CALIFORNIA STATE BOARD OF EQUALIZATION

SUMMARY DECISION UNDER REVENUE AND TAXATION CODE SECTION 40

In the Matter of the Petition for Reassessment of the 2017 Unitary Value for: **FRONTIER CALIFORNIA, INC. (0201)** Petitioner	)	Appeal No.: SAU 17-014 Case ID No.: 1017434 Nonappearance Hearing Date: December 14, 2017[1]

Representing the Parties:

For the Petitioner: Peter W. Michaels, Attorney at Law

For the Respondent: Julia Himovitz, Tax Counsel
Attorney for the State-Assessed Properties Division

Samuel Wang, Business Taxes Administrator III (Acting)
State-Assessed Properties Division

Counsel for Appeals Bureau: Dana R. Brown, Tax Counsel III (Supervisor)

VALUES AT ISSUE

	Value	Penalty	Total
2017 Board-Adopted Unitary Value	$3,003,100,000	$0	$3,003,100,000
Petitioner's Requested Unitary Value	$2,394,000,000	$0	$2,394,000,000
Respondent's Appeal Recommendation	$3,003,100,000	$0	$3,003,100,000
Respondent's Revised Recommendation	$2,798,100,000	$0	$2,798,100,000

Factual Background

Frontier California, Inc. (Petitioner), formerly Verizon California, Inc., is a wholly owned subsidiary of Frontier Communications Corporation and the second largest incumbent local exchange carrier in the State of California. On April 1, 2016, Frontier Communications Corporation announced

[1] The Board voted unanimously to grant the petition for reassessment, in part, and reduce the 2017 Board-adopted unitary value of $3,003,100,000 to $2,798,100,000.

the completion of its $10.54 billion acquisition of Verizon Communications, Inc. (Verizon) wireline operations in California, Texas, and Florida. Petitioner is regulated by the California Public Utilities Commission (CPUC), and, like other state-assessed incumbent local telephone companies, is designated as a telephone service provider of last resort (POLR).

After the purchase of Verizon wireline assets in California, Florida, and Texas, Petitioner contracted with Ernst & Young LLP (E&Y) to perform a Purchase Price Allocation (PPA) analysis in accordance with Financial Accounting Standards Board *Accounting Standards Codification 805 (ASC 805)*. A PPA is typically conducted for financial and tax reporting requirements to allocate the total purchase price to various assets and liabilities when mergers and acquisitions occur. PPA for fixed assets represents the assets' fair value at the time of the purchase. The PPA analysis and the results were included in Petitioner's quarterly and year end reports filed with the Securities and Exchange Commission (SEC) as well as its 2016 financial statements. The fair value pursuant to the PPA analysis for all California, Florida, and Texas fixed assets acquired from Verizon was $6.33 billion as of April 1, 2016. The fair value pursuant to the PPA for fixed assets specific to California was $3.4 billion as of April 1, 2016.

For the lien date 2017 appraisal, Petitioner provided the State Assessed Properties Division (Respondent) with the property statement and a Full Cash Value Appraisal report (Study) prepared by Duff & Phelps (D&P) on March 15, 2017. D&P's Study was based on Fiber-to-the-premise (FTTp) network architecture as the replacement network model. Petitioner provided the PPA prepared by E&Y on March 30, 2017. Respondent's 2017 appraisal was based on the PPA for fixed assets utilizing the replacement cost new less depreciation (ReplCLD) valuation methodology.

Legal Issue 1: Whether Petitioner Has Shown That The PPA Is Not Appropriate For Property Tax Appraisal Purposes.

<u>**Findings of Fact and Related Contentions**</u>

Petitioner states that Frontier Communications Corporation acquired Verizon's ongoing wireline operations in California, Florida, and Texas. Petitioner asserts that the transaction was a "legal entity" transfer and that as of April 1, 2016, this company did business as Frontier Communications, Inc. Petitioner asserts that for assessment purposes the underlying appraisal unit was identical before and after the transfer. Petitioner states that E&Y prepared the PPA report for financial reporting purposes and that every page is marked "Reliance Restricted." Petitioner further states that the PPA expressly states that its purposes and objective is "solely for the purposes of assisting [Petitioner's] Management with their application of the business combination requirements for financial reporting purposes under ASC 805." Petitioner notes that "fair value" is defined by the PPA report by reference to ASC 805 and ASC 820.

