SUPREME COURT OF ARIZONA

MESQUITE POWER, LLC, a limited liability company, Plaintiff/Appellee, v. ARIZONA DEPARTMENT OF REVENUE, an agency of the State of Arizona; COUNTY OF MARICOPA, a political subdivision of the State of Arizona, Defendants/Appellants.	**No. _______________** Court of Appeals No. 1CA-TX 22-0002 Arizona Tax Court No. TX 2018-000928

PETITION FOR REVIEW

MOONEY, WRIGHT, MOORE & WILHOIT, PLLC (No. 00609400)

Paul J. Mooney (No. 006708)
Bart S. Wilhoit (No. 020064)
The Mesa Tower, Suite 16000
1201 South Alma School Road
Mesa, AZ 85210-1189
Telephone: (480) 615-7500
Email: pmooney@mwmwlaw.com

Attorneys for Plaintiff/Appellee

TABLE OF CONTENTS

TABLE OF AUTHORITIES ii

INTRODUCTION 1

ISSUES PRESENTED 3

FACTS 4

REASONS REVIEW SHOULD BE GRANTED 7

ARGUMENT 8

I. The Opinion Ignores the Legislature's Definition of Taxable Property. 8

II. The Opinion's "Enhancement" Holding Impermissibly Allows Taxation of the PPA; *and* Zero Evidence Supports It. 10

III. The Opinion Conflates Market Value and Current Usage. 11

IV. The Opinion Ignores the Standard of Review and Weighs Evidence. 14

REQUEST FOR ATTORNEYS' FEES 16

CONCLUSION 16

APPENDIX TABLE OF CONTENTS 17

TABLE OF AUTHORITIES

Cases

Ariz. Dept. of Revenue v. Trico Electric Coop., 151 Ariz. 544 (1986)..................7, 8

Arizona State Tax Comm'n v. Staggs Realty Corp., 85 Ariz. 294 (1959)........ 2, 3, 7

Dobson v. Comm'r, 320 U.S. 489 (1943)..15

Great Western Bank v. LJC Development, 238 Ariz. 470 (2015) 14

In re America West Airlines, Inc., 179 Ariz. 528 (1994)............................ 2, 3, 7, 14

Maricopa County v. Trustees Ariz. Lodge, 52 Ariz. 329 (1938) .... passim

Mesquite Power, LLC v. Ariz. Dep't of Revenue, No.1 CA-TX22-0002 (12-20-2022) .... passim

State Tax Comm'n v. Phelps Dodge, 62 Ariz. 320 (1945) 10

Statutes

A.R.S. §42-11001(10)...8

A.R.S. §42-11001(4)...11

A.R.S. §42-11001(6)...4

A.R.S. §42-11054(C)(1) 11

A.R.S. §42-14152(A)..9

A.R.S. §42-14156.. passim

A.R.S. §42-14156(A)..8

A.R.S. §42-14156(A)(1) 8

A.R.S. §42-14156(A)(2) 8

A.R.S. §42-14156(A)(3) 8

A.R.S. §42-14156(A)(6)(d)...51

Statutes (cont'd)

A.R.S. §42-14156(B)(1) 8

A.R.S. §42-17154(A) 8

A.R.S. §42-18101 8

Article 9, §1 of the Arizona Constitution .... passim

Article 9, §11 of the Arizona Constitution 1, 3, 7, 8

Rules

Rule 21, Arizona Rules of Civil Appellate Procedure 16

Rule 23, Arizona Rules of Civil Appellate Procedure 1

Other Authorities

A. Smith, *The Tax Lawyer*, 58:2 at 404 (2005) 15

Guide to Business Valuations by Fishman, Pratt, Griffith and Wilson 54

Valuing Machinery and Equipment, (3rd ed. 2011) 54

INTRODUCTION

Pursuant to Rule 23, ARCAP, Plaintiff/Appellee, Mesquite Power, LLC ("Mesquite") seeks review of *Mesquite Power, LLC v. Ariz. Dep't of Revenue*, No.1 CA-TX22-0002 (12-20-2022) ("Opinion").[1] The Opinion reverses the Tax Court's (Hon. Danielle Viola) 11-page ruling following a five-day bench trial.[2] It holds the value of a "separate and severable" ***intangible*** contract owned by Mesquite's business must be included in the "full cash value" of Mesquite's ***tangible*** power plant for property tax purposes. (*Id.*, ¶39) This contradicts A.R.S. §42-14156 and disregards the Legislature's exclusive authority under Article 9, §11 to determine what property is subject to taxation. It also ignores the Tax Court's prior ruling on the same property after a six-day bench trial in 2018 (Hon. Christopher Whitten), which Appellants never appealed.[3]

Left unchanged, the Opinion fundamentally alters Arizona property tax law. It impermissibly holds the Arizona Department of Revenue ("ADOR") can value the entire ***business*** of an entity owning a power plant, instead of just the ***tangible property***, as directed by §42-14156. It violates Article 9, §§1 and 11 of the Arizona Constitution, and it contravenes at least three of this Court's precedents.

---

[1] Attached as Appendix 1.
[2] IR-86, attached as Appendix 2.
[3] IR-35:Ex.A, attached as Appendix 3.

The Opinion is wrong because: (1) It holds that intangible contracts (even when separate) must be considered when valuing the tangible property, contrary to the Legislature's direction in §42-14156; (2) it violates Article 9, §1—and this Court's *In re America West Airlines, Inc.*, 179 Ariz. 528 (1994) opinion—allowing ***identical*** power plants to be taxed differently based solely on whether the owners own other property; (3) it conflicts with this Court's *Maricopa County v. Trustees Ariz. Lodge*, 52 Ariz. 329, 336 (1938) decision, which holds intangible assets are ***not*** subject to taxation absent specific legislative authorization; (4) it contravenes *Arizona State Tax Comm'n v. Staggs Realty Corp.*, 85 Ariz. 294, 297 (1959), by expanding property taxes "through strained construction or implication" of unambiguous statutes; and (5) it disregards the applicable standards of review by not deferring to the Tax Court's rulings on these issues.

The Opinion is also fraught with errors. It makes factual misstatements and disregards undisputed facts. These errors, combined with its miscomprehension of property tax law, will—if not reversed—alter how property in Arizona is valued for tax purposes. It allows ADOR to value and tax an ***entire business*** under the property tax, rather than only the ***tangible property*** that business owns. In summary, the Opinion upends Arizona's property tax system, eviscerates longstanding law and ignores constitutional protections.

ISSUES PRESENTED

1. Does the Opinion erroneously reverse the Tax Court's factual findings based on correct legal conclusions regarding what is taxable under §42-14156, when it holds a separate, non-taxable, intangible contract "enhances" the value of Mesquite's tangible property and must be included in determining its value?

2. Does the Opinion fail to accord proper deference to the Legislature's exercise of the authority delegated by Article 9, §11 in enacting §42-14156?

3. Does the Opinion contradict this Court's holding in *Trustees Lodge* that intangible property is not taxable absent express legislative authorization, and thereby also violate the admonition in *Staggs* to avoid construing statutes to gather new objects of taxation by implication?

4. Does the Opinion's holding contravene the constitutional requirement of uniformity in Article 9, §1—as interpreted in *America West*—by valuing identical properties differently based solely on ownership of other property?

5. Does the Opinion improperly disregard the Tax Court's factual finding that ADOR's value exceeded market value, including its determinations about the experts' credibility, competency and the appraisal methods they used?

FACTS

This statutory tax appeal challenges ADOR's 2019 full cash value ("FCV") of the tangible property comprising Mesquite's power plant. Judge Viola found Mesquite proved the FCV was excessive because it exceeded "market value," violating A.R.S. §42-11001(6). (IR-86) She issued a 11-page Order, reducing the FCV from $197,000,000 to $105,000,000. (*Id.*) She entered Judgment and awarded fees and costs totaling $391,830.08. (IR-158:2) The Opinion reversed that ruling.

Mesquite owns a "combined-cycle" power plant ("Subject Property") known as "Block 2" of the Mesquite Power Plant. (IR-86:1) Everyone agrees that, pursuant to §42-14156, only the value of the land, real property improvements and tangible personal property used in operating that facility are taxable. (IR-86:4)

In addition, Mesquite's ***business*** owns a separate, non-taxable, intangible contract, known as a power purchase agreement ("PPA"). Under the PPA, Southwest Public Power Resources Group ("SPPR") pays $34,000,000 annually to Mesquite for its guarantee to provide an amount of electricity, regardless of whether SPPR purchases it.[4] (IR-35:Ex.A; IR-89:150-157) The PPA is a heat-rate call option whereby Mesquite's business can satisfy its obligations to SPPR with power generated from sources ***other than*** the Subject Property, which it regularly does.

