal affirmed. Initially, the court held that an assessment appeals board's factual determinations are entitled to the same deference and respect due a judicial decision. The court also held that the record supported the board's determination that the cable television service's right to do business, as well as the "enterprise value" of it as a going concern, had a separate value. Thus, the court held that the board's method of allocating one-third of the residual value, after assigning amounts to the tangible assets, to the possessory interest and the remainder to other nontaxable intangibles was reasonable under the circumstances. (Opinion by Puglia, P. J., with Blease and Sparks, JJ., concurring.)

HEADNOTES

Classified to California Digest of Official Reports

(1) **Property Taxes § 33—Assessment—Validity of Assessment—County Tax Assessment Appeals Board—Judicial Review.**—The factual determinations of a county assessment appeals board, as an agency of constitutional origin, are entitled to the same deference and respect due a judicial decision. Where it is claimed the board applied an improper method of valuing a taxpayer's assets, a question of law is presented, and a court may determine whether the challenged method of valuation is arbitrary, in excess of discretion, or in violation of the standards prescribed by law. Where it is claimed the board erroneously applied a proper method of valuation, the decision may be overturned only when no substantial evidence supports it, in which case the actions of the board are deemed so arbitrary as to constitute a deprivation of property without due process.

(2) **Property Taxes § 16—Subjects of Taxation—Real Property—Possessory Rights—Cable Television Service: Radio and Television § 6—Cable Television—Franchises—Components.**—A cable television service's possessory interest in the public rights-of-way for transmission of its service, although intangible, is taxable. However, the right profitably to use public easements is not the only intangible asset such a service possesses by virtue of its franchise rights. Cable television franchises consist of two primary components, the right to use the public streets to lay the cables and the right to charge a fee to subscribers for their use of the cable facilities.

(3) **Property Taxes § 11—Subjects of Taxation—Intangible Assets—Right to Conduct Business.**—In an action challenging a county assessment appeals board's allocation of value to a cable television service's tangible and intangible assets, the board properly concluded that the cable television service's right to do business had a separate value. The right to do business is an intangible asset exempt from property taxation. Moreover, the board's conclusion that favorable franchise terms, which made the cable television service more economical than was typical, had no value separate from the right to do business, was effectively a conclusion that the favorable terms were subsumed within, and enhanced the value of, the cable television service's right to do business.

(4) **Property Taxes § 42.2—Assessment—Valuation—Cable Television Service—Intangible Assets—Enterprise Value.**—In an action challenging a county assessment appeals board's allocation of value to a

cable television service's tangible and intangible assets, the record contained substantial evidence that the service had value apart from the franchise and tangible assets. Whether labeled as a subscriber list, going concern value, or enterprise value, the record supported the existence of value attributable to the operational nature of the service. These intangibles relate to the business and relate to real property only in their connection with the business using it. Thus, although intangible values may be reflected in the value of a possessory interest, they are not necessarily subsumed as a matter of law.

(5) **Property Taxes § 33—Assessment—Validity of Assessment—County Tax Assessment Appeals Board—Allocation of Value.**—In an action challenging a county assessment appeals board's allocation of value to a cable television service's tangible and intangible assets, substantial evidence supported the board's allocation of value to the right to do business, possessory interest, and going concern. In proceedings before an assessment board, the officers are presumed to have properly performed their duties, and the taxpayer has the burden of showing that the assessments were not fair and equitable. A State Board of Equalization rule enumerating the permissible modes of assessing possessory interests does not purport to be exclusive, and when no sound or practicable basis appears for apportionment of income as between enterprise activity and the property itself, then a method may be employed which imputes an appropriate income to the property. After assigning amounts to the tangible assets, the board reasonably allocated one-third of the residual value to the possessory interest and the remainder to other intangibles. None of these intangibles had value to the service independent of the others; there was no basis for attributing a higher value to any one of the intangibles, and no basis for attributing a higher value to the possessory interest.

[See **Cal.Jur.3d,** Property Taxes, § 78; 9 **Witkin,** Summary of Cal. Law (9th ed. 1989) Taxation, § 180.]

COUNSEL

Darrell W. Larsen, County Counsel, and Ronald S. Erickson, Assistant County Counsel, for Plaintiff and Appellant.

No appearance for Defendant.

Douglas Mo, Shartsis, Friese & Ginsburg and Paul M. Gordon for Real Parties in Interest and Respondents.

OPINION

PUGLIA, P. J.—Plaintiff Emil G. Shubat, the Sutter County Assessor (Assessor), appeals from the judgment of the trial court denying his petition for writ of administrative mandamus. The Assessor challenges the determination by defendant Sutter County Assessment Appeals Board No. 1 (Board) of the taxable value of real party in interest Nor Cal Cablevision, Inc. (Nor Cal). The Board found a portion of Nor Cal's overall value attributable to non-taxable intangible assets. The Assessor contends this determination is (1) contrary to law and (2) not supported by substantial evidence. We disagree and shall affirm.

I

Effective October 1, 1986, respondent and real party in interest Continental Cablevision, Inc. (Continental) purchased the outstanding shares of several subsidiaries of McClatchy Newspapers involved in the cable television business, including Nor Cal. Nor Cal provides cable television service to residents in both Sutter and Yuba Counties. After certain postsale adjustments, the total purchase price paid by Continental was $127,648,647.

In order to fulfill his statutory obligation to assess property at its full value (Rev. & Tax. Code, § 401), the Assessor reassessed the value of Nor Cal at the time of transfer. The computation of property value normally involves one or more of three general methods of valuation. The "market" approach looks at recent sales of comparable property, including that being valued. (Cal. Code Regs., tit. 18, § 4.) The "income" or discounted cash flow approach looks at the present value of a projected stream of income from use of the property. This present value depends upon not only the magnitude and duration of the projected income stream but the discount rate used. The higher the discount rate the lower the present value of the property. (Cal. Code Regs., tit. 18, § 8, subd. (d).) The third method of valuation, the "cost" approach, looks at the cost of replacing the property less accrued depreciation. (Cal. Code Regs., tit. 18, § 25, subd. (c).)

In computing a total value for Nor Cal, the Assessor used a market approach based on the price paid by Continental. Beginning with the amount reported by Continental as attributable to the purchase of Nor Cal, and making certain adjustments not relevant to this dispute, the Assessor arrived at a total value of $37,872,000.[1] Of this amount, $16,226,260 was allocated to tangible assets, such as land, buildings, equipment and other personal

[1]The total assessment was apportioned between Sutter and Yuba Counties to arrive at a taxable value in Sutter County of $19,887,206. There is no dispute regarding the allocation of

property; the remainder was allocated to intangibles. The only intangible identified by the Assessor was Nor Cal's taxable possessory interest in the public rights-of-way for delivery of cable signals, to which the entire residual amount was allocated.

Nor Cal objected to the reassessment and filed an application for reduction.[2] The Board was convened to hear Nor Cal's application. At the hearing before the Board, Nor Cal presented the report and testimony of its expert John E. Kane. Kane used both a market and income approach to arrive at a total value for Nor Cal of $28 million. For the income portion of his analysis, to which Kane assigned the greatest weight, a discount rate of 16 percent was used based on the risk associated with the business and the corresponding cost of capital.[3]

In determining the proper allocation of value among the various assets of Nor Cal, Kane first computed values for the tangible assets. He then used an "excess earnings" method to allocate value to the intangibles. This method required computation of the projected income attributable to the tangible assets by multiplying the total value of such assets by a discount rate of 13 percent, which Kane determined to be an appropriate rate of return based on the lower risk associated with tangibles. This income amount was then subtracted from the total projected income to come up with an income amount attributable to the intangibles.

Kane identified six intangible assets of Nor Cal, to wit: (1) subscriber list, (2) franchise operating rights, (3) a lease (not pertinent to this dispute), (4) assembled work force, (5) noncompete agreement, and (6) going concern. The second of these, the franchise rights, Kane further subdivided into (1) the right to conduct business, (2) favorable franchise terms, and (3) the possessory interest in the public rights-of-way.

The subscriber list referred to by Kane was actually the subscriber base, i.e., Nor Cal's customers. Using an income approach, Kane determined an income amount appropriate to this asset and applied a discount rate of 16 percent to compute a present value. After subtracting this amount from the

value between the two counties. Although, this appeal involves only the assessment for Sutter County, for the sake of convenience, we shall refer throughout this opinion to the combined value of the various assets of Nor Cal.

[2]The original application was actually filed on behalf of Continental. However, the matter was thereafter prosecuted in the name of Nor Cal.

[3]As explained by Kane, the discount rate fluctuates with the level of risk associated with the property or business. It represents the expected return on investment. The greater the risk associated with the property or business, the greater the return demanded by investors and hence the greater the discount rate. The greater the discount rate, the lower the present value of the asset.

total attributable to intangibles, Kane applied the remaining income to the three franchise rights in equal proportions. Kane then computed a present value for these intangibles using a higher discount rate than that applied to the tangible assets because of the higher risk involved. Nineteen percent was used for the right to conduct business and favorable franchise terms, while twenty percent was used for the possessory interest in public rights of way because of the added need to compensate for property taxation of this asset. Through this income valuation method, Kane arrived at values for these intangibles as follows:

Subscriber list	$5,202,124
Right to conduct business	$4,272,884
Favorable franchise terms	$4,272,884
Possessory interest in public rights of way	$4,059,929

Of these amounts, Kane independently computed values for the favorable franchise terms and possessory interest using other methods. The amounts computed corroborated his one-third allocation. The remaining value of Nor Cal was divided among the other intangible assets by various methods, with going concern allocated the residual of $518,155.

The Board generally agreed with the Assessor on total value of Nor Cal. However, the Board agreed with Kane this figure includes certain non-taxable intangibles. After subtracting the value of tangible assets and the subscriber list, the Board arrived at a residual value of $18,242,130. The Board rejected allocation of any value to the noncompete agreement and determined the favorable franchise terms are inseparable from the right to do business. This left three intangible assets, the possessory interest, the right to do business and the going concern value, to which the Board allocated the residual equally in accordance with the methodology used by Kane. In order to determine final taxable value, the Board added one-half of the present value of future franchise fees to the possessory interest.[4]

The Assessor initiated this proceeding challenging the Board's failure to allocate all residual value to the taxable possessory interest. The trial court

[4]Future franchise fees are estimated from projected revenue. These are considered another cost paid for the right to operate Nor Cal. The present value of such future payments is thus computed and added to total value of the system. The Board concluded only half of this amount is attributable to the possessory interest, with the other half attributable to the right to do business.