Petitioner states that the PPA does not use the terms "property tax" or "ad valorem tax," does not cite section 110 or Rule 6, and does not mention valuation and legal authorities governing the assessment of state-assessed unitary property in California. Petitioner also states that E&Y has confirmed that pole and cable removal costs were not considered in the preparation of the PPA report. Petitioner asserts that the PPA interchangeably uses the terms "replacement cost" and "reproduction cost" and provides two examples of that usage. Petitioner contends that "in countless respects" the "cost" model in the PPA is inconsistent with fundamental principles underlying application of the RCN in accordance with section 110 and Rule 6. Petitioner also contends that the PPA is inconsistent with the RCN model on which the Board of Equalization (Board) historically relied in valuing this property. Petitioner states that the PPA is a valuation for financial reporting purposes rather than property tax purposes and that this Board cannot reasonably conclude that the PPA satisfies requirements of section 110 and Rule 6.

In its reply brief, Petitioner states that the unitary value of the subject property as of lien date 2016 was $2,611,300,000 and Petitioner asserts that this property unit was virtually the same as the property unit as of the 2017 lien date. Petitioner states that the PPA report was prepared for financial reporting purposes and that Respondent's brief suggests that under ASC 820 "fair value" and purchase price are synonymous and that the PPA is based on payment received for the underlying legal entity sale. Petitioner states that the PPA report expressly restricts reliance on the report to financial reporting purposes. Petitioner asserts that Respondent's brief improperly argues that the PPA must be relevant for California property tax purposes because the report was filed with the Securities and Exchange Commission and was included in Frontier's 2016 annual report as well as Petitioner's financial statements.

Petitioner states that the Board recognizes that a property's recorded purchase price does not necessarily reflect all costs required to estimate value and does not necessarily exclude costs that do not contribute to value. Petitioner contends that Respondent's analysis fails to identify cost components of the PPA that under California property tax law should have been included or should have been excluded from the appraisal unit.

Petitioner states that its 2016 Board-adopted unitary value was premised on a replacement cost new (RCN) model, whereas the 2017 value is expressly based on the actual sale price of the subject property. Petitioner states that Respondent's brief asserts that Respondent considers the PPA to represent the RCN at the time of the transaction and that definition of fair value under ASC 820 "approximates" the definition of fair market value under section 110. Petitioner contends that Respondent cites no authority to support its position that the PPA and the RCN are interchangeable. Petitioner asserts that in many respects the "hybrid reproduction cost/replacement cost model in the PPA" is inconsistent with the principles underlying the application of RCN under section 110 and Rule 6 and is also inconsistent with the RCN model on which the Board has relied in valuing the subject property. Petitioner states that the PPA report does not mention the "fundamental components of a replacement local exchange telephone property unit" and lists 20 factors such as "cost assumptions for replacement technologies," "cost and mileage assumptions for deployment of fiber plant," and "treatment of underutilized drops." Petitioner contends that Respondent has produced no information or data in support of its value conclusion that the RCN of Petitioner's property unit increased by $392 million between 2016 and 2017.

Respondent disputes Petitioner's contention that valuation based on the PPA is inconsistent with R&T Code section 110, and Property Tax Rule[2] 6. Respondent asserts that Petitioner fails to identify the inconsistencies and how these inconsistencies render the PPA inappropriate for property tax assessment purposes. Respondent states that it appears Petitioner argues that Respondent errs in its reliance on the PPA because each page of the PPA report was labeled "Reliance Restricted," the report never mentioned the term "property tax" or "ad valorem tax," and there was no citation of section 110

[2] "Property Tax Rule" or "Rule" references are to sections of title 18 of the California Code of Regulations.

in the report. Respondent states that Petitioner seems to believe that by labeling every page of the PPA report "Reliance Restricted" or the failure to mention "property tax," or section 110 renders the PPA analysis an invalid basis for property tax valuation. Respondent asserts that Petitioner does not provide documentation or authority to support its assertion that the PPA is inappropriate for property tax assessment purposes.

