



Western States Petroleum Association
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President

December 17, 2014

VIA EMAIL Richard.Bennion@boe.ca.gov

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State Board of Equalization
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Re: **Proposal to Re-Adopt Property Tax Rule 474, *Petroleum Refining Properties***
Western States Petroleum Association's Objections to Proposed Rule 474

Dear Mr. Bennion:

The Western States Petroleum Association ("WSPA") respectfully submits the following opposing comments and objections to proposed Property Tax Rule 474 ("Rule 474"). The State Board of Equalization ("Board") issued a Notice of Proposed Action to Re-Adopt Rule 474 on October 24, 2014. The Board is scheduled to consider re-adoption of the rule on December 18, 2014. This letter should be included in the Board's official rulemaking file for Rule 474.

WSPA is a long-standing trade association comprised of energy companies that own and operate properties and facilities in the petroleum industry, including petroleum refineries.

WSPA opposes Rule 474 because the Board has failed to comply with the requirement under the Administrative Procedures Act ("APA"), Gov. Code §§ 11346.2(b)(5)(A), 11346.3 and 11346.5(a)(8). For this reason, WSPA urges the Board to reject Rule 474 at this time, and until the Board has substantially complied with the requirements under the APA.

Last year, the California Supreme Court (herein, the "Supreme Court") in *Western States Petroleum Assn. v. Board of Equalization*, 57 Cal. 4th 401 (2013), held that Rule 474, which was adopted by the Board and became effective December 2007, was procedurally invalid. The Supreme Court held that the Board failed to assess the economic impact of Rule 474 and thus the Board's initial determination that the rule would not have a significant adverse impact on businesses did not substantially comply with the APA. Specifically, the Court held that the Board's assessment was inadequate because it failed to make a reasoned estimate of all the cost impacts of the rule on affected parties. As described below, the Board has failed to rectify these deficiencies in its newest version of the proposed rule. Accordingly, the Board's continuing and ongoing failure to provide an adequate statutorily-required analysis of the economic impact of

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Rule 474 means that if the Board were to adopt it at this time, it should again be found invalid by the California courts.

Relevant California Statutes

Proposition 13 limits the assessment of real property to its full cash value (fair market value). (Cal. Const. art. XIII A, § 1.) The full cash value is the assessor's valuation as shown on the 1975-76 tax bill, or the appraised value when purchased, newly constructed, or a change in ownership occurs after the 1975 assessment. (*Id.*, § 2(a).) This full cash value base year value assessment ("base year value") may be increased annually by an amount equal to the greater of the California consumer price index or two percent (the "adjusted base year value"). (*Id.*, § 2(b); Rev. & Tax. Code ("RTC") § 51(a)(1)) The assessed value may be reduced temporarily to reflect a decline in value of the property. (Cal. Const. art. XIII A, § 2(b); RTC § 51(a)(2).) When the current full cash value of a property is less than the property's adjusted base year value, the current full cash value must be enrolled as the taxable value. (Property Tax Rule 461(f).)

When calculating whether a property has suffered a decline in value, it is necessary to determine what constitutes the real property interest to be valued. RTC § 51(d) provides that for purposes of calculating a property's full cash value, the property interest to be measured is "that appraisal unit that persons in the marketplace commonly buy and sell as a unit, or that is normally valued separately."

Under Property Tax Rule 461(e), when calculating the value of property to determine whether there has been a decline in value, land and improvements constitute a separate appraisal unit from fixtures and other machinery and equipment that are classified as improvements (herein, "fixtures"). Accordingly, when determining the assessed value of an industrial property, land and improvements are valued as a separate appraisal unit from fixtures, with the assessed value of each these two appraisal units separately determined as the lower of its separate standalone adjusted base year value or its fair market value. For industrial properties that have long been held by one owner, it is typical that the fair market value of land and buildings exceeds their base year value, while the fair market value of fixtures is typically less than the fixture adjusted base year value. Accordingly, under Proposition 13, RTC § 51(d) and Rule 461(e), increases in the full cash value of land and improvements would not be subject to assessment above the adjusted base year value of land and improvements, while declines in value in fixtures due to depreciation would be reflected in a lower enrolled taxable value for the fixtures.

As an exception to the basic rule in Rule 461(e) that fixtures must be treated as a separate appraisal unit from land and improvements, the Board adopted Rule 474 in 2007. Rule 474 established a separate, specific rule for the assessment of petroleum refining properties. Rule 474(d)(2) provided that for petroleum refining properties, land, improvements and fixtures are rebuttably presumed to be one appraisal unit. Accordingly, declines in value in fixtures due to depreciation would not be allowed to the extent that they were offset by increases in the fair market value of land and improvements.

Administrative Procedures Act

Under the APA, state agencies proposing to adopt a regulation must “assess the potential for adverse economic impact on California business enterprises and individuals, avoiding the imposition of unnecessary or unreasonable regulations or reporting, recordkeeping, or compliance requirements.” (Gov. Code § 11346.3(a).) The agency’s assessment of the potential for adverse economic impact requires the agency: (1) to base the regulation on adequate information regarding the need for, and consequences of, the proposed rule; and (2) to “consider the proposal’s impact on business, with consideration of industries affected including the ability of California businesses to compete with businesses in other states.” (Gov. Code § 11346.3(a)(1) and (2).)