We note a possible discrepancy in the Board's computation. The Board purported to divide the residual of $18,242,130 by three to arrive at an allocation to the three intangibles. Before addition of one-half the value of future franchise fees to the possessory interest, the Board assigned a value to the three intangibles of $6,072,212. However, one-third of $18,242,130 is

concluded the record substantiated allocation of value to the nontaxable right-to-do-business and going concern. The court further concluded the record adequately supported the specific amounts allocated. However, the court remanded to the Board to answer four questions: "(1) in valuing the 'possessory interest' held by Nor Cal did the Board consider the extent to which the naked 'possessory interest' is enhanced by nontaxable [*sic*] 'intangibles'? (2) what income does the Board ascribe to the 'possessory interest'? (3) in determining the income stream to be ascribed to the 'possessory interest' does the Board impute to the 'possessory interest' any income directly related to nontaxable [*sic*] 'intangibles,' and, if so, to what extent? and, (4) what capitalization rate did the Board rely upon in determining the value of the 'possessory interest,' together with the basis for the utilization of said rate?"

On remand, the Board responded that it had considered the extent to which the possessory interest was enhanced by nontaxable intangibles. In particular, the Board noted all the income allocated to the possessory interest was related to the nontaxable intangibles "because none of it could be earned absent Nor Cal's franchise, subscriber base, and other intangible assets that make Nor Cal a going concern." However, the Board further noted the extent of such contribution by the nontaxable intangibles "is not ascertainable." Regarding income stream attributable to the possessory interest, the Board indicated it "did not and could not rely on an income approach" for such valuation because of the unavailability of a suitable capitalization rate. Thus, the remaining questions posed by the court could not be answered although the Board noted that use of an income stream of $531,008 (one-third the residual income) and a capitalization rate of 8.744 percent (the overall system rate) results in a possessory interest value substantially equivalent to that arrived at by the Board.

Upon review of this supplemental decision, the court concluded the Board's findings were supported by substantial evidence and denied writ relief. Judgment was entered accordingly.

II

(1) As an agency of constitutional origin (Cal. Const., art. XIII, § 16; *Kaiser Center, Inc.* v. *County of Alameda* (1987) 189 Cal.App.3d 978, 982 [234 Cal.Rptr. 603]), the Board's factual determinations are entitled to the same deference and respect due a judicial decision. (*Strumsky* v. *San Diego County Employees Retirement Assn.* (1974) 11 Cal.3d 28, 36 [112 Cal.Rptr.

actually $6,080,710. The parties raise no contentions regarding this apparent computational error. We shall therefore accept the Board's computations for purposes of this appeal.

805, 520 P.2d 29].) Review of a board determination may therefore involve two distinct standards. Where it is claimed the Board applied an improper method of valuing a taxpayer's assets, this presents a question of law. We determine "whether the challenged method of valuation is arbitrary, in excess of discretion, or in violation of the standards prescribed by law." (*Bret Harte Inn, Inc.* v. *City and County San Francisco* (1976) 16 Cal.3d 14, 23 [127 Cal.Rptr. 154, 544 P.2d 1354].) Where it is claimed instead the Board erroneously applied a proper method of valuation, the decision may be overturned "only when no substantial evidence supports it, in which case the actions of the board are deemed so arbitrary as to constitute a deprivation of property without due process." (*Ibid.*)

The Assessor challenges the Board's allocation of value to nontaxable intangibles on two grounds. He contends all of the intangibles are taxable either in their own right or as they add value to the possessory interest. He further contends the Board's allocation to intangibles other than the taxable possessory interest was arbitrary and not supported by substantial evidence. These challenges implicate both standards of review.

III

We first consider the Assessor's claim all intangibles identified by the Board are taxable. Unless exempt under federal or state law, all property in California is subject to taxation according to its value. (Cal. Const., art. XIII, § 1; Rev. & Tax. Code, § 201; *County of Stanislaus* v. *Assessment Appeals Bd.* (1989) 213 Cal.App.3d 1445, 1451 [262 Cal.Rptr. 439].) " 'Property' includes all matters and things, real, personal, and mixed, capable of private ownership." (Rev. & Tax. Code, § 103.) Real property includes any possessory interest in real property which is defined as any right to possession of land, except where coupled with actual ownership of the land, or taxable improvements on tax-exempt land. (Rev. & Tax. Code, §§ 104, 107.)

The Board acknowledged and allocated value to four intangibles: right to do business, possessory interest, going concern, and subscriber list. (2) It is undisputed Nor Cal's possessory interest in the public rights-of-way for transmission of its service is taxable. (*Cox Cable San Diego, Inc.* v. *County of San Diego* (1986) 185 Cal.App.3d 368, 378 [229 Cal.Rptr. 839].) However, the right profitably to use public easements is not the only intangible asset obtained by Nor Cal by virtue of its franchise rights. Franchises such as at issue here consist of two primary components: "the right to use the public streets to lay the cables and the right to charge a fee to subscribers for their use of the cable facilities." (*County of Stanislaus* v. *Assessment Appeals Bd., supra*, 213 Cal.App.3d at p. 1452.)

(3) The right to do business has been recognized as an intangible asset exempt from property taxation. (*County of Stanislaus* v. *Assessment Appeals Bd., supra*, 213 Cal.App.3d at p. 1454.) The Assessor nevertheless contends Nor Cal's right to engage in a cable television business has no value because this is a right available to anyone and only has meaning when coupled with a right to use the public easements. This argument is frivolous. If it is open to anyone to conduct a cable television business, it is also open to anyone to use the public easements for this purpose. The two rights are concomitant and follow from the acquisition of a franchise. (*Id.* at p. 1452.) Obviously the Assessor would not argue the right to use public easements has no value merely because this right is open to everyone.

Cable operators "pay local entity franchise fees up to 5 percent of their gross receipts for the privilege of operating their businesses. They also are subject to income tax on their corporate franchise earnings under the Bank and Corporation Tax Law (pursuant to Cal. Const., art. XIII, § 27). Thus, it would be discriminatory to tax their right to engage in the cable television business under the property tax laws." (*Id.* at p. 1454.)

Nor Cal's general right to do business is further enhanced by favorable franchise terms identified by Kane. These Kane defined as terms of the franchises making them more economical than typical cable franchises. For example, Nor Cal is not required to fund a local public access corporation or provide service to low density areas. By concluding these favorable terms have no value separate from the right to do business, the Board effectively concluded they were subsumed within, and enhanced the value of, Nor Cal's right to do business. Thus, the Assessor's contention the right to do business had no separate value is unavailing.

(4) The Assessor also disputes separate valuation for the subscriber list and going concern. According to the Assessor, neither item exists separate from the possessory interest. However, regardless of the label used, the record contains substantial evidence Nor Cal had value apart from the franchise and tangible assets. According to Kane, Nor Cal had value by virtue of the integration of the various elements of the business. These elements he described as including "business and technical procedures, accounting and billing systems, programming contracts, FCC licenses (5) and relationships with local advertisers." Nor Cal also had a trained workforce in place and procedures for operating its business.

At the time of purchase by Continental, Nor Cal had a customer base of 26,075 basic subscribers out of 34,162 homes passed, or a 76 percent saturation rate. There were also 10,675 total pay channel units. Kane indicated this saturation rate was higher than average. The Assessor cannot

reasonably argue this customer base had no value to Nor Cal separate from use of the possessory interest. Were this true, a cable system with no customers would be as valuable as a comparably sized system with many customers. Admittedly, the customers are of no value without the possessory interest. However, the converse is also true. Thus, whether labeled a subscriber list, going concern value, or enterprise value, the record amply supports the existence of value attributable to the operational nature of Nor Cal. The question to be resolved therefore is not whether these assets have value, for clearly they do. We must decide, instead, whether value was properly allocated.[5]

IV

Despite separate existence, the Assessor contends the franchise rights and going concern value of Nor Cal must be subsumed within the possessory interest. According to the Assessor, these assets are no different from other intangible attributes of real property such as location, zoning, view, architecture, etc. which would not be separated from the real property for valuation purposes.

This argument too is frivolous. There is a fundamental distinction between the attributes identified by the Assessor and the intangibles involved in this dispute. Zoning, location and other such attributes relate directly to the real property involved. They are an integral part of and effectively define it. By contrast, intangibles such as going concern or franchise rights relate to the business being conducted on the real property. They relate to the real property only in their connection with the business using it.

[5]Although arguably not applicable to this dispute because its effective date came after the date of purchase, Revenue and Taxation Code section 107.7 provides further support for the separate existence and property tax exemption of the intangible assets recognized by the Board. Subdivision (d) provides: "Intangible assets or rights of a cable television system are not subject to ad valorem property taxation. These intangible assets or rights, include, but are not limited to: franchises or licenses to construct, operate, and maintain a cable television system for a specified franchise term (excepting therefrom that portion of the franchise or license which grants the possessory interest), subscribers, marketing, and programming contracts, nonreal property lease agreements, management and operating systems, a work force in place, going concern value, deferred, startup, or prematurity costs, covenants not to compete, and goodwill. However, a cable television possessory interest may be assessed and valued by assuming the presence of intangible assets or rights necessary to put the cable television possessory interest to beneficial or productive use in an operating cable television system."

This legislation was intended "to clarify the application of existing law and provide uniformity and certainty in the assessment of cable television possessory interests." (Stats. 1988, ch. 1630, § 3, p. 5940.) In *County of Stanislaus* v. *Assessment Appeals Bd., supra*, 213 Cal.App.3d 1445, 1452, footnote 3, the court indicated this section "is not considered a change in the law."

The Assessor nevertheless contends many cases have held intangibles such as involved here do not exist separate from the possessory interest and must therefore be assessed as part of it. In *Scott-Free River Expeditions, Inc.* v. *County of El Dorado* (1988) 203 Cal.App.3d 896 [250 Cal.Rptr. 504], this court held the right of a commercial rafting outfitter to exclusive commercial use of the flow of water in a river is a possessory interest subject to property taxation. The Assessor contends *Scott-Free* stands for the proposition the right to take a profit from the use of public property cannot be separated from the possessory interest in the property. However, in *Scott-Free* no issue was raised regarding the value to be placed on the possessory interest or whether the commercial rafting outfitter had value distinct from its tangible assets and the possessory interest. The sole issue raised was whether the taxing authority had the power to tax the possessory interest, an issue not disputed here. " '[C]ases are not authority for propositions not considered therein.' " (*Worthley* v. *Worthley* (1955) 44 Cal.2d 465, 472 [283 P.2d 19].)