Respondent states that the PPA was the starting point for the 2017 appraisal because the PPA was based on the actual sale price of the subject property which, according to Financial Accounting Standards Board *Accounting Standards Codification 820 (*ASC 820), represents the fair value of the subject property at the time of the transaction. Respondent states that Petitioner wishes to ignore this important information which is certified and validated by outside auditors, Petitioner's president, chief executive officer, and chief financial officer, and was included in the 2016 annual reports, financial statements, and various filings that Petitioner released to the general public and government regulators. Respondent asserts that a PPA is required to follow very strict guidelines according to ASC 805 and meet the definition of fair value set forth in ASC 820. Thus, Respondent contends that the PPA is relevant to the property tax assessment and Respondent considers it the most reliable information for determining the ReplCLD value indicator for Petitioner's unitary property.

Applicable Law

Burden of Proof

Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.) Therefore, Petitioner has the burden of showing that the assessment is incorrect or illegal. (*ITT World Communications v. Santa Clara* (1980) 101 Cal.App.3d 246; see also Cal. Code Regs., tit. 18, § 5541, subd. (a).)

Fair Market Value Standard

R&T Code section 110 defines "fair market value" as "the amount of cash or its equivalent that 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 the buyer and the seller have 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."

The Unitary Valuation Methods published by the Board[3] (UVM) at page 71 describes the "Sales Model" as a valid indicator of market value and states that "[t]he sale of a utility company is usually an arms-length transaction between a knowledgeable buyer and a knowledgeable seller. Extensive analyses generally are made by both parties with counsel from the best financial experts. Use of the Sales Model in this manner is consistent with the Revenue and Taxation Code Section 110(b) and the Board of Equalization Rule 2(b)." The UVM describes the components of the sales price of a utility property and prescribes the methodology for determining the fair market value from the sales price.

Analysis and Disposition

Respondent is presumed to have correctly determined the value of the property at issue, and Petitioner bears the burden of proving otherwise. Here, Respondent's use of the PPA for determining the current fair market value of Petitioner's unitary property is set forth in the Board's UVM as a valid methodology for valuation of state-assessed unitary property. The fact that, as Petitioner argues, the PPA report is marked "Reliance Restricted" and lacks any reference to property taxation or citation of R&T Code section 110 has no bearing on whether the PPA analysis is a valid basis for property tax valuation and Petitioner has not provided any authority for that proposition. Moreover, Petitioner has not cited any authority for its contention that the PPA analysis is invalid because it does not mention the "fundamental components of a replacement local exchange telephone property unit." For the foregoing reasons, the Appeals Bureau finds that Petitioner has not met its burden of proof to show error in the methodology used to determine the 2017 Board-adopted unitary value.

Issue 2: Whether Petitioner Has Shown That The D&P Study Should Be Considered By Respondent For The 2017 Unitary Appraisal.

Findings of Fact and Related Contentions

Petitioner states that Respondent's RCN and Petitioner's RCN based on the D&P Study are similar in many respects, but Petitioner asserts that the D&P Study also considers forms of obsolescence that are not identified or deducted from Respondent's RCN. Petitioner contends that Respondent's RCN does not make adjustments for excess space at Petitioner's central offices due to

[3] Available at < http://www.boe.ca.gov/proptaxes/pdf/methodsbook2003.pdf> (as of March 2003)

technological advances. Petitioner states that the D&P Study recognizes that RCN must be reduced to reflect uneconomic excess space in central offices. Petitioner also contends that Respondent's RCN does not make adjustments for excess capital costs associated with deployment of copper and conduit. Petitioner asserts that a replacement network would utilize fiber rather than copper and conduit would be deployed though small-profile hand hole boxes rather than large conduit manholes and vaults. Thus, Petitioner states that the D&P Study recognizes that construction projects dedicated to legacy assets would not be undertaken such that copper line would not be utilized and less conduit would be used.

Petitioner further contends that respondent's RCN does not make adjustments for the excess operating costs of copper networks as compared to a replacement fiber optic network that would reduce costs by more than 60 percent. Petitioner also asserts that a replacement packet switching electronics networks would reduce operating and maintenance expenses by more than 30 percent. Petitioner states that the D&P Study is premised on the deployment of fiber and packet switching electronics. Petitioner further asserts that respondent's RCN does not make adjustments for pole and aerial cable removal costs which often exceed the original cost of the equipment.

