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No. _____

IN THE
SUPREME COURT OF THE STATE OF CALIFORNIA

ELK HILLS POWER, LLC,

Plaintiff and Appellant

v.

CALIFORNIA STATE BOARD OF EQUALIZATION,

COUNTY OF KERN,

Defendants and Respondents.

After A Decision By The Court of Appeal,
Fourth Appellate District, Division One, No. D056943

The San Diego Superior Court, No. 37-2008-00097074-CU-MC-CTL
The Honorable Ronald L. Styn

PETITION FOR REVIEW

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ISSUE PRESENTED FOR REVIEW

Whether the Fourth District Court of Appeal erred in holding that the value of intangible rights known as "Emission Reduction Credits" can be expressly included in the taxable value of Petitioner's tangible property in violation of the longstanding constitutional exemption and statutory prohibition against the taxation of intangible assets, and in direct contravention of settled precedent from this Court and every appellate district in the state upholding those limits on the taxing power? (Cal. Const. art. XIII, §2; Rev. & Tax. Code §110(d) & §212.)

WHY REVIEW SHOULD BE GRANTED

The court of appeal's published opinion in this case ("Opinion") has dramatic, broad-based implications for business taxpayers throughout the State of California.[1] The Opinion contravenes an express constitutional exemption and a statutory prohibition against the *ad valorem* taxation of intangible assets and rights when tangible real and personal property is assessed. The Opinion also effectively creates intractable conflicts with prior decisions by this Court and every appellate district in the state that have upheld the exemption against taxing intangible assets, thereby rendering the Petitioner's intangible Emission Reduction Credits ("ERCs") subject to assessment for *ad valorem* tax purposes. The Opinion deviates from this Court's clear pronouncement upholding the constitutional

[1] A copy of the Opinion is attached hereto.

exemption at issue here in *Roehm v. County of Orange* (1948) 32 Cal.2d 280, the seminal precedent on this issue. Indeed, *Roehm* has been followed by this Court on two subsequent occasions and it is the benchmark relied upon by each of the state's appellate districts for more than sixty years in deciding numerous cases involving taxation of intangible assets.

The conflict created by the Opinion places all taxing authorities in the state, including appraisers employed by the State Board of Equalization ("Board") and all county assessors, in the impossible position of trying to apply a new and unworkable test in order to determine when – or if – the constitutional exemption for intangible assets applies. As those decisions are made, taxpayers throughout the state will be forced to challenge their *ad valorem* tax valuations, thus clogging both administrative tribunals and later the trial and appellate courts of this state with hundreds – if not thousands – of tax appeals focused on this issue. In turn, trial and appellate courts throughout the state will be forced to try and reconcile the new test adopted by the Fourth District's Opinion with more than sixty years of California jurisprudence that has consistently upheld the Constitution's exemption of intangible assets and rights from *ad valorem* taxation.

Under Article XIII, §2 of the California Constitution, the California Legislature is granted authority to tax only tangible property, but it is also expressly prohibited from taxing intangible assets and rights other than those specifically enumerated therein. (Cal. Const. art. XII, §2.) As

interpreted by this Court more than sixty years ago in *Roehm*, Article XIII, §2 "is a grant of power to the Legislature to provide for the assessment, levy, and collection of taxes, but it does not grant power to provide for the taxation of intangible assets other than those listed [in Article XIII, Section 2]."[2] (*Id.* at 285 (emphasis added).)

In 1995, the Legislature codified the principles articulated in *Roehm* and its progeny by amending Section 110 to add Subdivisions (d), (e) and (f). The court of appeal misinterpreted Subdivision 110(e) of the Revenue and Taxation Code as permitting the assessment of intangible assets whenever they are determined to be "necessary" to the beneficial and productive use of taxable, tangible property. This is an erroneous reading of the plain language of Section 110 as a whole. The court of appeal made this determination in contravention of the applicable canons of statutory construction. Moreover, while paying lip-service to the necessity of carrying-out the Legislature's intent in amending Section 110, the Fourth

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[2] The only taxable intangible assets/rights enumerated in Article XIII, §2 are "notes, debentures, shares of capital stock, bonds, solvent credits, deeds of trust, mortgages, and any legal or equitable interest therein." (Cal. Const. art. XIII, §2.) ERCs, like most other intangible assets, have never been taxable. At the time *Roehm* was decided, Rev. & Tax. Code §212 exempted all of the intangible assets listed in Article XIII, §2, except solvent credits. Since *Roehm* was decided, solvent credits have also been made statutorily exempt from taxation. (Rev. & Tax. Code §212(a).) **Thus, under current California law, all intangible assets are exempt from taxation.**

District failed and refused to review any of the pertinent legislative history that was made available to it in order to decide this issue.[3]

That history shows the Legislature included Subdivision 110(e) to permit taxing authorities to "assume the presence" of intangible assets, not to expressly add the value of those intangible assets to the value of tangible property in violation of the absolute constitutional exemption codified by Subdivision 110(d). For example, consistent with the Constitution and this Court's prior decision in *Roehm*, Subdivision 110(e) permits an assessor to "assume the presence" of a liquor license in valuing tangible property as a bar, but it does not permit the assessor to add the cost of that license to the value of the bar when assessing the real and personal property. (*See id.*)

The court of appeal's illogical interpretation of Subdivision 110(e) negates the long-standing rule against the taxation of intangible assets set forth in Rev. & Tax. Code §§110 and 212, both of which codify the exemption in Article XIII, §2 of the California Constitution. In short, the court of appeal's interpretation of Subdivision 110(e) renders the statute unconstitutional, because it allows for the taxation of intangible assets

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[3] Inexplicably, the court of appeal not only failed to review the applicable legislative history, it actually rejected a timely-filed amicus brief by the California Taxpayer's Association, the very organization that proposed the 1995 legislative amendments to Section 110 at issue herein. At the same time, the court also refused to take judicial notice of the legislative history. (Order denying application for leave to file *amicus curiae* brief and request for judicial notice, dated December 23, 2010.)

despite the constitutional exemption. In addition, the court's invention of a new test to determine whether an intangible asset is "necessary" or not, creates a direct and incurable conflict in appellate precedent that will confound California business taxpayers, taxing authorities and the lower courts.

This Court has weighed-in three times on the issue of how intangible assets should be dealt with for property tax purposes. (*See Roehm*, 32 Cal.2d at 290 (upholding the exemption for intangible liquor licenses); *Michael Todd Co. v. County of Los Angeles* (1962) 57 Cal.2d 684, 693 (upholding the exemption for intangible copyrights); *De Luz Homes, Inc. v. County of San Diego* (1955) 45 Cal.2d 546, 565-66 (upholding the exemption for intangible business enterprise value).) In each of these cases, this Court upheld the constitutional exemption. (*See id.*). The Fourth District's Opinion eviscerates that constitutional limitation and it implicitly overrules this Court's three prior decisions upholding it, not to mention decisions by every other appellate district in the state concerning this issue.

The single most important reason this Court should grant review in this case is because the Opinion creates great "dis-uniformity" in California jurisprudence. Indeed, *if* the newly-articulated "necessary" test set forth in the Opinion had been applied to the following California cases (among others that could also be cited), each would likely have been decided differently:

- The intangible **liquor license** deemed by **this Court** to be exempt from taxation in *Roehm*, would now be assessable, because it is "necessary" to the beneficial and productive use of a bar, liquor store or restaurant. (*Roehm,* 32 Cal.2d at 290.)
- The intangible **copyright** deemed by **this Court** to be exempt from taxation in *Michael Todd*, would now be assessable, because it is "necessary" for the beneficial and productive use of a motion picture. (*Michael Todd Co.,* 57 Cal.2d at 693.)
- The intangible **concession rights** owned by an airport-based rental car agency or a stadium-based food and beverage business deemed to be exempt from taxation by the **Second and Fourth District Courts of Appeal** would now be assessable because the concession rights are "necessary" to the beneficial and productive use of the companies' tangible taxable property. (*County of Los Angeles v. County of Los Angeles Assessment Appeals Bd.* (1993) 13 Cal. App.4th 102, 113; *Service America Corp. v. County of San Diego* (1993) 15 Cal. App.4th 1232, 1242.)

- The intangible **franchise** deemed to be exempt from taxation by the **Third, Fourth and Fifth District Courts of Appeal** would now be assessable because it is "necessary" to the beneficial and productive use of a cable television company's tangible property. (*County of Orange v. Orange County Assessment Appeals Bd. No. 1* (1993) 13 Cal. App.4th 524, 533; *Shubat v. Sutter County Assessment Appeals Bd. No. 1* (1993) 13 Cal. App.4th 794, 802-04; *County of Stanislaus v. County of Stanislaus Assessment Appeals Bd.* (1989) 213 Cal. App.3d 1445, 1454.)
- The intangible **broadband leases** (and other intangible assets) owned by a telephone company and deemed to be tax exempt by the **First District Court of Appeal** would now be assessable as part of a unit valuation because such leases are "necessary" to the beneficial and productive use of the telephone company's unitary property. (*GTE Sprint Communications Corp. v. County of Alameda* (1994) 26 Cal. App.4th 992, 999.)

It has been almost half a century since this Court addressed this important question of law – how the value of intangible assets is to be excluded from the valuation of tangible real and personal property. In

Roehm, this Court openly acknowledged the "**public importance**" that its decision would have on taxpayers throughout the State of California. (*Roehm,* 32 Cal.2d at 283 ("These contentions therefore raise questions of public importance that involve numerous rights and privileges other than liquor licenses . . . .").) Respectfully, it is time for this Court to weigh-in once more on this important issue and to re-affirm the constitutional exemption prohibiting the taxation of intangible assets. In the absence of review, taxpayers, taxing authorities, trial and appellate courts will be left navigating a mine field full of uncertainty and irreconcilable conflicts between the Opinion and prior appellate decisions on an issue that affects nearly every commercial property in California.

Moreover, review by this Court regarding the proper treatment of intangible "emission reduction **credits"** for property tax purposes may also be of particular import in light of California's recent enactment of so-called "cap-and-trade" legislation (AB32, now codified as Health & Safety Code §38500), which implicates the purchase and sale of intangible "carbon **credits**." Although formal implementation of the cap-and-trade legislation has been stayed by the San Francisco Superior Court, it is only a matter of time before California's taxing authorities are faced with how to deal with this new form of analogous intangible right. Hence, it will serve the interests of judicial economy for this Court to rule now on how emission-related "credits" should be treated for property tax purposes.

In summary, the Opinion in this case represents a radical departure from settled law on this issue of public importance, and the "necessary" test proposed in the Opinion for determining which intangible assets are taxable will result in numerous lawsuits concerning the valuation of both state-assessed and locally-assessed real and personal property throughout California. Review by this Court is essential to secure uniformity of decision that is now threatened by the Fourth District's Opinion, and to settle an important question of property tax law that affects virtually every business taxpayer in California; namely, how non-taxable intangible assets and rights are to be excluded in valuing taxable, tangible real and personal property. (Rule 8.500(b)(1), Cal. Rules of Ct.)

RELEVANT FACTUAL AND PROCEDURAL BACKGROUND

A. Procedural History

Petitioner Elk Hills Power, LLC ("EHP") requests this Court to review the published Opinion of the Fourth Appellate District, Division One, dated May 10, 2011. EHP instituted the original action in the Superior Court of San Diego County against the Board and Kern County, to challenge the Board's decision to assess ERCs owned and used by EHP for tax years 2004 through 2008. (1 CT 1-13)[4]

[4] All references to the Clerk's Transcript include reference to the volume, page number and lines, where applicable. For example 1 CT 125:5-14, refers to Volume 1 of the Clerk's Transcript at p.125, lines 5-14. Likewise,

Because the case involved a purely legal issue – whether intangible ERCs are assessable under California law – both parties filed motions for summary judgment in the trial court. (1 CT 105-23; 2 CT 226-251) After more than two hours of oral argument on those motions, the trial court denied EHP's motion and granted the Board's cross-motion on the basis of Rev. & Tax. Code §110**(f)**. (1 RT 57:2-9; 4 CT 833:17-22) The trial judge expressed doubts about his application of Section 110, so EHP filed a Motion for New Trial, arguing for application of the basic tenet of tax law that any doubt arising from the construction of a taxing statute must be resolved in favor of the taxpayer and against the taxing authority.[5] (4 CT 763-69) (*California Motor Transp. Co. v. State Board of Equalization* (1948) 31 Cal.2d 217, 223-24.) The trial court denied EHP's Motion for New Trial (4 CT 885-86), but the judge noted again that he had gone "back-and-forth" in resolving the legal issue herein. (2 RT 64:11-16)

On March 9, 2010, EHP filed a timely Notice of Appeal. (4 CT 888-89) On May 10, 2011, the court of appeal issued its Opinion. The Fourth District based its decision on a different subdivision of Rev. & Tax. Code §110 – Subdivision 110**(e)**. (Opinion, p.40-41) Specifically, the court held

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references to the Reporter's Transcript include reference to the volume, page number and lines.