Specifically, these statutory provisions require that an agency’s economic impact assessment must assess whether and to what extent the proposed rule will affect:

- (A) The creation or elimination of jobs within the state.
- (B) The creation of new businesses or the elimination of existing businesses within the state.
- (C) The expansion of businesses currently doing business within the state.
- (D) The benefits of the regulation to the health and welfare of California residents, worker safety, and the state’s environment. (Gov. Code § 11346.3(b)(1).)

As the Supreme Court did, we will review the other relevant statutory requirements in the APA:

1. Every agency that proposes to adopt a regulation is required to submit a notice of the proposed action to the Office of Administrative Law and to make the notice available to the public. (Gov. Code §§ 11346.2, 11346.5(a).)
2. The notice of the proposed action must contain a copy of the express terms of the regulation and an initial statement of reasons for proposing it (“*Initial Statement*”). (Gov. Code § 11346.2(a), (b).)
3. The *Initial Statement* must include a “statement of the specific purpose” for the adoption of the regulation and a “description of reasonable alternatives to the regulation and the agency’s reasons for rejecting those alternatives.” (Gov. Code § 11346.2(b)(1), (b)(5)(A).)
4. If the agency makes an initial determination that its proposed regulation will not have a significant adverse economic impact on business, the *Initial Statement* must include “[f]acts, evidence, documents, testimony, or other evidence on which the agency relies to support” this determination. (Gov. Code § 11346.2(b)(5)(A).)
5. If the agency makes an initial determination that its proposed regulation will not have a significant adverse economic impact on business, “it shall make a declaration to that effect in the notice of proposed action. In making this declaration, the agency shall provide in the record facts, evidence, documents, testimony, or other evidence upon

which the agency relies to support its initial determination.” (Gov. Code § 11346.5(a)(8).)

6. If the agency’s declaration pursuant to Gov. Code § 11346.5(a)(8) is in conflict with substantial evidence in the record, the regulation may be declared invalid. (Gov. Code § 11350(b)(2).)
7. The agency’s notice of proposed action must include a “description of all cost impacts, known to the agency at the time the notice of proposed action is submitted to the office, that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.” (Gov. Code § 11346.5(a)(9).)
8. If there has been substantial compliance with the requirement to provide the description of cost impacts, the regulation may not be invalidated because of the alleged inadequacy of the summary or cost estimates. (Gov. Code § 11346.5(c).)

Western States Petroleum Supreme Court Decision

Despite the leeway and deference given to agencies, the Supreme Court found the Board’s initial determination that Rule 474 would not have a significant adverse impact on business failed to substantially comply with the APA requirement that the Board *actually assess* the potential adverse economic impact on businesses based on the facts. An agency must *actually assess* the potential adverse economic impact on California businesses and individual businesses, which calls “for an evaluation based on facts.” (*Western States Petroleum*, 57 Cal. 4th at 428, citing *California Assn. of Medical Products Suppliers v. Maxwell-Jolly*, 199 Cal. App. 4th 286 (*Maxwell-Jolly*).)

The Supreme Court upheld the trial court’s finding that the Board had not adequately estimated the increased taxes that would result from treating refineries as a single appraisal unit for decline in value purposes. (*Western States Petroleum*, 57 Cal. 4th at 430.) As noted above, the principal effect of Rule 474 and its combining of land and improvements with fixtures as a single appraisal unit is to allow the erosion of fixture fair market value beneath fixture adjusted base year value to be assessed to the extent land and building values had appreciated above their adjusted base year values. The potential land appreciation that would now be subject to property tax is limited to the extent fixture value has fallen below its adjusted base year value. The trial court held that the economic impact statement required an accurate measure of these potential assessment increases and that “as a theoretical matter, surely there should be some quantification of the effect of depreciation of fixtures on assessed value.” (*Ibid.*) Since the Board had not provided an accurate estimate of refinery fixture depreciation (indeed it provided no estimate at all), the Supreme Court summarily affirmed the trial court, rejecting the Board’s analysis because it:

[F]ailed to provide “an economic impact based on data concerning fixture depreciation on assessed values” and thus “leaves a reader without an understanding of what the taxes on a representative refinery would have been under the formerly applicable Rule 461(e), and what the taxes would be under the new rule 474(d)(2).” (*Ibid.*, quoting the Court of Appeal.)

The Supreme Court agreed with the trial court and Court of Appeal because the Board did not explain how its analysis was a “valid or reasonable way to estimate the amount of fixture depreciation that would be offset by appraising land and fixtures as a single unit.” (*Ibid.*) The Supreme Court stated further, “[E]ven if the Board’s prediction of future land appreciation were correct, the Board’s calculation failed to consider prior land appreciation and the full tax impact that would occur if land were valued at actual market value rather than adjusted base year value.”

The Supreme Court clearly enunciated the standard the Board must satisfy: The Board’s estimate must consider prior land appreciation and quantify the amount of fixture depreciation that would be offset by the land appreciation if land were assessed at its actual market value (under Rule 474) instead of its adjusted base year value (under Rule 461(e)). Then, the estimate must calculate the full property tax impact that would occur under each scenario. By failing to meet these standards, the Supreme Court concluded that the Board failed to make a reasoned estimate of all cost impacts of the rule on affected parties.

In light of the Supreme Court’s *Western States Petroleum* decision, Rule 474 was invalidated. However, shortly thereafter the Board initiated the rulemaking process to re-adopt Rule 474.

New Initial Statement

On October 24, 2014, the Board issued “Initial Statement of Reasons for the Proposed Re-Adoption of California Code of Regulations, Title 18, Section 474, *Petroleum Refining Properties*”.