[4] The PPA was amended in 2017 to increase these guaranteed payments to $48,000,000 per year, starting in 2021. (IR-161—41:5-24)

(IR-161—36:23-37:15; 42:6-43:1; 44:3-14; 117:18-119:22; Opinion, ¶9) Appellants stipulated: (1) "Under the PPA, SPPR must make payments regardless of whether they take delivery of the power"; and (2) "The electricity needed to fulfill Mesquite's obligations under the PPA does not need to be produced by the Subject Property, because that electricity can be purchased by Mesquite on the open market or from any other source." (IR-65:5 ¶¶21-22)

Appellants, the Tax Court, and the Opinion all agree that: (1) The PPA is an intangible, non-taxable contract (IR-86:3; IR-51:2; IR-35:Ex.A; IR-40:7; IR-164—122:4-6 and 123:7-9; Opinion, ¶¶9-10); (2) the PPA is separate and severable from the plant (*Id.*); and (3) the FCV of Mesquite's tangible property for tax purposes cannot include the value of the PPA. (*Id.*) The Tax Court granted partial summary judgment on these issues and ADOR never appealed that ruling.[5] (IR-51:2)

Nevertheless, Appellants argued that "while the [PPA] was not taxable, its existence enhanced the value of the taxable property and should be considered in determining value." (Opinion, ¶12) The Opinion framed the issue as "whether the existence of an intangible agreement enhances the value of the real and tangible

---

[5] Mesquite previously tried TX2015-000095 involving the same property for tax years 2016-17. (IR-35:Ex.A) Judge Whitten ruled the PPA was a "non-taxable, intangible asset" that cannot be included in ADOR's valuations. He reduced the values to $130,876,000 (2016) and $99,714,000 (2017), and ADOR did ***not*** appeal. (*Id.*; Opinion, ¶10) Subsequently, the parties stipulated to Judgment for 2018, setting that FCV at $99,714,000. (IR-35:Ex.C)

personal property subject to the tax assessment." (*Id.*, ¶3) There was no evidence showing the PPA "enhanced" the FCV, and Appellants' own expert testified it did ***not*** add value to the plant:

> Q. [MR. MOONEY]: Your opinion is that you do not believe the PPA in this case had any value in and of itself that's separate from the plant; is that fair?
>
> A. [MR. BARRECA]: I believe there was no evidence that it had any value.
>
> Q. Okay. ***So, if the PPA had no value, then you would be of the view that it obviously cannot enhance the value of the plant itself?***
>
> A. Well, PPA in general. We're not talking in general. We're talking about this specific PPA.
>
> Q. Yes.
>
> A. ***It did not add value to the plant—***
>
> Q. Okay.
>
> A. ***—in any—any material way***.

IR-164—128:1-15 (emphasis added).

Nonetheless, the Opinion holds: "We conclude that the [PPA] enhances the value of Mesquite's taxable property because it contributes to the plant's cash flows and current usage. Thus, it must be considered in determining the property's value." (Opinion, ¶35)

Mesquite sought reconsideration, but its motion was denied.

REASONS REVIEW SHOULD BE GRANTED

The Court should grant review because the Opinion ignores separate rulings by two experienced Arizona Tax Court judges that will forever change how power plants are valued in Arizona. It contradicts settled law regarding delegation of power to the Legislature by Article 9, §11 of the Constitution—upheld by this Court in *Ariz. Dept. of Revenue v. Trico Electric Coop.*, 151 Ariz. 544, 549 (1986)—effectively abrogating the Legislature's determination in §42-14156 about what is taxable. It holds identical power plants can be taxed differently based solely on whether the business owning them also has a PPA. This violates Article 9, §1 of the Constitution and contravenes this Court's *America West* opinion.

The Opinion also conflicts with *Trustees Lodge*, which held "intangible" assets are not subject to taxation "absent specific legislative authorization." Not only does no such authorization exist, but in §42-14156 the Legislature expressly declared intangible assets are ***not*** taxable. The Opinion misconstrues this unambiguous statute "to gather new objects of taxation by strained construction or implication" in violation of *Staggs*.

In summary, this Petition raises issues of "statewide importance" that implicate millions of tax dollars, impact numerous taxpayers, and affect many cases now pending before the Tax Court.

ARGUMENT

I. The Opinion Ignores the Legislature's Definition of Taxable Property.

For electric generation property, §42-14156 defines what is subject to taxation and how to value it. In *Trico*, this Court upheld those directives, stating: "Article 9, §11 of the Arizona Constitution vests the legislature with 'the manner, method and mode of assessing, equalizing and levying taxes in…Arizona'." 151 Ariz. at 546.

Section 42-14156(A) specifies what is subject to tax: "land used by the facility" (A)(1); "real property improvements used in operating the facility" (A)(2); and "personal property used in operating the facility" (A)(3). Section 42-14156(B)(1) then expressly limits "[p]ersonal property" to "all ***tangible*** property except land and real property improvements."[6]

Additionally, as Judge Viola explained (IR-86:5-6), Arizona law imposes a lien against property liable for tax. A.R.S. §42-17154(A). If taxes are not paid, the lien can be sold and foreclosed upon, because ***the property*** owes the tax. A.R.S. §42-18101. This is an "*in rem*" obligation. Because the lien attaches to specific property, and the tax is based on that property's FCV, the value must match what the lien attaches to. Here, that is solely the ***tangible*** property comprising the plant.

[6] In §42-11001(10), the Legislature defined "personal property" as "property of every kind, both tangible and intangible not included in the term real estate." Hence, its express limitation in §42-14156 to "tangible" items only, shows intangible assets are ***not*** to be valued. Moreover, this Court held in *Trustees Lodge*: "[A]bsent specific legislative authorization, intangibles [like the PPA] are ***not*** subject to tax." *Id*. at 336.

In contrast, the PPA is a contract that is separate and severable from the plant. It gives rise to *in personam* rights and obligations belonging to Mesquite and SPPR. Because the lien does not reach the PPA, it cannot be included in calculating taxes due from the property. *Trustees Lodge*, 52 Ariz. at 336 ("Property taxes are…collectible only from the property assessed [and the] statutes do not provide for the seizure and sale of intangibles"). The Legislature never authorized taxation of the PPA—it expressly limited taxation to ***tangible*** property.[7]

The Opinion disregards these principles based on its erroneous conclusion that without the PPA, Mesquite's plant has no revenues and, therefore, no value. (Opinion, ¶34) The Opinion is incorrect. Its holding ignores (or miscomprehends) the evidence presented below.

Mr. Simzyk (Mesquite's appraiser) did not just "eliminate" the business's income from the PPA as the Opinion asserts. (IR-165—47:7-14; IR-162—56:12-57:4) Appellants' own experts admitted Mr. Simzyk ***increased*** the plant's historical merchant-generation revenues to reflect what the plant would dispatch if ***all*** its power went into the merchant market without the business owning a PPA. (*Id.*) He used a capacity factor (*i.e.*, ratio of dispatch to maximum dispatch) starting at sixty-

[7] Another practical problem with the Opinion is electric generation facilities are valued under §42-14156 based on the "cost" of the taxable assets. The reporting forms required by §42-14152(A) make no provision for reporting costs on intangible assets—because they are not taxable and have no "cost" to report.

eight percent. (IR-162—53:7-13; 57:9-15) That was significantly greater than the plant's historical capacity factor and net generation, forecasting greater output as a merchant than it ever achieved. (IR-89:65; IR-162:56-57) Valuing only the plant based on what it would earn as a merchant (without business revenue from the PPA) is a standard appraisal method and technique. (IR-162—57:19-24) Mr. Simzyk estimated what a willing buyer would pay for a stand-alone plant—the only taxable property. (IR-162:30-31) Thus, he appraised the plant correctly.[8]

II. The Opinion's "Enhancement" Holding Impermissibly Allows Taxation of the PPA; *and* Zero Evidence Supports It.

As discussed above, everyone agrees the PPA is an intangible, non-taxable contract that is separate and severable from the plant, and that the value of the taxable property cannot include the PPA's value. Hence, holding that the PPA's revenues "enhanced" the FCV of the taxable property is nothing more than another way to (impermissibly) tax the PPA. The Opinion asserts (without evidence) that the PPA adds value and increases the FCV of the taxable property, but in doing so it disregards the Legislature's express limitation in §42-14156. Borrowing a well-worn

[8] Therefore, the holding that Mr. Simzyk's testimony was insufficient to overcome the statutory presumption of correctness is also erroneous. David Rhodes testified as a buyer and seller of power plants that his opinion of the value of the tangible assets was between $40,000,000 and $80,000,000. This also overcame the presumption. (IR-161—114:14-115:13) *State Tax Comm'n v. Phelps Dodge*, 62 Ariz. 320, 330 (1945) (presumption "disappears whenever contradictory evidence is received" and is ***never*** "placed in the scale and weighed as evidence").

expression: "What cannot be done directly, cannot be done indirectly." Including value from the PPA as an alleged "enhancement" of the tangible property still taxes the PPA.

Regardless, there was no evidence the PPA "enhanced" the FCV of the taxable property. When asked that question, Appellants' expert conceded the PPA "***did not add value to the plant—in any material way***." (IR-164—128:1-15) The Opinion ignores the evidence—and the Tax Court's findings—improperly substituting its contrary conclusion despite this testimony.

III. The Opinion Conflates Market Value and Current Usage.

The Opinion also incorrectly holds the Tax Court's "market value" finding ignored "current usage" under §42-11054(C)(1). (Opinion, ¶39) "Current usage" is "the use to which property is put at the time of valuation." A.R.S. §42-11001(4). The Opinion mistakenly asserts the Subject Property's "current use" is a plant operated by a business also owning a PPA: "Mesquite cannot, consistent with reality, be valued as a plant without an in-place agreement providing a fixed income." [9] (*Id.*) ***Nothing*** in the record supports this baseless assertion. Indeed, numerous Arizona power plants operate without PPAs.

---

[9] ADOR cannot value "Mesquite" (the ***business***). It can only value the tangible property comprising the plant. Explaining this, the Tax Court stated: "Notably, the 'plant' does not have contract income under the PPA. Mesquite receives income under the PPA and may use sources other than the Subject Property to provide the energy upon which the guaranteed payments are made." (IR-86:5, n.2)

In the Pretrial Statement, Appellants stated:

> 2. Under Arizona law, the Subject Property's full cash value must be determined based on its "current use" as of the Valuation Date.
>
> 3. As of the Valuation Date, ***the Subject Property's current use, as a base load power plant***, was also its highest and best use.