In *Roehm v. County of Orange* (1948) 32 Cal.2d 280, 285 [196 P.2d 550], the court indicated: "Intangible values . . . that cannot be separately taxed as property may be reflected in the valuation of taxable property. Thus, in determining the value of property, assessing authorities may take into consideration earnings derived therefrom, which may depend upon the possession of intangible rights and privileges that are not themselves regarded as a separate class of taxable property. [Citations.]" (Accord, *Michael Todd Co.* v. *County of Los Angeles* (1962) 57 Cal.2d 684, 693 [21 Cal.Rptr. 604, 371 P.2d 340]; *ITT World Communications, Inc.* v. *County of Santa Clara* (1980) 101 Cal.App.3d 246, 257 [162 Cal.Rptr. 186].)

While we agree intangible values *may be reflected* in the value of a possessory interest, it does not follow such values are subsumed as a matter of law. In *County of Stanislaus* v. *Assessment Appeals Bd., supra*, 213 Cal.App.3d 1445, the assessor applied to the board to increase the value of the taxpayer cable television system to $18,350,000. It was argued this value was justified by the effect of nontaxable intangibles on the other assets of the business. The board concluded the intangibles could not be taxed and reduced the assessed value to $5,455,599. The trial court denied relief. (At pp. 1448-1449.)

The appellate court concluded the value of taxable assets may be enhanced by the nontaxable intangible assets. The court explained: "Without the right to put its possessory interest to beneficial or productive use by soliciting subscribers and charging them a fee for transmitting a signal, i.e., the right to engage in business, [the taxpayer's] possessory interest would have little or no market value." (At p. 1456.) The court concluded: "In

valuing [the taxpayer's] possessory interest on remand, the assessor shall consider the intangible right to do business as required by the above authorities. In so doing, the assessor may impute to the possessory interest an 'appropriate' income from the right to engage in business. [Citation.]" (*Ibid.*)

Significant to this ruling was the appellate court's failure to direct valuation at the full value of the cable system despite a stipulation that such value was $19.4 million. In effect, the court concluded the full value of the intangible right to do business need not be imputed to the possessory interest. Instead, the court remanded to permit the assessor to decide whether and to what extent the value of the possessory interest should be enhanced by the right to do business.

The trial court here did likewise. From the record before it, the court apparently could not determine if and to what extent the Board took into consideration the nontaxable intangibles in computing a value for the possessory interest. The court posed four questions to the Board primarily to clarify this point. In response to the question whether nontaxables were taken into consideration in valuing the possessory interest, the Board indicated: "Nor Cal's possessory interest would be of little or no value if Nor Cal did not also possess non-taxable intangibles such as its subscriber list, the right to operate a cable television business, and going concern value. The Board's $6,072,211 possessory interest value represents the 'in use' value of the possessory interest when put to beneficial and productive use along with and enchanced [*sic*] by Nor Cal's non-taxable intangibles." The Board further explained, in response to a question about the income attributed to the possessory interest: "[T]he income imputed to Nor Cal's possessory interest is $531,008. All of this income is directly related to Nor Cal's non-taxable intangibles because none of it could be earned absent Nor Cal's franchise, subscriber base, and other intangible assets that make Nor Cal a going concern. The converse is also true. The intangible assets enhance the value of each other and none of them standing alone have [*sic*] any substantial value. All of the income of the possessory interest is directly related to and dependent upon the non-taxable intangibles and the taxable tangibles and intangibles. To what extent the income attributable to the possessory interest is directly related to the non-taxable intangibles is not ascertainable." In our view, the record sufficiently establishes the Board considered the effect of intangibles on the value of the possessory interest. It was required to do no more.

V

(5) The Assessor contends the Board's allocation of value to the right to do business, possessory interest and going concern is not supported by

substantial evidence. According to the Assessor, the Board's decision to divide the residual into equal proportions was arbitrary and not within the permissible valuation methods. Instead, the Board should have adopted the Assessor's allocation of all residual to the taxable possessory interest.

In proceedings before an assessment board, "the assessing officers are presumed to have properly performed their duties; the taxpayer has the burden of showing that the assessments were not fair and equitable." (*ITT World Communications, Inc.* v. *County of Santa Clara, supra,* 101 Cal.App.3d at p. 252; Cal. Code Regs., tit. 18, § 321, subd. (a).) "Revenue and Taxation Code section 1610.8 requires the applicant for a reduction in an assessment to establish the full value of property by *independent evidence.*" (*County of San Diego* v. *Assessment Appeals Bd. No. 2* (1983) 148 Cal.App.3d 548, 559 [195 Cal.Rptr. 895], italics in original.)

Of the three intangibles assigned a portion of the residual by the Board, only the possessory interest is taxable. Thus, the Assessor's complaint is with the Board's allocation of only one-third of the residual to the possessory interest. How the Board allocated the other two-thirds is irrelevant.

State Board of Equalization rule 25 enumerates permissible modes of assessing possessory interests. Included are the three methods described earlier, the comparable sales approach, the income approach, and the cost approach. (Cal. Code Regs., tit. 18, § 25.) None of these methods was used by the Board. However, this rule does not purport to be exclusive. It indicates possessory interests "may" be measured by one or more of the enumerated methods.

The Assessor himself acknowledges a cable television possessory interest, "[b]y its nature," may not be measured by one of the approved methods. However, this does not mean, as the Assessor concludes, the full residual value must be apportioned to the possessory interest. As the court in *California Portland Cement Co.* v. *State Bd. of Equalization* (1967) 67 Cal.2d 578 [63 Cal.Rptr. 5, 432 P.2d 700], indicated: "When no sound or practicable basis appears for apportionment of income as between enterprise activity and the property itself, then a method may be employed which imputes an *appropriate* income to the property." (*Id.* at p. 584, italics added and citations omitted; accord, *County of Stanislaus* v. *Assessment Appeals Bd., supra,* 213 Cal.App.3d at p. 1455, and cases cited therein.)

Nor Cal relied almost exclusively on the testimony of its expert Kane. Kane determined the intangibles could be separated into six general categories: subscriber list, right to do business, favorable franchise terms, possessory interest, work force and noncompete agreement. Using an income

approach, Kane allocated an amount to the tangible assets and subscriber list. The remaining income was allocated in equal proportions to the right to do business, favorable franchise terms and possessory interest. After computing a present value for these and the other assets and including an allocation for the noncompete agreement, the residual value of Nor Cal was assigned to going concern.

The Board adopted Kane's approach to valuing intangibles with certain modifications. First, the Board rejected a separate allocation for favorable franchise terms, treating them instead as part of Nor Cal's right to do business. The Board also rejected Kane's allocation of the residual value to the going concern. According to the Board, going concern should have been assessed equally with the right to do business and possessory interest. Thus, after assigning appropriate amounts to the other assets, the Board allocated the residual one-third to the possessory interest and two-thirds to the remaining intangibles. The Board also allocated one-half of the present value of future franchise fees to the possessory interest and the other half to the right to do business.

In our view this methodology is reasonable and appropriate under the circumstances presented. As previously indicated, the Assessor himself acknowledged none of the traditional methods of valuation was possible. Nevertheless, Kane indicated the possessory interest, right to do business and going concern operated together to impart value to Nor Cal. None had value independent of the others, while together they had substantial value.

Kane opined the possessory interest contributed approximately one-third of Nor Cal's residual income after deducting that attributable to tangible assets and the customer base. Applying a discount rate of 20 percent, this resulted in an allocation of $4,059,929, which Kane corroborated with an independent valuation based on franchise fees paid.[6] Although Kane attributed the other two-thirds of the residual income to a different mix of intangibles than did the Board, this is of no concern to our analysis. None of these intangibles is taxable. The difference in value attributed to the possessory interest, $4,059,929 by Kane and $6,072,212 by the Board, is also of no moment. This discrepancy reflects merely a different total valuation of the business and different residual value, neither of which is challenged here.

The record also supports the Board's allocation of the present value of future franchise fees. Kane opined the two parts of the franchise, the

[6]Using a 50 percent profit margin, which Kane identified as typical in the industry, income attributable to the 5 percent franchise fee was determined. From this, a present value of $4,335,245 was computed.

possessory interest and right to do business, contribute equally to Nor Cal's income stream. Thus, the Board's allocation of value to the possessory interest, and corresponding exclusion from total taxable value for other intangibles, is supported by substantial evidence.

VI

None of the intangible assets identified by Kane and the Board has value to Nor Cal independent of the others. Each contributes to the total business. On the present record, there is no basis for attributing a higher value to any one of these intangibles and certainly no basis for attributing all value to the possessory interest. On the contrary, the opinions of Nor Cal's expert provide substantial evidence to support the allocation arrived at by the Board. In our view, the Board used an acceptable method of valuation and imputed an "appropriate" value to the possessory interest.

The judgment is affirmed.

Blease, J., and Sparks, J., concurred.

[No. B065128 Second Dist., Div. Two. Feb. 10, 1993.]

COUNTY OF LOS ANGELES, Plaintiff, Cross-defendant and Appellant,
v.
COUNTY OF LOS ANGELES ASSESSMENT APPEALS BOARD NO. 1, Defendant and Respondent;
DOLLAR RENT A CAR SYSTEMS, INC., Real Party in Interest and Respondent;
GRAND RENT A CAR CORPORATION et al., Real Parties in Interest, Cross-complainants and Respondents.

SUMMARY

The trial court denied a writ of mandate sought by a county challenging a decision of its assessment appeals board as to the extent of the taxable possessory interests of several car rental firms at three airports in the county. The firms, operating under concession agreements with the airports, maintained counters in the terminals and, at two of the airports, spaces in "ready/return" parking lots. They agreed to pay, subject to guaranteed minimums, a percentage of gross receipts from all car rentals delivered in the airports' areas. The county began assessing the firms' airport possessory interests by capitalizing their guaranteed or projected payments to the airports, on the premise that these payments constituted rent for possessory interests in the airports as business premises. This greatly multiplied the appraised value of the interests. The firms obtained a favorable decision from the superior court rejecting this method of assessment at one airport, which decision was not appealed and became final. The county nonetheless continued assessing the firms' possessory interests using the rejected concepts and formulae for subsequent years, and the firms obtained a ruling from the assessment appeals board that the prior judgment controlled and preclusively determined by collateral estoppel the extent of the interests and the invalidity of the assessments. The county then petitioned for a writ of mandate. (Superior Court of Los Angeles County, No. C 708538, William W. Huss, Judge.)

The Court of Appeal affirmed. It held that the trial court properly invoked its prior judgment to resolve adversely to the county the issue of the extent of the firms' possessory interests at the airport concerned for the tax years at

issue in the present case. Although that determination could not extend to the similar question now posed for the first time with respect to the other two airports, which were not the subject of the prior action, the court further held that taxable possessory interests in public property are grounded on physical possession or use of it, and that the further rights granted the firms by the concession agreements were not possessory interests. Accordingly, the trial court properly refused to reinstate the county's theory of valuation and its resulting assessments. (Opinion by Fukuto, J., with Boren, P. J., and Nott, J., concurring.)