[5] In announcing his ruling, the trial judge stated he could "easily write a dissenting opinion." (1 RT 57:13)

that because ERCs are "**necessary**" for the real and personal property of the Plant to be put to beneficial or productive use "**[t]here is no basis to remove the value of the ERCs from the value of the unit,**" despite the fact that ERCs are undisputedly intangible rights that are exempt from taxation in California. (Opinion p.40) Because EHP believed the court of appeal misstated the facts upon which it relied in reaching its decision, EHP filed a timely Petition for Rehearing on May 25, 2011. The court of appeal ordered defendants to respond to the Petition, but denied it on June 7, 2011.[6]

B. Facts Regarding Emission Reduction Credits or "ERCs".

In this case, the parties agreed and the trial court expressly found that ERCs are intangible rights. (1 RT 57:1-2) Simply expressed, ERCs are intangible rights, like a government permit, because they allow a power plant (or other emission source) to legally operate at specified emission levels. (3 CT 600:25-27; 601:1-10) In other words, ERCs are intangible rights that permit their owner to emit a certain level of pollutant(s) into the atmosphere. Notably, the California Legislature has stated that ERCs are not "property." "Certificates evidencing ownership of approved reductions issued by [an air quality] district shall not constitute instruments, securities,

[6] A copy of that order is also attached hereto.

or any other form of property." (Health & Safety Code §40710 (emphasis added).)

Petitioner purchased the ERCs at issue in order to construct its electric generation plant in Kern County ("Plant"). (1 CT 601:23-27) As part of the process of obtaining its "authority to construct" the Plant, EHP "surrendered" those same ERCs in order to commence production of electricity at specified emission levels. (2 CT 289-293)

C. Facts Regarding The Board's Assessment of ERCs.

There are three generally-recognized methods of valuing property for *ad valorem* tax purposes: (1) the cost approach; (2) the income approach; and (3) the sales comparison approach. One or more of these standard appraisal methods may be used to value different types of property. The cost approach focuses on what it would cost to replace an existing property with one of equivalent utility. The income approach can be used to value income-producing property by capitalizing the income produced by the property. The sales comparison approach looks at sales of comparable properties and makes adjustments to the sales prices to estimate market value. In this case, the Board employed two of these three approaches to value EHP's Plant – the cost approach (which was calculated for all five tax years), and the income approach (which was calculated for three of the five tax years). (3 CT 507:17-26; 508:1-4) The Board used

these methods to estimate the "full cash value" (market value) of the Plant. (*See id.*)[7]

The cost approach is an appropriate method to use when, as here, there are intangible assets associated with tangible property because: "The cost approach does not typically capture the value of intangible assets and rights . . . ." (1 CT 160) In this case, however, the Board ***added-in*** the value of the intangible ERCs in computing EHP's assessed value under the cost approach. Specifically, the Board computed a "statewide replacement cost" for ERCs and added that to its valuation of the Plant's tangible assets under the cost approach. (3 CT 535-542; 3 CT 565:17-23) This was improper and the court of appeal obviously misunderstood what the Board did. (Opinion, p.37)

The income approach is appropriate for valuing property that produces income, but it is <u>not</u> intended to value the business – only the property. When applicable, the assessor estimates the present value of the property's future income stream and applies an appropriate rate of return to estimate market value. One problem with this approach is that it also captures the value of intangible assets that are necessary for the property to produce income. Thus, under the income approach, the assessor must take an affirmative step to <u>exclude</u> the value associated with intangible assets

[7] The Board did not utilize the sales comparison approach to value the Plant, presumably because power plants are not frequently bought or sold.

because the value of all property that contributes to the income stream, whether tangible or intangible, is automatically subsumed in the valuation. (*See, e.g., South Bay Irrigation Dist. v. California-American Water Co.* (1976) 61 Cal. App.3d 944, 988.)

Because failure to exclude income associated with intangible assets would violate the prohibitions in Art. XIII, §2, in Section 110(d), and in case law interpreting these provisions, the Board adopted a specific technique for excluding value associated with intangible assets from an income approach. (3 CT 530-33) Although the Board *should* have followed this technique to exclude income attributable to ERCs from its income approach, it did not do so here.

In short, the record establishes that the Board did not take any steps to ensure that the value of **intangible** ERCs was excluded from the value of EHP's tangible, taxable property. Rather, in arriving at the unitary value of EHP's Plant, it is undisputed and the Board admits that it: (1) added the replacement cost of the ERCs to the Plant's value in its cost approach; and (2) failed to exclude any income attributable to intangible ERCs in its income approach. (3 CT 646:5-27; 647:1-11) Both of these actions represent clear violations of the Constitution and Section 110(d).[8]

[8] The Opinion asserts there is a factual dispute regarding the Board's treatment of ERCs (Opinion, p.12), and that the Board's worksheets (entered into the record by both parties) can be "interpreted either way"

DISCUSSION

I. The Constitution Prohibits Taxation of Intangible Assets.

The California Constitution, as interpreted by this Court in *Roehm*, expressly limits taxing authorities in California to the taxation of tangible property, and a limited number of intangible assets specifically enumerated in Article XIII, §2. (Cal. Const. art. XIII, §2) As noted earlier, the Legislature has chosen not to tax any of the enumerated types of intangible assets or rights. (Rev. & Tax. Code §212.) Hence, all intangible assets are currently exempt from *ad valorem* taxation under California law.

In this case, the parties agreed and the trial court expressly found that ERCs are intangible rights. (1 RT 57:1-2) ("They [ERCs] are an intangible, I'll make that finding on the record . . . .") Because they are intangible rights, ERCs cannot be taxed under the California Constitution and the value of the ERCs must be deducted from the unit value of EHP's Plant under Revenue & Taxation Code §110(d)(2).

This Court is charged with enforcing the provisions of the California Constitution and it "may not lightly disregard or blink at . . . a clear

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(Opinion, p.36), stating: "Jackson's exhibits also show the ERC site-specific adjustments for certain years, and they exclude the ERC costs from the total plant cost estimate." (Opinion, p.37) (emphasis added). This misrepresents the record. **The Board acknowledged below that it included the replacement cost of the ERCs in each of its valuations.** (1 RT 7:3-11; 3 CT 565:17-23) Simply put, there is no factual dispute about what the Board did. (Respondents' Brief, p.5)

constitutional mandate." (*Silicon Valley Taxpayers Ass'n v. Santa Clara County Open Space Authority* (2008) 44 Cal.4th 431, 448 (*citing State Personnel Bd. v. Department of Personnel Admin.* (2005) 37 Cal. 4th 512, 523).) Article XIII, §2 mandates that intangible assets and rights cannot be taxed. In this case, the court of appeal has interpreted Section 110 of the Revenue and Taxation Code in such a way as to eviscerate this constitutional limitation on the government's power to tax. Review by this Court is necessary to re-establish this important constitutional limitation.[9]

II. The Opinion Creates An Incurable Conflict In Legal Authority.

A. The Opinion Contradicts Supreme Court Precedent.

Intangible assets and rights are frequently associated with the value of real, personal, and unitary property, whether the intangible right is a liquor license, a copyright, a franchise, an ERC, or any one of many other intangible rights associated with the going-concern of a business. Accordingly, the question of how to apply Article XIII, §2 of the Constitution and how to exclude the value of intangible assets and rights for property tax purposes has been the topic of numerous court decisions over

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[9] The Opinion makes repeated references to how much EHP paid to purchase the ERCs at issue herein, and notes more than once how little tax was actually assessed for the ERCs. Respectfully, neither of those facts is relevant to any issue in this litigation. Indeed, the protections afforded by the California Constitution have no price tag. EHP brought this litigation to preserve its constitutional right not to have its intangible rights (ERCs) taxed. That is the only relevant inquiry here.

the last sixty-plus years, beginning with the seminal decision by this Court in *Roehm v. County of Orange* (1948) 32 Cal.2d 280. Decided in 1948, *Roehm* proclaimed the constitutional prohibition against taxing intangible rights, and it has been the law in California ever since.

The *Roehm* case posed the question of whether Orange County could assess a liquor license, an intangible asset, for property tax purposes. (*See id.* at 281.) Applying Article XIII, §2, this Court held that a liquor license is not assessable, because it is an intangible right protected from taxation under the Constitution. (*See id.* at 290.)

Like *Roehm*, this case raises an important question of law that has broad-based, real-world importance to taxpayers and taxing authorities alike, throughout the State of California. In *Roehm*, this Court recognized the public importance of its decision and acknowledged that its ruling would and should extend beyond liquor licenses to protect other intangible assets and rights from taxation:

> **Virtually the same reasoning could be advanced for the taxation of other forms of governmental permits**, stock exchange seats, press association membership, memberships in social, professional and fraternal clubs, patents, copyrights, goodwill, judgments, causes of action, and insurance policies, which have never been taxed as property in this state during its entire existence. **These contentions therefore raise questions of public importance that involve numerous rights and privileges other than liquor licenses, for the characteristics that it is claimed make liquor licenses taxable as property would likewise make numerous other rights and privileges taxable as property.**

(*Id.* at 283 (emphasis added).)

ERCs are one of the intangible rights that fall within the ambit of protection articulated by this Court in *Roehm*. Notably, ERCs are comparable to liquor licenses or other government permits. Like a liquor license, which is an intangible right associated with the business of a bar, a liquor store, or a restaurant, and which is "necessary" for the beneficial and productive use of the tangible property, an ERC is an intangible right belonging to the owner of a power plant that is necessary for the beneficial and productive use of that property as a power plant.

While this Court unequivocally held in *Roehm* that intangible rights are exempt from taxation under the California Constitution, there is dicta in *Roehm* that has created subsequent confusion. In fact, that dicta was quoted by the court of appeal in its Opinion here. (Opinion p.25-26.)

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

Roehm, 32 Cal.2d at 285 (emphasis added).

Although the meaning of the words "reflected in" has been debated over the years, it has always been clear that the *Roehm* dicta cannot be interpreted to mean that the entire value of a liquor license can be indirectly taxed as a matter of law. Such an interpretation of the dicta in *Roehm*

would eviscerate the case's holding, and no case since *Roehm* has interpreted the Court's statement to allow the state to do indirectly what it cannot do directly. Thus, there is no way the dicta in *Roehm* can be interpreted as the court of appeal has in this case to permit the Board's express inclusion of the replacement cost of the ERCs in the Board's valuation of EHP's Plant.

The 1995 amendments to Section 110 that are at issue here codified *Roehm* and clarified its dicta by explaining that while the **"presence"** of intangible assets and rights necessary to the beneficial and productive use of tangible property may be **"assumed"** for purposes of property taxation – under Subdivision 110**(e)** – the **value** of the ERCs must still be **excluded** under Subdivision 110**(d)**. (Rev. & Tax. Code §110(d)&(e).) Accordingly, it cannot be expressly included in the value as the Opinion holds here.

The prohibition against taxation of intangible rights enunciated in *Roehm* has been the law in California for more than sixty years, and it has been re-affirmed by this Court in two subsequent decisions. (*Michael Todd*, 57 Cal.2d at 693; *De Luz Homes,* 45 Cal.2d at 565-66.) The Opinion's new test allowing the taxation of intangible assets and rights if they are "necessary," directly undermines this long-standing precedent.

Applying the Fourth District's "necessary" test, an assessor can now add the replacement cost of a liquor license in valuing a bar or restaurant because the liquor license is determined to be "necessary" to the beneficial

and productive use of the tangible property, thus squarely contradicting this Court's holding in *Roehm*. (*Roehm* 32 Cal.2d at 290.) Likewise, applying the Opinion's "necessary" test, an assessor could refuse to make any deduction for value associated with a copyright, despite this Court's holding in *Michael Todd*. (*Michael Todd Co.* 57 Cal.2d at 693.)

Before taxpayers are forced to pay taxes on their intangible assets, whether they be liquor licenses, copyrights, ERCs or carbon credits (under the new "cap-and-trade" legislation), this Court should once again review this issue of great public importance and re-affirm the constitutional limitation on the government's power to tax that has been eviscerated by the Fourth District in its Opinion here.

B. The Opinion Conflicts With Numerous Appellate Precedents.

If the court of appeal's erroneous interpretation of Section 110 is left intact, lower courts will be left in a state of confusion regarding how to interpret and apply this conflicting case law. In addition to challenging existing Supreme Court precedent, the Opinion directly contravenes appellate court decisions from every appellate district in the state, and it creates confusion where once there was settled precedent addressing the tax treatment of intangible assets. Although Section 110 was amended in 1995, it did not alter California law regarding taxation of intangible rights. Rather, the amendments were drafted to codify and clarify the pre-existing

case law. (2 CT 409, 434, 439-440) In fact, there were at least five appellate court decisions in the years immediately preceding the amendments to Section 110 that rejected attempts by the Board or county assessors to assess intangible assets and rights. (*Shubat* (1993) 13 Cal. App. 4th at 802-804; *County of Orange* (1993) 13 Cal. App.4th at 533; *Service America Corp.* (1993) 15 Cal. App.4th at 1242; *County of Los Angeles* (1993) 13 Cal. App. 4th at 113; *GTE Sprint Communications Corp.* (1994) 26 Cal. App.4th at 999.)