IR-65:11 (emphasis added). Mesquite's ownership of the PPA did not change the "current use" of its taxable property as a base load plant. The Opinion acknowledges this: "It operates as a 'base load plant' [and] sells electricity it generates on the open market as a 'merchant plant'." (Opinion, ¶4) As such, this plant ***can***—and under §42-14156 ***must***—be valued on a stand-alone basis.[10]

Mesquite's plant operates independently of the PPA, allowing Mesquite to satisfy its obligations to SPPR with power from sources ***other than*** the Subject Property, which it does regularly. (IR-161—36:23-37:15; 42:6-43:1; 44:3-14;

---

[10] The Opinion mistakenly asserts there was no valuation of Mesquite's intangible property at trial. Leaving aside the parties' stipulation regarding the issue to be decided at trial (*i.e.*, the market value of the ***tangible property***), there was substantial evidence showing the PPA's separate value. Contrary to the Opinion's statement that the PPA represents the "market value" of electricity, Messrs. Rhodes and Simzyk testified the PPA's pricing was ***above*** market rates in order to guarantee access to power. (IR-161—243:4-17; IR-162—15:20-16:2; IR-165—159:2-22; 162:16-20). Additionally, the IRS and GAAP ***required*** an allocation of the purchase price between tangible property and intangibles. (IR-161—95:12-96:15; 97:18-25) That valuation was done by a third-party expert and reviewed by a third-party auditor. (IR-161—99:5-13) It assigned values of $75,367,000 to the Subject Property ($73,000,000 for plant and equipment and $1,367,000 for land), and $479,565,000 to intangibles ($454,565,000 for the PPA and $25,000,000 for another contract). ***This valuation is in evidence***. (IR-110) And there is more. *See*, Appendix 4.

117:18-119:22) The PPA's cash flows have nothing to do with the separate value of the ***tangible*** plant, which operates as a merchant. The Opinion's error lies in conflating the undisputed "use" of the taxable property (a base load power plant) with how Mesquite's ***business*** utilizes the separate PPA.[11]

A simple hypothetical illustrates this. Consider two identical fast-food restaurants across-the-street from each other—one a McDonald's and the other "Joe's Hamburgers." The McDonald's sells more food and earns more revenues from its ***business***, due to its valuable franchise (an intangible). Nonetheless, both restaurants' ***property*** is identical and ***must*** be valued the same for property tax purposes, regardless of whether a non-taxable intangible contract (the franchise in the hypothetical and the PPA here) makes one ***business*** more valuable.[12]

The Opinion would value two identical plants—one whose owner has a PPA, and another whose owner does not—dramatically differently. This contravenes Arizona law. This Court held valuing two identical airplanes differently based solely on other property belonging to their owners violates Article 9, §1 of the Constitution.

---

[11] Mesquite's ***business*** is worth more with the PPA. However, this is not a "current use" issue. Mesquite's plant can be valued as a power plant on a stand-alone basis as the Legislature directed in §42-14156. Plants with and without PPAs operate the same way to produce electricity and use the same types of equipment. An example is the sale of a nearly identical plant at Gila River (with no PPA) for $100 million. (IR-89:58-59 [Sale 1A])

[12] Business income is taxed through the state's income tax, not the property tax. *See*, *Roehm v. Orange County,* 32 Cal.2d 280, 289-91 (1948) (explaining why California does not tax "intangibles" for property tax purposes).

America West, 179 Ariz. at 531, 534 ("property of the same character must be taxed the same" and "similar property used in the same industry for the same purpose cannot be [valued] differently for ad valorem taxation" due to other property belonging to one owner). The Opinion allows Mesquite's plant to be valued differently from an identical plant, solely because Mesquite's ***business*** also owns a separate, non-taxable, intangible asset (the PPA) and the other's does not. This violates the Constitution.

IV. **<u>The Opinion Ignores the Standard of Review and Weighs Evidence</u>.**

Appellate courts must "defer to the trial court's superior position to weigh the evidence, make credibility determinations, and resolve conflicts in facts and expert opinions." *Great Western Bank v. LJC Development*, 238 Ariz. 470, 482 ¶42 (2015). The Opinion ignores the Tax Court's factual findings, substituting its own opinions. The facts discredit its assertions that: (1) There was no valuation of the PPA (footnote 10, *supra*); (2) there was no evidence the PPA was at above-market rates (IR-161—243:4-17; IR 162—15:20-16:2; IR-165—159:2-22; 162:16-20); (3) there was no evidence of a market for PPAs (IR-161—115:24-116:22; 219:14-220:9; 250:13-20); and (4) the PPA enhanced the taxable property's value. (IR-164—128:1-15)

Similarly, the Opinion's discussion of additional risk factors in the income approach weighs and/or ignores evidence. (Opinion, ¶¶40-48) This includes Mr.

Simzyk's testimony about how and why he included the risk factors he used, and corroborating testimony by Mr. Rhodes that the cost of equity for stand-alone plants is at least 20%—almost 2% higher than Mr. Simzyk's 18.2% (including risk factors). *See* Appendix 5. It also ignores the Tax Court's findings about credibility and competency, which overcame the presumption of correctness. (IR-86:8-9)

Judge Viola evaluated ***all*** the evidence. Her findings are entitled to deference, as are Judge Whitten's virtually identical findings following the previous trial. The Arizona Tax Court is a specialized tribunal, similar to the U.S. Tax Court. *See*, *Dobson v. Comm'r*, 320 U.S. 489, 498-99 (1943) ("the [Tax Court] deals with a subject that is highly-specialized and so complex as to be the despair of judges."). It was created to develop a uniform body of tax law in Arizona. That purpose is thwarted when appellate courts ignore its rulings, a problem well-illustrated here, because the same property valued correctly by two experienced Tax Court judges—based on 11 days of testimony—will be valued differently based on this erroneous Opinion, unless review is granted and it is reversed.[13]

[13] As one commentator observed: "[Appellate] judges should not feel free to reverse experts such as Tax Court judges on matters that properly invoke their expertise." A. Smith, *The Tax Lawyer*, 58:2 at 404 (2005).

REQUEST FOR ATTORNEYS' FEES

Pursuant to Rule 21, ARCAP, Mesquite requests an award of fees.

CONCLUSION

This Court should grant review and reverse the Opinion.

RESPECTFULLY SUBMITTED this 20th day of January, 2023.

MOONEY, WRIGHT, MOORE & WILHOIT, PLLC

By: /s/Paul J. Mooney
Paul J. Mooney
Bart S. Wilhoit
Attorneys for Plaintiff/Appellee

APPENDIX TABLE OF CONTENTS

Appendix 1 – Court of Appeals Opinion, *Mesquite Power, LLC v. Arizona Department of Revenue,* 1-CA-TX 22-0002 dated 12-20-2022 18-31

Appendix 2 – Under Advisement Ruling, *Mesquite Power, LLC v. Arizona Department of Revenue,* TX2018-000928 dated 11-06-2021, IR-86 32-42

Appendix 3 –Minute Entry, *State of Arizona Department of Revenue v. Mesquite Power LLC,* TX2015-000095 dated 6-28-2018, IR-35:Ex. A and IR-89:150—157 43-50

Appendix 4 – IR-110; IR-111: 25-31; IR-161—98:2-99:17; IR-98:3; IR-117:22, Table 2)...51

Appendix 5 – Mesquite's Answering Brief at pages: 15, 17, 19-21, 41-43, and 48-55, and Exhibit B;
IR-86:7, fn.5; IR-162—162:25-163:5; IR-86:8-9; IR-162—173:1-18; IR-173:19-174:16; IR-89:74-75; IR-162—187:13-20; IR-161—62:3-15; 68:2-21; 69:9-11; IR-162—179:22-180:23; IR-180:24-181:4; IR-162—174:17-175:9; IR-177:11-20; IR-163:60:2-7; IR-162; IR-175:14-177:8; IR-177:21-178:11; IR-182:9-:16; IR-163—60:8-15; IR-44:17-45:5; IR-49:1-6; IR-178:12-16; IR-181:5-22; IR-162—178:17-179:21 52-54

APPENDIX ONE

IN THE
ARIZONA COURT OF APPEALS
DIVISION ONE

MESQUITE POWER, LLC, *Plaintiff/Appellee*,

v.

ARIZONA DEPARTMENT OF REVENUE, *Defendant/Appellant*.

No. 1 CA-TX 22-0002
FILED 12-20-2022

Appeal from the Arizona Tax Court
No. TX2018-000928
The Honorable Danielle J. Viola, Judge

VACATED AND REMANDED WITH INSTRUCTIONS

COUNSEL

Mooney, Wright, Moore & Wilhoit, PLLC, Mesa
By Paul J. Mooney (argued) and Bart S. Wilhoit
Counsel for Appellee

Arizona Attorney General's Office, Phoenix
By Lisa Neuville (argued) and Kimberly Cygan
Counsel for Appellant

OPINION

Judge Paul J. McMurdie delivered the Court's opinion, in which Presiding Judge Brian Y. Furuya and Judge Jennifer B. Campbell joined.

M c M U R D I E, Judge:

¶1 The Arizona Department of Revenue ("Department") appeals from the tax court's judgment reducing the full cash value of property held by Mesquite Power, LLC ("Mesquite") for the 2019 tax year. The Department argues the tax court erred by (1) discounting the impact of an established power purchase agreement on the property's value and (2) considering incompetent expert testimony.

¶2 We hold that where intangible assets enhance the real and tangible property's value, a competent appraisal must consider the effect such intangible assets have on the taxable property's value. Thus, we vacate the judgment, vacate the award of attorney's fees, costs, and expenses, and remand for the court to affirm the statutory value found by the Department.

