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April 18, 2014

State Board of Equalization
Property and Special Taxes Department
450 N Street
PO Box 942879
Sacramento, CA

RE: Item M1 on SBE's Agenda for April 22, 2014 -- Proposed Letter to Assessor's: Guidance Regarding Taxable Possessory Interests: Property Tax Rule 21(d) – Term of Possession for Valuation Purposes

Dear Honorable Members of the State Board of Equalization:

The California County Assessors' Association ("CAA") hereby submits this letter to address the CAA's concerns regarding Item M1 on the State Board of Equalization's Agenda for the meeting scheduled for April 22, 2014. Item M1 is a Proposed Letter to Assessors (LTA) regarding Property Tax Rule 21. The CAA received notice of this matter via a Notice of Board Action, which was sent to County Assessors on or about April 7, 2014. This letter is prompted primarily by the CAA's concern about certain statements contained in the proposed LTA regarding the interpretation of Property Tax Rule 21(d)(1), as newly set forth in the proposed LTA, and the published Court of Appeal decision in the case *Charter Communications Properties LLC v. County of San Luis Obispo* (2011) 198 Cal.App.4th 1089 (hereafter "*Charter Communications*"). The CAA respectfully requests that the Board give due consideration to the views of the CAA, as expressed herein, whose members are charged with the constitutional duty to value all California property based on its "full value". (Cal.Const., Art. XIII, § 1.)

While the CAA recognizes the SBE's overriding concern, as expressed in the LTA, that county assessors appraise and assess taxable possessory interests (TPIs) in a uniform manner and consistent with the California Constitution's mandate that all property be assessed at fair market value (Cal.Const., Art. XIII, § 1), the CAA believes that the proposed LTA creates a new interpretation of Rule 21 that is neither consistent with California case precedent addressing the assessment of TPIs, nor in accord with the constitutional and statutory duty of county assessors to assess all property based on its full cash value. (Cal.Const., Art. XIII, § 1; Rev. & Tax. Code, § 110.) In the end, uniform practices must *in all instances* be consistent with fair market valuation.

The proposed LTA purports to clarify the Board's interpretation of Rule 21(d), specifically with regard to an assessor's authority to use a "reasonably anticipated term of possession" in valuing a TPI, rather than a stated term of possession in a lease or franchise agreement governing a particular TPI. Rule 21 is, itself, intended to provide guidance to assessors when appraising the value of a TPI under Revenue and Taxation Code 107 et seq., which expressly provide for

the authority of assessors to utilize a "reasonably anticipated term of possession" in the method of valuing a TPI for assessment purposes. (See also SBE Formal Issue Paper, No. 01-18R, p. 4 of 13 ["reasonably anticipated term of possession standard is ingrained in California law" and is "statutorily mandated as an integral part of the preferred method of valuing a cable television possessory interest"].) However, SBE staff's proposed LTA introduces entirely new concepts into the SBE's interpretation of Rule 21. On page 4 of the proposed LTA, SBE staff recognizes the AAB's duty to determine whether there is clear and convincing evidence that the public owner and private possessor have modified the stated term of a TPI, such that a reasonably anticipated term of possession may be utilized by the assessor in determining the full cash value of the property for assessment purposes. However, for the first time since the Board's promulgation of Rule 21 and its predecessor, Rule 23, SBE staff is seeking to restrict Rule 21(d)'s allowance of the use of a reasonably anticipated term of possession to only those instances where an assessor can establish that a stated term of possession in a lease or franchise agreement has been modified *via the application of contract principles.*

On page 4, the proposed LTA states:

> "When making [the determination whether a public owner and private possessor have modified the stated term], the Board interprets Rule 21(d)(1) to require these principles be followed:
>
> 1. As a matter of law, the public owner and private possessor must have modified the right to possess the land *in a manner that is legally cognizable under contract law principles (e.g. promissory estoppels, quasi-contract, breach of contract, a writing consistent with the statute of frauds, implied contract, detrimental reliance, etc.).*
>
> 2. No party can prove by clear and convincing evidence that a modification has taken place under Rule 21(d)(1), when either party's agreement to the asserted modification constitutes an ultra vires act that renders the modification void ab initio (i.e., an unenforceable act that is invalid from the outset because it is beyond the scope of powers of the parties under applicable local, state or federal laws).
>
> 3. Unless allowed by the statutory scheme, the reasonably anticipated term of possession may never exceed a limit placed on the occupancy of public land by the Legislature."
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> (Emphasis added.)

Every point noted above is an entirely new interpretation placed on Rule 21. The SBE has considered Rule 21 in prior LTA's, Issue Papers, and SBE Correspondence (see e.g., SBE Formal Issue Paper, No. 01-18R; Memorandum to the SBE from SBE Executive Director, Ramon Hirsig, dated August 22, 2007). In none of these previous papers has SBE staff indicated that a "reasonably anticipated term of possession" is to be restricted to clear and convincing proof *via contract principles only*. More importantly, this was not the holding of the Court of Appeal in *American Airlines v. County of Los Angeles* (1976) 65 Cal.App.3d 325, which the Proposed LTA indicates is "authoritative law" on the issue: "As a matter of law, *American Airlines*, AH510, and Rule 21 (d)(1) provide the authoritative guidance that county assessors and AABs must look to when making [] a determination [as to whether clear and convincing evidence exists to establish that a modification of a stated term has occurred]." (Proposed LTA, p. 3.)

What the Court of Appeal in *American Airlines* held was that in order to depart from the stated term of possession, the assessor must establish the existence of an "understanding" as to renewal *or* an *"expectation"* that is based *on statute, contract, or evidence of "real substance".* (See e.g., *American Airlines*, *supra*, at pp. 331-332.) The reference to an "expectation" based on "contract" was only one of the factors that the court in *American Airlines* concluded could form the basis for an assessor's departure from the stated term of possession

in a lease or franchise agreement for purposes of assessing the full value of the TPI. The proposed LTA thus ignores the direction of the Court of Appeal in *American Airlines* as to the factual basis California assessors may reasonably rely on in order to prove by clear and convincing evidence that the reasonably anticipated term is something other than the stated term in the leasehold or franchise agreement governing the TPI. It does so by introducing a new restrictive interpretation of Rule 21 that allows only the use of contract principles when attempting to overcome a stated term of possession in order that the assessor may value a TPI at its true fair market or full cash value. As SBE staff previously recognized, use of a reasonably anticipated term of possession standard in valuing a TPI is ingrained in California law. (See SBE Formal Issue Paper No. 01-18R, p. 4 of 13.)

By restricting an assessor's ability to depart from a stated term of possession only where the assessor may prove by clear and convincing evidence via facts supporting a "contract" theory or principle that there has been a modification of the governing lease or franchise agreement, SBE staff will be ensuring, at least with respect to cable franchise agreements, that these valuable TPIs are not assessed at "full value" in accordance with the constitutional mandate. *American Airlines* did not direct such an outcome. In fact, the Court of Appeal in *American Airlines* acknowledged that "Rule 23 unquestionably sanctions the assessment of taxes based upon the 'reasonably anticipated term of possession' of a possessory interest where the creating lease itself limits possession to a shorter term. . . ." (*American Airlines*, *supra*, 65 Cal.App.3d 325, 328.) The *American Airlines* court merely found that the rule "as applied" to the airlines at issue in that case was not proper because the assessor did not present *sufficient evidence* establishing support for the 25-year "reasonably anticipated term of possession" that he used when valuing the airlines' TPIs. (*Id.* at pp.329-332 [the court emphasized that the LA County Assessor concluded only that the airlines would be there for a minimum of 5 years longer].) For this reason, the *American Airlines* court concluded that the airlines had no "possessory interests in the leased premises following expiration of the terms of the leases, that is, no possession, claim or right therefore, as required by the Revenue and Taxation Code section 107." (*Id.* at p. 332.)