In contrast, under the Fourth District's new interpretation of Subdivision 110(e), any intangible asset or right that can be construed to be "**necessary**" for the beneficial and productive use of the tangible property can be taxed, notwithstanding the constitutional exemption for intangible property. For example, under the Opinion's new "necessary test," a taxing authority need not make any deduction for income associated with intangible concession rights or franchises, despite Subdivision 110(d)(3)'s opposite mandate, and despite contrary holdings by the Second, Third, Fourth and Fifth Districts. (*County of Los Angeles,* 13 Cal. App. 4th 102; *Service America Corp.,* 15 Cal. App.4th 1232; *County of Orange,* 13 Cal. App.4th 524; *Shubat,* 13 Cal. App.4th 794; *County of Stanislaus,* 213 Cal. App.3d 1445.)

Of particular note is the First District Court of Appeal's decision involving a state-assessee such as EHP, whose real and personal property is

valued and taxed on a "unitary" basis. (*See GTE Sprint Communications Corp. v. County of Alameda* (1994) 26 Cal. App.4th 992, 995.) In *GTE Sprint,* the taxpayer provided the Board with detailed evidence identifying and separately valuing its intangible assets. (*See id.* at 999.) Despite undisputed evidence of the existence and value of these intangible assets provided by the taxpayer, the Board deliberately failed to exclude the value of the intangible assets from its unitary assessment of Sprint's property. (*See id.* at 999, 1004.) The First District correctly held that the Board had erred, explaining that "the Board's appraisers are required by law to **identify and value intangible assets**, if any, and **exclude these values from the appraisal of the taxpayer's property**." (*Id.* at 999 (emphasis added).) Indeed, it was the First District's 1994 decision in *GTE Sprint* that provided the impetus for the mandate in Subdivision 110(d)(2) that was added by the 1995 amendments.

Ironically, the Opinion even cites the First District's decision in *GTE Sprint* for the proposition that "an assessor cannot merely pay **lip service** to the concept of exempting intangible assets from taxation." (Opinion p.27)(emphasis added) Yet, in this case, the Board has not even paid "lip service" to the constitutional requirement. Rather, the Board's actions in this case and the Opinion's approval of those actions directly contradict the First District's clear holding in *GTE Sprint.*

The record here is undisputed that EHP provided the Board with explicit evidence of the existence and value of its intangible ERCs (on the Board's own form) and the Board failed to make any deduction for these intangible rights from its unit valuation, in direct contravention of *GTE Sprint's* holding. Moreover, the Board explicitly added the replacement cost of the ERCs to the value of the tangible real and personal property in its cost approach. Respectfully, absent guidance by this Court, how are trial appellate courts to reconcile this clear split in authority?

This Court should grant review of an appellate decision "[w]hen necessary to secure uniformity of decision or to settle an important question of law." (Rule 8.500(b)(1), Cal. Rules of Ct.) That rule is clearly implicated here. Review is necessary to secure harmony and uniformity in the appellate court decisions involving taxation of intangible assets or rights, as well as to ensure a correct and uniform construction of Article XIII, §2 of the Constitution, and Revenue & Taxation Code §110. The Opinion represents a gross departure from numerous appellate decisions construing the constitutional exemption for intangible assets, and it raises an issue of great public importance that will have widespread effect on taxpayers, taxing authorities and courts throughout the state.[10]

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[10] Again, with the recent enactment of California's "**cap and trade**" legislation, a decision from this Court regarding emission reduction credits could provide important guidance to lower courts that will undoubtedly have to grapple with how taxing authorities should treat carbon credits.

III. The Opinion Is Manifestly Erroneous.

A. The Opinion's Interpretation of Section 110 is Wrong.

In 1995, the California Legislature amended Sections 110 and 212 of the Revenue and Taxation Code, which concern the treatment of intangible assets in real property valuation. The amendments were intended to codify and clarify existing law, beginning with *Roehm* and culminating in *GTE Sprint*, regarding how the full cash value of tangible property should be determined when intangible assets or rights are present, and how the value of intangible assets and rights should be removed or deducted from the value of real, personal or unitary property for *ad valorem* tax purposes. (2 CT 434, 439-440, 448) The legislative intent behind these amendments was to create statewide clarity and uniformity regarding the treatment of intangible assets in property taxation.

As amended, the relevant subdivisions of Section 110 state:

> (d) Except as provided in subdivision (e), for purposes of determining the "full cash value" or "fair market value" of any taxable property, **all of the following shall apply**:
>
> > (1) The value of intangible assets and rights relating to the **going concern value of a business using taxable property shall not enhance or be reflected in the value of the taxable property**.
> >
> > (2) If the principle of **unit valuation** is used to value properties that are operated as a unit and the unit includes intangible assets and rights, then the fair market value of the taxable property contained within the unit shall be determined **by removing from the value of the unit the fair market value of the intangible assets and rights contained within the unit**.

> (3) The exclusive nature of a concession, franchise or similar agreement, whether de jure or de facto, is an intangible asset that shall not enhance the value of taxable property, including real property.
>
> (e) Taxable property **may** be assessed and valued by **assuming the presence of** intangible assets or rights necessary to put the taxable property to beneficial or productive use.
> (f) For purposes of determining the "full cash value" or "fair market value" of real property, intangible attributes of real property shall be reflected in the value of the real property. These intangible attributes of real property include **zoning, location, and other attributes that relate directly to the real property involved**.

(Rev. & Tax. Code §110 (emphasis added).)

The legislative committees described the addition of Subdivisions 110(d) & (e) as codifying existing case law providing that taxing authorities may **assume the presence** (or "existence") of intangible assets and rights necessary to put the related real and personal property to beneficial or productive use, but that they still must segregate and deduct the value of intangible assets from assessment. (2 CT 408-409; 435-436; 439-440; 448.)

The key to deciding this case is harmonizing the various subdivisions of Section 110 and interpreting them within the ambit of the Constitution and this Court's decision in *Roehm*. The court of appeal acknowledged this important tenet of statutory interpretation: "When construing a statute, the courts will strive to harmonize and give effect to both constitutional and statutory provisions and will uphold the legislative

act unless it clearly conflicts with a state constitutional provision." (Opinion p.15) (*citing Professional Engineers in California Government v. Wilson* (1998) 61 Cal. App.4th 1013, 1025.) Ironically, while quoting this important rule of statutory construction, the court altogether failed to apply it. Consequently, it interpreted Subdivision 110(e) in a way that creates a clear conflict with the Constitution.

EHP's position is straightforward and it harmonizes the three subdivisions of Section 110. First, Subdivision 110(f) does not apply, because ERCs are not an "attribute" of real property like zoning, location, architecture and view. (Rev. & Tax. Code §110(f).) Second, Subdivision 110(e) applies to the extent that it permits the Board to **assume the presence** of ERCs in valuing EHP's Plant. (Rev. & Tax. Code §110(e).) This means the Board can value the tangible property at its "beneficial and productive use," which is as an electric generation plant, rather than at its salvage value. Third, and most importantly, Subdivision 110(d)(2) – the only subdivision that specifically addresses the unit valuation of a state assessee's property – also applies and it requires the Board to **remove the value** of the intangible ERCs from the unit valuation of the Plant. In other words, the **presence** (or existence) of the ERCs "may" be **assumed** under Subdivision 110(e) in order to value the Plant at its beneficial and productive use, but the value of the ERCs "shall" be **deducted** from the

unitary value of the Plant under Subdivision 110(d)(2). (Rev. & Tax. Code §110(d),(e).) That is the proper construction of Section 110.

The court of appeal disagreed with this interpretation and it held that Subdivision 110**(e)** – and it alone – determines the outcome of this case. Because it found that ERCs are "**necessary**" to the beneficial and productive use of the tangible property, Subdivision (d) does not apply at all and the value of the ERCs need not be deducted from the Plant's value.

> [A]lthough section 110, subdivision (d)(1) can forbid valuing taxable property by reflecting the value of the intangible assets that relate to it as a "going concern" business, **that subdivision (d)(1) will not apply to a situation otherwise expressly provided for in its subdivision (e).** Specifically, **where the presence of intangible assets is "necessary" for the property to be put to beneficial or productive use, then the unitary valuation may assume the presence of such necessary assets.** (§110, subd. (e).) This kind of power plant is subject to particular forms of regulation, these ERCs are properly deemed "necessary" for its beneficial and productive use, and therefore the ERC contribution to the value of the plant is a permissible consideration in the overall valuation determination. **There is no basis to remove the value of the ERCs from the value of the unit, where the unit cannot legally operate without them.**

(Opinion p.39-40 (emphasis added).) Earlier in its Opinion, the court further described its "necessary" test: "We think that determining whether this **"necessary"** criteria is present, with respect to intangible assets relating to a given taxable property, will be the critical factor for determining whether section 110, subdivision (d) **or** subdivision (e) will

govern the treatment of the intangible assets." (Opinion p.20 (emphasis added).)

Essentially, the court of appeal has interpreted Subdivision 110(e) in such a way as to render Subdivision 110(d) meaningless. It also renders the statute in direct conflict with the constitutional exemption. Specifically, the Opinion misconstrues the introductory clause of Subdivision 110(d) – "[e]xcept as provided in subdivision (e)" – to mean that in any case where an intangible asset or right is "necessary," only Subdivision 110(e) applies. According to the Opinion, these two provisions are mutually exclusive – if Subdivision 110(e) applies, Subdivision 110(d) cannot. This construction is plainly wrong and it cannot be harmonized with the Constitution or the abundant case law interpreting the exemption for intangible rights.

Under the court of appeal's broad interpretation of Subdivision 110(e), whenever an intangible asset or right is "necessary" there will never be a basis to deduct its value under Subdivision 110(d)(1),(2) or (3). In the case of state-assessees such as EHP, under the court of appeal's new test, there would never be a deduction allowed under Subdivision 110(d)(2) because in a unit valuation, all intangible assets are – by definition – for the beneficial and productive use of the unitary property. Indeed, it is difficult to even conceive of a situation in which a unitary taxpayer would ever be eligible for the deduction mandated by Subdivision 110(d)(2) if the Opinion is correct.

Because no concession or franchise is implicated by the present set of facts, the court of appeal did not explicitly address Subdivision 110(d)(3), but the Opinion likewise renders that subdivision meaningless. Hence, if it is not reversed, even "concessions, franchises or similar agreements" – as long as they are deemed "necessary" – are taxable despite the express mandate in Subdivision 110(d)(3) to exclude their values.

The court of appeal's mistake lies in its unconstitutionally broad interpretation of Subdivision 110(e). To illustrate how it has misconstrued Subdivsion 110(e), it is necessary to repeat the statutory language:

> Taxable property may be assessed and valued by **assuming the presence of** intangible assets or rights necessary to put the taxable property to beneficial or productive use.

(Rev. & Tax §110(e) (emphasis added).)

When properly read, it is clear that Subdivision 110(e) permits the Board or an assessor to **assume the presence** of necessary intangible assets or rights so that the property is valued as what it is; *i.e.*, its "beneficial and productive use." (Rev. & Tax. Code §110(e).) However, it does not permit the Board or an assessor to **add the cost of** the necessary intangible assets to the value of the tangible property as it did here. It also does not permit the Board to assume **the income** associated with the necessary intangible rights by failing to deduct it from a value calculated using the income approach. **Simply put, this provision does not permit the Board to "assume" the value of the necessary intangible assets or rights, only**

their presence. Here, it allows the Board to value EHP's property as a functioning power plant rather than as a random collection of equipment.

Petitioner agrees that **the presence** of ERCs may be assumed so that the tangible real and personal property may be valued at its beneficial and productive use as a power plant. (Rev. & Tax. Code §110(e).) However, there is a stark difference between "assuming the presence of" the ERCs and "expressly adding" (and failing to deduct) a value component for ERCs, which is what the Board undisputedly did here in direct violation of Subdivision 110(d)(2) and the Constitution.

In summary, the court of appeal has interpreted Subdivision 110(e) in such a way as to render the statute unconstitutional and to permit the express inclusion of value associated with intangible rights into an assessment of tangible real and personal property. This Court should grant review in order to interpret Section 110 in such a way that it affirms the constitutional limitation on the government's power to tax.