FACTS AND PROCEDURAL BACKGROUND

¶3 The heart of this dispute is Mesquite's power plant's full cash value assessment for the 2019 tax year. At issue is whether the existence of an intangible agreement enhances the value of the real and tangible personal property subject to the tax assessment.

1. Mesquite's Power Plant.

¶4 Mesquite's power plant is one-half of a two-block, combined-cycle, natural gas-fired electric generation facility in western Maricopa County. It operates as a "base load plant," meaning it runs continuously. The plant sells the electricity it generates on the open market as a "merchant plant."

¶5 A power plant's capacity is measured in megawatts. The plant has a nameplate capacity of 691.6 megawatts and a net operating capacity of 625 megawatts. Another metric, called "heat rate," confirms how efficiently a plant converts fuel into energy. The plant's historical heat rates are superior to the average for comparable facilities in the region and across the United States.

2. Transaction History.

¶6 Sempra U.S. Gas & Power ("Sempra") built the plant in 2003. Sempra structured the plant and its accompanying business as Mesquite. In 2015, Sempra sold Mesquite to ArcLight Capital Partners, LLC ("ArcLight") for nearly $357 million.

¶7 ArcLight spent over $27 million in capital improvements for the plant. In December 2017, less than a month before the January 1 valuation date[1] for the 2019 tax year, ArcLight solicited offers for the sale of Mesquite. Southwest Generation Operating Company ("Southwest") first offered $518 million, and the deal closed in July 2018 for around $556 million. Southwest currently owns Mesquite.

3. The Purchase Agreement.

¶8 Southwest's purchase of Mesquite from ArcLight included transferring a contract for power generation ("Purchase Agreement"). Under the Purchase Agreement, Mesquite guaranteed the Southwest Public Power Resources Group ("SPPR") access to 271 megawatts of electrical capacity until May 2021, when the capacity increased to 475 megawatts. In return, SPPR promised to pay Mesquite $34 million per year, rising to $48 million per year in 2022, as well as certain operation and maintenance costs for the plant. SPPR's payments are fixed whether SPPR draws upon any guaranteed electrical capacity. The terms of the Purchase Agreement run through 2046. Both before and after the purchase by Southwest, Mesquite remains bound by the Purchase Agreement.

¶9 The Purchase Agreement does not require that Mesquite provide electricity to SPPR from the Mesquite plant. If it chooses, Mesquite may purchase power on the open market to cover the capacity guarantee to SPPR. Although technically the Purchase Agreement and the plant are severable, any such severance would require approval by SPPR. According to Southwest's vice president, the presence of the Purchase Agreement was a deciding factor in purchasing the property.

4. Litigation History.

¶10 This is not the first time Mesquite has appeared before the tax court. While still under the ownership of ArcLight, Mesquite challenged the Department's valuation of the property for the 2016 and 2017 tax years. The tax court issued a consolidated judgment in Mesquite's favor, establishing reduced property values for those years and finding that the Purchase Agreement was a "non-taxable, intangible asset." The Department did not appeal that judgment.

---

[1] A.R.S. § 42-14153(C) provides that a property's value is the value "determined as of" the valuation date. *Siete Solar, LLC v. Ariz. Dep't of Revenue*, 246 Ariz. 146, 150, ¶ 17 (App. 2019).

¶11 In this case, the Department valued the property for the 2019 tax year at $196 million ("statutory value"). Mesquite appealed that assessment to the tax court, claiming that the statutory value exceeded the property's market value in violation of A.R.S. § 42-11001(6). Mesquite argued that the property's full cash value should be reduced to $105 million.

¶12 Before the tax court, Mesquite moved for partial summary judgment on whether the Purchase Agreement could be considered in the property's valuation. Mesquite asserted that the 2016–17 rulings estopped the Department from considering the Purchase Agreement. The Department, in turn, argued that while the Purchase Agreement was not taxable, its existence enhanced the value of the taxable property and should be considered in determining value. The tax court entered partial summary judgment for Mesquite, ruling that the Purchase Agreement is a "non-taxable, intangible asset that is separate and severable from the tangible property." The court partially denied the motion about "whether cash flows attributable to the Purchase Agreement can be considered as part of the valuation of Mesquite's property." The court did not address the cash flow issue in its final judgment.

¶13 At trial, Mesquite offered expert testimony supporting its $105 million evaluation claim. The Department offered expert testimony valuing the property at $432 million. Each expert considered the three standard appraisal methods (market,[2] income, and cost), although Mesquite's expert gave no weight to the cost or market approaches. Only the Department's evaluation included the "cash flows attributable" to the Purchase Agreement. Mesquite's expert, instead, constructed a hypothetical income model that excluded the Purchase Agreement income.

¶14 After a five-day bench trial, the tax court ruled for Mesquite, valuing the property at $105 million for the 2019 tax year. The Department appealed, and we have jurisdiction under A.R.S. §§ 12-2101(A)(1) and 42-1254(D)(4).

---

[2] In the tax court, the parties called the market approach the "sales comparison" approach, we apply the terminology found in A.R.S. § 42-16051(B)(1)–(3). *See Maricopa County v. Sperry Rand Corp.*, 112 Ariz. 579, 581 (1976).

DISCUSSION

¶15 “We view the facts in the light most favorable to sustaining the trial court’s judgment.” *Cimarron Foothills Cmty. Ass’n v. Kippen*, 206 Ariz. 455, 457, ¶ 2 (App. 2003) (quoting *Sw. Soil Remediation, Inc. v. City of Tucson*, 201 Ariz. 438, 440, ¶ 2 (App. 2001)). We will “defer to the trial court’s factual findings as long as the record supports them.” *In re the Gen. Adjudication of All Rts. to Use Water in the Gila River Sys. & Source*, 198 Ariz. 330, 337, ¶ 15 (2000). We review pure questions of law and mixed questions of law and fact *de novo*. *See Robson Ranch Mountains, LLC v. Pinal County*, 203 Ariz. 120, 125, ¶ 13 (App. 2002).

¶16 When challenging the statutory value, the taxpayer must rebut the statutory presumption and show that a lower valuation is correct. *See Graham County v. Graham County Elec. Coop., Inc.*, 109 Ariz. 468, 469–70 (1973).

¶17 Arizona values property at its “full cash value” for tax purposes. *Bus. Realty of Ariz., Inc. v. Maricopa County*, 181 Ariz. 551, 553 (1995). “Full cash value” generally means “fair market value,” defined as “that amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts.” *Id.* Fair market value can be derived by using “standard appraisal methods and techniques.” A.R.S. § 42-11001(6).

¶18 “Current usage shall be included in the formula for reaching a determination of full cash value.” A.R.S. § 42-11054(C)(1). “The valuation of electric generation facilities,” like the property here, is determined by looking at, among other things, “[t]he value of land, ... [t]he valuation of real property improvements used in operating the facility, ... [and the] valuation of personal property used in operating the facility.” A.R.S. § 42-14156(A)(1)–(3). “‘Personal property’ means all tangible property except for land and real property improvements.” A.R.S. § 42-14156(B)(2).

A. Mesquite Misattributes Value to the Purchase Agreement.

¶19 The parties agree that Southwest bought Mesquite—including real and personal property and the Purchase Agreement—for about $556 million. Mesquite’s expert appraised the tangible property at $105 million. Though there was no appraisal for Mesquite’s intangible property, it follows from the sale price that, as of the time of Southwest’s purchase, Southwest valued Mesquite’s intangible

property (which includes the Purchase Agreement) at more than $400 million.

¶20 Although Mesquite did not separately appraise the value of the Purchase Agreement, the Department argues that the Purchase Agreement has little to no independent value. The Department also contends, however, that the Purchase Agreement's presence enhances the value of the real and tangible property of the plant.

¶21 The Purchase Agreement is a contract to provide electricity to SPPR in exchange for SPPR paying Mesquite a fixed annual rate and operational costs. But the Purchase Agreement itself does not represent or evidence the value of these transactions. If the Purchase Agreement no longer existed, it would change nothing about the plant or its ability to produce the same electrical capacity. So long as the plant can produce electricity, a new sale agreement could be negotiated with SPPR or any other willing purchaser. The plant's electricity production generates value no matter how the sale of that electricity is made or who is purchasing the electricity.

¶22 Still, Mesquite argues that the Purchase Agreement has independent value because, under the agreement, Mesquite will be paid no matter if SPPR chooses to take any electrical power. This argument is not persuasive. SPPR's choice to obtain power under the Purchase Agreement is irrelevant because Mesquite's obligation to guarantee power under that agreement persists. Any income Mesquite receives under the Purchase Agreement is *earned* by ensuring SPPR has *access* to the specified capacity. That Mesquite may or may not need to use the plant to satisfy its obligations under the Purchase Agreement does not alter the reality that electricity can be produced and sold by the plant, much less the circumstances of actual use relevant during the valuation period. And if the income must yet be achieved through performance under the contract, the value of the income is not inherent to the contract.

¶23 This is not to say that a contract can never hold value. For instance, a contract may have inherent value if its terms are favorable such that the bargained-for return is worth more than the consideration would secure on the open market. But the tax court did not make such a finding. If anything, the Purchase Agreement provides the best evidence for the fair market value of Mesquite's obligation, as the agreement was entered at arm's length.

¶24 Finally, even if the Purchase Agreement holds some value, Mesquite has failed to show that the inherent value of the Purchase Agreement explains the $400 million gap between the purchase price and the claimed property value. We thus conclude that Mesquite misattributes the value of the taxable property to the Purchase Agreement.