In its reply brief, Petitioner contends that its opinion of value is supported by a fair market value appraisal expressly based on R&T Code section 110, subdivision (a) and conforms to Rule 6(d) and guidelines for measuring Obsolescence for Equipment of State-Assessed Telecommunications Companies, as well as valuation methods set forth in Board publications. Petitioner further contends that in contrast to the PPA report, the D&P Study addresses factors such as cost assumptions for replacement technologies enumerated in the petition as described above. Petitioner contends that the D&P Study is "strikingly similar to countless telephone company replacement cost new appraisals" submitted by D&P and CostQuest, that Respondent has "verified" over the past decade. Finally, Petitioner contends that the "so-called disparity" between the D&P Study and the PPA report, as asserted by Respondent, arises solely because Respondent's appraisal is based on the PPA, rather than RCN as prescribed by law.

Respondent states that the D&P Study utilized a ReplCLD methodology and in the determination of the RCN the Study relied on CostQuest's advanced network models. Respondent further states that the Study's RCN assumes what CostQuest would consider as the most likely network built today for petitioner's California footprint as of a valuation date based on 100% fiber to the premises architecture and using soft-switch electronics to streamline equipment needed in the central offices. Respondent argues that petitioner's position that the D&P's Study takes into consideration many factors underlying valuation of a replacement cost model is not supported by Code sections, Rules, or any Assessor's Handbook Sections.

Respondent states that Petitioner wants to ignore the fact that the PPA report was prepared as a result of the acquisition of the subject property on April 1, 2016. Respondent states that the PPA was based on the actual price paid for the subject property and had to meet guidelines and requirements set forth in ASC 805 and ASC 820. Respondent further states that the PPA was published in Petitioner's 2016 annual report, financial statements and various filings with SEC. The PPA was certified and validated by Petitioner's president, CEO, CFO, and its outside certified public accountant (CPA). Respondent, on the other hand, asserts that the D&P Study was based on the estimated RCN for a network that does not currently exist and is not going to be built by Petitioner. Respondent contends that the validity of the RCN utilized in the D&P Study cannot be verified and is not published in Petitioner's financial statements or SEC filings.

Respondent states that it also did not consider the D&P Study as a reliable indicator of market value because the Study's value conclusion was not supported by Petitioner's PPA analysis. Respondent asserts that the Study's value conclusion for Petitioner's tangible fixed assets is $2,028,000,000 which is $1.4 billion less than the PPA. Respondent further asserts that Petitioner did not provide any valid explanation of the disparity. Therefore, Respondent concluded that the PPA was much more appropriate for the property tax assessment purposes than the D&P Study and that the PPA was also the only reliable information to depend on for the 2017 lien date property tax assessment.

Applicable Law

Burden of Proof

Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.) Therefore, the petitioner has the burden of showing that the assessment is incorrect or illegal. (*ITT World Communications v. Santa Clara* (1980) 101 Cal.App.3d 246; see also Cal. Code Regs., tit. 18, § 5080 subd. (a).)

<u>ReplCLD Value Indicator</u>

Property Tax Rule 6, subdivision (a) provides, in part: "The reproduction or replacement cost approach to value . . . is preferred when neither reliable sales data . . . nor reliable income data are available . . . ." In general, the ReplCLD valuation methodology is estimated by applying trend factors—price level changes, including the application of "current prices to the labor and material components of a substitute property capable of yielding the same services and amenities, with appropriate additions as specified . . ." (Property Tax Rule 6, subd. (d).) Then, the resulting adjusted cost amount is "reduced by the amount that such cost is estimated to exceed the current value of the reproducible property by reason of physical deterioration, misplacement, over- or under-improvement, and other forms of depreciation or obsolescence. The percentage that the remainder represents of the reproduction or replacement cost is the property's percent good." (Property Tax Rule 6, subd. (e).)

<u>Replacement Cost New</u>

The replacement cost new (RCN) is an estimate of the current cost to replace a property with a new property *of equivalent utility*, which should include all economic costs necessary to put the property to productive and beneficial use. The RCN is calculated by applying an index factor, which is acquired from industry data, to the historical acquisition cost of the unitary property of the assessee, segregated by year of acquisition. The use of index factors applied to historical cost data is the preferred method of calculating the RCN for mass appraisal purposes. The historical cost of property is adjusted (in the aggregate or by groups) for replacement cost level changes by multiplying the cost incurred in a given year by the appropriate replacement cost index factor. RCN should reflect the current cost a knowledgeable person or company would pay if it were necessary to replace the subject property with a new property of equivalent utility. RCN is considered an excellent starting point for estimating the value of newer property that is not regulated for rate of return, because the property owner has the freedom, with competitive constraints, to adjust revenues to current costs based on market factors. (*Unitary Valuation Methods* (March 2003), p. 23.)