Beginning on page 11, the Board set forth a discussion intended to comply with the APA requirements, entitled “INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2, SUBDIVISION (b)(5) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b).” This section had several subsections.

Economic Impact

Initially, the Board just ignored all prior law, including fully ignoring Rule 461(e), which had for over 30 years required land and buildings to be treated as a separate appraisal unit from fixtures. In the subsection of the *Initial Statement* entitled *Economic Impact of the Re-Adoption of Rule 474*, the Board takes a position that Rule 474 imposes no additional costs on businesses because assessors are already authorized by Revenue and Taxation Code (“RTC”) § 51(d) to assess petroleum refining properties as a single appraisal unit for decline in value purposes. The Board explains as follows:

Board staff determined that, in the absence of Rule 474, county assessors are currently authorized by RTC section 51(d), as interpreted by the California Supreme Court in *WSPA v. BOE*, to determine that petroleum refinery property (land, improvements, and fixtures) constitutes a single appraisal unit for measuring declines in value when persons in the marketplace commonly buy and sell refinery property as a unit.

[...]

Therefore, Board staff concluded that the re-adoption of Rule 474 is fully consistent with the existing mandates of RTC section 51(d), and that there is nothing in the proposed re-adoption of Rule 474 that would significantly change how individuals and businesses, including county assessors and petroleum refinery owners, would generally behave due to the current provisions of RTC section 51(d) as interpreted by the California Supreme Court in *WSPA v. BOE*.

As a result, the Board has determined that the re-adoption of Rule 474 does not impose any costs on any persons, including businesses, in addition to whatever costs are imposed by RTC section 51(d) as interpreted by the California Supreme Court in *WSPA v. BOE*, and there is nothing in Rule 474 that would impact revenue.

This fails to comply with the APA and the clear mandate from the Supreme Court that the Board make an initial *actual assessment* of the economic impact of Rule 474. In this *Economic Impact* subsection, the Board has essentially ignored the Supreme Court directive, and instead concluded that Rule 474 does not effectuate a change in law because assessors are already authorized to assess the land, improvements and fixtures of petroleum refining properties as a single appraisal unit for decline in value purposes under RTC § 51(d). In effect, the Board is arguing that Rule 474 is unnecessary because the rule it establishes is already provided for by statute in RTC § 51(d).

Certainly, the Board does not believe this. Under this argument, no property tax regulation would ever impose a cost because it could always be deemed consistent with its underlying authorizing statute. Even in the Board's reply brief to the Supreme Court in *Western States Petroleum*, it conceded that "Rule 474 is not merely an interpretation of section 51(d) under specific circumstances, but a new rule with general application to petroleum refineries for Proposition 8 valuation purposes" (Appellant's Reply Brief, p. 5.) Just because the Supreme Court held that the prior Rule 474 was *substantively* valid as an appropriate interpretation of RTC § 51(d) and consistent with Proposition 13 does not mean that Rule 474 was not a change in the prior regulatory interpretation of Rule 461(e). Accordingly the Supreme Court was correct in demanding that the Board quantify the additional tax revenue that would be collected as result of Rule 474 well as the additional costs imposed as compared to a world without Rule 474.

To that point, it is clear from the Supreme Court that the requisite comparison for economic impact is to compare the costs to businesses without the regulation to the costs to businesses with the regulation. Without Rule 474, Rule 461(e) states, without equivocation, that for purposes of calculating declines in value, "fixtures and other machinery and equipment classified as improvements constitute a separate appraisal unit." There is no other specific rule applicable to petroleum refining property. The Supreme Court clearly endorsed the trial court's view that the Board is required to calculate the increased taxes, taking into consideration the effect of fixture depreciation on assessed values. (*Western States Petroleum*, 57 Cal. 4th at 430.) In addition, the Supreme Court agreed with the Court of Appeal's holding that the Board must calculate the difference in taxes on refineries using Rule 461(e) and the new proposed Rule 474, stating that the Board's analysis in the first adoption of Rule 474 "leaves a reader without an

understanding of what the taxes on a representative refinery would have been under the formerly applicable Rule 461(e), and what the taxes would be under the new rule Rule 474(d)(2).” (*Ibid.*) Thus, the Board’s comparison of the effect of its proposed Rule 474 to the costs on business under RTC § 51(d) is not the correct comparison, and thus the statement that the rule imposes no costs fails to satisfy the APA requirement that the agency *actually assess* the potential adverse economic impacts of a proposed regulation.

Tax Effect

Despite the Board’s stated view that Rule 474 is not a substantive change, the Board concedes that it must provide some calculations because the Supreme Court rejected its methodology in the first adoption of the rule. Putting aside the obvious inconsistencies in the positions that, first, “there is no cost”, and second, “but we will calculate the cost,” the calculations in the *Initial Statement* are deficient as a matter of law because they failed to comport with the Supreme Court’s mandate, as explained below. Accordingly, the *Initial Statement* fails to substantially comply with the APA requirements and if adopted would again be struck down by the courts.

To “accurately compare the total assessed value of a petroleum refinery when its fixtures are valued as a separate appraisal unit under Rule 461(e) and valued as part of the same appraisal unit with land and improvements under Rule 474,” the Board sought data regarding market values and adjusted base year values of refineries from county assessors through the California Assessors’ Association, for the tax years 2009 through 2013. The Board obtained the information 10 refineries, and includes the data and its analysis of the data as *Attachment F*.