B. The Purchase Agreement Enhances the Value of the Taxable Property.

¶25 Mesquite maintains that because the Purchase Agreement is a "non-taxable, intangible asset that is separate and severable from the tangible property," it cannot be considered in determining the property's tax valuation. In its appraisal, Mesquite's expert excluded the income generated under the Purchase Agreement and declined to factor the Purchase Agreement into Mesquite's risk assessment. As a result, Mesquite's appraisal for $105 million hinged on hypothetical cash flows and risk as if the Purchase Agreement did not exist.

¶26 Among other criticisms, the Department argues that Mesquite's appraisal is flawed because the Purchase Agreement contributes to the cash flow of the taxable tangible property. It also claims that the Purchase Agreement's income guarantee reduces the risk of operating the plant. The Department asserts that the Purchase Agreement's inherent value may be non-taxable, but to appraise the property as if the Purchase Agreement did not exist would artificially reduce the value of the taxable property and be error.

¶27 As a matter of mixed fact and law, we review *de novo* whether an appraisal technique is proper under standard appraisal methods. *See Eurofresh, Inc. v. Graham County*, 218 Ariz. 382, 387, ¶ 23 (App. 2007). As applied here, we address whether a tax valuation of real and personal property should consider intangible assets.

¶28 *Maricopa County v. Viola*, a case involving apartments participating in the low-income housing tax credits ("LIHTC") program, is instructive. 251 Ariz. 276 (App. 2021). Under the LIHTC program, property owners received federal tax credits for agreeing to thirty-year restrictions on the rent they can charge tenants. *Id.* at 278, ¶ 2. The tax court found this agreement intangible and untaxable. *Cottonwood Affordable Hous. v. Yavapai County*, 205 Ariz. 427, 429 (Ariz. Tax Ct. 2003).

¶29 We affirmed the tax court's ruling through special action and held that the LIHTC program must be considered when valuing property subject to the restrictions. *Viola*, 251 Ariz. at 281, ¶ 19. We explained that

"[a]n LIHTC property cannot be valued as if it were a conventional apartment complex because it is not and cannot be used as such." *Id.* at 280, ¶ 15. This holding reflects the statutory requirement that "[c]urrent usage" be considered in reaching the formula for full cash value. A.R.S. § 42-11054(C)(1). We agreed with the tax court's conclusion:

> A willing buyer, knowing that there is a restriction as to the amount of rent that can be charged, would pay less for a low income housing project than for a regular commercial apartment complex. This property should not be valued as though a buyer would not consider the restrictions. A valuation for an LIHTC project, determined under any of the standard appraisal methods, that does not take the deed restrictions into account will not result in a determination of fair market value for that property.

Id. at 279–80, ¶ 13 (quoting *Cottonwood Affordable Hous.*, 205 Ariz. at 430). Thus, while the LIHTC restrictions were not taxable property, it would be error to evaluate the apartments without considering their effect on the property.

¶30 Parallel reasoning applies here to the Purchase Agreement and the Mesquite plant. True, the Purchase Agreement raises rather than lowers the value of the business. That said, a willing buyer would still consider the Purchase Agreement's impact on the plant. Southwest's vice president affirmed this by testifying that Southwest would have never bought Mesquite's business without the Purchase Agreement. Because the Purchase Agreement influences the purchase price a willing buyer would pay for the property (and, more basically, whether to buy the property), the proper valuation of the property should reflect the effect of the Purchase Agreement. *See Viola*, 251 Ariz. at 279–80, ¶ 13.

¶31 Mesquite argues that it would be improper to consider the Purchase Agreement's enhancement of the value of the taxable property because the Purchase Agreement is "separate and severable from the tangible property." Mesquite maintains that because the tax court granted partial summary judgment on the issue and it was not appealed, the Department cannot contest the Purchase Agreement's separate and severable status.

¶32 But the Purchase Agreement's severability does not resolve whether it enhances the value of real and tangible property. The Purchase Agreement is severable, but it has not been severed. An asset that may be

removed from the property does not exempt it from taxation. A contrary view would defeat the purpose of including "personal property" in the valuation statute. *See* A.R.S. § 42-14156(A)(3). And more importantly, A.R.S. § 42-11054(C)(1) directs that tax evaluations be based on the property's "[c]urrent usage," not hypothetical usage.

¶33 Severable as it may be, the Purchase Agreement is not easily disentangled from the plant. The two were transferred together in the sale from ArcLight to Southwest. The terms of the Purchase Agreement require a supermajority buyer's approval to sell or transfer the Purchase Agreement independently, and Mesquite presented no examples of contracts like the Purchase Agreement being sold on the market separately from power plants. The Purchase Agreement provides operation and maintenance payments for Mesquite. We reject any suggestion that an agreement that offers, among other things, payment of operation and maintenance costs is not directed toward the operation or maintenance of the facility and can be ignored in an income-approach valuation.

¶34 Finally, the Purchase Agreement is not a unique or exclusive method for selling electrical power. Both parties presented evidence that most power plants not owned by a utility company operate and receive income through long-term contracts. Yet Mesquite's expert eliminated the revenue generated under the Purchase Agreement in his appraisal because the contract produced it. Taken to its extreme, such an approach would conclude that fully-subscribed power plants hold *no* value. Such a view defies reason and economic reality. Mesquite may not avoid taxes by sequestering its value into an untaxable contract just because such a contract is hypothetically severable and independent of the property on which it depends for its relevance. To hold otherwise also would run contrary to A.R.S. § 42-14156.

¶35 We conclude that the Purchase Agreement enhances the value of Mesquite's taxable property because it contributes to the plant's cash flows and current usage. Thus, it must be considered in determining the property's value.

C. Because Mesquite's Appraisal Failed to Evaluate the Property as It Exists, It Is Incompetent to Rebut the Statutory Presumption.

¶36 Generally, the tax valuation "as approved by the appropriate state or county authority is presumed to be correct and lawful." A.R.S. § 42-16212(B). The taxpayer may overcome this presumption by presenting competent evidence that the taxing authority's valuation is excessive.

Inspiration Consol. Copper Co. v. Ariz. Dep't of Revenue, 147 Ariz. 216, 219 (App. 1985). "Evidence is competent for the purposes of rebutting the statutory presumption and of showing that the Department's valuation was excessive when it is derived by standard appraisal methods and techniques which are shown to be appropriate under the particular circumstances involved." *Id.* at 223.

¶37 If the taxpayer uses a different valuation method than the taxing authority, it must establish that its approach was appropriate under the circumstances. *Inspiration Consol. Copper Co.*, 147 Ariz. at 219. Yet if the taxpayer and taxing authority use the same appraisal method "but differ as to the correct treatment of factors utilized in such method, the taxpayer's evidence is nevertheless competent and sufficient to overcome the statutory presumption." *Id.*

¶38 The experts for the Department and Mesquite considered the three standard appraisal approaches, though they "differ[ed] as to the correct treatment of factors" and the relative weights given each method. *See Inspiration Consol. Copper Co.*, 147 Ariz. at 219. The Department's expert gave some weight to each of the three approaches. By contrast, Mesquite's appraisal relied on the income-based approach, claiming it is the most relied on by buyers and sellers in the industry. This approach uses the projected future cash flows of the property to determine its present value.

¶39 But Mesquite did not calculate cash flows for the plant in its current usage. Instead, Mesquite only included income from what it considers the taxable property, constructing a hypothetical income model for the property as if the Purchase Agreement did not exist. Mesquite's model is improper because it envisions the plant operating in a way that is not its "[c]urrent usage." *See* A.R.S. § 42-11054(C)(1). Mesquite cannot, consistent with reality, be valued as a plant without an in-place agreement providing a fixed income. *See Viola*, 251 Ariz. at 280, ¶ 15. This error alone would render Mesquite's appraisal "[in]appropriate under the particular circumstances involved." *Inspiration Consol. Copper Co.*, 147 Ariz. at 223.

¶40 But we have more concerns with Mesquite's appraisal. For example, in calculating the weighted average cost of capital ("WACC") for its model, Mesquite's expert included a "small company size premium" and a "company-specific" risk factor. Mesquite added these two values

together under the label "additional risk factor" ("R_u").[3] The Department did not use either of these risk factors. The Department challenges the application of R_u, arguing that it is unjustified and that its two components are duplicative.

¶41 We agree with the Department. The record offers no indication that the small company premium and the company-specific risk are not improperly duplicative. Mesquite's expert explained the small company premium at trial, testifying that small companies are "inherently more risky because of . . . size, lack of diversification, and the liquidity in general." But Mesquite's expert report justifies the company-specific risk in a single sentence, claiming that it "account[s] for the electrical generation industry, lack of diversification and illiquidity." When asked on direct examination whether applying the company-specific risk beyond the small company premium would be double counting, Mesquite's expert replied:

> It's not double counting because, again, we've got the risk associated with there being a company and diversification, right? We still have the unsystematic risk that's associated with—again, the fact that we don't have that diversification. We have a single asset, and more specifically, just the real and personal property of that asset.

¶42 Despite the expert's nominal denial, the testimony fails to disprove the Department's accusation of double counting. The whole of Mesquite's evidence encompasses both the small company premium and the company-specific risk based on diversification and liquidity grounds. The use of two factors to account for the same risk is duplicative. Without contrary justification, the R_u factor appears to be little more than an attempt to pad the numbers such that they arrive at Mesquite's preferred value. *See Del. Open MRI Radiology Assocs., P.A. v. Kessler*, 898 A.2d 290, 339 (Del. Ch. 2006) ("[T]he company specific risk premium often seems like the device experts employ to bring their final results into line with their clients' objectives, when other valuation inputs fail to do the trick.").