B. The Court of Appeal Completely Ignored Section 110's Legislative History.

In amending Section 110, the Legislature clearly did not intend for Subdivision 110(e) to override Subdivision 110(d), thereby rendering the statute unconstitutional. In fact, the opposite is true. In a letter dated September 15, 1995, Senator Ken Maddy, author of the amendments at issue herein, explained the language of Subdivision 110(e) as follows:

> The bill provides that the intangible assets and rights relating to the going concern (such as goodwill and trade names) are not to be reflected in the value of property. However, under subdivision (e) of Section 110 of the Revenue and Taxation Code as added by the bill, property may be valued **assuming the existence** of intangible assets necessary to put the property to productive use. **This subdivision makes it clear that property need not be valued at salvage value but at its value when put to beneficial or productive use. For example, under the terms of the bill, an assessor could not use a liquor license to enhance the value of taxable property. However, the assessor may assume the presence of a license so that a bar's taxable property may be taxed as a bar and not at salvage value (i.e., as a warehouse).**

(2 CT 450) (emphasis added).

As Senator Maddy explained, the purpose of adding Subdivision 110(e) was to permit the Board and local assessors to value property at its beneficial and productive use which requires them to "**assume the existence**" of certain intangible assets and rights. (Rev. & Tax. Code §110(e).) Contrary to the Opinion, it was not the Legislature's intent for Subdivision 110(e) to negate Subdivision 110(d). Instead, the purpose of Subdivision 110(e) was merely to assure that property would be valued at its beneficial and productive use. Nearly fifty years ago, this Court explained the meaning of the phrase "value of property when put to beneficial or productive use." (*Michael Todd,* 57 Cal.2d at 696.) In *Michael Todd,* the Court explained that "market value" for assessment purposes was the "value of property when put to beneficial or productive use" and "not merely whatever residual value may remain after the property

is demolished, melted down, or otherwise reduced to its constituent elements." (*Id.*)

Under *Michael Todd*, taxing authorities are permitted to value tangible property based on its market value when put to beneficial or productive use, and not simply at "salvage or scrap value." (*See id.*) However, this does not mean that the value of "necessary" intangible rights can be expressly added into a cost approach or that no deduction for those same intangible rights need be made under an income approach as happened here.

Properly, the Opinion acknowledges the importance of determining legislative intent in construing the amendments to Section 110: "In construing all these related statutory provisions, our task is to select the construction that comports most closely with the Legislature's apparent intent, with a view toward promoting rather than defeating the statutes' general purpose, and avoiding any construction that would lead to unreasonable, impractical or arbitrary results." (Opinion, p.40, (*citing Mejia v. Reed* (2003) 31 Cal.4th 657, 663; *Copley Press, Inc. v. Superior Court* (2006) 39 Cal.4th 1272, 1291).)

However, as noted earlier, while paying lip-service to the importance of legislative intent, the court of appeal refused to even consider the *amicus curiae* brief filed by the California Taxpayers' Association ("Cal-Tax") in this case, which specifically addressed the entire legislative history

underlying the 1995 amendments to Section 110, even providing a separate Appendix containing copies of the entire history with a request for judicial notice. (*See* Order denying Cal-Tax's application for leave to file *amicus curiae* brief and request for judicial notice, dated December 23, 2010.) Cal-Tax is the largest and oldest organization of California taxpayers and it was the main sponsor of the amendments at issue here. Candidly, it is incomprehensible that the court of appeal would choose to ignore an *amicus* filing and request for judicial notice regarding the pertinent legislative history by a statewide organization that played a key role in shaping the legislation at issue here, but that is what transpired below.

If the court of appeal had interpreted Subdivision 110(e) by considering the legislative intent – as it acknowledged is proper – it would not have construed the statute as it did. Instead, it would have understood that Subdivision (e) does not swallow Subdivision (d) and eviscerate the constitutional exemption for intangible property. Rather, the Legislature merely intended for this Court's admonition in *Michael Todd* to apply – to value property at its "beneficial and productive use."

CONCLUSION

For the foregoing reasons, this Court should grant the Petition for Review and re-affirm the constitutional exemption from taxation for intangible assets and rights that was first articulated by this Court in *Roehm*. In addition, this Court should construe Subdivisions 110(d),(e) and

(f) in a manner that upholds that constitutional limitation on the power of government to tax. Finally, review should be granted to resolve the incurable conflict in existing precedent created by this Opinion, which will affect business property taxpayers and taxing authorities throughout the State of California, and result in needless litigation.

RESPECTFULLY SUBMITTED this 20th day of June, 2011.

LAW OFFICE of PETER MICHAELS

By: Peter W. Michaels

Peter W. Michaels

Attorneys for Petitioner Elk Hills Power, LLC

CERTIFICATE OF WORD COUNT

Pursuant to Rule 8.504(d)(1) of the California Rules of Court, the undersigned hereby certifies that the foregoing Petition for Review is in 13 point Times New Roman font and contains **8,004** words, including footnotes, but excluding the Table of Contents, Table of Authorities, Certificate of Service, this Certificate of Compliance, and the attached Exhibits. In making this certification, I have relied on the word count of the computer program used to prepare the brief.

RESPECTFULLY SUBMITTED: June 20, 2011.

Peter W. Michaels
Attorney for Petitioner Elk Hills Power, LLC

CERTIFICATE OF SERVICE BY MAIL

Elk Hills Power, LLC v. California State Board of Equalization, et al.

1. At the time of service I was at least 18 years of age and not a party to this legal action.

2. My business address is 6114 La Salle Avenue, #445, Oakland, California 94611-2802.

3. On June 20, 2011, I enclosed copies of

Petition for Review

in envelopes and deposited the sealed envelopes with the U.S. Postal Service, with the postage fully prepaid.

4. The envelopes were addressed as follows:

Tim Nader, Esq. Brian Wesley, Esq. Deputy Attorney General California Department of Justice Office of the Attorney General Business and Tax Section 300 South Spring Street, Suite 1702 Los Angeles, CA 90013 *Attorneys for Defendant/Respondent, California State Board of Equalization*	1 copy
Jerri S. Bradley, Esq. Deputy County Counsel County of Kern 1115 Truxtun Ave., 4th Floor Bakersfield, CA 93301 *Attorney for Defendant/Respondent, Kern County*	1 copy

Superior Court, County of San Diego Clerk of the Court 220 W. Broadway San Diego, CA 92101	1 copy
The Honorable Ronald L. Styn Superior Court, County of San Diego 220 W. Broadway San Diego, CA 92101	1 copy
California Court of Appeal Fourth Appellate District Division One 750 B Street, Suite 300 San Diego, CA 92101	1 copy

5. I am a resident of or employed in the county where the mailing occurred. The document was mailed from Oakland, California.

I declare under penalty of perjury that the foregoing is true and correct.

Date: June 20, 2011

Peter W. Michaels
Printed Name

Peter W. Michaels
Signature

COURT OF APPEAL, FOURTH APPELLATE DISTRICT

DIVISION ONE

STATE OF CALIFORNIA

ELK HILLS POWER, LLC, Plaintiff and Appellant, v. CALIFORNIA STATE BOARD OF EQUALIZATION et al., Defendants and Respondents.	D056943 (Super. Ct. No. 37-2008-00097074-CU-MC-CTL) ORDER DENYING PETITION FOR REHEARING

THE COURT:

The petition for rehearing is denied.

HUFFMAN, Acting P. J.

Copies to: All parties

Filed 5/10/11

CERTIFIED FOR PUBLICATION

COURT OF APPEAL, FOURTH APPELLATE DISTRICT

DIVISION ONE

STATE OF CALIFORNIA

ELK HILLS POWER, LLC, Plaintiff and Appellant, v. BOARD OF EQUALIZATION et al., Defendants and Respondents.	D056943 (Super. Ct. No. 37-2008-00097074-CU-MC-CTL)

APPEAL from a judgment of the Superior Court of San Diego County, Ronald L. Styn, Judge. Affirmed.

Law Offices of Paul Michaels, Peter W. Michaels; Mooney, Wright & Moore and Paul J. Mooney for Plaintiff and Appellant.

Edmund G. Brown, Jr. and Kamala D. Harris, Attorneys General, Felix E. Leatherwood, Leslie Branman Smith and Tim Nader, Deputy Attorneys General for Defendant and Respondent California State Board of Equalization.

Theresa A. Goldner, County Counsel, and Jerri S. Bradley, Deputy County Counsel, for Defendant and Respondent County of Kern.

This action for refund of property taxes and for declaratory relief was brought by an owner-operator of an independent electric power plant, plaintiff and appellant Elk Hills Power, LLC (Elk Hills), against defendant California State Board of Equalization (the Board), and the County of Kern (the County, where the plant is located), for taxes paid from 2004 to 2008. As a state assessee, Elk Hills sued the defendants under California Revenue and Taxation Code section 5148, subdivision (a).[1] Elk Hills's major claim of entitlement to refunds relates to the application of section 110, which provides definitions and guidelines for determining the "full cash value" or "fair market value" of assessed property, including, as relevant here, the treatment of intangible rights relating to "the uses and purposes to which the property is adapted and for which it is capable of being used," and relating to "the enforceable restrictions upon those uses and purposes." (§ 110, subd. (a).)

Specifically, in order to construct and operate its independent electric power plant (the power plant), Elk Hills purchased and applied certain emission reduction credits (ERCs), pursuant to Health and Safety Code section 40709, with the approval of

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1 All statutory references are to the Revenue and Taxation Code unless otherwise indicated. It is not disputed that this independent, wholesale or merchant electric generation facility is a power plant subject to California Constitution, article XIII, section 19's unit taxation, not to the tax limits imposed by Proposition 13 on real property. (*Independent Energy Producers Assn., Inc. v. State Bd. of Equalization* (2004) 125 Cal.App.4th 425, 451.)

regulatory authorities. Such credits are part of a statutory scheme allowing the issuing, applying, deploying, trading, banking, and/or refunding of interchangeable air pollution ERCs, among regulatory authorities and power plant operators (also known as "emissions sources"), to enable a plant owner to suitably operate its power plant, in terms of its selection of the available technology and compliance with regulatory limits on pollution. (Health & Saf. Code, §§ 40709-40913; for regulations implementing § 40709, see Cal. Code Regs., tit. 17, § 91500 et seq.)

According to Health and Safety Code section 40709, subdivision (b), this ERC system "is not intended to recognize any preexisting right to emit air contaminants, but to provide a mechanism for [regulatory] districts to recognize the existence of reductions of air contaminants that can be used as offsets, and to provide greater certainty that the offsets shall be available for emitting industries." (*Ibid.*) Once this power plant went into operation, it began to utilize Elk Hills's deployed ERCs, and it will continue to do so while it operates at its current level, to continue its compliance with state emissions requirements. (Pub. Resources Code, § 25000 et seq., the Warren-Alquist State Energy Resources Conservation and Development Act.)

Beginning in 2004, when the Board assessed Elk Hills's power plant on a unitary basis, it utilized two valuation approaches, a replacement cost approach and an income analysis. (*ITT World Communications, Inc. v. City and County of San Francisco* (1985) 37 Cal.3d 859 (*ITT*).) With respect to each approach, it considered the value added to the power plant by the ERCs, in their nature as intangible rights that contributed to the productivity and value of the power plant property. (§ 110, subd. (e) ["Taxable property

may be assessed and valued by assuming the presence of intangible assets or rights necessary to put the taxable property to beneficial or productive use."].)

On appeal, Elk Hills contends the trial court misinterpreted section 110, when granting the Board's motion for summary judgment and denying the cross-motion of Elk Hills. In applying section 110, the trial court drew certain conclusions from the undisputed facts to determine that (1) when Elk Hills purchased and applied the ERCs for construction and operation of its power plant, the ERCs represented intangible rights that relate directly to the power plant real property, and therefore section 110, subdivision (f) applied;[2] (2) since those ERCs are not transferable while the plant is operating in accordance with the way it was built, the ERCs were necessary to lawfully operate the power plant in accordance with state emissions requirements (§ 110, subd. (e)). Using those conclusions, the trial court relied on section 110, subdivisions (e) and (f), to rule in favor of the Board: "The ERC's rights apply directly to the power plant's real property because they were necessary to construct the power plant"; thus, the Board "properly included these rights in its replacement cost approach and was not required to subtract such rights from its income analysis."

On appeal, Elk Hills points out that this is a matter of first impression with respect to the character of ERCs as intangible rights. It renews the arguments made to the trial

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2 Section 110, subdivision (f) provides: "For purposes of determining the 'full cash value' or 'fair market value' of real property, intangible attributes of real property shall be reflected in the value of the real property. These intangible attributes of real property include zoning, location, and other attributes that relate directly to the real property involved." As we next explain, subdivisions (d) and (e) section 110 are also integral to our analysis.

court, that under the parties' stipulated facts and a proper construction of section 110, when all its subdivisions are read together and harmonized, the Board should be found to have illegally imposed extra annual taxes directly upon the valuable intangible ERC assets (worth around $10 million), or alternatively, failed to deduct their value as required, thereby imposing on Elk Hills an extra tax burden of around $300,000 in all, for the subject five years. (§ 110, subd. (d)(2).)