The Board’s analysis looks at the base year values for the fixtures at each of these 10 refineries and compares them to the Board’s estimates of the fair market values of the fixtures. It then makes the same comparison between the base year values of the land and improvements at the 10 refineries and the Board’s estimates of the fair market values of the land and improvements. Based on this Board-determined data, the Board then makes its determination of each refinery’s assessed value under Rule 474 and each refinery’s assessed value under Rule 461(e), and when they are different, the percentage difference between the two. The Board concluded that:

- The owners of two of the 10 refineries would pay *higher* property taxes under RTC § 51(d) and Rule 474, than under Rule 461, in two of the five past years;
- The owners of two of the 10 refineries would pay *higher* property taxes under RTC § 51(d) and Rule 474, than under Rule 461, in three of the five past years;
- The owners of three of the 10 refineries would pay *higher* property taxes under RTC § 51(d) and Rule 474, than under Rule 461, in four of the five past years; and
- The owners of two of the 10 refineries would pay *higher* property taxes under RTC § 51(d) and Rule 474, than under Rule 461, in all five of the five past years.

Board’s Inaccurate Estimates

Because WSPA believes that Board's estimated fixture fair market values in its analysis are substantially overstated, and well in excess of fair market value, WSPA believes that the estimated additional property tax burdens are wrong and therefore unreasonable. In short, because the Board's estimates greatly overstated the fair market value of refinery fixtures, they greatly understate the depreciation in fixture value underneath their respective base year values. Ironically, the Board has made exactly the same mistake it made previously and for which it was chastised by the Supreme Court: *The Board has failed to adequately and accurately estimate fixture depreciation beneath fixture base year value*, and determine how much this depreciation would be offset by land appreciation, considering past appreciation. Since determining fixture depreciation is the most critical factor in estimating the economic impact and incremental property tax effect of Rule 474, the new *Initial Statement* is inherently deficient. Accordingly, if the Board adopts Rule 474 at this time and this latest economic impact statement were subjected to review by the courts once again, there is no reason to expect a result any different from the Supreme Court declaring Rule 474 procedurally invalid as it ruled in *Western States Petroleum*.

For the Board to provide an economic impact based on data concerning fixture depreciation on assessed value, as the Supreme Court mandate requires, the Board's estimates must use data that is accurate. The accuracy of the estimated additional property tax burden imposed on the petroleum refining industry by Rule 474 depends entirely upon the accuracy of the Board's estimation of fair market values. If the input estimated property values are inaccurate, then the estimate of the additional property tax burden that would occur if the rule is adopted would necessarily be wrong. If the estimate of additional property tax burden is wrong, then the Board's economic impact statement would leave "a reader without an understanding of what the taxes on a representative refinery would have been under" Rule 461(e) compared to what they would be under the proposed Rule 474. (*Western States Petroleum*, 57 Cal. 4th at 430.)

Simply looking at the figures, it is clear that the Board's method of estimating fixture fair market values is fatally flawed. The first clear evidence that the Board's estimates of fixture fair market values are flawed is that they are not consistent with one another and vary wildly over the course of the five years used in the Board's analysis. The best, standard measure for refinery value is fair market value per "complexity barrel." The value of a refinery is proportional to its complexity times its crude capacity, or complexity-barrels. While this is an advanced concept, the valuation of the California refineries per complexity barrel ought to be consistent, since this methodology accounts for the differences between the refineries in the "complexity" of the oil refined. This is a standard appraisal method accepted by industry appraisers and assessors alike, and certainly is known to Board staff.

Exhibit 1 to this letter, *Board of Equalization Stated Fair Market Value for Fixtures – Complexity Barrels*, illustrates the problem with the Board's figures. We were able to match the Board's 10 Refineries A through J to their owners and then obtain complexity barrels of refinery capacity for each. The complexity barrels of refining capacity figure for each refinery is public information. Exhibit 1 shows the range of Board values per complexity barrel of the 10 refineries analyzed. They range from \$281 for Refinery J in one year, up to \$1,489 for Refinery F in another year. As repeated here below, these values are all over the place, and ought to be within a consistent, tight range, especially because the 10 refineries that the Board used for its analysis and set forth in *Attachment F* are all within Los Angeles and Contra Costa County.

Board Determined Fair Market Values Per Complexity Barrel of Refinery Capacity
(See Exhibit 1)

Refinery A	\$446 to \$619 (the Carson refinery)
Refinery B	\$463 to \$665
Refinery C	\$697 to \$919
Refinery D	\$541 to \$588
Refinery E	\$475 to \$1,136
Refinery F	\$344 to \$1,489
Refinery G	\$431 to \$810
Refinery H	\$315 to \$413
Refinery I	\$384 to \$490
Refinery J	\$281 to \$719

Because there are such wild variances in the values per complexity barrel in the Board's data and analysis, it is clear that the Board's estimates of fair market value of the fixtures at the refineries in *Attachment F* to the *Initial Statement* are badly flawed. There is no reasonable reason why these figures would be so wildly different.

More significantly, the Board's values are not in line with the market value of a refinery that sold in 2013. Data available from the June 2013 sale of the BP Carson refinery (the "Carson refinery") and related assets to Tesoro Corporation (the "Tesoro Acquisition") highlights how overstated the Board's estimated fixture fair market value figures are from true market value as established in an arm's-length, open market transaction. (See BP's Press Release attached to the *Initial Statement* as *Attachment E*.) The Carson refinery is well-located and data from the sale is perfectly suited to analyzing what fair market value of a California refinery ought to be.