¶43 Moreover, the effect of R_u on the overall valuation is immense. For instance, R_u adds 10.37% to the rate of return on equity capital, more

---

[3] Mesquite applies the label "additional risk factor" to both the sum, R_u, and to the 5% company-specific risk factor which is a subcomponent of R_u. For clarity, we call the subcomponent the "company-specific risk" and the total 10.37% amount R_u.

than doubling the number it would otherwise be (and, incidentally, roughly doubling the number Southwest projected as a rate of return on equity when purchasing Mesquite). Removing R_u and relying only on Mesquite's expert's numbers for every other step in the analysis would lead to a total valuation of over $230 million—a number greater than the statutory value. The wild disparity in these values is especially alarming given Mesquite's sparse justifications for incorporating both risk factors.

¶44 The Department also argues that the small company premium and company-specific risk factors cannot be competently applied without evidence to justify their use. The Department supports this position by citing an unpublished decision, *Transwestern Pipeline Company v. Arizona Department of Revenue*, No. 1 CA-TX 19-0006, 2020 WL 4529622 (Aug. 6, 2020) (mem. decision). In *Transwestern*, the Department appealed a tax court's judgment that adopted a taxpayer's WACC calculation for the 2016 and 2017 tax years. *Id.* at *2, ¶ 6. The taxpayer's expert appraisal included small company premiums and company-specific risk factors that, in total, did not exceed five percent. *Id.* at *3, ¶ 14.

¶45 The Department challenged the validity of the risk factors, arguing that "company-specific risks duplicate the risks already accounted for in the small-company risk premium and the industry beta." *Transwestern Pipeline Co.*, No. 1 CA-TX 19-0006, at *3, ¶ 15. The Department also argued that the risk factors were unjustified because

> there is no evidence in the record that Transwestern uniquely suffered from the identified company-specific risks . . . while other companies in the pipeline industry do not. . . . [Transwestern] failed to provide sufficient factual basis for the premium; either specific financial analysis to determine whether a company-specific risk premium is appropriate or the amount of such a premium.

Id. While the taxpayer argued that applying company-specific risks followed "standard appraisal method[s]," the Department countered that "the evidence must still show risks specific to the company, above general risks to the entire industry." *Id.* at *4, ¶ 16.

¶46 We agreed with the Department that there was insufficient evidence identifying risks specific to Transwestern above the general risk to the industry or risks common to all business ventures. *Transwestern Pipeline Co.*, No. 1 CA-TX 19-0006, at *5, ¶ 19. We vacated the part of the judgment adopting the taxpayer's WACC calculation, holding that "we

need not defer to the tax court's conclusion based on [Transwestern's] testimony when we cannot find competent record evidence that Transwestern specifically suffered from the specific risk factors accepted by the court." *Id.* at *4, ¶ 16; *see also Pima County v. Cyprus-Pima Mining Co.*, 119 Ariz. 111, 119 (1978) (The expert's capitalization method was not competent evidence when he departed from projected copper prices and failed to adjust for inflation.).

¶47 *Transwestern* follows holdings from other jurisdictions. *See Gesoff v. IIC Indus., Inc.*, 902 A.2d 1130, 1158 (Del. Ch. 2006) (Company-specific premiums should not be applied without justifying evidence.); *see also Minn. Energy Res. Corp. v. Comm'r of Revenue*, 886 N.W.2d 786, 793–94 (Minn. 2016) (Lack of evidentiary support for company-specific risk justifies a tax court's decision to exclude this factor.); *cf. Horn v. McQueen*, 353 F. Supp. 2d 785, 839 (W.D. Ky. 2004) (Appraisals must be "careful not to 'double-count'" by applying a company-specific risk, "especially as modified . . . for smaller companies."). While a company-specific risk may apply in some cases, the choice to use and the value of such a factor must be supported by the evidence.

¶48 Here, the R_u factor is more than double what it was in *Transwestern*. But there is no evidence in the record suggesting that Mesquite is inferior to similar plants. On the contrary, its heat rates are superior to nationwide and regional averages. There is also no evidence that Mesquite is riskier than similar plants. Over half of Mesquite's capacity is contracted through 2046, and Mesquite's expert testified that plants under a contract are less risky than those without an agreement. We conclude that Mesquite has failed to provide evidence to justify its use of the 10.37% R_u factor. As a result, its inclusion was unreasonable and "[in]appropriate under the particular circumstances involved." *Inspiration Consol. Copper Co.*, 147 Ariz. at 223.

¶49 Lastly, we respond to the Department's suggestion that Mesquite must apply the unit principle. An appraisal using the unit valuation method would calculate the plant's total value as an operating unit and remove any untaxable assets' fair market value from the full value. The Department cites several cases from other jurisdictions that apply the unit principle. *See Elk Hills Power, LLC v. Bd. of Equalization*, 304 P.3d 1052 (Cal. 2013) (power plant); *RT Commc'ns, Inc. v. State Bd. of Equalization*, 11 P.3d 915 (Wyo. 2000) (telephone company); *In re Appeal of ANR Pipeline Co.*, 79 P.3d 751 (Kan. 2003) (natural gas pipeline).

¶50 The advantage of the unit principle is that it captures the value generated by the cooperation of mutually beneficial assets. In so doing, it considers the "[c]urrent usage" of the property. *See* A.R.S. § 42-11054(C)(1). Given the shortcomings in Mesquite's appraisal, we need not decide whether the unit valuation principle is appropriate here.

¶51 We hold that any valuation approach must appraise the operating unit by its current usage to be competent. Property appraisal evidence is only competent "when it is derived by standard appraisal methods and techniques which are shown to be appropriate under the particular circumstances involved." *Inspiration Consol. Copper Co.*, 147 Ariz. at 223. Though derived by nominally standard methods, Mesquite's appraisal is inappropriate under the circumstances because, by assuming the Purchase Agreement does not exist, it does not reflect the property as it is. Thus, Mesquite's expert testimony is incompetent to rebut the statutory presumption.

CONCLUSION

¶52 We vacate the tax court's judgment and remand for the tax court to impose the statutory value. We vacate the tax court's award of attorney's fees, expert witness fees, and costs. We deny Mesquite's request for appellate attorney's fees, costs, and other expenses under A.R.S. § 12-348(B) because Mesquite did not prevail on the merits.

AMY M. WOOD • Clerk of the Court
FILED: AA

APPENDIX TWO

Clerk of the Superior Court
*** Electronically Filed ***
11/09/2021 8:00 AM

THE SUPERIOR COURT OF THE STATE OF ARIZONA
IN THE ARIZONA TAX COURT

TX 2018-000928 11/06/2021

HONORABLE DANIELLE J. VIOLA

CLERK OF THE COURT
K. Cabral
Deputy

MESQUITE POWER L L C PAUL J MOONEY

v.

ARIZONA DEPARTMENT OF REVENUE LISA A NEUVILLE

JUDGE VIOLA

UNDER ADVISEMENT RULING

The Court held a bench trial on August 16, 2021, August 17, 2021, August 18, 2021, August 19, 2021, and August 20, 2021. At the conclusion, the Court took the matters presented under advisement. The Court has now had an opportunity to consider the evidence and arguments presented, including Defendants' Closing Argument filed August 30, 2021 and Plaintiff's Rebuttal Closing Argument filed September 10, 2021.

Background[1]

This dispute concerns the determination of the full cash value of the Mesquite Power Plant (the "Subject Property") for tax year 2019. The Subject Property consists of what is referred to as "Block 2" of the "Mesquite" Power Plant, which was constructed as part of a two-block "combined-cycle," natural gas-fired ("CCGT") electric generation facility. Block 2 uses two GE "frame 7" combustion turbines powered by natural gas, and a single GE D11 steam turbine to produce electricity, with shared control facilities and it is located in Maricopa County. A power plant's capacity is measured in megawatts ("MW"). Block 2 has a nameplate capacity of 691.6 MW, with a net operating capacity of 625 MW.

ADOR is charged with the duty of annually determining the full cash value of "all property, owned or leased, and used by taxpayers" in the operation of an electric generation facility in

[1] These findings of fact and conclusions of law were agreed upon by the parties and are taken from paragraphs 1-27 of the Joint Pre-Trial Statement dated July 21, 2021.

Arizona, pursuant to A.R.S. § 42-14151. The Subject Property constitutes an "electric generation facility" as referred to in A.R.S. § 42-14151(A), and ADOR valued it as such under A.R.S. § 42-14156.

Maricopa County assessed property taxes against the Subject Property for tax year 2019 based on the full cash value ADOR determined, and those taxes were all timely paid by Mesquite, so the Court has jurisdiction over this case. The relevant valuation date for the determination of the Subject Property's full cash value for tax year 2019 is January 1, 2018 (hereinafter, the "Valuation Date"). Mesquite is not raising any challenge in this case about whether ADOR correctly applied the statutory methodology prescribed by A.R.S. §42-14156(A) when it valued the Subject Property for tax year 2019. Instead, Mesquite contends that the statutory value of the Subject Property exceeds the market value of the Subject Property in violation of A.R.S. § 42-11001(6). ADOR and Maricopa County contend the market value of the Subject Property exceeds the statutory valuation.

According to A.R.S. §42-11001(6), "'Full cash value,' for property tax purposes, means the value determined as prescribed by statute. If a statutory method is not prescribed, full cash value is synonymous with market value, which means the estimate of value that is derived annually by using standard appraisal methods and techniques. Full cash value is the basis for assessing, fixing, determining, and levying primary and secondary property taxes on property described in section 42-13304. Full cash value shall not be greater than market value regardless of the method prescribed to determine value for property tax purposes."