<u>Economic Principle of Substitution</u>

The rationale for the use of the cost approach is based on the economic principle of substitution which holds that a rational person will pay no more for a property than the cost of acquiring a satisfactory substitute, assuming no costly delay. If the condition of no costly delay is not satisfied, the cost of the delay must be added to the cost of a substitute property. If the delay in acquiring a substitute is too costly so that it would not be worthwhile to replace the property, then the cost of replacement cannot be said to represent the property's market value. (AH 502, p. 12.)

<u>Analysis and Disposition</u>

Respondent is presumed to have correctly determined the value of the property at issue, and Petitioner bears the burden of proving otherwise. Here, the D&P Study utilized a ReplCLD methodology and the Study's RCN assumes the network that CostQuest would consider as the most likely network for Petitioner's California footprint as of the 2017 lien date based on 100% fiber to the premises architecture and soft-switch electronics to streamline equipment needed in the central offices. However, the assumptions underlying D&P's Study are not supported by R&T Code sections, Rules, or Assessor's Handbooks. The D&P Study was based on the estimated RCN for a network that does not currently exist and is not going to be built by petitioner whereas the PPA analysis is based on the actual price paid for Petitioner's property in compliance with guidelines and requirements set forth in ASC 805 and ASC 820. Moreover, the Study's value conclusion for petitioner's tangible fixed assets is $2,028,000,000 which is $1.4 billion less than the PPA and Petitioner has provided no evidence or argument to explain such a large value disparity. Thus, the Appeals Bureau finds that Petitioner has not met its burden of proof by establishing that the D&P Study is a reliable basis for determining the fair market value of Petitioner's unitary property.

Issue 3: Whether Petitioner Has Shown That It Is Appropriate For Respondent To Adjust The PPA For Pole And Cable Removal Costs Identified In The D&P Study.

<u>Findings of Fact and Related Contentions</u>

Petitioner argues that Respondent did not consider a PPA adjustment for pole and cable removal cost because Respondent believed that those adjustments had been reflected in the PPA. Petitioner asserts that E&Y confirmed that such adjustments were not reflected in the PPA. Petitioner states that in 2016 the Board made an adjustment for pole and cable removal costs for the subject property and that it is Petitioner's understanding, based on communications with knowledgeable sources at Pacific Bell, that Respondent made adjustments for pole and cable removal cost for that identically-situated property taxpayer in both 2016 and 2017. Thus, Petitioner contends that Respondent should make a $378.6 million adjustment to its 2017 Board-adopted unitary value.

In its reply brief, Petitioner states that in 2016, the Board's assessment, using RCN deducted pole and aerial cable removal costs in the amount of $344.1 million, provided support for a 2017 pole and cable cost removal deduction of $378.6 million in Petitioner's 2017 Board-adopted unitary value. Petitioner asserts that E&Y confirmed that the PPA report was prepared solely for the purpose of complying with business combination accounting requirements for financial reporting purposes under ASC 805 and under California law and prior Board practice a pole and cable removal cost adjustment was necessary.

Respondent states that it did not consider the D&P Study's $378,000,000 pole and cable removal cost adjustment as necessary in Respondent's appraisal for the following reasons: 1) The PPA represented the fair market value at the time of the transaction; 2) Petitioner failed to provide evidence to justify how the $378,000,000 pole and cable removal cost adjustment is applicable to the PPA; and 3) when Respondent compared the D&P Study values for poles and cables after removal cost adjustments with Respondent's ReplCLD for poles and cables, the differences could not justify the removal cost adjustments Petitioner requests.

Respondent asserts that the key question is not whether E&Y's pole and cable PPA valuation reflected removal costs, rather, it is whether E&Y's pole and cable valuation reflected the fair market values. Respondent states that E&Y's pole and cable valuation was part of the PPA published in Petitioner's 2016 financial statements and filings with the SEC and was also validated by Petitioner's president, CEO, and its outside CPA. Most importantly, Respondent asserts that the PPA had to meet the definition of fair value according to ASC 820, which states "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." Respondent states that its ReplCLD value for poles (joint and 100 percent owned) based on the PPA included in the 2017 unitary assessment is $172,000,000. Respondent states that the D&P Study pole value before adjustment for removal cost was $434,000,000 and the D&P Study has a pole removal cost adjustment of $317,000,000 resulting in a net pole value of $117,000,000 which represents a difference of only $55,000,000. Respondent states that its ReplCLD value for cable included in the 2017 unitary assessment is $1.141 billion and the D&P Study ReplCLD value for cable is $1.136 billion which already reflected a $61,000,000 cable removal cost adjustment. Because the difference between Respondent's and Petitioner's cable value is only $5,000,000, Respondent asserts that no adjustment for cable removal cost is justified.