The Tesoro Acquisition included the Carson refinery and many non-refinery assets such as integrated terminals and pipelines and a network of service stations throughout Southern California, Arizona and Nevada.¹ Tesoro paid \$1.075 billion for the entire bundle of these assets. (See *Initial Statement, Attachment E*.) The Carson refinery is "Refinery A" on the *Attachment F*. Subsequent to the sale, Tesoro Corporation sold the non-refinery assets to a related entity, and Tesoro Corporation kept the Carson refinery itself.² The amount Tesoro Corporation paid for all of the assets, including the non-refinery assets, was \$1.075 billion *total for the entire bundle*. Clearly the non-refinery assets have value, which means that the value of the refinery assets along is less than the \$1.075 billion Tesoro paid for *all of the assets*. Even using, for the sake of argument only, the full \$1.075 billion purchase price that was for the refinery and the non-refinery assets as the refinery value (again, which it clearly is not since the

¹ The assets included in the sale included the 266 Mbpd Carson refinery, related marine terminals, land terminals and pipelines; the ARCO brand and associated registered trademarks; the supply rights to stations in central and southern California, Nevada and Arizona; an anode coke calcining operation and a 51 percent ownership in the Watson cogeneration facility, both located at the Carson refinery. (Tesoro Corporation, Annual Statement on Form 10-K filed with the U.S. Securities and Exchange Commission for the fiscal year ending December 31, 2013, p. 7.)

² See Tesoro Corporation's 2013 Annual Statement on Form 10-K at p. 39.

non-refinery assets have demonstrable value), and allocating 89 percent to the fixtures and 11 percent to the land (using the Board's allocation percentages for Refinery A), that means that the value of Refinery A on a complexity barrel basis was \$313³ in 2013. Again, this \$313 value includes all of the non-refinery assets as well.

The Board estimated a fair market value of the Refinery A *fixtures alone* in 2013 at \$1.360 billion (and the entire refinery including land, plus all of the non-refinery assets, sold for \$1.075 billion). Even including all of the other non-refinery assets, the \$313 value per complexity barrel is significantly below the Board's Refinery A low-to-high range of \$446-\$619 per complexity barrel as shown on Exhibit 1. Certainly if the value of the non-refinery assets were removed from the total \$1.075 billion purchase price to derive the real fair market value for the refinery fixtures only, the \$313 would be reduced significantly.

Moreover, compare that \$313 value to all of the other values on Exhibit 1. It is clear that the \$313 is only higher than two values, the value for Refinery J from 2010, and Refinery H from 2013. Of course, once the non-refinery values are removed from the Tesoro Acquisition \$1.075 billion total purchase price, clearly the Carson refinery market value per complexity barrel would be lower than all of the Board's estimates, *for all 10 refineries, in all five years*. Some of the Board estimates are two to four times the \$313 figure before removing the non-refinery assets. This demonstrates how unrealistic and unreasonable the Board's estimates are. The best evidence of the fair market value of a California refinery is the Carson refinery, as established through the June 2013 sale, and *all* of the Board's estimates exceed that value by significant margins.

Further evidence that the Board-derived values are flawed can be shown by looking at the values of the refineries on the basis of crude barrels of refining capacity. Exhibit 2 to this letter, *Board of Equalization Stated Fair Market Value for Fixtures – Crude Barrel Capacity*, demonstrates this point. Exhibit 2 is a summary of the highest and lowest values for each refinery across the 2009-2013 years, derived from the Board's analysis on *Attachment F* to the *Initial Statement*, and shows the Board's estimated fair market values of fixtures at each of the 10 refineries analyzed divided by the number of crude barrels of refining capacity per day.

Board Determined Fair Market Values of Fixtures Per Crude Barrel of Refinery Capacity
(See Exhibit 2)

Refinery A	\$5,112 to \$7,095 (the Carson refinery)
Refinery B	\$5,342 to \$7,663
Refinery C	\$7,491 to \$9,870
Refinery D	\$7,722 to \$8,391
Refinery E	\$7,181 to \$17,173
Refinery F	\$4,787 to \$20,698
Refinery G	\$6,098 to \$11,450
Refinery H	\$5,304 to \$6,959

³ (\$1.075 billion x .89) divided by 3,048,413 complexity barrels.

Refinery I	\$5,723 to \$7,294
Refinery J	\$5,913 to 12,835

Using the Carson refinery as a good example again to demonstrate how overstated the Board's estimates are, even if the entire \$1.075 purchase price figure were used to determine fair market value per barrel of refining capacity, the figure would be \$3,800.⁴ Compare this (which again includes all of the non-refinery assets) to the Board's estimates of per barrel of capacity fair market values of fixtures for the 10 refineries on Exhibit 2.

Not only is the Board's estimated value of the Carson refinery inconsistent with the data from Tesoro Acquisition, but the Board's estimates of all of the other nine refineries are all inconsistent with this arm's length, market-based value of California refineries on a per barrel of capacity basis. Even if we simply look at the overall fair market values the Board ascribed to all of the refineries for lien date 2013 (land, improvements and fixtures combined), and compare them to the Carson refinery, it is clear that the Board's figures are wildly overstated.

