



STATE OF NEVADA
STATE BOARD OF EQUALIZATION

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DEONNE E. CONTINE
Secretary

In the Matter of)	
)	
Sierra Pacific Power Company – Electric)	
Nevada Power Company – Electric)	Consolidated
Sierra Pacific Power Company – Gas)	Case No. 17-106
PETITIONERS)	Case No. 17-107
)	Case No. 17-108
Nevada Department of Taxation)	
RESPONDENT)	

NOTICE OF DECISION

Appearances

Norman Ross appeared on behalf of Petitioners, Sierra Pacific Power Company – Electric, Nevada Power Company – Electric, and Sierra Pacific Power Company -- Gas.

Jeffrey Mitchel and Sorin Popa appeared on behalf of the Department of Taxation (Department).

Summary

The matter of the petitions for review of centrally-assessed property valuations for the 2017-2018 tax year assessment filed by Sierra Pacific Power Company (SPPC) – Electric (Case No. 17-106), and Nevada Power Company (NPC) – Electric (Case No. 17-107), and SPPC – Gas (Case No. 17-108) came before the State Board of Equalization (State Board) for hearing in Carson City, Nevada on August 29, 2017, after due notice to the Taxpayers and Department. Each of the Petitioners do business in Nevada as NV Energy.

The Tax Commission (Commission), at a regular session commencing on the “first Monday in October of each year,” is required to “establish the valuation of any property of an interstate and intercounty nature used directly in the operation of all interstate or intercounty . . . natural gas transmission and distribution, [and] electric light and power companies.” NRS 361.320(1). In such cases, the Commission is required to value “all physical property used directly in the operation of any such business of any such company in this State, as a collective unit.” NRS 361.320(2). To this end, the Commission is authorized to establish formulas for the establishment of value. NRS 361.320(5). The Commission’s valuation regulations for such property, also known as “centrally-assessed properties,” is based on “reconciliation of one or more indicators of value.” NAC 361.421 *et seq.*

These indicators include an historical cost less depreciation approach (HCLD) and an income approach indicator. The HCLD indicator is calculated based on a "gross book cost for financial reporting purposes of all taxable operating property, including . . . contributed plant," with a deduction for "accrued book depreciation." NAC 361.421. Contributed plant, also known as "contribution in aid of construction" (CIAC) is "plant which has been contributed to a utility by a prospective customer or which has been constructed by the utility and paid for by the prospective customer for which no reimbursement is required to be made by the utility to the prospective customer as a prerequisite to obtaining service." NAC 361.260. The income approach indicator is based on an "adjusted net operating income" (NOI) that is "capitalized (converted to value) using an appropriate capitalization rate for the industry group." NAC 361.423.

In addition to the foregoing two indicators, a taxpayer is also permitted to submit an optional replacement cost new less depreciation (RCNLD) calculation. NAC 361.4215. A taxpayer-submitted RCNLD calculation must include "all taxable operating property of the collective unit being assessed," and it "must have been performed in accordance with generally accepted appraisal methodology." NAC 361.4215(2).

A taxpayer claiming that the Commission's decision constitutes an "overvaluation or excessive valuation" of a centrally-assessed property is entitled to bring a direct appeal to the State Board. NRS 361.403. At a State Board hearing, the petitioner bears the burden of providing "evidence of the valuation of the property" by "using appropriate appraisal standards." NRS 361.403; NAC 361.735.

In this case, the Commission established the value of all centrally-assessed properties, including Petitioners' properties, at a regular session on October 3, 2016. Subsequently, Petitioners filed direct appeals to the State Board received on January 17, 2017. The appeals are based upon a claimed wrong use of depreciation in the cost approach per NAC 361.421 and NAC 361.415 and upon the inclusion of CIAC in the cost approach.

The State Board consolidated Case No. 17-106, Case No. 17-107, and Case No. 17-108, which involve properties under common ownership (NV Energy), as they involve common issues (the use of book depreciation in the cost approach and the inclusion of CIAC in the cost approach). At the hearing, the State Board treated Case No. 17-106 as the lead case.

The State Board, having considered all evidence, documents and testimony pertaining to the valuation of the property in accordance with the applicable statutes and regulations, hereby makes the following Findings of Fact, Conclusions of Law and Decision.