In a revised analysis, Respondent states that after the appeals conference, it re-evaluated the percent good factors applied to the poles and aerial cables during the original appraisal and concluded that an allowance for additional depreciation was necessary to reflect more accurately the conditions in the market. As a result, Respondent made adjustments to the percent good factors applied to the poles and aerial cables resulting in a net value reduction of $109,956,825.

<u>Applicable Law</u>

<u>Burden of Proof</u>

Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.) Therefore, the petitioner has the burden of showing that the assessment is incorrect or illegal. (*ITT World Communications v. Santa Clara* (1980) 101 Cal.App.3d 246; see also Cal. Code Regs., tit. 18, § 5080 subd. (a).)

<u>Analysis and Disposition</u>

Respondent is presumed to have correctly determined the value of the property at issue, and Petitioner bears the burden of proving otherwise. Here, the PPA report included pole and cable valuation as published in Petitioner's 2016 financial statements and filings with the SEC and the PPA was required to meet the definition of fair value according to ASC 820, which states "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." Petitioner has not presented any evidence to show that the $378,000,000 pole and cable removal cost adjustment is applicable to the PPA.

However, Respondent has determined after reviewing the percent good factors applied to the pole and aerial cables that an allowance for additional depreciation is necessary and, as a result, those adjustments to the percent good factors reduce Petitioner's 2017 Board-adopted unitary value by $109,956,825. Petitioner has not presented any evidence or argument to show error in this adjustment and the reduction is thus presumed to be correct.

Issue 4: Whether Petitioner Has Shown That Respondent Failed To Make An Adequate Adjustment For Functional And Economic Obsolescence In The 2017 Board-Adopted Unitary Value.

<u>**Findings of Fact and Related Contentions**</u>

Petitioner asserts that Respondent's RCN does not make necessary functional obsolescence adjustments for building inutility, excess capital costs, and excess operating costs and requests an adjustment in the amount of $141.8 million. Petitioner further asserts that Respondent's RCN understates external obsolescence arising from customer loss due to an 11.9 percent decline in subscriber count from the third quarter of 2013 to April 1, 2016, when the legal entity transfer occurred. Petitioner asserts that there was 16 percent rate of subscriber loss between April 1, 2016 and lien date 2017, and preliminary 2017 results indicate that customer losses continue at nearly 2 percent per month. Petitioner states that a capacity utilization analysis, based on a normalized level of connections and projected subscriber totals at years'-end 2017, 2018 and 2019 indicate external obsolescence of approximately 21.2 percent. In its reply brief, Petitioner states that fundamental principles of California property tax law requires that adjustments for functional and economic obsolescence be made to the 2017 Board-adopted unitary value.

Respondent states that Petitioner provided a property statement and the D&P Study which utilized the RCN as the starting point for developing an opinion of value, adjusted for depreciation, functional obsolescence, and economic obsolescence. Respondent states that obsolescence adjustments, both functional and economic, will vary significantly depending on the methodologies and data used in an appraisal. Because Respondent did not accept Petitioner's 2017 lien date valuation study by D&P, Respondent asserts that none of D&P's obsolescence adjustments would be applicable or relevant to Respondent's appraisal.

Respondent contends that Petitioner provided no evidence to indicate that Respondent's valuation of the copper cable and digital switch did not represent fair market value or need to be adjusted for additional functional obsolescence. According to Respondent, the PPA represented the fair value so there was no need for additional functional obsolescence adjustment except for the functional obsolescence that was unknown to Petitioner at the time of the sale. In addition, Respondent determined that none of the functional obsolescence Petitioner is requesting is new or unknown to Petitioner at the time of the PPA. Respondent states that in the original appraisal, Respondent allowed an economic obsolescence adjustment to reflect losses of Petitioner's wireline customers since the PPA date, based on information provided by Petitioner. Respondent states that Petitioner did not provide any documentation or evidence to support additional economic obsolescence adjustments or to quantify how much more economic obsolescence adjustment Petitioner requests.