HEADNOTES

Classified to California Digest of Official Reports

(1) **Judgments § 81—Res Judicata—Collateral Estoppel—Doctrine.**—Collateral estoppel forecloses relitigation of an issue that is identical to one decided in a prior case involving the same party or parties or those in privity with them and which resulted in a final judgment on the merits.

[See Cal.Jur.3d, Judgments, § 236 et seq.]

(2a, 2b) **Judgments § 97—Res Judicata—Collateral Estoppel—Matters Concluded—Interest in Real Property—Taxation of Possessory Interest.**—In denying a writ of mandate sought by a county challenging a decision of its assessment appeals board as to the extent of the taxable possessory interests of several car rental firms at three airports in the county, the superior court properly invoked its prior judgment against the county in an earlier case involving the same parties at one of the airports. The judgment had become final and the primary issue was identical, even though the present case concerned later assessments and different agreements, since the terms that generated the possessory interests in question were the same, as were the facilities, and hence so were the interests themselves. There had also been no change in the content or character of the law subsequent to the first judgment. However, similar questions posed for the first time with respect to the other two airports were not precluded.

(3) **Judgments § 96—Res Judicata—Collateral Estoppel—Matters Concluded—Interest in Real Property—Questions of Law.**—Whether an arguably precluded issue is one of law or more properly a mixed question of law and fact is ultimately inconsequential; collateral

estoppel yet applies to "legal" issues, albeit with more qualifications than in cases of factual issues.

[See 7 Witkin, Cal. Procedure (3d ed. 1985) Judgment, § 274 et seq.]

(4) **Property Taxes § 16—Subjects of Taxation—Real Property—Possessory Rights—Requirement of Physical Possession.**—Just as private possessory interests in public property are a species of taxable property, the possession or use grounding these interests means and requires not just some benefit from the public property, but physical possession or use of it. Hence, in a mandamus action brought by a county challenging a decision of its assessment appeals board as to the extent of the taxable possessory interests of several car rental firms at airports in the county, the trial court properly rejected the county's assessment, which was based on the firms' "use" of the airports as a whole, valued by capitalizing the firms' concession fees (a percentage of gross receipts), rather than on their possession and exclusive use of their counters and reserved parking lots. Further rights granted by the firms' agreements with the airports, to do business at the airports and their environs, were not possessory interests; they were intangibles, not subject to property tax. Moreover, the firms' income stemmed largely from commercial endeavors other than their physical facilities there.

COUNSEL

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OPINION

FUKUTO, J.—The County of Los Angeles (County) seeks reversal of a judgment which denied its petition for writ of mandate against the County's assessment appeals board (Board) and awarded possessory interest tax refunds to car rental companies that operate at the three major airports within the County. The Board and the trial court rejected the County's contention that the rent-a-cars' possessory interests extend to the use of each airport generally, not simply the areas the companies occupy (principally service counters), and also disapproved the County's method of valuing the interests, by capitalizing concession fees which were based on and included enterprise income. We conclude that the trial court correctly resolved these issues, which to some extent had already been conclusively determined by another superior court judgment in 1986. The judgment consequently will be affirmed.

FACTS

This case concerns ad valorem property tax assessments of possessory interests of four car rental companies (Dollar Rent A Car Systems, Inc. (Dollar), Grand Rent A Car Corporation (Avis), The Hertz Corporation (Hertz), and National Car Rental System, Inc. (National), hereafter collectively the rent-a-cars) at Los Angeles International Airport (LAX), Burbank-Glendale-Pasadena Airport (Burbank), and Long Beach Municipal Airport (Long Beach), for tax years 1985-1987 with respect to LAX and 1983-1987 with respect to Burbank and Long Beach. Except for Dollar with respect to Long Beach, each of the rent-a-cars has operated under "concession agreements" or (in the case of Burbank) "leases and concession agreements" (hereafter collectively the agreements) with the airports' respective owners, the City of Los Angeles, the Burbank-Glendale-Pasadena Airport Authority, and the City of Long Beach.

The agreements grant both the right to conduct a car rental business at the particular airport and the right to occupy and use certain limited portions of it, namely designated counters or booths, and, in the case of Burbank and more recently Long Beach, spaces in a "ready/return" parking lot. The Burbank agreements also grant a nonexclusive right to use common areas to be designated, as well as terminal public areas such as restrooms and waiting areas; the Long Beach agreements authorize joint use of walkways surrounding the rental booths, as well as "the use . . . on [*sic*] the Airport" to conduct the car rental concession. In exchange for these rights, the rent-a-cars have agreed to pay the airport authorities, subject to guaranteed minimums, 10 percent of gross receipts from all car rentals delivered in the

airports' areas, whether or not arranged through the booths. Burbank separately charges specified "rent" for the booths and lot spaces.

1. *The Prior Litigation.*

The present case is the second to review the propriety of the County's assessments of the rent-a-cars' airport possessory interests. In 1982 the County Assessor began assessing these interests by capitalizing the rent-a-cars' guaranteed or projected payments to the airports under the agreements, on the premise that these payments constituted "rent" for possessory interests in the airports as business premises. This change, from previous assessment of the rent-a-cars' possessory interests as comprising only their exclusive counter spaces, increased the appraised value of the interests, in the case of LAX, by roughly 5,000 to 10.000 percent.

The rent-a-cars sought redetermination of the 1982 LAX assessments before one of the County's assessment appeals boards. That board rejected the County's assertion that the taxable possessory interests extended further than the airport counters (and related telephone reservation boards), and reduced the appraisals, although not as much as the rent-a-cars had requested.

The parties then commenced a series of actions and proceedings in Los Angeles Superior Court, to review the administrative decision. The cases were ordered consolidated and tried before a single judge. (Hertz Corporation v. County of Los Angeles (Super. Ct. L. A. County, No. C537445).) The court rendered a statement of decision and judgment in favor of the rent-a-cars, embracing the following principal determinations.

(1) The rent-a-cars' possessory interests at LAX included only their counters, telephone boards, and signs, the latter two not having significant value.

(2) The taxable value of these interests was fair market rent, which would be no greater than the assessed value of airline counter space at the airport, then $15 per square foot. However, the rent-a-cars having sought reduction only to $45 per foot, they would receive that measure.

(3) The County's contrary method of valuation, based on capitalized concession fees, was invalid for two further reasons. First, it produced valuations of similarly situated, like-kind-and-character properties that widely differed between the rent-a-cars, in violation of constitutional requirements of uniform, equal taxation. Second, it improperly included income and value derived not from the property but from the rent-a-cars'

overall enterprises—i.e., business produced not by the airport counters but through advertising, goodwill, national reservation systems, and the like.[1]

The judgment, rendered August 27, 1986, ordered reduction of the LAX assessments accordingly, together with refunds.

2. *The Present Case.*

The County did not appeal from the 1986 judgment, and it became final. Nevertheless, the County continued to assess the rent-a-cars' possessory interests, at all three airports, using the same concepts and formulas the superior court had rejected. The County did so under the premise, as stated by its counsel at administrative hearings, that "The superior court decision is not binding authority. . . . And the assessor does not have to follow a superior court decision . . . ."

The rent-a-cars again sought reduction of their assessments, this time at all three airports, for various years including and following 1983. After an extended hearing, the Board ruled that the prior judgment controlled and preclusively determined, by collateral estoppel, the extent of the possessory interests, as well as the invalidity of the assessments because they attributed unequal values and included enterprise value. After resolving adversely to the rent-a-cars a separate issue concerning the projected duration of their interests, the Board reassessed the various values at levels amounting to only a few percent of those the County had advanced.

The County then commenced this litigation, by petition for writ of mandate (Code Civ. Proc., § 1094.5) against the Board. As real parties in interest, the rent-a-cars answered, alleging collateral estoppel by the prior judgment as a defense. All but Dollar also filed cross-complaints seeking tax refunds.

At the hearing on its motion for peremptory writ, the County argued, "[A]t some point . . . the County of Los Angeles has to be able to go to court and get review of what we consider a patently erroneous decision. . . . We're appealing the 1986 decision here today, your Honor." The court denied the County's petition, holding that the prior judgment controlled the case, and rejecting the County's contention that there had been a subsequent change in the law of possessory interests, justifying a different result.

The County moved for reconsideration, based on a new appellate decision, announced two weeks after the court's tentative decision. (*United Air Lines, Inc.* v. *County of San Diego* (1991) 1 Cal.App.4th 418 [2 Cal.Rptr.2d 212]

[1]The court further found that the Board's reduced valuations—roughly one-quarter of the assessor's—were unsupported by evidence.

[hereafter *United Air Lines*].) The court granted reconsideration, but adhered to its ruling denying the petition. The subsequent judgment also awarded Hertz, Avis, and National refunds, as sought by their cross-complaints, but denied, without prejudice to other tax years, their further claims that the Board had improperly judged their remaining terms of possession.[2]

DISCUSSION[3]

As reflected above, the primary basis for both the judgment below and the Board's determinations which it affirmed was the superior court's prior, 1986 judgment, in proceedings between the same parties, rejecting the County's method of assessing the possessory interests at LAX. We therefore turn first to the question of collateral estoppel, prompted also by considerations of judicial economy that in part animate that doctrine.

(1) Collateral estoppel forecloses relitigation of an issue that (1) is identical to one decided in a prior case (2) involving the same party or parties or those in privity with them and (3) which resulted in a final judgment on the merits. (E.g., *Bernhard* v. *Bank of America* (1942) 19 Cal.2d 807, 813 [122 P.2d 892].) (2a) In the present case the second and third criteria plainly appear: the County and the rent-a-cars all were parties to the prior litigation, which ended in a final judgment on the merits that the County chose not to appeal. The remaining inquiry concerns the identity of issues between the two cases.

(3)(See fn. 4.) The primary issue determined in the prior litigation was that the rent-a-cars' possessory interests at LAX extended to no more than their counters (and insignificant boards).[4] (2b) With respect to LAX, this issue is identical to the threshold one in the present case. Although the two

[2]At the conclusion of the hearing on the writ petition, the court directed those rent-a-cars with cross-complaints pending to file a motion for summary judgment on that phase of the case. The record on appeal does not reflect any such proceedings, but the County as appellant does not complain of any such procedural omission.

[3]The County has requested judicial notice of certain congressional hearings that were conducted and published well before the hearings in the trial court, but were not offered there. We deny this untimely request to expand the record. (See Code Civ. Proc., § 1094.5, subd. (e).) The rent-a-cars' request for judicial notice of portions of the administrative record in the prior case also is denied. (See Evid. Code, § 352.)