To support its claims, Elk Hills relies on basic canons of statutory construction and on the authorities interpreting the character of intangible rights, and argues the ERCs were impermissibly separately assessed under the terms of section 110, subdivision (d): "*Except as provided in subdivision (e)*, for purposes of determining the 'full cash value' or 'fair market value' of any taxable property, all of the following shall apply: [¶] (1) The value of intangible assets and rights relating to the going concern value of a business using taxable property shall not enhance or be reflected in the value of the taxable property. [¶] (2) If the principle of unit valuation is used to value properties that are operated as a unit and the unit includes intangible assets and rights, then the fair market value of the taxable property contained within the unit shall be determined *by removing from the value of the unit the fair market value of the intangible assets and rights contained within the unit* . . . ." (Italics added.)

In response, the Board, joined by the County (together the Board), contends that a proper determination of the statutorily defined character of ERCs as intangible rights leads to a conclusion that the governing provision is section 110, subdivision (e) (an express exception to § 110, subd. (d)), such that under section 110, subdivision (e), this

power plant must be "assessed and valued by assuming the presence of intangible assets or rights necessary to put the taxable property to beneficial or productive use." (*Ibid.*) According to the Board, these ERCs are intangible assets "that cannot be separately taxed as property," but that may be reflected in the valuation of taxable property, because assessing authorities may take into consideration those earnings derived from the unit that "depend upon the possession of intangible rights and privileges that are not themselves regarded as a separate class of taxable property." (*Roehm v. Orange County* (1948) 32 Cal.2d 280, 285-286 (*Roehm*).)

The Board is correct. Its unitary taxation determinations properly assessed the power plant "*as a going concern.*" (*ITT, supra*, 37 Cal.3d 859, 864; original italics.) The Board's worksheets in the record that contained site-specific adjustments for the ERCs, as relied on by Elk Hills, do not demonstrate the Board impermissibly assessed and taxed the value of the ERCs as a single asset, even though the tax forms filed by Elk Hills listed a value for the asset. Instead, the Board legitimately took into account the value added by the ERCs, as contributing to the value and earnings of the property as a whole. Based on the undisputed facts presented here, we limit our decision to an interpretation of section 110, subdivision (e), and need not reach issues concerning subdivision (f) of that section. Under section 110, subdivision (e), the power plant was correctly "assessed and valued by assuming the presence of intangible assets or rights necessary to put the taxable property to beneficial or productive use," because without the presence of the deployed ERCs, the power plant cannot operate and function as intended, to make energy and money. We affirm.

FACTUAL AND PROCEDURAL BACKGROUND

A. Emission Reduction Credits; Assessments; Complaint

In the early 2000's, Elk Hills, as the owner-operator of an independent wholesale electric power company, built the plant in Kern County, California.[3] In compliance with emission regulations of the San Joaquin Air Pollution Control District (the District), Elk Hills purchased about $10 million worth of ERCs, and used them to obtain the necessary permits and certifications for the power plant, completed in 2003, to commence operations. Beginning in 2004, Elk Hills filed tax returns that included the Board Form BOE-529-I (Form 529-I), reporting the cost of the ERCs as $10,701,575.

In 2004 and continuing into 2005, the Board utilized one of the three general methods of valuation for property assessment of the plant. This was the replacement cost approach for analyzing valuation, in light of the cost of replacing the property with a substitute property, less accrued depreciation (the replacement cost approach). (See *Watson Cogeneration Co. v. County of Los Angeles* (2002) 98 Cal.App.4th 1066, 1071 (*Watson*).)

From 2006 to 2008, the Board continued to use the replacement cost approach (in part, as next explained), and it also added an alternative valuation method, an income

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3 Sempra Energy, which owns a one-half interest in Elk Hills, is not a named defendant in this case. During the new trial motion, counsel for Elk Hills discussed whether the trial court might wish to recuse itself, based upon activity in a prior case involving Sempra Energy, but it was determined there was no need for any recusal, and no issues about that are raised on appeal.

approach utilizing a "capitalized earning ability" or CEA factor (the income approach).[4] The Board gave this income approach less weight than the replacement cost approach (i.e., the income approach represented 20 percent of the analysis in 2006, and 30 percent in 2007-2008).

In reaching its valuation conclusions, the Board's assessor's worksheets listed a "site-specific adjustment" for each year that referred to the ERCs as part of the calculation of replacement cost estimates. The parties do not dispute that the site-specific adjustment was applied per megawatt to reach the value of the ERCs, as part of the Board's analysis of statewide information from regulatory authorities, to factor in a replacement amount for the ERCs. The power plant generates at least 500 megawatts, and the assessor's notes also take into account figures on depreciation and remaining economic life, among other relevant considerations.[5]

After amendments, in February 2009, Elk Hills's operative complaint for tax refunds under section 5148, subdivision (a), was filed in San Diego as the proper venue, due to the location of an office of the Attorney General here. Elk Hills set forth the lien date unitary assessed values for each of the five years' assessments that were challenged,

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4 A capitalized earnings approach is usually used to determine the unitary value of public utility property, "because market data are practically nonexistent: public utilities are rarely bought and sold." (*ITT, supra*, 37 Cal.3d 859, 864, fn. 3.)

5 To the extent Elk Hills appears to challenge the Board's choices of valuation methods, the Board defends its primary approach, the replacement cost method, as a discretionary choice well founded in the facts. (*De Luz Homes, Inc. v. County of San Diego* (1955) 45 Cal.2d 546, 564.) Elk Hills responds that it has no quarrel with the use of the approaches, but rather the manner in which they were carried out. (Cal. Code Regs., tit. 18, §§ 3, 6, 8.) We examine that contention in part IV, *post*.

ranging from around $293 million through $335 million, and alleged that these were excessive because the Board had assessed the intangible ERCs in an illegal manner. The Board and County answered the complaint and case management proceedings followed.

B. Cross-Motions for Summary Judgment

The parties prepared cross-motions for summary judgment, arguing questions of law for interpretation of the definitions provided in section 110 and section 212. In Elk Hills's motion, it argued the ERCs qualify as intangible assets that are exempt from taxation, under section 110 and section 212, subdivision (c), providing: "Intangible assets and rights are exempt from taxation and, except as otherwise provided in the following sentence, the value of intangible assets and rights shall not enhance or be reflected in the value of taxable property. *Taxable property may be assessed and valued by assuming the presence of intangible assets or rights necessary to put the taxable property to beneficial or productive use.*" (Italics added.)

In support of its motion, Elk Hills provided an original and supplemental declarations by James Asay, its tax manager. Also in support, Elk Hills provided a declaration by its vice president, Joseph Rowley, who described the process through which Elk Hills obtained governmental approvals for the plant, by purchasing and deploying the ERCs for almost $11 million. The surrendered ERC certificates do not have a face value. Elk Hills did not dispute that it could not operate the plant as designed without applying the ERCs, under applicable regulation.

In general, each declaration from Elk Hills describes the assessment process and the respective understandings of how the ERCs were treated as intangible assets, as

supported by documents prepared during the process and newly prepared interpretive analyses. The declarations incorporate numerous exhibits, including annual tax forms reporting the cost of acquiring the ERCs (over $10 million), excerpts from the Board's manuals and guidelines, and a supporting legal memorandum on behalf of a Board member. According to Elk Hills, in preparing the unitary valuation of the plant, using the two different valuation methods, the Board failed to recognize that the value of all relevant governmental permits were already bundled in, and it impermissibly treated the ERCs' value separately. The refunds sought amounted to somewhere between $226,000 to $300,000.

In the Board's motion for summary judgment, it sought to defend its assessments as appropriate under well accepted unitary valuation methods and principles. In support of its motion, the Board provided original and supplemental declarations by its principal property appraiser Donald Jackson, who described the valuation methods and considerations his staff used in calculating the unitary value of the plant. They included in the valuation the typical costs associated with possessing many types of permits necessary to the facilities' construction and operation, including not only ERCs but also building permits and waste discharge permits. Other costs were capitalized to such permits, including filing fees, engineering fees, environmental fees, attorney fees, and so forth (soft costs). The staff did not expressly consider actual or booked ERC costs, as those were reported on Elk Hills's tax forms (to be further described in the discussion portion of this opinion). Normally, ERCs are issued to sources of emissions, and they

can be banked to offset an operator's future emission overloads, or a power plant operator can sell the ERCs to other sources. (Health & Saf. Code, § 40709 et seq.)

The Board provided a declaration from David Warner, director of the permit services department for the District, about the necessity for District-issued ERCs, if a power plant operator cannot otherwise comply with emission control regulations. To construct the plant, Elk Hills supplied the "best available control technology" (BACT) to reduce emissions, but it nevertheless was also required to purchase ERCs at market rates, to allow it to use its technology at 500 megawatt production levels and to offset future emissions.

Elk Hills was therefore required to surrender (or "deploy") five of the certificates for ERCs it had purchased, from other emission sources, to enable its technology to produce power at the permitted levels. These covered excess pollutants such as nitrogen oxides, volatile organic compounds, and sulfur oxides.

Judicial notice was sought and granted of legislative history materials for section 110 and section 212, subdivision (c), to support the Board's position that ERCs must be considered in determining the fair market value of power plants, through assuming the presence of the ERCs as intangible assets or rights that are necessary to put the taxable property to beneficial or productive use, and allowing them to be reflected in the fair market value determination.

An extensive opposition and reply process then took place, in which each party filed supplemental and responsive separate statements, containing more documentation of

the plant approval process and the five years of assessments. The County joined in the position taken by the Board.

C. Oral Argument and Rulings

At the outset, the trial court observed that there appeared to be some remaining factual dispute about how the assessments were actually carried out, i.e., whether the ERCs were separately assessed, or whether their presence was assumed as part of the replacement value calculation, and later in the income approach. In response, Elk Hills argued that the "Site Specific Adjustments: ERC" displayed on Board worksheets showed how separate valuation and separate taxes must have been imposed on the ERCs. Elk Hills also contended that its tax forms, Form 529-I, provided evidence that the ERCs cost over $10 million, which was value that could be removed, but a portion of that value was apparently impermissibly taxed, when the Board's worksheets referred to the "site-specific adjustments" for the ERCs, of amounts ranging from $5,400-$20,000.

The Board's position, on the other hand, was that under either valuation method, the ERCs were necessary to the beneficial and productive use of the plant, requiring that the unit valuation assumed there was value they contributed or added, such that no separate assessments of the intangibles were made. The ERCs amounted to costs necessary for the use of the property that could not be removed from the assessment. The ERCs were related to the particular property involved, which the regulatory authorities had evaluated in terms of its weather conditions, inversion layers, and other factors that affected how much pollution could be tolerated there.

At oral argument, the parties did not address section 110, subdivision (f) until the latter part of the hearing. Ultimately, the trial court ruled there were no triable issues of material fact and summary judgment must be granted for the Board, while the cross-motion by Elk Hills was denied. The order made the following key findings:

"1. The Emission Reduction Credits (ERCs) purchased and applied by [Elk Hills/EHP] for its power plant provide[s] intangible rights that relate directly to the power plant real property. The closest case is *Mitsui Fudosan v. County of* [*Los Angeles*] (1990) 219 Cal.App.3d 525 [dealing with intangible transferable development rights].

"2. The ERCs were purchased and used by [Elk Hills/EHP] to build its power plant in compliance with the San Joaquin Air Pollution Control District's emission requirements. The ERCs in question, while purchased and tradable at one point, were purchased and applied to build the power plant. Furthermore, such ERCs are not transferable while the plant is operating in accordance with the way it was built. The ERCs were necessary to lawfully operate the power plant in accordance with state emissions requirements.

"3. The ERCs' rights apply directly to the power plant's real property because they were necessary to construct the power plant; thus, they fall within Revenue and Taxation Code section 110, subdivision (f). Therefore, the Board of Equalization properly included these rights in its replacement cost approach and was not required to subtract such rights from its income analysis." Declaratory relief was denied.

Elk Hills brought a motion for new trial, which was denied. Mainly, Elk Hills unmeritoriously argued that when oral argument was held on the merits, the trial court

had frankly admitted to having some difficulty in deciding the case, and that factor somehow justified an assumption that "there was a doubt or ambiguity in the construction of Section 110 and, therefore, the case should be resolved in favor of the taxpayer." (See *California Motor Transp. Co. v. State Board of Equalization* (1947) 31 Cal.2d 217, 223-224 (*California Motor Transp.*) [statutes levying taxes will be construed, in doubtful or ambiguous cases, in favor of the taxpayer rather than the government entity].)

In response to Elk Hills's new trial arguments, the trial court candidly admitted that it had struggled with the interpretation of section 110, but even applying the statutory construction rule that was cited (*California Motor Transp., supra*, 31 Cal.2d 217), the court adhered to its original ruling, based upon its understanding of case authority for characterization of intangible assets for taxation purposes, which allowed the ERCs value to be included in the unitary valuation. The Board's motion for summary judgment was granted and judgment was entered in favor of the Board and the County. Elk Hills appeals.