A merchant power plant is a plant that sells the electricity it generates to third-parties on a wholesale basis. The Subject Property was designed to operate as a base load plant. Peaking plants tend to be lower megawatt plants than base load plants. On the Valuation Date the Subject Property was operated as a merchant power plant.

2018 Purchase and Sale Agreement

On May 4, 2018, AL Mesquite Seller, LLC ("AL Mesquite"), a wholly owned subsidiary of ArcLight Capital, LLC ("ArcLight") and SWG Arizona Holdings, LLC ("SWG"), a wholly owned subsidiary of Southwest Generation Operating Company, LLC ("SWGOC", collectively "SWG") entered into a Purchase and Sale Agreement under which SWG would acquire all right, title, and interest in Mesquite's business, including ownership of the Subject Property. The transaction between AL Mesquite and SWG closed on or about July 11, 2018, which was after the Valuation Date in this case. After the Closing Date, the transaction price was finalized at $555,598,000. Mesquite is the seller under an Amended and Restated Power Purchase Agreement

dated September 15, 2017 (hereinafter, the "PPA") with the Southwest Public Power Resources Group ("SPPR").

PPA

On January 22, 2021, the Arizona Tax Court ruled on Mesquite's motion for partial summary judgment in this case, granting that motion in part as follows:

> **"IT IS ORDERED** granting Plaintiff's Motion for Partial Summary Judgment in part as to the following: the PPA is a "non-taxable, intangible asset" that is separate and severable from the tangible property and the valuation of Mesquite's tangible property for property tax purposes cannot include the value of the PPA. Plaintiff's Motion is denied as to whether cash flows attributable to the PPA can be considered as part of the valuation of Mesquite's property."

SPPR consists of credit-worthy electric utilities and it also includes municipalities, power cooperatives, tribal power authorities, irrigation, and electrical districts, as well as other similar entities who are authorized to sell power to consumers. Southwest Public Power Agency, Inc. ("SPPA") is the administrative and scheduling agent on behalf of SPPR. The original power purchase agreement was entered into on July 7, 2011. It was subsequently amended three times prior to the current PPA. On the Valuation Date, the PPA started with contracted capacity of 271 MW, but the contracted capacity increased to 475 MW on May 1, 2021. Under the PPA, SPPR must make payments to Mesquite regardless of whether they take delivery of power. The Subject Property does not need to produce the electricity needed to fulfill Mesquite's obligations under the PPA because Mesquite can purchase the electricity on the open market or obtain it from any other source.

Mesquite bears the burden of proof on its claim for tax year 2019 that ADOR's statutorily-derived full cash value of $196,870,000 exceeds the market value of the Subject Property as of January 1, 2018, in violation of A.R.S. §42-11001(6). At trial, both parties offered evidence regarding the "market value" of the Subject Property as of the January 1, 2018 Valuation Date. Mesquite retained Mark R. Simzyk, ASA, at Duff & Phelps, LLC, as an independent appraiser to render his expert opinion as to the market value of the Subject Property as of January 1, 2018. Mr. Simzyk opined that the market value of the taxable, tangible real and personal property associated with the Subject Property as of the Valuation Date was $105,000,000. The Defendants retained Stephen Barreca, PE, ASA (now retired), CDP, founder of BCRI Valuation Services as its independent appraiser to render his expert opinion as to the market value of the Subject Property as of the Valuation Date. Mr. Barreca opined that the market value of the Subject Property was

$432,000,000 as of the Valuation Date. Pursuant to A.R.S. § 42-13304(2), the full cash value shall be used for all purposes in lieu of limited property value.

Analysis

The issue before the Court is the market value of the Subject Property as of the Valuation Date and whether the statutorily-derived full cash value determined by ADOR exceeds the market value. Market value is "that amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts." *Business Realty of Arizona, Inc. v. Maricopa County*, 181 Ariz. 551, 553 (1995) (quotations omitted).

ADOR's statutorily-derived value is presumed to be correct. The presumption of correctness as stated in A.R.S. § 42-16212(B) is rebutted by competent evidence. *Eurofresh, Inc. v. Graham County*, 218 Ariz. 382, 386, ¶ 16 (App. 2007). "Competent evidence" is evidence "derived by standard appraisal methods and techniques which are shown to be appropriate under the particular circumstances involved." *Id.* (citations omitted). Standard appraisal methods and techniques include the sales comparison approach, the cost approach, and the income approach. *London Bridge Resort, Inc. v. Mohave County*, 200 Ariz. 462, 464, ¶ 6 (App. 2001). While the Court begins with the presumption that the ADOR's value is "correct and lawful" pursuant to A.R.S. § 42-16212(B), that presumption has been described as a presumption of fact; once competent evidence is presented it "disappears." *Inspiration Consol. Copper Co. v. Ariz. Dep't of Revenue,* 147 Ariz. 216, 219, 223 (App. 1985), *disapproved of on other grounds by Cyprus Bagdad Copper Corp. v. Ariz. Dep't of Revenue*, 188 Ariz. 345, 348 (App. 1997).

Pursuant to A.R.S. § 42-14156, only land, real property improvements, and tangible personal property are taxable. Personal property is defined as "all tangible property except for land and real property improvements as defined in this section." A.R.S. § 42-14156(B)(2). Real property improvements are defined as "buildings, including administration buildings, maintenance warehouses and guard shacks, water retention ponds, sewage treatment ponds, reservoirs, sidewalks, drives, curbs, parking lots, tunnels, duct banks, canals, fencing and landscaping." A.R.S. § 42-14156(B)(3).

The parties dispute how the PPA impacts—or does not impact—the valuation of the Subject Property. The Court recognizes its prior conclusion that "the PPA is a 'non-taxable, intangible asset' that is separate and severable from the tangible property and the valuation of Mesquite's tangible property for property tax purposes cannot include the value of the PPA." Minute Entry 1/22/21. The Court did not make a determination as to "whether cash flows attributable to the PPA can be considered as part of the valuation of Mesquite's property." *Id.* Mesquite asserts that the PPA cannot be included in the valuation of the Subject Property. Mesquite further asserts that Defendants included the value of Mesquite's entire business including

the PPA in their valuation. Plaintiff's Rebuttal Closing Argument at 12. On the other hand, Defendants argue, "Contrary to Mesquite's assertions, considering the plant's contract income does not mean that this Court is valuing an intangible asset." Defendants' Closing Argument at 12.[2] Defendants cite several out of state cases in support of their position. However, the Court does not find such cases persuasive.[3]

In support of its position, Mesquite asserts that a tax lien attaches to the property liable for the tax. *See* A.R.S. § 42-17153(A). Mesquite asserts that a tax lien would not attach to the PPA or any revenue produced because the PPA only involves *in personam* rights. Mesquite argues that the value of the item taxed must match what a tax lien would attach to which in this case would be the tangible real and personal property. The Court finds Mesquite's argument

[2] Notably, the "plant" does not have contract income under the PPA. Mesquite receives income under the PPA and may use sources other than the Subject Property to provide the energy upon which the guaranteed payments are made. Ex. 6.

[3] *See Michigan Wisconsin Pipe Line Co. v. Iowa State Bd. of Tax Review*, 368 N.W.2d 187, 192-3 (Iowa 1985) ("The department used the stock and debt approach merely as an indicator of the market value of the Iowa pipeline property. The value of intangible property was considered only insofar as it affected the value of the Iowa tangible assets as part of a going concern. The resulting valuation was of tangible assets only."); *RT Communications, Inc. v. State Bd. of Equalization*, 11 P.3d 915, 923-25 (Wyo. 2000) (Intangible property may be utilized in valuing company as a whole to the extent intangible property enhances value of tangible property when using the unitary method to value public utility property. "[H]owever, to the extent that intangible property has value beyond any enhancing effect on tangible property and is separable from those assets, it must be excluded."); *In re Appeal of ANR Pipeline Co.*, 79 P.3d 751, 768-69 (Kan. 2003) (Kansas statute required the government to "determine the fair market value of public utility property annually, both real and personal, tangible and intangible." Interstate natural gas pipeline was valued using unit method and "the unit value may include the fair market value of the tangible, real, and intangible property which makes up the assets of the business"); *Elk Hills Power, LLC v. Board of Equalization*, 304 P.3d 1052, 1067-68 (Cal. 2013) (In analyzing the valuation of a power plant and the treatment of emission reduction credits (ERCs) that enabled the plant to function, the Court found: "[T]he value of intangibles that directly enhance that income stream cannot be subsumed in the valuation of taxable property. . . intangible rights like ERCs merely allow for the taxable property to generate income when put to its beneficial or productive use. Thus, their contribution to the income stream is indirect, whereas intangible assets like the goodwill of a business, customer base, and favorable franchise terms or operating contracts all make a direct contribution to the going concern value of the business as reflected in an income stream analysis. Only the latter category of intangible assets and rights has a quantifiable fair market value that must be deducted from an income stream analysis prior to taxation").

persuasive. Based on the evidence presented, the Court finds that neither the PPA nor its revenue should be included in the value of the Subject Property.[4]

The Court reviewed the parties' expert opinions and testimony regarding the valuation methods. The following is the Court's analysis of the three valuation methods.