[4]Whether this issue is one of law, as the parties assert, or more properly a mixed question of law and fact, is ultimately inconsequential. The parties cite a series of cases that characterize whether or not a taxpayer has any possessory interest as a question of law, independently reviewable regardless of its treatment at the administrative level. (E.g., *Pacific Grove-Asilomar Operating Corp.* v. *County of Monterey* (1974) 43 Cal.App.3d 675, 680-683 [117 Cal.Rptr. 874].) Collateral estoppel yet applies to "legal" issues, albeit with more qualifications than in cases of factual issues. (See 7 Witkin, Cal. Procedure (3d ed. 1985)

cases involve different tax years and, for some of them, different agreements, the agreements with respect to LAX are materially identical, as is the physical situation to which they apply. The prior judgment's determination of the extent of the rent-a-cars' possessory interests at LAX therefore appears to preclude the County's present effort to claim and assess broader possessory interests there.

Apparently having abandoned the untenable position that a superior court judgment cannot be "binding" beyond its immediate case, the County propounds two principal objections to application of collateral estoppel in this context and fashion. The first is that the present case concerns later assessments, of interests for the most part created by different agreements than those at issue in the prior case. As already stated, this is not decisive. The terms of the several LAX agreements that generated the possessory interests in question are the same, as are the facilities in question, and hence so are the interests themselves. That this case involves later tax years does not separate the issues or render them nonidentical. (Cf. *Montana* v. *United States* (1979) 440 U.S. 147, 158-162 [59 L.Ed.2d 210, 219-222, 99 S.Ct. 970] [determination that tax was constitutional applied by collateral estoppel to subsequent suit involving different contracts].)

Second, the County seeks to invoke the doctrine that collateral estoppel as to legal issues should not apply where the content or character of the law has changed since the first judgment, so that application of it would produce obsolete, inequitable administration of the laws. (See *Montana* v. *United States*, *supra*, 440 U.S. at pp. 161-162 [59 L.Ed.2d at pp. 221-222]; *Commissioner* v. *Sunnen* (1948) 333 U.S. 591, 599-601 [92 L.Ed. 898, 906-908, 68 S.Ct. 715]; Rest.2d Judgments, § 28(2)(b).) In this regard, the County contends that, following the prior judgment, the law governing the issue of the extent of the rent-a-cars' possessory interests changed, favorably to the County's "airport as a whole" theory. To this alleged effect, the County relies on a Court of Appeal decision recognizing a possessory interest in commercial river-rafters' rights to use a river (*Scott-Free River Expeditions, Inc.* v. *County of El Dorado* (1988) 203 Cal.App.3d 896 [250 Cal.Rptr. 504] [hereafter *Scott-Free*]), another such decision concerning aircraft landing rights (*United Air Lines*, *supra*), a federal Court of Appeals case involving a possessory interest in an experimental fusion device (*U.S.* v. *County of San Diego* (9th Cir. 1992) 965 F.2d 691), and finally, the Supreme Court's depublication of a decision by the Fourth District Court of Appeal that had rejected contentions similar to the County's with respect to car rental

Judgment, §§ 274-276, pp. 714-717.) As discussed, the County's efforts to invoke some of these restrictions are unavailing.

possessory interests at San Diego's Lindbergh Field (*Hertz Corporation* v. *County of San Diego* (Nov. 28, 1990) D010144).

The County's attempted use of the last-noted depublication is baseless. (Cal. Rules of Court, rule 979(e).) And, as we shall explain shortly, none of the substantive decisions on which the County relies altered or upset the law the prior judgment followed. Accordingly, there is no impediment to applying collateral estoppel by that judgment to its full reach in this litigation. The superior court properly invoked its prior judgment to resolve adversely to the County the issue of the extent of the rent-a-cars' possessory interests at LAX for the tax years here in issue.

That determination cannot, however, extend to the similar question now posed for the first time with respect to Burbank and Long Beach, which were not the subject of the prior action. The prior action determined the extent of the rent-a-cars' possessory interests at LAX. Although the agreements between the rent-a-cars and the authorities at Burbank and Long Beach are similar to those with respect to LAX, they are not identical. Nor are the physical situations coterminous. Most prominently, the limited possessory interests which the rent-a-cars admitted at the other two airports include not only different counters at different facilities but also "ready/return" parking spaces, not implicated or addressed in the prior case. In light of these differences, the prior judgment cannot be deemed to have decided the issue of extent of possessory interests at Burbank and Long Beach.

Similarly, we do not perceive collateral estoppel to obtain with respect to the prior judgment's conclusions that the County's method of valuation case was improper. Those determinations related to the particular facts of that case, involving the 1982 LAX assessments. Although the County employed the same valuation techniques in the present case, the holding of unlawfully unequal taxation involved, and requires, comparison of particular assessments; and the finding that enterprise value was improperly included for LAX in 1982 cannot be transposed to later tax years, and operations in other locations, without evidence of the nature and source of the income and value appraised in those years.

Accordingly, the correctness of the judgment below cannot be fully decided by invocation of the prior judgment. (4) However, we are convinced that the trial judge here, like his predecessor in the prior case, correctly resolved the dispositive issues on the merits. We begin with the question of the extent of possessory interests at Burbank and Long Beach.

Possessory interest law and taxation implicate private interests in public property, which is not itself subject to property tax. The statutory definition

of a possessory interest is "Possession of, claim to, or right to the possession of land or improvements, except when coupled with ownership of the land or improvements in the same person." (Rev. & Tax. Code, § 107, subd. (a).) Other definitions add "exclusive use" to "possession." (Cal. Code Regs., tit. 18, § 21, subd. (a), (e).) In recent years there has been much litigation concerning the nature and degree of "exclusivity" of use necessary to create a possessory interest. The consistent trend of decisions has been to favor assessors' claims, by holding that possessory interests may arise from limited or concurrent exclusive uses, so long as they involve a grant of rights not shared by the general public. (See, e.g., *Freeman* v. *County of Fresno* (1981) 126 Cal.App.3d 459 [178 Cal.Rptr. 764].) But none of these holdings impairs or retreats from the basic principle that, just as possessory interests are a species of taxable property, the possession or use which grounds them means and requires not just some benefit from the public property, but physical possession or use of it.

This is the fundamental flaw in the County's claim that the rent-a-cars own or hold possessory interests "in the airport as a whole," or in their "full bundle of rights in the airport locations." Under the agreements and evidence concerning Burbank and Long Beach, as at LAX, there is no dispute that the rent-a-cars enjoy possession and exclusive use of their counters (booths) and ready/return spaces. But that is the full extent of the rent-a-cars' rights of possession or use of airport property, except in common with, and coequal to, everyone else. And this means that the County's concept of a broader possessory interest cannot be sustained.

The cases the County principally relies upon illustrate and confirm the foregoing. In *Scott-Free*, *supra*, 203 Cal.App.3d 896, numerous commercial river-rafters challenged the assessor's determination that their use permits, authorizing exclusive commercial use of the river, created possessory interests in it. Rejecting the challenge, the court confirmed that although the river was not taxable property, the plaintiffs' use of it was. Further, the court held, these rights of use were exclusive even though multiple, because plaintiffs, but not the public, had "a special right of access for profit." (*Id.* at p. 910.) Both of these holdings were based on the facts that the plaintiffs physically used—i.e., rafted upon—the river.

Similarly instructive is *United Air Lines*, *supra*, 1 Cal.App.4th 418. There, a divided court sustained a claim of possessory interests in several airlines' use of airport landing areas and related facilities (runways, wash racks, etc.), finding that the airlines were a distinct category of exclusive users (regularly scheduled passenger carriers). But both the claim of interest and the holding

concerned physical occupancy and use of specific facilities. There was no suggestion that the airlines, primary and pervasive users of the airport, held a general possessory interest in "the airport as a whole."

Thus, even apart from the issue of enterprise, the mere fact that the rent-a-cars derive customers and revenues through the gates of an airport terminus or "system" does not define the existence and extent of their possessory interest in the airport property. The County's colloquial concept of airport "use" does not account for possession or occupancy, and thus misconceives the elements and requisites of a possessory interest.[5]

In a further attempt to expand the meaning of possessory interest, the County cites *U.S.* v. *County of San Diego, supra*, 965 F.2d 691, 694, for the proposition that "[A] license or permit is a taxable possessory interest in property." This contention too is exaggerated. The quoted statement—made in a case approving taxation of a possessory interest in a fixture subject to taxpayer use—inaccurately paraphrased the California authority on which it relied, *Stadium Concessions, Inc.* v. *City of Los Angeles* (1976) 60 Cal.App.3d 215 [131 Cal.Rptr. 442]. *Stadium Concessions* recognized possessory interests in food concession stands located in sports arenas. Holding that the underlying agreement and facts satisfied the possessory interest test, including exclusive use, the court stated, "[A] concession agreement may, in a particular case, *produce* a possessory interest in public premises by the concessionaire." (*Id.* at p. 225, italics added.)[6]

That indeed has occurred under the rent-a-cars' concession agreements with Burbank and Long Beach (and LAX)—but only with respect to the property exclusively possessed and used. The further rights granted by the agreements, to do business at the airports and their environs, are not possessory interests. They are intangibles, not subject to property (possessory interest) tax. (Accord, *County of Stanislaus* v. *Assessment Appeals Bd.* (1989) 213 Cal.App.3d 1445, 1452-1454 [262 Cal.Rptr. 439].)

For related reasons, the Board and the trial court also properly disapproved the County's method of valuation, which involved capitalizing the rent-a-cars' concession fees, which are measured as a percentage of their income from their airport area operations. The County seeks to justify this approach by characterizing these payments as "rents" and asserting they

[5]This misconception also pervades the arguments of amici curiae in support of the County.

[6]Similarly, the portion of *Stadium Concessions* cited by the Ninth Circuit was a treatise's statement that a possessory interest may be held by " 'a *mere permittee or licensee.*'" (*Id.* at p. 222, original italics.) (But see *Kaiser Co.* v. *Reid* (1947) 30 Cal.2d 610, 619 [184 P.2d 879], cited by both *Stadium Concessions* and *U.S.* v. *County of San Diego* [a "right to use [which is] no more than a permit or license" could not give rise to a possessory interest or "be responsible for a 'property' tax"].)

were arrived at through a market process by which the rent-a-cars evaluated and agreed to pay reasonable value for their possessory interests. But this analysis again fails to differentiate between the possessory interests in question and the valuable but intangible business opportunities for which the agreements provide and the concession fees also pay.