Board's Overall Fair Market Value Estimates for Lien Date 2013 from Attachment F

Refinery A	\$1,533,355,051 (the Carson refinery)
Refinery B	\$1,766,347,425
Refinery C	\$1,362,773,677
Refinery D	\$1,292,007,019
Refinery E	\$1,821,953,554
Refinery F	\$1,368,262,574,
Refinery G	\$1,318,591,387
Refinery H	\$624,523,309
Refinery I	\$924,198,374
Refinery J	\$ 3,722,232,049 (2012)

The Carson refinery sold in June 2013 along with a bundle of non-refinery assets for a total purchase price of \$1.075 billion. That total purchase price for *all of the assets* is lower than eight of the 10 Board-derived total refinery fair market values for 2013 (and 2012 for Refinery J, since 2013 data was not provided). Given that the Carson refinery is one of the largest refineries in California in terms of refinery capacity in complexity barrels and in overall crude barrel refining capacity, it makes absolutely no sense that all of the other Board-determined fair market values would exceed the arm's-length sales price value of the Carson refinery. And certainly when the non-refinery assets are removed from the \$1.075 billion purchase price, it is clear that *all* of the Board's fair market value estimates exceed the actual Carson refinery fair market value as of the sale date.

The point is that the Tesoro Acquisition provides a supportable fair market value measure of a quality, well-equipped refinery that is well-located in a metropolitan area with significant demand for its product. Given these enormous variances in value, it is difficult for the Board to

⁴ (\$1.075 billion x .89) divided by 252,000 barrels.

argue that its estimates are reasonable. In fact, the Board's failure to adequately estimate the true magnitude of fixture depreciation is exactly the error the Supreme Court concluded was the fatal flaw in the Board economic analysis in the first version of Rule 474. (See *Western States Petroleum*, 57 Cal. 4th at 430.) As explained below (and in the attached chart), the Board's egregious overstatement of fixture value causes it to grossly understate the true tax effect of Rule 474. As discussed below, we would expect the courts to rule just as they did previously and conclude that the Board's failure to provide an economic impact statement that adequately estimated the property tax increment of Rule 474 made the rule procedurally invalid.

The Impact of Wrong Data

On *Initial Statement – Attachment F*, the Board used *past data* to estimate the future impact of Rule 474 on the petroleum refining industry. Putting aside the misjudgment of using historical data to project the future impact of a tax regulation, it is clear that the Board's estimated additional property tax costs that will be caused by proposed Rule 474 are not reasonable given that so many of its input figures are clearly flawed.

The attached example, *Proposed Rule 474 Property Tax Impact of Overstating Fixture Values*, illustrates this point:

In this hypothetical refinery, the fixtures have an adjusted base year value of \$200 million. The Board has incorrectly overstated its estimate of the fixture fair market value at \$150 million. The actual fair market value of the fixtures is only \$50 million. On the land, the fair market value is \$175 million, and the base year value is \$25 million.

In this example, the \$150 million in land appreciation above the land base year value is subject to possible assessment under Rule 474, but only to the extent that the actual fixtures had depreciated in value below the fixtures base year values.

Using the Board's overstated estimate of \$150 million as the fair market value of the fixtures, the Board has only allowed for \$50 million of fixture depreciation (\$200 million fixture base year value less the estimated \$150 million fair market value). Accordingly, the Board's calculation of the incremental economic effect under Rule 474 would result in only \$50 million of additional land appreciation as being subject to assessment, and the additional property tax cost on that additional assessed value would be approximately \$500,000 (one percent of \$50 million).

On the other hand, if the Board's estimates were corrected to show actual fair market value for the fixtures at \$50 million, Rule 474 produces a much more severe economic impact. In this case, the \$50 million fixture value means that there has been \$150 million in fixture depreciation (\$200 million fixture base year value less the actual \$50 million fair market value). Thus, the incremental effect of applying Rule 474 is that the full \$150 million of incremental land value is subject to being included in the refinery's assessed value, producing an additional

property tax cost that would be approximately \$1,500,000 (one percent of \$150 million).

Thus, the incremental assessed value produced by Rule 474 using an accurate measure of the fixture value is \$150 million instead of \$50 million in this example. The incremental property tax collected from the refinery would be \$1.5 million, three times the incremental tax effect produced by the Board's overstated fixture value estimate.

As further evidence that the Board's estimates of fixture fair market value are greatly overstated are the multiple cases where the Board's purported fixture fair market values on a particular refinery exceed that refinery's fixture Proposition 13 adjusted base year value (the fixture cost when newly added adjusted annually by the Proposition 13 inflation factor). (See *Initial Statement, Attachment F*: Page 1—Refinery E for 2009 and 2012; Page 2—Refinery F for 2009 and 2012, Refinery G for 2009, Refinery I for 2009 and 2010, and Refinery J for 2012.) This is obviously incorrect. As any appraiser would confirm, industrial fixtures lose significant value as soon as they start production. Thus, it is nearly impossible for industrial fixtures to ever have a fair market value in excess of their adjusted base year value. Yet, the Board's flawed analysis contains multiple examples of the implausible conclusion that refinery fixtures actually *appreciate in value*.

The Supreme Court held that the APA requires the Board "to estimate the amount of fixture depreciation that would be offset by appraising land and fixtures as a single unit." (*Western States Petroleum*, 57 Cal. 4th at 430.) Because it has used incorrect estimates for fixture values, fixture depreciation on the California refineries is not property captured in the Board's model. Accordingly, the Board's analysis could not possibly provide clear, objective, or reasoned estimates of the additional full property tax caused by the newly adopted Rule 474. As a consequence, the Board has not made a reasoned estimate the amount of fixture depreciation that would be offset by land values.