DISCUSSION

After setting forth basic rules of review, we frame the issues presented for interpretation of section 110, with reference to its subdivisions upon which the parties rely. We then set forth unitary tax principles and the rules regarding the tax treatment of intangible assets. To properly characterize the intangible rights represented by the ERCs, we refer to the highlights of the separate statutory schemes that created ERCs. We can then determine the appropriate nature of the rights and privileges that ERCs represent, for tax purposes.

I

APPLICABLE STANDARDS

We review de novo the trial court's decision to grant the Board summary judgment on stipulated and undisputed facts. (*Shamsian v. Atlantic Richfield Co.* (2003) 107 Cal.App.4th 967, 975.) Because the court was presented with purely legal questions, its statement of decision is not binding on us, and we are free to draw our own conclusions of law from the stipulated and undisputed facts. (*Sea World, Inc. v. County of San Diego* (1994) 27 Cal.App.4th 1390, 1397; *Independent Energy Producers Assn., Inc. v. State Bd. of Equalization, supra,* 125 Cal.App.4th 425, 436.)

Likewise, since the primary issue presented at trial and on appeal, statutory interpretation, is a question of law, we independently review the issue. (*Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 7-8 (*Yamaha I*).) " 'The ultimate interpretation of a statute is an exercise of the judicial power . . . conferred upon the courts by the Constitution and, in the absence of a constitutional provision, cannot be exercised by any other body.' " (*Id.* at p. 7, citing *Bodinson Mfg. Co. v. California Employment Commission* (1941) 17 Cal.2d 321, 326.)

When construing a statute, the courts will strive to harmonize and give effect to both constitutional and statutory provisions and will uphold the legislative act unless it clearly conflicts with a state constitutional provision. (*Professional Engineers in California Government v. Wilson* (1998) 61 Cal.App.4th 1013, 1025.) Where there are several sets of statutes relating to the same subject, they must be harmonized and given effect if possible. (*Id.* at p. 1021; *Mejia v. Reed* (2003) 31 Cal.4th 657, 663.)

"In construing statutes, we must determine and effectuate legislative intent." (*Woods v. Young* (1991) 53 Cal.3d 315, 323.) " 'To ascertain intent, we look first to the words of the statutes' [citation], 'giving them their usual and ordinary meaning' " unless otherwise clearly intended or indicated. (*Lennane v. Franchise Tax Bd.* (1994) 9 Cal.4th 263, 268 (*Lennane*); *Standard Oil Co. v. State Board of Equalization* (1974) 39 Cal.App.3d 765, 768 (*Standard Oil*).) "If there is no ambiguity in the language of the statute, 'then the Legislature is presumed to have meant what it said, and the plain meaning of the language governs.' " (*Lennane, supra*, at p. 268.)

If, however, there is ambiguity in the statutory language, we resort to extrinsic sources to determine legislative intent, including the ostensible legislative object to be achieved and the legislative history. (*Freedom Newspapers, Inc. v. Orange County Employees Retirement System* (1993) 6 Cal.4th 821, 828; *Jones v. Lodge at Torrey Pines Partnership* (2008) 42 Cal.4th 1158, 1163.) Guidance from an administrative agency's interpretative rulings may be given an appropriate degree of judicial deference. (*Yamaha I, supra*, 19 Cal.4th at pp. 7-8.)[6]

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6 At this point, we note that Elk Hills has attached to its briefs excerpts from the Board's unitary valuation methods manual, and from the 1998 assessor's handbook. Also, Elk Hills attached to its brief a 2005 opinion letter by counsel for the Board discussing the status of ERCs within the valuation methods used for state assessed utility plants. These materials were presented to the trial court, and objections were sustained to the opinion letter, because it was informal in nature and contradicted by a later legal opinion adopted by the Board. Pending appeal, Elk Hills requested judicial notice of the manual and handbook, which was denied as they are already in the record. We are aware that assessors' handbooks have been relied upon by the courts and have been accorded great weight in the interpretation of valuation questions. (*Watson, supra,* 98 Cal.App.4th 1066, 1068.) However, none of those administrative materials materially assists us in deciding

At this point, we address the initial argument made by Elk Hills that generally, statutes levying taxes will be construed, in doubtful or ambiguous cases, in favor of the taxpayer rather than the government entity. (*California Motor Transp., supra*, 31 Cal.2d 217, 223-224.) On the other hand, statutes providing an exemption from tax are reasonably, but strictly, construed against the taxpayer. (*Standard Oil Co., supra*, 39 Cal.App.3d 765, 769-770.) An exemption will not be inferred from doubtful statutory language, and " ' "settled principles of statutory construction require that any doubt be resolved against the right to the exemption. . . ." ' [Citation.]" (*Ibid.*)

In fact, Elk Hills does not claim ambiguity of section 110 per se, instead arguing only its subdivision (d)(2) may control. The Board characterizes that argument as seeking an exemption from taxation of ERCs, and also an exemption for any value they might add to taxable property. Section 110 is not itself a levying nor an exemption provision, but instead, it appears in property tax law in the chapter for construction and defining terms to be used in that body of law. (Rev. & Tax Code, Div. I, Property Taxation, General Provisions, pt. 1, ch. 1, Construction.) Our purpose is to construe section 110 in its definitional sense, for defining fair market value of, in this case, state assessed property.[7]

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this matter, which should appropriately be viewed as presenting pure questions of law as applied to undisputed facts. We also denied a request to file an amicus brief by an interested organization, California Taxpayers Association.

7 There is no contention that the definitions set forth in section 110, subdivisions (b) or (c) relate to this case, since they refer to the purchase of property. Elk Hills built the

We accordingly reject any argument by Elk Hills that the statements by the trial court in rendering its rulings, that this was a difficult case, somehow mean that the taxpayer must prevail, merely applying the canons of statutory construction. Tax litigation is inherently complex, and the trial court was merely making a well justified observation, with which we agree. In any case, it is well accepted that we must review the correctness of the ruling, and not the reasoning of the trial court. (*D'Amico v. Board of Medical Examiners* (1994) 11 Cal.3d 1, 19.) The proper approach is to construe the statute according to the above rules, without unnecessary preconceptions, and then apply its provisions to the undisputed facts in the record.

II

INTERPRETATION OF SECTIONS 110 AND 212

Our task is to apply the statutory definitions set forth in sections 110 and 212 in the present context of unitary taxation of the power plant. "Unit taxation prevents real but intangible value from escaping assessment and taxation by treating public utility property as a whole, undifferentiated into separate assets (land, buildings, vehicles, etc.) or even separate kinds of assets (realty or personalty)." (*ITT, supra,* 37 Cal.3d 859, 863.)

In defining "full cash value" or "fair market value" in section 110, subdivision (a), the Legislature refers to the basic qualities of a bona fide sale of property on the open market, where the parties are not under undue pressure to sell, "and both the buyer and the seller have knowledge of all of the uses and purposes to which the property is adapted

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plant and has operated it since 2004, and the record does not indicate it is likely to be sold at any particular time.

and for which it is capable of being used, and of *the enforceable restrictions upon those uses and purposes*." (§ 110, subd. (a); italics added.) Obviously, a power plant is subject to numerous such governmental restrictions, both at ground level and in the air, where pollutants are emitted. Obtaining permits for operation at certain emission levels is required so that the power plant technology can operate at its optimal level.

According to Elk Hills, section 110, subdivision (d)(2), must govern its assessment, so that with respect to the replacement cost approach, ERC values (intangibles) cannot be included for the plant's value. Then, with respect to the income indicator approach, ERC values would be removed, excluded, or deducted from the plant's value. As support in the record, Elk Hills relies on its Form 529-I, estimating the cost of its ERCs at over $10 million. It also relies on the Board's assessor's worksheets that show there is a "site-specific adjustment" for ERCs, in the replacement cost calculation, for most of the tax years (2005-2008).

Before evaluating those claims, we note that it is significant that section 110, subdivision (d)(2), the subdivision Elk Hills relies upon, begins: "*Except as provided in subdivision (e),* for purposes of determining the 'full cash value' or 'fair market value' of *any taxable property*, all of the following shall apply[.]" (Italics added.) Because section 110, subdivision (d) operates only as *not otherwise provided* in subdivision (e), it is important to read all the subdivisions together.

In section 110, subdivision (d)(1), the enumerated criteria are: "The value of intangible assets and rights relating to the going concern value of a business using taxable property shall not enhance or be reflected in the value of the taxable property."

Apparently, *any* real property taxation question may fall within that subsection. However, its subdivision (d)(2) then specifically refers, as here, to a unitary valuation case: "If the principle of unit valuation is used to value properties that are operated as a unit and the unit includes intangible assets and rights, *then the fair market value of the taxable property contained within the unit shall be determined by removing from the value of the unit the fair market value of the intangible assets and rights contained within the unit.*" (Italics added; we need not consider its subdivision (d)(3), relating to concessions or franchises, which are not involved here.)

Section 110, subdivision (e), states in full: "Taxable property may be assessed and valued by assuming the presence of intangible assets or rights *necessary to put the taxable property to beneficial or productive use*." (Italics added.) We think that determining whether this "necessary" criteria is present, with respect to intangible assets relating to a given taxable property, will be the critical factor for determining whether section 110, subdivision (d) or subdivision (e) will govern the treatment of the intangible assets.

Before turning to the meaning of section 110, subdivision (f), as cited by the trial court,[8] we first seek to reconcile the interaction of its subdivisions (d) and (e), in the case of a unitary valuation matter, like this one. According to Elk Hills, section 110,

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8 Section 110, subdivision (f) states: "For purposes of determining the 'full cash value' or 'fair market value' of real property, intangible attributes of real property shall be reflected in the value of the real property. These intangible attributes of real property include zoning, location, and other attributes *that relate directly* to the real property involved." (Italics added.)

subdivision (d)(2) stands alone in a unit valuation case and must require "*the fair market value of the taxable property contained within the unit*" to be determined by removing from that value *"the fair market value of the intangible assets and rights contained within the unit.*" This would be some level of return upon its reported $10 million-plus value of the ERC assets, yearly, or a total of about $300,000 over the five years.

To the contrary, the Board argues that in a unitary valuation case, it is not correct to read section 110, subdivision (d)(2) without first referring to section 110, subdivision (e), which overrides it as the principal component of the section's definitions. Section 110, subdivision (e) therefore requires that since the power plant cannot operate at a "beneficial or productive" level without its permits, including the ERCs, then the plant should be assessed and valued "by assuming the presence of intangible assets or rights *necessary* to put the taxable property to beneficial or productive use," which allows the ERCs to be valued within the power plant operating context, even if not separately. (Italics added; see *ITT, supra*, 37 Cal.3d 859, 863 [public utility property is valued "as a whole, undifferentiated into separate assets (land, buildings, vehicles, etc.) or even separate kinds of assets (realty or personalty)].") "Necessary" operating permits are part of the greater whole, even with regard to their value.

Likewise, section 212, subdivision (c), contains "necessity" language very similar to section 110, subdivision (e): "Intangible assets and rights are exempt from taxation and, except as otherwise provided in the following sentence, the value of intangible assets and rights shall not enhance or be reflected in the value of taxable property. *Taxable property may be assessed and valued by assuming the presence of intangible assets or*

rights necessary to put the taxable property to beneficial or productive use." (§ 212, subd. (c); italics added.)

On a preliminary basis, we disagree with Elk Hills that the initial clause of section 110, subdivision (d) may be disregarded (i.e., that referring to § 110, subd. (e)). Nor can the two subdivisions both be implemented here. Instead, whether for unitary or other property taxation, section 110, subdivision (e) must govern in those cases where it is critical for the assessor to consider how the taxable property is "put to beneficial or productive use," and when such beneficial or productive use requires the presence of intangible assets or rights as "necessary." In such a case, the appraiser for the assessor may assume their presence in valuing the property. Here, this would mean taking into account the value added to the plant by the existence of the applied ERCs, when assessing the plant as a "going concern," i.e., while it is producing power and emitting pollutants as allowed by the ERCs. (See *ITT, supra*, 37 Cal.3d 859, 863-864.)

Although the trial court expressly relied upon section 110, subdivision (f), we must review the actual decision and not the reasoning of the trial court.[9] It might be observed that it is unclear whether the terms of section 110, subdivision (f), specifying real property, may be squarely applicable to unitary valuation, which includes both real and personal property. (See *ITT, supra*, 37 Cal.3d 859, 863-864.) It is a most abstract question if ERCs, as intangibles, expressly qualify as "attributes of real property," such as

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9 The trial court's first paragraph in the ruling was that the ERCs purchased and applied by Elk Hills for its power plant provide intangible rights that "relate directly" to the power plant real property. That language is found in section 110, subdivision (f), but it is not dispositive here, when the section is read as a whole.

zoning or location, or are other "attributes that relate directly to the real property involved," since ERCs allow some level of pollution to be emitted, but mainly in the airspace above the real property. It is not necessary for us to engage in such an academic exercise and we decline to base our decision upon section 110, subdivision (f).