Furthermore, the County's argument cannot overcome the evidence and determination below that the income the rent-a-cars earn at their airport locations stems largely from commercial endeavors other than their physical facilities there, i.e., enterprise. There was substantial evidence that most of the income upon which the concession fees and hence the County's valuations were based derived not from the rent-a-cars' limited physical presence at the airport but from remote and extensive business techniques to draw customers and reservations. But that is neither an accurate nor a proper basis to determine the value of taxable property, even if the property is a possessory interest lease providing for percentage rentals. (*California Portland Cement Co.* v. *State Bd. of Equalization* (1967) 67 Cal.2d 578, 584 [63 Cal.Rptr. 5, 432 P.2d 700]; *County of Riverside* v. *Palm-Ramon Development Co.* (1965) 63 Cal.2d 534, 538 [47 Cal.Rptr. 377, 407 P.2d 289].)

Accordingly, the trial court properly refused to reinstate the County's theory of valuation and its resulting assessments.[7] This does not mean that valuation of the rent-a-cars' possessory interests may not consider their airport locations, as contributing to and enhancing their independent value as business properties. (Cf. *County of Stanislaus* v. *Assessment Appeals Bd.*, *supra*, 213 Cal.App.3d at pp. 1455-1456.) That factor, which the rent-a-cars have represented their own appraisals took into account, remains appropriate for consideration in any reassessment. However, as between the possessory interest concepts and valuation methods adduced below, the Board and the trial court properly disapproved the County's.

DISPOSITION

The judgment is affirmed.

Boren, P. J., and Nott, J., concurred.

[7]We find it unnecessary to consider the constitutional question of unequal taxation.

[No. A055683. First Dist., Div. Two. Jan. 19, 1993.]

FREEPORT-McMORAN RESOURCE PARTNERS, Plaintiff and Appellant, v.
COUNTY OF LAKE, Defendant and Respondent.

SUMMARY

In an action in which a geothermal power plant owner challenged the county's assessment of the owner's property, the trial court granted the county summary judgment. The owner had acquired long-term contracts to sell electricity to a power company for a fixed price. This particular type of contract was subsequently disapproved by the California Public Utilities Commission, but existing contracts remained in force. In assessing the value of the owner's plants, the county assessor calculated the income stream for the years of the contract by reference to the fixed energy price in the contract. The owner challenged the assessment, asserting that the valuation should have been based on the market price for energy, an amount lower than the contract price. The county board of equalization upheld the assessor's method of forecasting income. The owner brought its action in superior court for refund of taxes and declaratory relief. The trial court found that the income approach was the appropriate method by which to determine the fair market value of the property, that the assessor's and the board's valuation method was valid, and that substantial evidence supported the board's determination concerning the proper application of the income approach to valuation. (Superior Court of Lake County, No. 26135, Robert L. Crone, Jr., Judge.)

The Court of Appeal affirmed. It held that the full value of the property included projected income at the contract rates, rather than market rates, since a prospective purchaser would be willing to pay more for the plant with the existing contracts. The court also held that the contracts were the means by which the property was put to beneficial use for purposes of assessing the property's full value. It preliminarily held that the question presented was one of law, and thus it reviewed the trial court's decision de novo. (Opinion by Kline, P. J., with Smith and Benson, JJ., concurring.)

HEADNOTES

Classified to California Digest of Official Reports

(1a, 1b) **Property Taxes § 33—Assessment—Validity—Standard of Review—Challenge to Method of Assessment Used.**—On appeal of a summary judgment, by which the trial court ruled that a county assessor's method of valuation of certain property was valid, the issue was one of law, and thus a de novo standard of review was applicable. The property owner, who operated geothermal plants, had acquired contracts to sell electricity to a power company at a fixed price. This particular type of contract was disapproved by the California Public Utilities Commission, but existing contracts remained in force. The county assessor calculated the income stream for the years of the contract by reference to the fixed energy price in the contract. The owner asserted that the valuation should have been based on the market price. The parties disputed which method of determining the income stream was the more appropriate, but there were no disputed issues of fact. The parties agreed even on the amount of the valuation under either approach. Thus, the question presented was one of law.

(2) **Property Taxes § 33—Assessment—Validity—Standard of Review.**—Where a taxpayer challenges the validity of the valuation method used by an assessor, the trial court must determine as a matter of law whether the challenged method of valuation is arbitrary, in excess of discretion, or in violation of the standards prescribed by law. The appellate court's review of such a question is de novo. By contrast, where the taxpayer challenges the application of a valid valuation method, the trial court must review the record presented to the board of equalization to determine whether the board's findings are supported by substantial evidence but may not independently weigh the evidence. The appellate court also reviews a challenge to application of a valuation method under the substantial evidence rule.

(3) **Property Taxes § 42—Assessment—Valuation—Full Value or Fair Market Value: Words, Phrases, and Maxims—Full Value—Fair Market Value.**—For purposes of Rev. & Tax. Code, § 401 (all property subject to general property taxation must be assessed at its full value), full value, or fair market value, is a measure of desirability translated into money amounts, and might be called the market value of property for use in its present condition.

(4) **Property Taxes § 42—Assessment—Valuation—Methods—Income Method.**—In assessing property for tax purposes, the income method is

one of three basic methods for determining full cash value, the others being the comparative sales approach and the reproduction and replacement cost approach. The income method rests upon the assumption that in an open market a willing buyer of the property would pay a willing seller an amount approximately equal to the present value of the future income to be derived from the property. Under this approach, an appraiser values an income-producing property by estimating the present worth of a future income stream. The income approach may be called the capitalization method because capitalizing is the process of converting an income stream into a capital sum, i.e., value. The assessor capitalizes the sum of anticipated future installments of net income from the property, less an allowance for interest and the risk of partial or no receipt. Since a property's full value must be determined by reference to the price it would bring on an open market, the net earnings to be capitalized are not those of the present owner of the property, but those that would be anticipated by a prospective purchaser.

(5a-5c) **Property Taxes § 42.2—Assessment—Valuation—Capitalization of Geothermal Plant's Income.**—In valuing geothermal power plants for property tax purposes, the county assessor properly capitalized the plant's income from fixed-priced contracts under which the plant sold electricity to a power company at rates above market price. The plant's owner had acquired the long-term contracts to sell electricity for a fixed price. Although this particular type of contract was subsequently disapproved by the California Public Utilities Commission, existing contracts remained in force and could be transferred to subsequent purchasers. Even though the contracts were no longer available, the full value of the property included projected income at the contract rates, rather than market rates, since a prospective purchaser would be willing to pay more for the plant with the existing contracts. Also, the contracts were the means by which the property was put to beneficial use for purposes of assessing the property's full value. Moreover, the higher price received under the contracts was not the result of successful operation of the plants but of the regulatory scheme that allowed the owner the benefit of a long-term fixed contract price.

[See **Cal.Jur.3d,** Property Taxes, § 78; 9 **Witkin,** Summary of Cal. Law (9th ed. 1989) Taxation, § 185.]

(6) **Property Taxes § 12—Subjects of Taxation—Personal Property—Intangible Values.**—Although only tangible personal property is subject to taxation under Cal. Const., art. XIII, § 2, intangible values that

cannot be separately taxed as property may be reflected in the valuation of taxable property. Thus, in determining the value of taxable property, assessing authorities may take into consideration earnings derived therefrom, which may depend upon the possession of intangible rights and privileges that are not themselves regarded as a separate class of taxable property.

(7) **Property Taxes § 42—Assessment—Valuation—Methods—Income Method—Earnings From Enterprise Activity.**—Under the income approach to valuation of taxable property, only earnings from the property itself or the beneficial use thereof are to be considered. Income derived in large part from enterprise activity may not be ascribed to the property. When no sound or practicable basis appears for apportionment of income as between enterprise activity and the property itself, then a method may be employed which imputes an appropriate income to the property.

COUNSEL

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OPINION

KLINE, P. J.—This case arises from a dispute regarding the property tax assessment of geothermal power plants owned by appellant Freeport-McMoran Resource Partners (Freeport). Appellant contends the county overvalued the property by basing its assessment on capitalization of the income stream of fixed price contracts under which appellant sells electricity to Pacific Gas and Electric Company (PG&E) at rates well above present market rates.

STATEMENT OF THE CASE AND FACTS

Under the Public Utility Regulatory Policies Act of 1978 (PURPA), 16 United States Code section 796 et seq., and Federal Energy Regulatory

Commission (FERC) rules, utilities are required to purchase electricity from "qualifying facilities" (facilities that meet FERC requirements) at a price no greater than the utility's "avoided cost" (the cost the utility would have incurred by generating the electricity itself). (16 U.S.C. § 824a-3 (1985); 18 C.F.R. § 292.101(b)(6)(1990).) As a result of PURPA, the California Public Utilities Commission (CPUC) approved "standard offer" contracts to encourage qualifying facilities to sell energy to public utilities on standardized terms. The energy prices in these contracts were developed by public utilities and approved by the CPUC in 1983 based on then current forecasts of future market prices for fuel. Four types of standard offer contracts were developed, of which two are relevant here. Standard Offer 1 agreements (SO1) provided for payments to be adjusted throughout the contract term to reflect changes in the utility's short-run avoided costs; Standard Offer 4 agreements (SO4) were long-term energy supply contracts that contained various payment options including a fixed price option.

As of the lien date, March 1, 1989, appellant owned and operated two geothermal power plants in Lake County that were qualifying facilities under PURPA (West Ford Flat and Bear Canyon Creek). Appellant had previously acquired from third parties SO4 contracts with 20-year terms and the plants began supplying energy to PG&E under the terms of these contracts in 1989.[1] The contracts provided for a fixed price for the first 10 years based upon 1983 projections of PG&E's avoided costs over the contract term, the principal component of these long-run avoided costs being the market price of natural gas purchased by PG&E to generate electricity. Payment during the subsequent 10 years was to be based on PG&E's short-run avoided operating costs, which are adjusted from time to time to reflect changes in the market price of natural gas.

In 1985, the CPUC suspended approval of new SO4 agreements with fixed energy prices, after determining that the fixed prices did not reflect market prices for energy because they were based on overestimates of the utilities' long-run avoided operating costs due to incorrect assumptions that market prices for natural gas would continue to rise. As of March 1, 1989, the only new standard offer contracts available to geothermal plants from PG&E were the adjustable SO1 agreements. Existing SO4 contracts remained in force.