Failure to Analyze Impact on All Refineries

In *Western States Petroleum*, the Supreme Court criticized the Board's economic impact assessment analysis for only considering data from nine of the 20 major refineries in the state, the five in Los Angeles County and the four in Contra Costa County. The Board extrapolated from the data on the nine, estimating based on the averages from the nine what the total values of all refinery property was in the state, and the breakdown of the estimated totals between fixtures and land and improvements: (*Western States Petroleum*, 57 Cal. 4th at 429-430.). Thus, it is clear the Supreme Court did not believe that the Board's initial economic impact assessment from the first adoption of the rule in 2007 could reasonably project the economic impact of the rule on the 20 refineries from data it had from only nine. Here, in the present proposal, the Board's initial economic impact assessment uses data from *only 10 of the 20 major refineries*, and thus it continues to draw its conclusion from only half of the available data. WSPA believes that the Supreme Court would continue to question the validity of the Board's conclusions as to the statewide impact of Rule 474 since the Board's analysis continues to be based on data from only half of the California refineries.

Failure to Assess Other Impacts on Jobs and Business

Last, WSPA believes that the Board failed to properly comply with the APA provision set out in Gov. Code § 11346.3(b)(1), which requires the Board's economic impact assessment to assess whether and to what extent Rule 474 would affect (i) the creation or elimination of jobs in California; (ii) the creation of new businesses or the elimination of existing businesses within California; (iii) the expansion of businesses currently doing business in California; and (iv) the benefits of the rule to the health and welfare of California residents, worker safety, and the California environment. WSPA believes that to comply with this requirement, it is not enough for the Board to say, perfunctorily, that Rule 474 would not have an impact on any of these matters. However, this is precisely what the Board has done. In the *Initial Statement*, the Board states:

Therefore, based on these facts and all of the information in the rulemaking file, the Board has determined that the proposed re-adoption of Rule 474 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. [¶] Finally, Rule 474 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the re-adoption of Rule 474 will not affect the benefits of Rule 474 to the health and welfare of California residents, worker safety, or the state's environment.

The statute clearly requires agencies to prepare an economic impact assessment "that assesses" these matters. WSPA believes that the Supreme Court would conclude that the Board has to actually carefully assess and evaluate these matters, and not simply say conclusively that it has determined that the proposed rule would not eliminate jobs nor result in the elimination of existing business in California.

Conclusion

The Supreme Court set a clear mandate on the Board for its regulations to satisfy the APA. The APA requires the Board to include a description of all costs impacts that business would necessarily incur as a result of the proposed rule known to the Board in its notice of proposed action. The Board's estimate of economic impact must consider the *full tax impact* of the rule. Under the APA, alleged inadequacies in cost estimates may only save a proposed rule from invalidation if there is substantial compliance with the economic impact estimate. WSPA believes the Board's estimates are flawed and erroneous, which is obvious upon any reasoned analysis of them. With flawed and erroneous figures, the Board has not substantially complied with the requirement to provide a description of the full tax cost impacts of proposed Rule 474. Accordingly, WSPA believes that the Board's economic analysis fails to satisfy the Supreme Court's mandate that the Board make a reasoned estimate of all the cost impacts of the rule on affected parties.

Sincerely,

A handwritten signature in blue ink, appearing to read "Catherine H. Reheis-Boyd".

Catherine H. Reheis-Boyd
President
Western States Petroleum Association
(916) 498-7752

EXHIBIT 1

BOARD OF EQUALIZATION STATED FAIR MARKET VALUE FOR FIXTURES - COMPLEXITY BARRELS

	Complexity Barrels of Refinery Capacity	Board Determined Fair Market Values of Fixtures		Board Determined Fair Market Values Per Complexity Barrel Of Refinery Capacity	
		2009 to 2013		2009 to 2013	
		<u>Low</u>	<u>High</u>	<u>Low</u>	<u>High</u>
Refinery A	3,048,413	\$ 1,359,876,090	\$ 1,887,388,187	\$ 446	\$ 619
Refinery B	3,101,350	\$ 1,437,067,764	\$ 2,061,450,203	\$ 463	\$ 665
Refinery C	1,450,650	\$ 1,011,250,213	\$ 1,332,461,979	\$ 697	\$ 919
Refinery D	1,979,325	\$ 1,071,086,534	\$ 1,163,881,804	\$ 541	\$ 588
Refinery E	2,260,600	\$ 1,073,496,817	\$ 2,567,404,620	\$ 475	\$ 1,136
Refinery F	2,238,050	\$ 770,703,336	\$ 3,332,322,123	\$ 344	\$ 1,489
Refinery G	1,697,300	\$ 731,794,729	\$ 1,373,985,234	\$ 431	\$ 810
Refinery H	1,685,825	\$ 530,401,266	\$ 695,911,963	\$ 315	\$ 413
Refinery I	2,160,075	\$ 829,822,975	\$ 1,057,579,171	\$ 384	\$ 490
Refinery J	4,587,150	\$ 1,288,224,045	\$ 3,298,620,241	\$ 281	\$ 719