FINDINGS OF FACT

- 1) The State Board is an administrative body created pursuant to NRS 361.375.
- 2) The State Board is mandated to hear direct appeals of property tax valuations of the Commission pursuant to NRS 361.403.
- 3) The Taxpayer and the Assessor were given adequate, proper and legal notice of the time and place of the hearing before the State Board, and the matter was properly noticed pursuant to the Open Meeting Law at NRS 241.020.

- 4) Petitioners are public utilities subject to regulation by the Nevada Public Utilities Commission (PUCN). *SBE* 31. The subject properties consist of electric generation, transmission, distribution and general purpose assets and natural gas distribution assets. See *Record for Case 17-106, SBE page 15*. The property operates in an “integrated manner” to provide utility service to retail customers. *Id.* The property is of an “interstate or intercounty” nature, and is thus subject to central assessment under NRS 361.320. *Id.*, *SBE pp. 13-14*.
- 5) The Commission is required to establish the valuation for assessment purposes of any property of an interstate and inter-county nature, including the property of all interstate or inter-county natural gas transmission and distribution companies pursuant to NRS 361.320 and applicable regulations. Petitioners’ are the owners of property of an interstate or inter-county nature. See NRS 361.032; NRS 361.320. The Commission established the unitary values for the subject properties at a regular session on October 3, 2016 pursuant to NRS 361.320. *Id.*, *SBE p. 13*.
- 6) Petitioners timely filed direct appeals to the State Board from the valuations established by the Commission. *Id.*, *SBE pp. 1-2*. The appeals are based upon a claimed wrong use of depreciation in the cost approach per NAC 361.421 and NAC 361.415 and upon the inclusion of CIAC in the cost approach.
- 7) At the hearing, the State Board consolidated Case No. 17-106, Case No. 17-107, and Case No. 17-108, which involve properties under common ownership (NV Energy), as they involve common issues (the use of depreciation in the cost approach and the inclusion of CIAC in the cost approach). The State Board treated Case No. 17-106 as the lead case. See *Tr.*, 8-29-17, p. 5, *ll. 7-16*.
- 8) Mr. Ross presented Petitioners’ position on their two central issues regarding the valuations established by the Commission based on the cost approach: first, their claim that the failure to exclude the value of all CIAC is improper, and second, their claim that the use of book depreciation alone is inadequate to capture all appraisal depreciation. See *Tr.*, p. 5, *l. 17 through p. 25, l. 6*.
- 9) As to Petitioners’ first claim, Mr. Ross asserted that the value of CIAC plant is improperly included in the cost approach at an “amount other than zero.” For Case No. 17-106, he stated that the value of such contributed plant is currently \$420 million. *Tr.*, p. 6, *ll. 5-16*.
- 10) For an example of CIAC plant, Petitioners described a distribution line extension to serve a single customer at a total cost of \$10,000, of which \$7,000 was reimbursed by the customer (representing CIAC plant) and \$3,000 was borne by the utility (representing a capital investment by the utility in its operating property). *SBE* 19. Mr. Ross stated that such contributed plant is of no value to a rate-regulated utility because it generates “no increase in net cash flows.” Instead, he asserted that increases in net cash flow result solely from capital investments by the utility in its operating property. See *Tr.*, 8-29-17, p. 6, *ll. 18-23*. He also stated that “increases in the number of utility customers served does not result in a greater net cash flows.” *Id.* Mr. Ross also denied that CIAC plant has any “effective purchasing power” – one of what he termed four “interdependent factors necessary for value to be created.” *Tr. p. 7, ll. 18-21; SBE 24*. Based on his assertion that CIAC plant generates no “net cash flows,” Mr. Ross expressed his opinion that no amount for CIAC has been captured in the income approach calculations that were

reviewed by the Commission in establishing the unitary valuations. *Tr.*, 8-29-17, p. 6, ll. 5-16.