The county's witnesses testified before the Lake County Board of Supervisors, acting as the Board of Equalization (Board) that the terms of the SO4

[1]Appellant originally acquired SO4 contracts for supply of energy from as yet unbuilt facilities in Sonoma and Lake counties; PG&E consented to transfer of the contracts to appellant's properties.

contracts could not be changed during the contract term; that the contracts were assignable; that appellant's properties would be offered for sale only in conjunction with the SO4 contracts that provided the terms for sale of electricity and so were necessary to make the projects economically viable; that a project with an SO4 agreement would sell at a higher price than one with an SO1 agreement because the former guarantees a higher income; and that an SO4 contract in and of itself (not attached to a project) would not have value in the marketplace. Appellant's witness testified that geothermal plants and SO4 contracts are distinct assets that can be sold separately and have separate values, but acknowledged that as a general rule purchasers of the projects simultaneously purchase the contracts.

In determining the assessed value of appellant's plants, the assessor calculated the income stream for the years 1989-1998 by reference to the fixed energy prices in the SO4 agreements. The West Ford Flat plant was valued at $166,163,000, and the Bear Canyon Creek plant was valued at $100,630,000. Appellant applied for changed assessment, contending the assessor should have based his valuation on the market prices for energy in effect in 1989, which were much lower than the prices in the SO4 contracts. According to appellant, the two plants should have been valued at $55,412,000 and $22,908,700 respectively. The Board held a hearing on appellant's applications on November 29 and 30, 1989, and issued findings of fact on May 22, 1990, upholding the assessor's method of forecasting income. The Board determined that the taxable values of the plants were $157,108,287 and $93,801,278 respectively.

On November 13, 1990, appellant filed a complaint in superior court for refund of taxes and declaratory relief. The parties stipulated to the relevant facts and submitted the matter on cross-motions for summary judgment. The parties agreed that the capitalized income approach was the proper one to use in determining the value of geothermal properties but disagreed as to the proper method for determining the income stream to be utilized under this approach. The parties further agreed that if appellant's method of determining the income stream was accepted the correct values of the two properties would be $55,412,000 and $22,908,700, while if the Board's method was accepted the correct values would be $157,108,287 and $93,801,278.

On August 28, 1991, the court granted the county's motion for summary judgment, ruling that the income approach was the appropriate method by which to determine the fair market value of the properties, that the assessor's and Board's valuation method was valid and that substantial evidence supported the Board's determination concerning the proper application of the income approach to valuation.

A timely notice of appeal was filed on November 15, 1991.

DISCUSSION

I.

(1a) The parties dispute whether this court should employ a de novo or a substantial evidence standard of review in this case. **(2)** Where a taxpayer challenges the validity of the valuation method used by an assessor, the trial court must determine as a matter of law "whether the challenged method of valuation is arbitrary, in excess of discretion, or in violation of the standards prescribed by law." (*Bret Harte Inn, Inc.* v. *City and County of San Francisco* (1976) 16 Cal.3d 14, 23 [127 Cal.Rptr. 154, 544 P.2d 1354].) Our review of such a question is de novo. (*Dennis* v. *County of Santa Clara* (1989) 215 Cal.App.3d 1019, 1025-1026 [263 Cal.Rptr. 887].) By contrast, where the taxpayer challenges the application of a valid valuation method, the trial court must review the record presented to the Board to determine whether the Board's findings are supported by substantial evidence but may not independently weigh the evidence. (*Bret Harte Inn, Inc.* v. *City and County of San Francisco*, *supra*, 16 Cal.3d at p. 23; *Dennis* v. *County of Santa Clara*, *supra*, 215 Cal.App.3d at p. 1026.) This court, too, reviews a challenge to application of a valuation method under the substantial evidence rule. (*Dennis* v. *County of Santa Clara*, *supra*, 215 Cal.App.3d at p. 1026.)

(1b) In the present case, the assessor employed the income approach to valuation, which "estimates current fair market value of a property by attempting to determine the amount that an investor would be willing to pay for the right to receive the future income the property is projected to produce." (*Union Pacific Railroad Co.* v. *State Bd. of Equalization* (1991) 231 Cal.App.3d 983, 989-990 [282 Cal.Rptr. 745].) The parties stipulated that they "agree that the 'income approach to value,' referred to in Rule 8, 18. CCR § 8, is the proper approach for assessing properties of this kind" and that the only dispute in the case is "about the proper method for determining the income stream for these properties under an income approach to valuation." Appellant views this as a case for de novo review, characterizing the issue as whether the valuation method used by the county and Board was proper; the county views the disputed issue of which income stream to utilize as a question of "application" of the income method of valuation.

The determination whether a challenge is to "method" or "application" is not always easy. In *Union Pacific Railroad Co.* v. *State Bd. of Equalization*, *supra*, 231 Cal.App.3d 983, 989, railroad operating assets had been assessed

by means of the " 'income' or 'capitalized earnings ability' approach." The parties agreed this was the best general approach for valuing the assets in question but disputed issues regarding the size of the income stream—whether certain costs should be deducted as expenses and whether the income stream should be projected as a perpetuity or a limited lifetime. (*Id.*, at pp. 989-990.) With respect to the standard of review, the court stated: "A valuation method may be recognized as theoretically coherent and logical, yet be so inappropriate to the type of property being assessed as to ensure, for all properties of that general kind, that the results reached will not approximate fair market value. A claim of this kind could be termed a challenge to the 'application' of the method, presenting a factual question. But where the claim is that, due to the basic undisputed characteristics shared by an entire class of properties, the challenged method will produce systematic errors if applied to properties in that class, the issue is not factual but legal. The issue is not whether the assessor misunderstood or distorted the available data, but whether he or she chose an appraisal method which by its nature was incapable of correctly estimating market value." (231 Cal.App.3d at p. 992; see *Southern Pacific Transportation Co.* v. *State Bd. of Equalization* (1987) 191 Cal.App.3d 938, 956 [237 Cal.Rptr. 191].)

Similarly, here, the parties dispute which of two possible methods of determining the income stream to be used in an assessment under the income approach to valuation is the more appropriate given the nature of the properties and industry in question. There are no disputed issues of fact; the parties agree even on the amount of the valuation under either approach. The question presented is one of law and we review the court's decision de novo.

II.

(3) Revenue and Taxation Code section 401[2] requires that all property subject to general property taxation be assessed at its "full value." " '[F]ull cash value' " or " 'fair market value' " is defined as "the amount of cash or its equivalent which property would bring if exposed for sale in the open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other and both with knowledge of all of the uses and purposes to which the property is adapted and for which it is capable of being used and of the enforceable restrictions upon those uses and purposes." (§ 110, subd. (a); see *De Luz Homes, Inc.* v. *County of San Diego* (1955) 45 Cal.2d 546, 563 [290 P.2d 544]; Cal. Code Regs., tit. 18, § 2.) Fair market value " 'is a measure of desirability translated into money amounts

[2]All statutory references will be to the Revenue and Taxation Code unless otherwise specified.

[citation], and might be called the market value of property for use *in its present condition.*' " (*Union Pacific R.R. Co.* v. *State Bd. of Equalization* (1989) 49 Cal.3d 138, 148 [260 Cal.Rptr. 565, 776 P.2d 267], quoting *De Luz Homes, Inc.* v. *County of San Diego*, *supra*, 45 Cal.2d at p. 562, italics added in *Union Pacific*.)

(4) The income method is one of three basic methods for determining full cash value, the others being the comparative sales approach and the reproduction and replacement cost approach. (Cal. Code Regs., tit. 18, § 3; *Bret Harte Inn, Inc.* v. *City and County of San Francisco*, *supra*, 16 Cal.3d 14, 24.) "The income method rests upon the assumption that in an open market a willing buyer of the property would pay a willing seller an amount approximately equal to the present value of the future income to be derived from the property." (*Bret Harte Inn, Inc.* v. *City and County of San Francisco*, *supra*, 16 Cal.3d at p. 24.) "Under this approach, an appraiser values an income-producing property by estimating the present worth of a future income stream. 'The income approach may be called the capitalization method because capitalizing is the process of converting an income stream into a capital sum, i.e., value.' [Citations.] The assessor capitalizes 'the sum of anticipated future installments of net income from the property, less an allowance for interest and the risk of partial or no receipt.' [Citation.]" (*Union Pacific R.R. Co.* v. *State Bd. of Equalization*, *supra*, 49 Cal.3d at p. 148; see Cal. Code Regs., tit. 18, § 3, subd. (e) [defining income approach as "[t]he amount that investors would be willing to pay for the right to receive the income that the property would be expected to yield, with the risks attendant upon its receipt"].) Since a property's "full value" must be determined by reference to the price it would bring on an open market, "[t]he net earnings to be capitalized . . . are not those of the present owner of the property, but those that would be anticipated by a prospective purchaser." (*De Luz Homes, Inc.* v. *County of San Diego*, *supra*, 45 Cal.2d at p. 566.)

(5a) Appellant contends that assessment of the value of its properties based upon the income to be generated under the SO4 contracts violated the requirement that an objective, market based standard be used to determine the income to be capitalized. According to appellant, because SO4 contracts were no longer available as of the lien date, the value of the properties must be determined by reference to the market price for electricity reflected in an SO1 contract.

Appellant relies upon cases holding that the value of properties subject to below-market rate leases must be determined by reference to the income the properties could generate on the open market rather than the income generated under the actual contracts. (*Clayton* v. *County of Los Angeles* (1972) 26

Cal.App.3d 390 [102 Cal.Rptr. 687]; *Dennis* v. *County of Santa Clara, supra,* 215 Cal.App.3d 1019.) These cases rest upon the premise that property owners cannot deflate the value of their properties for tax purposes by entering "bad" leases. (*Clayton* v. *County of Los Angeles, supra,* 26 Cal.App.3d at pp. 392-393; *Dennis* v. *County of Santa Clara, supra,* 215 Cal.App.3d at pp. 1029-1031; see *Carlson* v. *Assessment Appeals Bd. I* (1985) 167 Cal.App.3d 1004 [213 Cal.Rptr. 555] [improper to consider privately imposed restrictions on use of property in determining value].) As explained in *De Luz Homes, Inc.* v. *County of San Diego, supra*: "The present owner may have invested well or poorly, may have contracted to pay very high or very low rent, and may have built expensive improvements or none at all. To value property by capitalizing his anticipated net earnings would make the value of property equal to the present value of his profits; since, however, the legislative standard of value is 'full cash value,' it is clear that whatever may be the rationale of the property tax, it is not the profitableness of property to its present owner." (45 Cal.2d at p. 566.)