We now turn to the particular nature of the ERCs to test the above hypothesis on the sole applicability of section 110, subdivision (e), under a necessity analysis. How much of a separate, intangible, alienable character is retained by the ERCs, when they have been applied to property for which they are "necessary" for the ongoing highest and best use of the property? Stated another way, under section 110, subdivision (a), is the value represented by the ERCs a component of the unitary value, in light of the enforceable restrictions upon the use of the property as a power plant?

III

RELATED STATUTORY SCHEMES

A. Features of Unitary Taxation of Power Plant

California Constitution, article XIII, section 2 is the general provision for property taxation "of all forms of tangible personal property . . . , and any legal or equitable interest therein not exempt under any other provision of this article. . . ." It is undisputed that California Constitution, article XIII, section 19 governs, authorizing the Board to annually assess certain property, including "companies transmitting or selling gas or electricity. This property shall be subject to taxation to the same extent and in the same manner as other property." (*Ibid.*)

"The Board is charged with the ad valorem unit taxation of public utility property by article XIII, section 19 of the California Constitution." (*GTE Sprint Communications Corp. v. County of Alameda* (1994) 26 Cal.App.4th 992, 1001-1002 (*GTE Sprint*).) It is well understood that unit taxation of public utility property is necessary "to ascertain and reach with the taxing power the entire real value of such property." (*ITT, supra*, 37 Cal.3d 859, 863.) " '[P]ublic utility property cannot be regarded as merely land, buildings, and other assets. Rather, its value depends on the interrelation and operation of the entire utility as a unit. Many of the separate assets would be practically valueless without the rest of the system.' " (*Ibid.*)

Thus, in reading together the relevant constitutional and statutory provisions in *ITT*, the Supreme Court concluded "that unit taxation is properly characterized not as the taxation of real property or personal property or even a combination of both, but rather as the taxation of property *as a going concern.* First, what the Board assesses is the value of the public utility property as a going concern; it considers the earnings of the property as a whole, and does not consider, less still assess, the value of any single real or personal asset. Second, what the Board allocates to the local taxing authority is, again, a share of the value of the public utility property as a going concern . . . ." (*ITT, supra*, 37 Cal.3d 859, 864-865; original italics.)

To value utility property *as a going concern,* "the Board must appraise it at its full value when put to its beneficial and productive use." (*GTE Sprint, supra*, 26 Cal.App.4th 992, 1002, citing *ITT, supra*, 37 Cal.3d at p. 862; also see § 723 ["The board may use the

principle of unit valuation in valuing properties of an assessee that are operated as a unit in a primary function of the assessee."].)

We are aware that the same "going concern" language used by the Supreme Court in *ITT*, *supra*, 37 Cal.3d 859, 863-864, a unitary valuation case, also appears in section 110, subdivision (d)(1), regarding the valuation of a business using taxable property and also using intangible assets (but not necessarily in a unitary valuation case). However, the going concern language does not appear in the subdivision relied upon by Elk Hills, section 110, subdivision (d)(2), which is limited to unitary valuation cases. Nor does section 110, subdivision (e) mention it. For our purposes, the going concern concept applied to utility operations, as explained by the Supreme Court, is the most useful. For a particular kind of intangible asset (the "necessary" kind), we believe section 110, subdivision (e) should be used for evaluating this operating power plant.

B. Tax Treatment of Intangible Assets

In carrying out the functions of the power plant, Elk Hills is subject to numerous form of governmental regulation, including permit requirements of varying types. Many governmental permits or licenses are classic examples of intangible assets, some of them necessary to the business and some of them optional or readily transferable. *Roehm*, *supra*, 32 Cal.2d 280, 285-286, stands for the basic proposition that intangible assets that are not specified in the statutory definitions of assets subject to taxation are exempt from property assessment, in particular, liquor licenses. However, the court also made clear that intangible asset values "that cannot be separately taxed as property may be reflected in the valuation of taxable property. Thus, in determining the value of property,

assessing authorities may take into consideration earnings derived therefrom, which may depend upon the possession of intangible rights and privileges that are not themselves regarded as a separate class of taxable property." (*Id.* at p. 286.)

In *Watson, supra,* 98 Cal.App.4th 1066, the court provides a short course in the lore of intangible assets. Under section 212, subdivision (c), " 'the value of intangible assets and rights shall not enhance or be reflected in the value of taxable property.' But subdivision (c) also provides that '[T]axable property may be assessed and valued by assuming the presence of intangible assets or rights necessary to put the taxable property to beneficial or productive use.' (See also § 110, subds. (d) & (e).) [¶] In accordance with this exemption, California decisions have held that assets such as copyrights, liquor licenses, airport car rental concessions, ballpark food concessions, and cable television franchises are intangible rights which cannot be directly subjected to property tax assessment. [Citations.] But while 'intangible property is exempted from direct property taxation, the courts in this state have repeatedly held that the value of such intangible property may be included in the valuation of otherwise taxable tangible property.' [Citations.]" (*Watson, supra*, at pp. 1069-1070.)

In *GTE Sprint*, *supra*, 26 Cal.App.4th 992, the court applied established rules that intangible asset values may be treated as enhancing the value of the tangible property, but nevertheless, where it is possible to identify and value certain intangible assets and estimate their separate income expectancies, then the Board must exclude their values when assessing the tangible property for taxation. (*Id.* at pp. 1002-1007.) On that record, the court found certain nontaxable intangible assets were inexplicably deemed by the

assessor, without analysis, to be subsumed in the fair market value of the property, such that no effort was made to remove the value of the following nontaxable, intangible assets: "the Sprint trade name; customer base; assembled workforce; favorable broadband leases of transmission capacity from other carriers; favorable property leases; advertising agency relationships; favorable debt financing contracts; inventory of advertising materials; and the benefit of avoiding significant start-up costs by purchasing a going concern, which Sprint identified as goodwill and other intangible assets." (*Id.* at pp. 998, 1004-1008.)

In *GTE Sprint, supra,* 26 Cal.App.4th 992, 1002-1007, the court ruled that the assessor had used an erroneously absolutist approach, by failing to make any effort to identify and value any nontaxable item, for purposes of deducting them from the allocated unit value. Although the intangible assets were valuable and enhanced the unit value, some of them also had independent value, apart from any possessory interest in the unit. (See *Shubat v. Sutter County Assessment Appeals Bd.* (1993) 13 Cal.App.4th 794, 802-804.) In *Shubat*, the court reasoned: " 'While we agree intangible values *may be reflected* in the value of a possessory interest, it does not follow such values are subsumed as a matter of law.' " (*Id.* at p. 804, cited in *GTE Sprint, supra,* 26 Cal.App.4th at pp. 1005-1006; original italics.)

Thus, an assessor cannot merely pay lip service to the concept of exempting intangible assets from taxation. If there is substantial evidence showing the presence and separate value of such intangible assets, the intangibles must be excluded from assessment. (*GTE Sprint, supra*, 26 Cal.App.4th 992, 1005-1008.) An assessor cannot

merely characterize all intangibles as providing "enhancement value" of the unit, if the evidence is otherwise. This would thwart meaningful judicial review. (*Id.* at p. 1008.)[10]

Thus, in *GTE Sprint*, the court required reassessment, because "the Board's appraisers are required by law to identify and value intangible assets, if any, and exclude these values from the appraisal of the taxpayer's property. The Board's own appraisers admitted that they did not attempt to identify any intangible assets, but instead ignored the detailed evidence produced by Sprint, which identified and separately valued numerous intangible assets. It is this indifference by the Board and its appraisers, in the face of opposing, credible testimony from Sprint of the existence of separate intangible assets, which we find to be error." (*GTE Sprint, supra*, 26 Cal.App.4th 992, 999.)

It is not enough for the taxpayer to speculate that the Board relied on impermissible factors. (*Los Angeles SMSA Ltd. Partnership v. State Bd. of Equalization* (1992) 11 Cal.App.4th 768, 777-778 (*LA SMSA*).) Nor may the taxpayer provide only circumstantial evidence to establish that the assessor improperly utilized or included for valuation the intangible assets (such as permits and related business enterprise). (*American Sheds, Inc. v. County of Los Angeles* (1998) 66 Cal.App.4th 384, 395 (*American Sheds*).) The taxpayer must produce persuasive evidence of separate

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10 It is undisputed that both sections 110 and 212 were amended in 1995, to implement the principles of *GTE Sprint, supra,* 26 Cal.App.4th 992. The section 110 amendment added subdivisions (d), (e) and (f). (Stats. 1995, ch. 498, § 5, pp. 3831-3832.) The section 212 amendment designated the existing paragraphs as subdivisions (a) and (b), and added subdivision (c), relating to intangible assets and rights. (Stats. 1995, ch. 498, § 6, p. 3832.)

treatment of the intangibles, to show abuse of discretion or lack of evidence in support of the assessments.

In *American Sheds, supra*, 66 Cal.App.4th 384, it was held that the assessor could properly determine the value of a landfill property, by taking into consideration its earnings, some of which directly depended " 'upon the possession of intangible rights and privileges that are not themselves regarded as a separate class of taxable property.' [Citation.]" (*Id.* at p. 392; italics omitted.) Those intangible rights and privileges were "an assortment of governmental permits authorizing the landfill operation, principally the operating permit issued by the county's department of health services and waste discharge requirements issued by the regional water quality board." (*Id.* at p. 388.) Although certain intangibles associated with the realty, such as zoning, permits, and licenses, are not real property and may not be taxed as such, if those intangibles nevertheless affect the real property's value, "for example by enabling its profitable use, they may properly contribute to an assessment of fair market value." (*Id.* at p. 392.) An assessor "should consider the intangibles insofar as they contributed to the property's beneficial use," and in doing so, the assessor may "impute an amount of income derivable by reason of the intangible right to do business." (*Id.* at p. 393, citing *County of Stanislaus v. Assessment Appeals Board* (1989) 213 Cal.App.3d 1445, 1455-1456 (*Stanislaus*).)

As a practical matter, the assessment may recognize the impact of the presence of intangible rights upon the beneficial use of the property, with respect to valuing the amount of income it could yield; it is only forbidden to subsume in the unit value any

separate intangible income, and hence value, that should have been attributed to nontaxable intangibles. (*American Sheds, supra*, 66 Cal.App.4th 384, 396.)

In *Mitsui Fudosan v. County of Los Angeles, supra,* 219 Cal.App.3d 525, 528-530, the question was whether intangible transferable development rights (air space) should be considered as adding assessable property value to undeveloped land. The court determined that such rights amounted to an interest in real property, giving rise to a taxable event when they were transferred, and to a conclusion that they allowed a higher and better use of the property and should therefore be considered in valuation.

C. Background and Context of ERC Statutory Scheme

Considering the above descriptions of the nature of different intangible assets and rights, the characterization of the ERCs for unitary tax purposes must take into account the nature and character of ERCs, which the trial court correctly observed are intended to provide incentives to power plant operators to improve air quality. "Most of the California statutes governing air quality are set forth in Division 26 of the Health and Safety Code (Health & [Saf. Code, §]39000 et seq.). The statutes coordinate state, regional, and local air pollution control by establishing 'air basins' based on similar meteorological and geographical conditions. [Citations.] They create a State Air Resources Board [citations], and Regional Air Pollution Control Districts combining the smaller districts in each air basin [citations] . . . . [¶] Air quality districts must develop plans and regulations to achieve and maintain ambient air quality standards. [Citations.]" (12 Witkin, Summary of Cal. Law (10th ed. 2005) Real Property, § 898, p. 1082.)

The statutory scheme creating ERCs is part of the Health and Safety Code, Division 26, Air Resources, whose legislative declaration of intent is found in Health and Safety Code section 39001: "The Legislature, therefore, declares that this public interest shall be safeguarded by an intensive, coordinated state, regional, and local effort to protect and enhance the ambient air quality of the state. Since air pollution knows no political boundaries, the Legislature declares that a regional approach to the problem should be encouraged whenever possible and, to this end, the state is divided into air basins. The state should provide incentives for such regional strategies, respecting, when necessary, existing political boundaries." To carry out this goal, Health and Safety Code section 40000 places upon local and regional authorities, including this air pollution control district, "the primary responsibility for control of air pollution from all sources [other than emissions from motor vehicles, which generally are the responsibility of the state board]." Thus, the District has the authority (exercised here) to adopt rules and regulations that, e.g.,"(a) Require the use of best available control technology for new and modified sources, and the use of best available retrofit control technology for existing sources. . . ." (Health & Saf. Code, § 40601.)