With respect to a cable franchise possessory interest, at the expiration of a leased term, the franchisee is still in possession and in fact has the right to remain in possession absent a showing by the public franchisor that the cable operator did not operate its franchise in a reasonable manner. In this regard, the federally-established and protected process for franchise renewal is set out at 47 USC § 546, and preempts state law to the contrary. (47 USC § 556(c).) Congress has stated:

> The purpose of this section [47 USC § 546] is to establish a process which protects the cable operator against an unfair denial of renewal by the franchising authority. *It is intended that a cable operator whose past performance and proposal for future performance meet the standards established by this section be granted renewal.* This protection is intended to encourage investment by the cable operator at the time of the initial franchise and during the franchise term. It will ensure such investment will not be jeopardized at franchise expiration without actions on the part of the operator justifying such a loss of business. . . .
>
> (1984 U.S. Code Cong. and Adm. News, p. 4709; emphases added.)

The plain thrust of federal law is that an incumbent franchisee that operates the franchise in a reasonable manner will be protected under federal law with regard to franchise renewal. Furthermore, even if franchise renewal were denied, the incumbent franchisee is entitled at that time to recapture the fair market value of its investment. (47 USC § 547(a).) It is true that section 547 has not been interpreted or construed since its enactment in 1984. This in itself, however, is compelling circumstantial support for the point that incumbent cable franchisees routinely secure renewal of their franchises.[1]

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[1] Per the FCC Cable Television Information sheet (http://transition.fcc.gov/mb/facts/csgen.html), "by October 1998 there were more than 10,700 systems serving more than 65 million subscribers in more than 32,000 communities."

The holding in *American Airlines*, which Rule 21's "mutual understanding" language was purportedly predicated upon, recognized that use of a "reasonably anticipated term of possession" could be based on an expectation grounded in statutory law or on other evidence of substance (not just contract principles) that the franchisee would remain in possession with a right to operate its franchise for a term longer than the stated term of possession. SBE staff's Proposed LTA eliminates the *American Airlines* court's recognition of this legitimate use of a "reasonably anticipated term of possession" in valuing a cable franchise TPI. By doing so, it ensures that these valuable TPIs will most certainly not be assessed at "full value" in accordance with the constitutional mandate.

In addition to the foregoing, SBE staff's exclusive reliance in the Proposed LTA on *American Airlines* for guidance on the issue of whether an assessor may use a reasonably anticipated term of possession is unclear. *American Airlines* is not the only authoritative Court of Appeal case interpreting Rule 21 and the use of a reasonably anticipated term of possession.

Other California appellate courts have approved of an assessor's use of a "reasonably anticipated term of possession" for valuing TPIs. (See e.g., *Charter Communications Properties LLC v. County of San Luis Obispo*, *supra*, 198 Cal.App.4th 1089 and *Silveria v. County of Alameda* (2006) 139 Cal.App.4th 989.) The appellate courts deciding these cases did not uphold a reasonably anticipated term of possession *based on contract principles*; however, they did uphold the use of a reasonably anticipated term of possession based on facts that established that the county assessors had properly determined that a reasonably anticipated term of possession should be used in assessing the TPIs at issue.