The cases do not, however, require that valuation be based on market rather than actual income forecasts in all circumstances. In *De Luz Homes, Inc.*, the court determined that the value of a housing project located on a military installation should be determined by capitalizing expected future actual income, noting that future income could be expected to remain stable because rents were controlled by the government and occupancy was assured by the fact that the project was located on a permanent military installation. (45 Cal.2d at pp. 571-572.[3] *Host International, Inc.* v. *County of San Mateo* (1973) 35 Cal.App.3d 286 [110 Cal.Rptr. 652], involved valuation of the possessory interest under a lease of space for food concessions at San Francisco International Airport. The lease required Host to pay the higher of a monthly minimum or a percentage of gross sales; Host argued that valuation based on its actual rental payments was improper because these payments exceeded the income that could have been obtained if the leasehold was sold on the open market. The court held it proper to use Host's experience as a guide to market value, as there were no sales of comparable leases and no evidence other operators would not assume the existing lease. (35 Cal.App.3d at p. 289.)

In the present case, appellant owns a geothermal plant and a contract guaranteeing for 10 years an income that exceeds the income obtainable

[3]*De Luz Homes, Inc.* did not involve a question of market versus above- or below-market rents; the alternative means of determining future income considered by the court was to impute an amount of income equal to a minimum reasonable return on estimated market value. (45 Cal.2d at p. 565.) The court indicated that the imputed income method should be used where future income could not be estimated with reasonable accuracy or could not be ascribed entirely to the property, as when actual income is derived largely from enterprise activity. (*Id.*, at pp. 565, 572.)

absent the contract. Appellant's argument that its future income must be determined based on current market prices because SO4 contracts are no longer available ignores the obvious fact that appellant's income for the ten year period in question is fixed by the SO4 contract at a level above the current market price. The evidence in this case showed that appellant's plant would only be offered for sale in conjunction with the SO4 contract because the contract is integral to the economic viability of the plant and that a prospective purchaser would be willing to pay more for a plant with an SO4 contract than for a plant without one because the SO4 contract guarantees a higher income. As stated in *Host International, Inc.*, "*De Luz* permits reference to appellant's operation in determining what another lessee would pay for the same space upon like terms. It recognizes also, as a factor in market value of the possessory interest, governmental control of the project and stability of income . . . ." (35 Cal.App.3d at p. 290.) Since the "full value" of appellant's property must be taxed (§ 401), and "full cash value" must be determined, under the income approach, by capitalizing the net earnings "that would be anticipated by a prospective purchaser" (*De Luz Homes, Inc.*, *supra*, 45 Cal.2d at p. 566), to ignore the SO4 contracts would be to artificially deflate the value of appellant's properties.[4]

Indeed, appellant's characterization of the "market" to which reference must be made in determining the value of its properties is misguided. While appellant stresses that only SO1 contracts are currently available from PG&E, this simply means that a purchaser negotiating with PG&E for a new power purchase agreement would only be able to obtain an SO1 contract. The evidence showed that a purchaser could obtain an SO4 contract in a transaction for an existing power project with an SO4 contract, and that no SO1 contract projects were in operation in PG&E territory. Since some 60 to 70 percent of the 1,300 to 1,500 qualifying facilities in California operate

[4]Appellant's reliance on the board of equalization's property tax rule 8, subdivision (d) is unavailing. Rule 8, subdivision (d), provides: "In valuing property encumbered by a lease, the net income to be capitalized is the amount the property would yield were it not so encumbered, whether this amounts exceeds or falls short of the contract rent and whether the lessor or the lessee has agreed to pay the property tax." (Cal. Code Regs., tit 18, § 8, subd. (d)) Appellant extrapolates from this a rule that property must be valued without consideration of any type of contract pertaining to income to be derived from property. We are unwilling to accept appellant's broad definition of rule 8, subdivision (d). The rule is by its terms addressed specifically to leases; it serves the purpose of precluding potential manipulation by property owners of the taxable value of their property (See *Clayton* v *County of Los Angeles*, *supra*, 26 Cal.App.3d 390; *Dennis* v. *County of Santa Clara*, *supra*, 215 Cal.App 3d 1019) The present case presents no possibility of such manipulation, since the income to be generated by the property is fixed by contract terms that cannot be altered Capitalization of the income to be generated under the contract properly measures the value of appellant's property because it is the income a prospective purchaser of the property not only could anticipate but would be guaranteed.

with SO4 contracts, the assessor determined that the market for SO4 projects constituted a market for prospective purchasers. The evidence thus shows that the proper market against which to judge the value of appellant's plants was that consisting of existing facilities with SO4 contracts.

We are not persuaded by appellant's argument that consideration of the SO4 contract income impermissibly taxes nontaxable intangible property. **(6)** Only tangible personal property is subject to taxation. (Cal. Const., art. XIII, § 2; *ITT World Communications, Inc.* v. *County of Santa Clara* (1980) 101 Cal.App.3d 246, 251 [162 Cal.Rptr. 186].) But " '[i]ntangible values . . . that cannot be separately taxed as property *may be reflected in the valuation of taxable property.* Thus, in determining the value of [taxable] property, assessing authorities may take into consideration earnings derived therefrom, which may depend upon the possession of intangible rights and privileges that are not themselves regarded as a separate class of taxable property.' " (*County of Stanislaus* v. *Assessment Appeals Bd.* (1989) 213 Cal.App.3d 1445, 1455 [262 Cal.Rptr. 439], quoting *Roehm* v. *County of Orange* (1948) 32 Cal.2d 280, 285 [196 P.2d 550], italics added in *County of Stanislaus.*) " '[M]arket value for assessment purposes is the value of property when *put to beneficial or productive use.*' " (*County of Stanislaus* v. *Assessment Appeals Bd., supra,* 213 Cal.App.3d at p. 1455, italics in original.) For example, *County of Stanislaus, supra,* involved taxation of a cable television franchise. The franchise was viewed as consisting of two components, the right to use public streets for cables and the right to charge fees to subscribers for use of the cable facilities. The former component, the possessory interest, was taxable while the latter component, the right to do business, was not. Nevertheless, the court concluded that the value of the intangible right—without which the possessory interest could not be put to beneficial or productive use—should be considered in valuing the possessory interest. (213 Cal.App.3d at pp. 1451-1456.) **(5b)** In this case the SO4 contracts are the means by which appellant's properties are put to beneficial use and must be considered in assessing the properties' "full value."

We are similarly unpersuaded by appellant's argument that valuation on the basis of the SO4 contract improperly taxes appellant's enterprise activity or business skill. **(7)** Under the income approach to valuation, only "earnings from the property itself or the beneficial use thereof" are to be considered; income derived in large part from enterprise activity may not be ascribed to the property. (*California Portland Cement Co.* v. *State Bd. of Equalization* (1967) 67 Cal.2d 578, 584 [63 Cal.Rptr. 5, 432 P.2d 700]; *United Air Lines, Inc.* v. *County of San Diego* (1991) 1 Cal.App.4th 418, 438 [2 Cal.Rptr.2d 212].) "When no sound or practicable basis appears for

apportionment of income as between enterprise activity and the property itself, then a method may be employed which imputes an appropriate income to the property." (*California Portland Cement Co.* v. *State Bd. of Equalization, supra,* 67 Cal.2d at p. 584; *United Air Lines, Inc.* v. *County of San Diego, supra,* 1 Cal.App.4th at p. 438.) In *California Portland Cement Co.*, the owner of a quarry and adjacent cement factory contended that profitability of its manufacturing business could not be considered in valuing the property. The court rejected the owner's argument that its business profits were not relevant to determining the "full cash value" of the cement mill as "a play on words which lacks persuasion," noting that the quarry and cement mill were "operated as a unit, with each contributing to the economy and profitability of the other." (67 Cal.2d at p. 585) (5c) In the present case, because the SO4 contract is the means by which appellant can sell the electricity it produces, the income generated by the SO4 contract is inextricably tied to the beneficial use of the property and properly considered in assessing its value.

Moreover, there is no evidence the increased value of the SO4 contract over an SO1 contract's market rate is due to appellant's enterprise activity: The higher price received under the SO4 contract is not the result of appellant's successful operation of its plants but of the regulatory scheme that allowed appellant the benefit of a long-term fixed contract price.

The judgment is affirmed.

Smith, J., and Benson, J., concurred.

[No. A055683. First Dist., Div. Two. Feb. 18, 1993.]

FREEPORT-McMORAN RESOURCE PARTNERS, Plaintiff and Appellant, v.
COUNTY OF LAKE, Defendant and Respondent.

[Modification* of opinion (12 Cal.App.4th 634; 16 Cal.Rptr.2d 428) on denial of petition for rehearing.]

KLINE, P. J.—The opinion filed on January 19, 1993, is hereby modified as follows:

At page 13 [12 Cal.App.4th 644, advance report]: Footnote 4 is deleted. The following is inserted at the end of the page [12 Cal.App.4th 644, advance report, foll. line 19] as a new paragraph:

"Appellant's reliance on the board of equalization's property tax rule 8, subdivision (d), is unavailing. Rule 8, subdivision (d), provides: "In valuing property encumbered by a lease, the net income to be capitalized is the amount the property would yield were it not so encumbered, whether this amounts exceeds or falls short of the contract rent and whether the lessor or the lessee has agreed to pay the property tax." (Cal. Code Regs., tit. 18, § 8, subd. (d).) Appellant extrapolates from this a rule that property must be valued without consideration of any type of contract pertaining to income to be derived from property. We are unwilling to accept appellant's broad interpretation. Rule 8, subdivision (d), is by its terms addressed specifically to leases; it serves the purpose of precluding potential manipulation by property owners of the taxable value of their property. (See *Clayton* v. *County of Los Angeles*, *supra*, 26 Cal.App.3d 390; *Dennis* v. *County of Santa Clara*, *supra*, 215 Cal.App.3d 1019.) The present case presents no possibility of such manipulation, since the income to be generated by the property is fixed by contract terms that cannot be altered. Unlike leases (*Clayton* v. *County of Los Angeles*, *supra*, 26 Cal.App.3d 390; *Dennis* v. *County of Santa Clara*, *supra*, 215 Cal.App.3d 1019) or deed restrictions (*Carlson* v. *Assessment Appeals Bd. I*, *supra*, 167 Cal.App.3d 1004), the contracts that determine the income to be produced by appellant's properties are regulated by

*This modification requires movement of text affecting pages 637-646 of the bound volume report.

the state and cannot be modified by the parties without governmental approval. In light of this regulation, capitalization of the income to be generated under the contract properly measures the value of appellant's property because it is the income a prospective purchaser of the property not only could anticipate but would be guaranteed. It would appear obvious that if the situation were reversed and the SO4 contracts prescribed a below-market rate of income, appellant would be advancing precisely the position taken by the county here—and, in that situation, would be entitled to the benefit of the decrease in property value."

This modification does not effect a change in the judgment.

The petition for rehearing is denied.