- 11) In addition, Mr. Ross stated his belief that the value of utility plant “subsidized by CIAC” is already captured in the value of locally assessed real property. *Tr.*, p. 7, ll. 22-25. On this basis, Mr. Ross asserted there would be double assessment if the value of such contributed plant were included in Petitioners valuations. *Tr.*, p. 16, ll. 15-20. As to this point, Member Schiffmacher noted that in Nevada improvements to real property are valued at cost (in contrast to land, which is based on market value), and contributed utility plant is not placed on the assessment of a locally assessed parcel of real property. *Tr.*, p. 16, l. 22 through p. 17, l. 11. In response to Member Schiffmacher’s query whether such contributed assets appear on the utility’s books, Mr. Ross conceded that utility does hold “legal title to such assets,” and is responsible to “repair or replace those assets should a need to do so arise.” *Tr.*, p. 18, ll. 6-11.
- 12) As to Petitioners’ second claim, Mr. Ross stated that a book depreciation-based cost approach is not complete as it does capture all three forms of depreciation. *Tr.*, p. 8, l. 24 through p. 9, l. 9. He further stated that the book depreciation values used to calculate the valuations established by the Commission based on the cost approach are “not equivalent to market value.” *Id.*
- 13) On the foregoing grounds, Mr. Ross argued that the valuations established by the Commission based on the cost approach and are in “error,” and thus should be afforded no weight. *Tr.*, p. 13, ll. 4-10. Instead, he argued that the State Board should adopt the “only other sound valuation,” *i.e.*, the income approach values that were reviewed by the Commission in establishing the unitary values. *Id.*
- 14) Mr. Mitchell presented the Department’s defense of the unitary values established by the Commission. *Tr.*, p. 25, l. 7 through p. 30, l. 8. Those unitary values are based on a reconciliation of a cost approach indicator of value and an income approach indicator of value. *Id.* In Case No. 17-106, the reconciled value for SPPC – Electric is approximately \$1.8 billion, which results from weighing the cost approach value (approximately \$2.6 billion) at approximately 16 percent, and weighing the income approach value (approximately \$1.6 billion) at approximately 84 percent. *SBE* 34.
- 15) The starting point in developing such unitary values, Mr. Mitchell explained, is the underlying fundamental principle is that all property in Nevada is taxable unless specifically exempt. *Tr.*, 8-29-17, p. 26, ll. 5-8. Here, Petitioners are the legal owners of CIAC plant, it is part of their operating property, and it is not specifically exempt from taxation. *Id.*
- 16) In response to Mr. Ross’ assertion that there would be double assessment if the value of such contributed plant were included in Petitioners valuations, Mr. Mitchell explained that CIAC plant owned by a utility is not locally assessed. *Tr.*, p. 26, ll. 8-14. Accordingly, the CIAC plant owned and used by Petitioners to provide their utility services should be accounted for and appropriately taxed to Petitioners. *Id.* In response to Mr. Ross’ assertion that CIAC plant lacks any “effective purchasing power,” Mr. Mitchell explained that CIAC plant is transferable, and in fact legal title to Petitioners’ CIAC plant has transferred in the past. *Tr.*, p. 26, l. 20 through p. 27, l. 2. Responding to a question from Member Harper, Mr. Mitchell explained that factors other than, or in addition, to the value of CIAC plant (including the use of an income approach for a regulated public utility)

account for the difference between the reconciled value (of \$1.8 billion) and the income approach value (of 1.6 billion). *Tr.*, p. 29, ll. 8-19. In short, CIAC plant exists as a component part of the utility's operating plant and thus is properly reflect in a utility's unitary value. *Id.*