Applicable Law

Burden of Proof

Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.) Therefore, the petitioner has the burden of showing that the assessment is incorrect or illegal. (*ITT World Communications v. Santa Clara* (1980) 101 Cal.App.3d 246; see also Cal. Code Regs., tit. 18, § 5080 subd. (a).)

Analysis and Disposition

Respondent is presumed to have correctly determined the value of the property at issue, and Petitioner bears the burden of proving otherwise. Because we find that Petitioner's D&P Study did not use a valid valuation methodology, the functional and economic obsolescence adjustments requested by Petitioner are not applicable or relevant to Petitioner's 2017 Board-adopted unitary value which was based on the PPA report. We note that Respondent made an adjustment for economic obsolescence to reflect wireline customer losses since the sale date based on information provided by Petitioner. In addition, Petitioner did not provide any evidence to support additional economic obsolescence adjustments. For those reasons, the Appeals Bureau recommends no adjustment for this issue.

Issue 5: Whether Petitioner Has Shown that Respondent Failed To Appropriately Calculate The Value of Petitioner's Video Franchise Possessory Interests.

Findings of Fact and Related Contentions

Petitioner states that it holds a state-issued video franchise under the Digital Infrastructure and Video Competition Act of 2006 (DIVCA) and that Verizon received its initial DIVCA franchise in 2007. Petitioner also states that a DIVCA franchise is valid for ten years and the holder must apply to the CPUC to renew for another ten-year period. Petitioner states that in September 2016, it applied for a franchise renewal which was granted in October 2016, and is effective through March 2027.

Petitioner states that video customer losses resulted in a 27.5 percent decrease in franchise fee payments between the fourth quarter 2015 and the fourth quarter of 2016. Petitioner asserts that Respondent's franchise fee calculation assumes the 2016 franchise fee payments will remain constant over the full ten-year franchise term and does not account for anticipated future subscriber loss or subscriber loss between the first and fourth quarters of 2016. Petitioner contends that the value attributable to the video franchise must be reduced by $52 million.

In its reply brief, Petitioner maintains that demand for conventional video services is declining dramatically and will continue to decline. Petitioner contends that Respondent's assumption that video franchise payments will remain constant over the next ten years is unfounded.

Respondent states that Petitioner is requesting Respondent recalculate the video franchise possessory interest based on an annual reduction rate in franchise payments of 27.5 percent for the remaining term of the franchise agreement. Respondent states that a video franchise possessory interest is defined as an annual fee charged by a local government to a private cable television provider for using public property as a right-of-way for its cable. For property tax assessment purposes, the franchise video possessory interest is calculated according to R&T Code section 107.7, subdivision (b)(1) which states, "[t]he preferred method of valuation of a cable television possessory interest or video service possessory interest by the assessor is capitalizing the annual rent, using an appropriate capitalization rate." Section 107.7, subdivision (b)(2) also provides that "[f]or purposes of this section, the annual rent shall be that portion of that franchise fee received that is determined to be payment for the cable possessory interest or video service possessory interest for the actual remaining term or the reasonably anticipated term of the franchise or license or the appropriate economic rent." In other words, the capitalized annual rent shall be based on the future possessory interest payment for the actual remaining term of the franchise agreement.

Respondent states that Petitioner claimed a 27.5 percent reduction in franchise fee payments between the fourth quarter of 2015 and the fourth quarter of 2016 and requests a video franchise possessory interest calculation based on an annual reduction of 27.5 percent in video franchise fee payments for the remaining term of the agreement. Respondent asserts that the video franchise possessory interest payment can increase, decrease or remain constant but Petitioner has provided no evidence to show that the video franchise payment has been reduced permanently and will continue to drop at a rate of 27.5 percent every year for the remaining term of the agreement.

During the appeals conference, Respondent states that Petitioner claimed that demand for its conventional video services is declining dramatically and that it will continue to decline for the foreseeable future. After further discussion with Petitioner, Respondent reviewed information provided by Petitioner and determined that an adjustment could be made to the video franchise possessory interest calculation for the estimated annual reduction in the franchise fee payments.

Respondent states that Petitioner's calculation of its annual reduction in franchise fee payment was a comparison of its 2015 fourth quarter payment and 2016 fourth quarter payment. Because the video franchise fee PI is calculated based on an annual payment, Respondent explains that it recalculated the estimated yearly reduction using the 2015 total payment and the 2016 total payment, which yields an annual reduction rate of 9.95 percent per year resulting in a value reduction of $39,965,197.