In California all published decisions are given precedential effect in state courts. (Cal. Rules of Court, Rule 8.1115.) A published decision of a Court of Appeal is binding on all trial courts, irrespective of which appellate district or division rendered it. (*Auto Equity Sales, Inc. v. Superior Court* (*Hesenflow*) (1962) 57 Cal.2d 450, 455.) This principle is especially true with regard to the reason for the ruling on a particular point of law addressed in the published appellate court decision. (*Gogri v. Jack in the Box Inc.* (2008) 166 Cal.App.4th 255, 272.) Despite these well-established principles, the Proposed LTA states: "[W]e stress that [*Charter Communications*] does not provide any legal authority for purposes of guiding a county assessor or an AAB in determining whether clear and convincing evidence exists to establish that a modification of a stated term has occurred. As a matter of law, *American Airlines*, AH510, and Rule 21(d)(1) provide authoritative guidance that county assessors and AABs must look to when making such a determination. Any reading of *Charter* that is inconsistent with the advice given in this LTA should be disregarded." (Proposed LTA, p. 3-4.) The CAA submits that there is no basis in law for the quoted statements contained in the Proposed LTA. Indeed, a County Assessment Appeals Board could no more legitimately disregard the holding of *Charter Communications* on the points of law established therein than could an inferior court of this state. Moreover, *Charter Communications* is a more recent published opinion than *American Airlines*, and both decisions issued from the same District Court of Appeal. The *American Airlines* case predates Rule 21, and its predecessor rule, Property Tax Rule 23, did not contain the language that was interpreted by the Court of Appeal in *Charter Communications, supra,* 198 Cal.App.4th 1089. Thus, contrary to the statement made in the Proposed LTA, *Charter Communications* is, in fact, *the only* authoritative Court of Appeal decision on the issue of what evidence would meet the clear and convincing standard required by an assessor to establish a "mutual understanding" or agreement that the reasonably anticipated term of possession is something other than the stated term in the lease or franchise agreement. Put simply, under California law, *Charter Communications* is *authoritative law.* (See e.g., Cal. Rules Court, Rule 8.1115.)

In 2001, when the present language of Property Tax Rule 21 was first considered for adoption by the SBE, the Board considered comments from both the CAA and the California Taxpayers' Association on the proposal to utilize a "clear and convincing" standard in Property Tax Rule 21. This standard was not even suggested by the appellate court in *American Airlines*, although the Board's stated purpose for adopting Rule 21 was predicated on *American Airlines*. (See e.g., Formal Issue Paper 01-018R, p. 5 of 13.) In the Chief

Counsel's Memorandum to the Board, dated March 6, 2014, wherein SBE staff first articulated a need to interpret Rule 21 exclusively via the use of contract principles, counsel states: "The clear and convincing evidence standard requires that the evidence be so clear as to leave no substantial doubt (i.e., be sufficiently strong to command the unhesitating assent of every reasonable mind). *(Tannehill v. Finch* (1986) 188 Cal.App.3d 224, 228.)" Although the CAA still believes that the appropriate standard ought to be a preponderance of the evidence, the CAA is compelled to point out to the Board that the case cited by SBE staff, *Tannehill v. Finch*, *supra*, does not provide the correct definition for the clear and convincing standard. In fact, the definition supplied by staff counsel was expressly disapproved by the same District Court of Appeal that decided *American Airlines* and *Charter Communications.* In rejecting the very definition of the clear and convincing standard quoted by staff counsel from the *Tannehill* case, the Second District Court of Appeal stated as follows: "We observe the restrictive language proposed . . . seems to impose a burden approaching the criminal burden, proof beyond a reasonable doubt . . . . [Such a standard] would have misled the jury and properly was refused." (*Mattco*, *supra*, at pp. 848-849.)

In sum, the Proposed LTA contains statements inconsistent with California law on the issue of what constitutes precedential, decisional law, and purports to establish an overly restrictive interpretation of Property Tax Rule 21, one which is *not in accord* with *American Airlines, supra,* 65 Cal.App.3d 325. Most importantly, the Proposed LTA would provide an interpretation of Rule 21(d) that would prevent certain TPIs from being assessed at their full cash value, an outcome inconsistent with both the statutory and constitutional mandates governing the assessment of all California property. For all of the reasons expressed herein, the CAA respectfully requests that the SBE not approve the Proposed LTA in its present form.

Respectfully submitted,

Larry Ward
President, California County Assessors' Association