Pursuant to Health and Safety Code section 40700, air pollution control districts have the general powers and duties of a corporate and political body, or a public agency. One such duty is to administer ERC usage, under Health and Safety Code section 40709, subdivision (a), through "a system by which all reductions in the emission of air contaminants that are to be used to offset certain future increases in the emission of air contaminants shall be banked prior to use to offset future increases in emissions. The

system shall provide that only those reductions in the emission of air contaminants that are not otherwise required by any federal, state, or district law, rule, order, permit, or regulation shall be registered, certified, or otherwise approved by the district air pollution control officer before they may be banked and used to offset future increases in the emission of air contaminants." (Health & Saf. Code, § 40709.) Under Health and Safety Code section 40709, subdivision (b), this ERC system "is not intended to recognize any preexisting right to emit air contaminants, but to provide a mechanism for districts to recognize the existence of reductions of air contaminants that can be used as offsets, and to provide greater certainty that the offsets shall be available for emitting industries." (*Ibid.*; for regulations for implementing Health & Saf. Code, § 40709 to allow interchangeable air pollution ERCs, see Cal. Code of Regs., tit. 17, § 91500 et seq.)

Under Health and Safety Code section 40710, it is clarified that ERC certificates "evidencing ownership of approved reductions issued by a district shall not constitute instruments, securities, or any other form of property." Section 212, subdivision (b) provides that money kept on hand for normal use in a business is not subject to property tax. Although Elk Hills claims ERCs are tradeable like money or currency, we do not see how these ERCs may be so characterized, because of the extremely restricted market in which they may be traded and their highly specialized function.

The use of ERCs, as part of the certification process for approval of a power plant site, is provided for in Public Resources Code, Division 15, Energy Conservation and Development, Chapter 6, Power Facility and Site Certification, section 25500 et seq. Under Public Resources Code sections 25200 and 25500, the Energy Resources

Conservation and Development Commission, commonly known as the California Energy Commission (the Commission), has the power (among others), to certify sites for new power plants.[11] As part of its written decision under Public Resources Code section 25523, on power facility and site certification, the Commission shall include such items as "(a) Specific provisions relating to the manner in which the proposed facility is to be designed, sited, and operated in order to protect environmental quality and assure public health and safety."

As most relevant here, under Public Resources Code section 25523, subdivision (d)(1), findings by the Commission are required about the conformity of the proposed site and related facilities with certain standards, i.e., "public safety standards and the applicable air and water quality standards, and with other applicable local, regional, state, and federal standards, ordinances, or laws." (*Ibid.*) Specifically, under Public Resources Code section 25523, subdivision (d)(2), "The commission may not find that the proposed facility conforms with applicable air quality standards pursuant to paragraph (1) unless the applicable air pollution control district or air quality management district *certifies* . . . that complete emissions offsets for the proposed facility have been identified and will be obtained by the applicant within the time required by the district's rules, [and] [t]he commission shall require as a condition of certification that the applicant obtain any

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11 The Commission is an arm of the California Natural Resources Agency, an environmental agency that administers various environmental statutes, and provides for research and development of mitigation measures for power plants. (Pub. Res. Code, §§ 1 et. seq., 801 & 25404.)

required emission offsets within the time required by the applicable district rules . . . prior to the commencement of the operation of the proposed facility." (Italics added.)

In light of the various restrictions imposed on power plants by these related bodies of law, we next apply accepted principles for tax treatment of intangible assets to this record.

IV

APPLICATION: TAX TREATMENT OF ERCS

The controlling and dispositive portion of the ruling is: "The ERCs were purchased and used by [Elk Hills/EHP] to build its power plant in compliance with the [District's] emission requirements. The ERCs in question, while purchased and tradable at one point, were purchased and applied to build the power plant. Furthermore, such ERCs are not transferable while the plant is operating in accordance with the way it was built. The ERCs were necessary to lawfully operate the power plant in accordance with state emissions requirements." Further, although the court cited to section 110, subdivision (f), in its reasoning, its next related findings may logically stand alone: "The ERCs rights apply directly to the power plant's real property because they were *necessary* to construct the power plant . . . . Therefore, the Board . . . *properly included these rights in its replacement cost approach and was not required to subtract such rights from its income analysis*." (Italics added.)

To evaluate those legal conclusions, we first consider what the record shows on how the valuation methods were applied. We then turn to the policies promoted by the various statutes involved.

A. Valuation Methods

The same interpretive problems are presented on each of the valuation methods used by the Board. We believe Elk Hills has made only a very weak showing of how the assessments were actually performed, by providing its original and supplemental declarations by James Asay, its tax manager. These mainly consist of his own analyses of valuation, utilizing the Board's templates.

In the Board worksheets provided, entitled "Replacement Cost New Characteristics, Combined Cycle Gas Turbine Plant; Base Load and Peaker Plants," a line item for site-specific adjustments for ERCs was provided, and for the years 2007 and 2008, the total plant cost was set forth, as it excluded ERCs and land soft costs. Asay's interpretation of the Board's worksheets is that the "site-specific adjustment" attributable to ERCs was a cost increment *improperly* utilized in calculating replacement cost indicator of value. He explains that the site-specific adjustment for the ERCs was multiplied by the number of megawatts generated by the power plant, to calculate the Board's ERC cost additive. As exhibits, he attached his own table showing the Board's valuation, and his revisions to remove the value he said was attributable to the ERCs. Likewise, he provided three exhibits that he prepared, to show his own calculations of income that was imputed to intangible assets, which represented a percentage of the book value of the intangible assets ($10 million plus), under a capitalized earnings approach. He also relied on Board valuation manual excerpts in doing so.

Elk Hills next relied on their annual tax forms reporting the cost of acquiring the ERCs (over $10 million). The certificates surrendered do not have a face value.

However, that value was subjected to the above treatment, as performed by Asay. Elk Hills's record cites consist of his declaration, references to it in the separate statement, and Board worksheets that can be interpreted either way.

From that showing, we conclude that as the taxpayer, Elk Hills is mainly speculating that the Board relied on impermissible factors. (*LA SMSA, supra,* 11 Cal.App.4th 768, 777-778.) The Forms 529-I are essentially circumstantial evidence for establishing that the assessor improperly utilized or included for valuation the costs or income from the intangible assets. (*American Sheds, supra,* 66 Cal.App.4th 384, 395.) Even if we accept that Asay is an experienced tax manager, his opinions, about how the Board must have erred by valuing ERCs separately to provide an inaccurate ERC cost additive, are not necessarily persuasive.

The Board's position, on the other hand, is that the procedure used by Asay is incorrect, because the Board's valuation was not based on the value or cost of the ERCs as reported by Elk Hills. Instead, as principal property appraiser, Donald Jackson's declaration states that the Board did not use the booked costs that Elk Hills reported in its property statements, to value the plant. Nor did the Board attempt to appraise or estimate the value of the ERCs alone, particularly the banked ERCs. Rather, Jackson states that in calculating replacement cost value, including both soft and hard costs, the Board utilized a standardized estimate of ERC acquisition costs that would be necessary to obtain the necessary building and operating permits for a new plant. This standardized approach is used to estimate on a statewide basis the costs normally necessary to obtain such permits. Also, the 2004 soft cost estimate was larger than 2005-2008, because of startup costs.

Next, Jackson explained how the replacement costs of applied ERCs are determined for all electric generation facilities, on a statewide basis, to include in the replacement cost value indicators. The Board uses an ERC factor applied to the rated capacity of each facility, as stated in megawatts of power produced. "The ERC factor is determined based upon information gathered from the state assessees' property statements filed with the Board and on information gathered from the California Energy Commission." A new replacement cost value indicator is calculated each year as of the lien date, for staff to update the then-current estimated costs of the ERCs that must be acquired and applied, in utilizing the replacement value methodology. In particular, the Board did not use a deduction for any applied ERCs in the income indicator method, but did so for the replacement cost indicator method.

As exhibits, Jackson attached five yearly appraisal data reports for Elk Hills, to show the Board's determination of the unitary value of the plant. Jackson's exhibits included the same template used by Elk Hills's tax manager Asay, but he shows a zero value for "income imputed to intangible assets," whereas Elk Hills, in Asay's tables, created an entry for that figure. Jackson's exhibits also show the ERC site-specific adjustments for certain years, and they exclude the ERC costs from the total plant cost estimate.

Unlike in *GTE Sprint, supra*, 26 Cal.App.4th 992, 1001-1003, this record does not show a refusal by the Board to address the taxpayer's evidence of separate values of intangible assets. Instead, the Board made site-specific adjustments for the ERCs, based on its formula, and the record does not demonstrate why those adjustments were

improper. Nor does the face of Form 529-I provided by Elk Hills, showing the cost of the ERCs, prove that the Board impermissibly failed to exclude such separate value from the plant's fair market value. Likewise, Elk Hills did not demonstrate that the income indicator of value was improperly utilized, with respect to the ERCs.

We examine the parties' respective showings with reference to the term "necessary," as found in section 110, subdivision (e). Under Public Resources Code section 25523, subdivision (d)(2), no power plant facility site may be approved unless the operator conforms with applicable air quality standards, or alternatively, obtains certification "that complete emissions offsets for the proposed facility have been identified and will be obtained by the applicant within the time required by the district's rules," prior to the commencement of the operation of the power plant. (*Ibid.*) This supports a conclusion that the assessor is allowed to "consider the intangibles insofar as they contributed to the property's beneficial use," and in doing so, the assessor may "impute an amount of income derivable by reason of the intangible right to do business." (*American Sheds, supra,* 66 Cal.App.4th 384, 393, citing *Stanislaus, supra*, 213 Cal.App.3d 1445, 1455-1456.) Since the valuable ERCs were necessary to the ongoing productive use of the property, they were properly considered here, under section 110, subdivision (e).

B. Statutory Policies

Here, as in *LA SMSA, supra,* 11 Cal.App.4th 768, 776, "the crux of the problem" is that Elk Hills cannot demonstrate that the Board misinterpreted the actual or booked ERC costs that were reported by Elk Hills, by impermissibly attributing income and value to

them, or incorrectly imposing the tax directly on their value. Instead, those intangible assets were deemed to add to the value of taxable tangible property, because no earnings would be possible without them, due to the regulatory requirement of such " 'possession of intangible rights and privileges that are not themselves regarded as a separate class of taxable property.' " (*Ibid.*, citing *Roehm*, *supra*, 32 Cal.2d 280, 285; see also *Michael Todd Co. v. County of Los Angeles* (1962) 57 Cal.2d 684, 693-694 [film valued with copyright].)

As a policy matter, we find it most unlikely the Legislature intended by its creation of the ERCs' statutory scheme, or by amending the statutes regarding the treatment of intangibles, essentially to provide a unitary tax deduction or tax credit for those power plant operators that cannot operate a plant at state accepted levels of admissions, but that instead must obtain ERCs through purchase or trade, to enable them to commence and continue operations at a higher level of emissions. Although ERCs are originally a valuable intangible asset, once they have been surrendered to the regulatory agencies to enable the plant to operate, they do not retain a fair market value apart from the taxable property, that may be removed from the fair market value of the unitary property, within the meaning of section 110, subdivision (d)(2). We decide only the case before us under section 110, subdivision (e), and we do not consider any facts not presented here, such as if nonapplied or nondeployed ERCs remain in the possession of an emission source, such as a power plant operator that has taxable property.

Moreover, although section 110, subdivision (d)(1) can forbid valuing taxable property by reflecting the value of the intangible assets that relate to it as a "going

concern" business, that subdivision (d)(1) will not apply to a situation otherwise expressly provided for in its subdivision (e). Specifically, where the presence of intangible assets is "necessary" for the property to be put to beneficial or productive use, then the unitary valuation may assume the presence of such necessary assets. (§ 110, subd. (e).) This kind of power plant is subject to particular forms of regulation, these ERCs are properly deemed "necessary" for its beneficial and productive use, and therefore the ERC contribution to the value of the plant is a permissible consideration in the overall valuation determination. There is no basis to remove the value of the ERCs from the value of the unit, where the unit cannot legally operate without them.

In construing all these related statutory provisions, our task is to select the construction that comports most closely with the Legislature's apparent intent, with a view toward promoting rather than defeating the statutes' general purpose, and avoiding any construction that would lead to unreasonable, impractical, or arbitrary results. (See *Mejia v. Reed, supra*, 31 Cal.4th at p. 663; *Copley Press, Inc. v. Superior Court* (2006) 39 Cal.4th 1272, 1291 [where more than one statutory construction is arguably possible, courts favor the construction that leads to reasonable results consistent with the apparent legislative purpose].) Section 110, subdivision (e) allows the assessor to assume the presence of the ERCs that are necessary to operate the taxable property productively, and to value the fair market value of the property accordingly. We need not rely upon the provisions of section 110, subdivision (f) for that result.

DISPOSITION

The judgment is affirmed. Respondents are awarded costs on appeal.

HUFFMAN, Acting P. J.

WE CONCUR:

HALLER, J.

O'ROURKE, J.