- 17) Mr. Popa continued with the Department's presentation, starting with a summary of the case history. *Tr.* p. 30, l. 15 through p. 42, l. 18. Following Petitioners' submission of their annual property tax reports, Mr. Popa stated that the Department's workpapers and information describing the valuation process were provided to Petitioners on August 15, 2016. *Tr.*, p. 30, l. 19 through p. 31, l. 7. Subsequently, the parties engaged in numerous discussions which culminated in a mutual agreement to revised lower values on September 16, 2017 (listed on SBE 34). *Id.* Mr. Popa proceeded present the Department's response to three issues: first, the use of book depreciation as opposed to appraisal depreciation; second, the inclusion of the value of CIAC plant; and, three, the reliance on the cost approach indicator of value. See *Tr.* p. 31, l. 15 through p. 32, l. 9.
- 18) First, Mr. Popa explained the basis for use of book depreciation as opposed to appraisal depreciation in performing a cost approach calculation. See *Tr.*, p. 32, l. 10 through p. 37, l. 1. The Commission's regulations require the use of the historical book costs, with a deduction for the accrued book depreciation (which may include physical, functional and economic obsolescence). NAC 361.808 and NAC 361.421. *Id.*
- 19) The reliance on historical costs less depreciation methodology (HCLD), Mr. Popa noted, is consistent with the authoritative manual published by Western States Association of Tax Administrators (WSATA), which states that "[Historical Cost Less Depreciation] sometimes referred to as 'as 'net book value,' is one of the more important indicators of value for rate based regulated public utilities. . . . HCLD is a valid indicator of value if the utility is subject to rate base regulation by a public utilities commission." See *Tr.*, 8-29-17, p. 36, ll. 12-17; SBE 33. Petitioners' have publicly acknowledged that their book depreciation reflects the "loss in service value" caused by "wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand and the requirements of public authorities." SBE 32. The revised lower values reflect the reconciliation of two indicators of value, and thus those values (as agreed to on September 16, 2017 (listed on SBE 34)), reflect the deduction of additional obsolescence and depreciation. See *Tr.*, 8-29-17, p. 36, ll. 18-25.
- 20) Second, Mr. Popa explained that the inclusion of CIAC (or contributed) plant in the cost approach is also expressly required by the Commission's regulations. *Tr.*, 8-29-17, p. 37, ll. 2-10. NAC 361.421(1). Consistent with this requirement, the cost approach indicators of value as prepared by the Department have included the value of CIAC plant since at least 1982. *Tr.*, 8-29-17, p. 37, ll. 14-24. Again, this cost approach methodology finds support in the WSATA Manual which states that "unless state law provides that CIAC or similar donated property is exempt from property taxation, it should be included in HCLD at its net book value." *Tr.*, p. 38, ll. 7-12. Nevada law does not exempt CIAC plant, and to exclude it from Petitioners' unitary valuations would create an inequality or inequity between Petitioners and other similarly-situated taxpayers. See *Tr.*, p. 37, ll. 2-10.
- 21) Third, Mr. Popa explained that the final valuations resulted from an analysis of the relative significance, applicability and defensibility of the indication of value derived from each approach to arrive at the appropriate final estimate of value for the system as required by Commission regulation. See *Tr.*, p. 39, l. 6 through p. 42, l. 17. Here, Mr.

Popa noted that the Petitioners did not provide any replacement cost new less depreciation (RCNLD) studies which might have assisted in further quantifying functional obsolescence. *Tr. 40, ll. 5-13*. If a taxpayer does submit an RCNLD study, it must encompass "all taxable operating property of the collective unit being assessed." NAC 361.4215(2).

- 22) Mr. Popa further summarized three reasons for not giving full weight to the income approach indicator of value: (i) Petitioners' income stream is affected by regulatory concessions to the PUCN that limit the revenue recovery to which they might otherwise be entitled, (ii) the values based on the income approach indicators of value are substantially lower than valuations in the merger transaction approved by the PUCN almost six years, and (iii) while many different factors come into play with the valuations in the prior merger transaction, it does appear that that sole reliance on the income approach as proposed by Petitioners would result in an incomplete and inadequate value. *See Tr., 8-29-17, p. 41, l. 1 through p. 42, l. 15*.
- 23) In summary, based on the foregoing Mr. Popa stated the Department's recommendation that the values certified by the Commission remain unchanged. *Tr., p. 42, ll. 8-15*.
- 24) The State Board found the Department's methodology to be credible in view of all the information provided. *See Tr., p. 54, l. 4 through p. 57, l. 12*. The unitary values for Petitioners' centrally-assessed properties should not be determined based on each individual asset within the pool of assets owned by the property owner. Here, the CIAC plant is part of the operational assets and contributes maybe not directly to the bottom line but it is an important and integral part of the inventory. In Case No. 17-106, the reconciled value for SPPC – Electric is approximately \$1.8 billion weighs the cost approach value at approximately 16 percent, and weighing the income approach value at approximately 84 percent. Based on the evidence presented, the reconciliation of the two indicators of value does account for any obsolescence or depreciation. *Id.*
- 25) Accordingly, based on the evidence presented, the State Board affirms the weighing of weighing the cost approach value (approximately \$2.6 billion) at approximately 16 percent, and weighing the income approach value (approximately \$1.6 billion), which gives substantial weight to income approach valuation. While Petitioners argued there were deficiencies in the cost approach indicator of value (e.g., it did not adequately account for all obsolescence or depreciation), they did not present any alternative study or valuation of their own. *See Tr., p. 54, l. 19 through p. 56, l. 14*. The State Board unanimously voted to affirm the value certified by the Commission. *See Tr., p. 56, l. 21 through p. 57, l. 12*.
- 26) Any finding of fact above construed to constitute a conclusion of law is adopted as such to the same extent as if originally so denominated.