Applicable Law

Burden of Proof

Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.) Therefore, the petitioner has the burden of showing that the assessment is incorrect or illegal. (*ITT World Communications v. Santa Clara* (1980) 101 Cal.App.3d 246; see also Cal. Code Regs., tit. 18, § 5080 subd. (a).)

Analysis and Disposition

Respondent is presumed to have correctly determined the value of the property at issue, and Petitioner bears the burden of proving otherwise. Here, Respondent recalculated the estimated yearly reduction using the 2015 total payment and the 2016 total payment and Petitioner has not presented any evidence showing error in this calculation. Thus, Respondent's reduction of $39,965,197 is presumed correct.

Issue 6: Whether Petitioner Has Shown That Respondent Failed To Properly Assess Petitioner's Construction Work In Progress (CWIP).

Findings of Fact and Related Contentions

Petitioner contends that its 2017 Board-adopted unitary value overstates its CWIP in two ways. First, Petitioner asserts that the CWIP amount includes $33,758,281 in cost that as of the 2017 lien date had already been capitalized and placed in service. Second, the CWIP amount includes costs associated with projects dedicated to non-growth or legacy build outs that would not be undertaken in a true replacement network. Petitioner states that non-growth projects comprised 61 percent of its lien date 2017 CWIP balance which should be reduced by that amount or $107,736,463.

Respondent states that Petitioner provided documentation during the 2017 appraisal season to support its claims that certain CWIP was tax-exempt intangible property. Respondent states that it reviewed the documentation and made all necessary adjustments except for $33,700,000 which was determined to be duplicative of an adjustment that was already reflected in the 2016 year-end CWIP balance. Respondent states that Petitioner requests a $33,700,000 adjustment in the 2017 unitary valuation but provides no evidence to dispute Respondent's determination that a $33,700,000 adjustment would be duplicative.

Respondent also states that Petitioner claims that Respondent should adjust the CWIP for non-growth legacy build out. Respondent states that, in general, CWIP can be categorized as either growth or replacement (non-growth). Growth CWIP represents costs of new CWIP properties that are being added to an existing network. Replacement CWIP is CWIP cost related to replacing a portion of an existing network. Respondent states that in the D&P Study, only the growth CWIP costs were accounted for because, according to Petitioner, the RCN developed by CostQuest and utilized by D&P included all the replacement CWIP. Respondent states that it did not rely on either the RCN developed by CostQuest or the D&P Study and, therefore, needed to account for 100 percent of the taxable CWIP, both growth and replacement, in the ReplCLD value indicator. Respondent notes that its methodology is supported by the UVM and asserts that Petitioner has not provided documentation to support its position that only growth CWIP should be included in Respondent's ReplCLD value indicator.

After the appeals conference, Respondent states that it reevaluated the post year-end CWIP account corrections and the non-taxable CWIP work papers provided by Petitioner. Accordingly, Respondent determined that an additional adjustment to the taxable CWIP in the original appraisal is appropriate and Respondent's revised taxable CWIP value results in a $55 million reduction to Petitioner's 2017 Board-adopted unitary value.

Applicable Law

Burden of Proof

Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.) Therefore, the petitioner has the burden of showing that the assessment is incorrect or illegal. (*ITT World Communications v. Santa Clara* (1980) 101 Cal.App.3d 246; see also Cal. Code Regs., tit. 18, § 5080 subd. (a).)

Analysis and Disposition

Respondent is presumed to have correctly determined the value of the property at issue, and Petitioner bears the burden of proving otherwise. Here, Respondent considered Petitioner's post year-end CWIP account corrections and non-taxable CWIP and made an additional adjustment to the taxable CWIP resulting in a $55 million reduction to Petitioner's 2017 Board-adopted unitary value. Petitioner has presented no evidence showing error, so we presume Respondent's adjustment to be correct.

Decision

Accordingly, the petition for reassessment is granted, in part, reducing the 2017 Board-adopted unitary value from $3,003,100,000 to $2,798,100,000.*

Diane L. Harkey, Chairwoman

Fiona Ma, Member

Jerome Horton, Member

Betty Yee, Member

George Runner, Member

* The decision was rendered in Sacramento, California on December 14, 2017. This summary decision document was approved on February 27, 2018, in Sacramento, California.