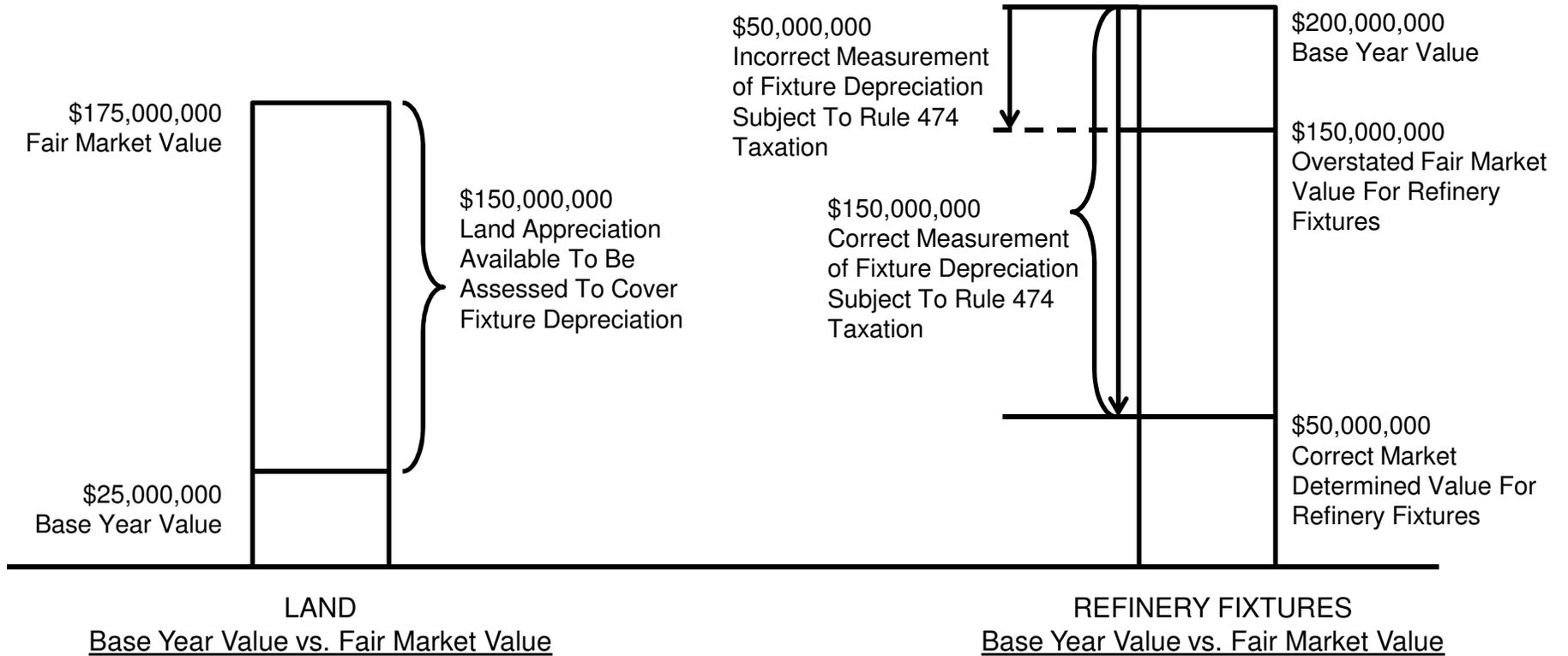
EXHIBIT 2

BOARD OF EQUALIZATION STATED FAIR MARKET VALUE FOR FIXTURES - CRUDE BARREL CAPACITY

	Crude Barrels of Refinery Capacity	Board Determined Fair Market Values of Fixtures 2009 to 2013		Board Determined Fair Market Values of Fixtures Per Crude Barrel of Refinery Capacity 2009 to 2013	
		<u>Low</u>	<u>High</u>	<u>Low</u>	<u>High</u>
Refinery A	252,000	\$ 1,359,876,090	\$ 1,887,388,187	\$ 5,396	\$ 7,490
Refinery B	269,000	\$ 1,437,067,764	\$ 2,061,450,203	\$ 5,342	\$ 7,663
Refinery C	135,000	\$ 1,011,250,213	\$ 1,332,461,979	\$ 7,491	\$ 9,870
Refinery D	138,700	\$ 1,071,086,534	\$ 1,163,881,804	\$ 7,722	\$ 8,391
Refinery E	149,500	\$ 1,073,496,817	\$ 2,567,404,620	\$ 7,181	\$ 17,173
Refinery F	161,000	\$ 770,703,336	\$ 3,332,322,123	\$ 4,787	\$ 20,698
Refinery G	120,000	\$ 731,794,729	\$ 1,373,985,234	\$ 6,098	\$ 11,450
Refinery H	100,000	\$ 530,401,266	\$ 695,911,963	\$ 5,304	\$ 6,959
Refinery I	145,000	\$ 829,822,975	\$ 1,057,579,171	\$ 5,723	\$ 7,294
Refinery J	257,000	\$ 1,288,224,045	\$ 3,298,620,241	\$ 5,013	\$ 12,835

PROPOSED RULE 474

PROPERTY TAX IMPACT OF OVERSTATING FIXTURE VALUES



SBE Systemic Overstatement Of Refinery Fixture Fair Market Value
Understates Property Tax Effect of Rule 474

Correction of Error Produces Incremental 3x Property Tax Effect

- With Overstated Fixture FMV → Property Tax Effect is 1% x \$50,000,000 = \$500,000
- With Correct Fixture FMV → Property Tax Effect is 1% x \$150,000,000 = \$1,500,000