CONCLUSIONS OF LAW

- 1) Petitioners timely filed notices of appeal, and the State Board accepted jurisdiction to determine these matters.
- 2) The Department and the Commission are administrative agencies or bodies created pursuant to Title 32 of the Nevada Revised Statutes.

- 3) The Commission is required to establish the values for “all physical property used directly in the operation of any such business of any such company in this State, as a collective unit.” NRS 361.320(2). The Commission is also authorized to adopt the formulas to be used to establish the valuation of property it is charges with establishing. NRS 361.320(5). In this regard, the Commission has adopted by regulation the formulas, or indicators of value, to be used to establish the taxable value of centrally-assessed properties. NAC 361.421 et seq.
- 4) The unitary values for centrally assessed property must be based on a reconciliation of a cost approach indicator of value and an income approach indicator of value. NRS 361.320(5). The cost approach (or HCLD) indicator is calculated based on a “gross book cost for financial reporting purposes of all taxable operating property, including . . . contributed plant,” with a deduction for “accrued book depreciation.” NAC 361.421. The income approach indicator is based on an “adjusted net operating income” (NOI) that is “capitalized (converted to value) using an appropriate capitalization rate for the industry group.” NAC 361.423. A taxpayer is also permitted to submit an optional replacement cost new less depreciation (RCNLD) calculation. NAC 361.4215. A taxpayer-submitted RCNLD calculation must include “all taxable operating property of the collective unit being assessed,” and it “must have been performed in accordance with generally accepted appraisal methodology.” NAC 361.4215(2).
- 5) Contributed plant, also known as “contribution in aid of construction” (CIAC) is “plant which has been contributed to a utility by a prospective customer or which has been constructed by the utility and paid for by the prospective customer for which no reimbursement is required to be made by the utility to the prospective customer as a prerequisite to obtaining service.” NAC 361.260.
- 6) The State Board has the authority to hear direct appeals of property tax valuations certified by the Commission pursuant to NRS 361.403.
- 7) All property within Nevada is subject to taxation “[e]xcept as otherwise provided by law.” NRS 361.045. Contributed or CIAC plant exists as a component part of the utility’s operating plant and thus is properly reflected in a utility’s unitary value. NAC 361.421(1). The methods used for assessing taxes throughout the state must be applied uniformly to all similarly-situated taxpayers. *Bd. of Equalization v. Bakst*, 122 Nev. 1403, 1413 (2006). The Nevada Supreme Court has rejected the theory that double taxation results where characteristics of one property enhances the value of another property. *Sun City Summerlin v. Dep’t of Taxation*, 113 Nev. 835, 843 (1997) (stating that with “regard to the issue of double taxation, the correct view is that there is no necessary correlation between one property’s increase in value and another property’s decrease in value”).
- 8) The Commission’s regulations require the use of the historical book costs, with a deduction for the accrued book depreciation (which may include physical, functional and economic obsolescence). NAC 361.808 and NAC 361.421. The regulations also expressly require that the value of CIAC plant be included in the cost approach. NAC 361.421(1). Nevada law does not provide any exemption for CIAC plant.

- 9) The subject properties are appraised at the proper taxable value in accordance with NRS 361.320 and NAC 361.421 and 361.423 for the 2017-2018 tax year. The assessed value is 35% of the taxable value.
- 10) Petitioners did not meet their burden to provide "evidence of the valuation of the property" by "using appropriate appraisal standards." NRS 361.403; NAC 361.735.
- 11) Any conclusion of law above construed to constitute a finding of fact is adopted as such to the same extent as if originally so denominated.

DECISION

Based on the above Findings of Fact and Conclusions of Law the State Board upheld the valuations as certified by the Commission on Oct. 3, 2016.

BY THE STATE BOARD OF EQUALIZATION THIS 9th DAY OF NOVEMBER, 2017



Deonne Contine, Secretary
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