Valuation Methods

Mesquite retained Mark Simzyk of Duff & Phelps to provide his expert opinion as to the market value of the Subject Property as of the Valuation Date. Mr. Simzyk's expertise includes the valuation of power generation facilities. Ex. 1. Specifically, Mr. Simzyk's primary focus is the energy sector, oil refineries, petrochemical, and power generation. Mr. Simzyk testified that he has performed over 100 valuations of power plants. He worked on business valuations that involved intangible PPAs. Duff & Phelps inspected the Subject Property on September 4, 2019. Ex. 2 at 11. Mr. Simzyk reviewed the Tax Court's prior ruling regarding the PPA and he did not include the PPA in his valuation of the Subject Property. He clarified that he did not value the business of Mesquite but instead an asset – i.e., the power plant. Mr. Simzyk considered the income approach, cost approach, and sales comparison approach ultimately concluding that the income approach was the primary indicator of value. Ex. 2 at 89. Mr. Simzyk found that the market value of the taxable, tangible real and personal property associated with the Subject Property was $105,000,000.

Defendants retained Stephen Barreca of BCRI Valuation Services to provide his expert opinion as to the market value of the Subject Property as of the Valuation Date. Mr. Barreca has an extensive history of performing appraisals. Mr. Barreca testified that he has authored between 15 and 20 power plant valuations. Mr. Barreca's history in valuing power plants is not as extensive as that of Mr. Simzyk. Mr. Barreca did not inspect the Subject Property as part of his evaluation. Ex. 131 at 3. He did not read the PPA. Additionally, Mr. Barreca did not review the Tax Court's prior ruling regarding the PPA before performing his valuation analysis. Mr. Barreca testified that he valued the tangible personal property of the Subject Property. Mr. Barreca used the cost

[4] The Department asserts that this case is similar to *Eurofresh, Inc. v. Graham County*, 218 Ariz. 382 (App. 2007), and that Mesquite must demonstrate the value of the PPA to be removed from the statutory valuation. *See* Defendant's Closing Argument at 4. However, *Eurofresh* is distinguishable. In *Eurofresh*, the parties disagreed on how external obsolescence affected the replacement cost of a greenhouse when the external obsolescence applied by the taxpayer was based on sales of distressed property. *Id*. at 384-85, ¶¶ 8-10. The issue in *Eurofresh* was the reduction in value based on external obsolescence, not the reduction in value based on the exclusion of an intangible asset like the PPA from the value of the tangible taxable property at issue here. *Eurofresh* is inapplicable to the Department's argument.

approach, income approach, and sales comparison approach ultimately concluding that all approaches generated credible results. Ex. 131 at 37. After assigning the results of each approach with a weighted percentage, Mr. Barreca found that the market value of the Subject Property was $432,000,000.

The Court notes that that the Tax Court previously determined the value of the Subject Property to be $130,876,000 for tax year 2016 and $99,714,000 for tax year 2017. The parties settled the subsequent tax year and agreed to a value of $99,714,000 for tax year 2018. Defendants now argue that the market value of the Subject Property is $432,000,000. The Court does not find the evidence presented by Defendants persuasive in supporting their position that the market value of the Subject Property increased by over $300,000,000 between tax year 2018 and tax year 2019. In reaching this conclusion, the Court notes that Mesquite received the benefit of an amended PPA that increased the annual guaranteed payments from $34,000,000 to $48,000,000 in year 2021 whether or not the Subject Property provided power under the PPA.

Income Approach

Mr. Simzyk valued the plant as a merchant base load plant competing in the market by selling energy at wholesale prices. In applying the income approach, Mr. Simzyk developed a five-year Discounted Cash Flow ("DCF") method analysis, a ten-year Discounted Cash Flow method analysis, a Direct Capitalization analysis, and a Guideline Public Company Method analysis. *See* Ex. 2 at 62-81. For the discounted cash flow method, Mr. Simzyk included an adjustment based on the small size of the business and the risk associated with a stand-alone asset and lack of diversification.[5] Mr. Simzyk calculated the 5-year DCF at $104,400,000 and the 10-year DCF at $105,800,000. Ex. 2 at 77. The Direct Capitalization method resulted in an opinion of full cash value of $101,100,000 and the Guideline Public Company Method of $97,300,000. Ex. 2 at 78 and 80. Mr. Simzyk gave more weight to the DCF analyses than the other two methods concluding that $105,000,000 was a reasonable indicator of value using the income approach.

In his analysis of the income approach, Mr. Barreca concluded that the Direct Capitalization method was more reliable than a Discounted Cash Flow method. Based on Mr. Barreca's application of the Direct Capitalization method, Mr. Barreca found an indicator of value of $457,000,000. Ex. 131 at 36. Mr. Barreca used the historical cash flow from Mesquite's operating statements to develop the cash flow used in his analysis. Mr. Barreca did not reduce the value under the income approach by the value of the PPA. According to Mr. Barreca, he had no

[5] Both Mr. Simzyk and Mr. Reilly testified that including additional risk premiums was a standard appraisal method and technique.

evidence to use to calculate the value or determine a value existed for the PPA.[6] Mr. Barreca confirmed that he included the income from the PPA because the owner of the Subject Property receives income from the PPA. He further testified that the PPA was inextricably linked to the Subject Property. Mr. Barreca's position ignores that Mesquite could have provided the energy under the PPA from sources other than the Subject Property. A.R.S. § 42-14156(A) defines the property of electrical generation facilities subject to taxation: 1) the value of the land used in operating the facility; 2) the value of real property improvements used in operating the facility; and 3) the value of personal property used in operating the facility. The property subject to taxation is limited to tangible personal property. A.R.S. § 42-14156 (B)(2).

Mr. Simzyk and Mr. David Rhodes testified that the income approach is used most often in the sales of power plants and was the approach used in previous sales of the Subject Property. Mr. Rhodes has worked in the industry for thirty years and has bought and sold approximately ten power plants in the last ten years. According to Mr. Rhodes, the discounted cash flow method is the method used to determine value. This testimony was consistent with Mr. Simzyk's determination of value: "The Income Approach is the primary, if not the only, valuation methodology utilized by buyers and sellers of electrical generating facilities. The Subject Assets have transacted twice in the preceding three years – first, in 2015 and then again in July 2018. Both of these transactions were predicated almost entirely on the income producing potential and the value generated by the long-term contracts of the Power Purchase Agreements. In both transactions, only a small percentage of the total transaction consideration was considered allocable to the tangible assets." Ex. 2 at 87.

Defendants criticize Mr. Simzyk's appraisal because it did not use the income projections prepared by SWG or Mesquite's historical financial statements and instead used allegedly unsupported risk premiums. The Court finds the criticisms unfounded. Mr. Simzyk explained that the projections and the financials included both intangible and tangible assets. As Mr. Simzyk and Mr. Rhodes testified, the revenue generated from the PPA is not dependent up on the Mesquite Power Plant, instead, Mesquite could choose to source the electricity elsewhere. Additionally, Mr. Simzyk relied on multiple sources for his inputs that he testified was a standard appraisal method and technique. His opinions necessarily involve subjective determinations. Mr. Simzyk's testimony as to the Subject Property's tax year 2019 market value is competent evidence of the market value of the Subject Property. Mr. Simzyk applied standard appraisal methods and

---

[6] Including the income from the PPA in the analysis while claiming the PPA has no value is inconsistent. Moreover, by including income from the PPA, Mr. Barreca necessarily included the value of the PPA (an intangible asset) because without the PPA, there would be no income in the form of payments. Either way, Mr. Barreca's own report contains information as to the value of the PPA. Ex. 131, pg. 22, Table 2 (Property Plant & Equipment $118,925 and Power Purchase Agreement $238,013 – Source D&P Purchase Price Allocation 3/30/16).

techniques using the income approach. Defendant did not present competent evidence to the contrary. The Court found Mr. Simzyk's testimony persuasive. When performing the income approach analysis, Mr. Simzyk used inputs, projections, and other adjustments for which he used his professional discretion. Based on the testimony, the Court found the inputs and adjustments to be reasonable.

Cost Approach

In his report, Mr. Simzyk considered but did not use a cost approach because it is not an approach used by buyers and sellers. *See* Ex. 2 at 87 ("while the Cost Approach is a valuation methodology, it is not generally utilized or considered by buyers or sellers to value electrical generation facilities in formulating bids or during the purchasing process"). Mr. Rhodes also testified that the cost of the power plant is irrelevant to the decision regarding the purchase of a power plant. Mr. Simzyk explained: "The Cost Approach is typically utilized to verify the reliability of the results derived from the Income Approach for the tangible assets. As such, while we have considered and researched the Cost Approach, we have not fully developed it for the purpose of this valuation due to the difficulty to adequately quantify economic obsolescence in a market that has little demand for merchant generators of electricity." Ex. 2 at 87. Instead, Mr. Simzyk placed all weight on the income approach as it is the preferred standard for valuing electric generation properties.

On the other hand, Mr. Barreca asserts that the cost approach is appropriate as it is the approach most used by assessors and inherently excludes intangible assets. Ex. 131 at 13; *see also* Ex. 131 at 37 (the Cost Approach "is ideally suited for property tax valuations because it inherently excludes intangibles and provides an indication of the Fair Market Value intrinsic to the physical assets"). While the Court recognizes the cost approach as a standard appraisal method, it is not the method relied on by willing buyers and willing sellers of power plants. In applying the cost approach, Mr. Barreca considered both the Replacement Cost New Less Depreciation and Reproduction/Duplication Cost New Less Depreciation methods. Ex. 131 at 15. After reconciling both cost approaches, Mr. Barreca found an indication of value of $423,000,000 for the Subject Property. Ex. 131 at 30. The Court does not find Mr. Barreca's opinion based on the cost approach to be persuasive because the cost approach is not the approach used by buyers and sellers of power plants.

Sales Comparison Approach

Both Mr. Simzyk and Mr. Barreca developed indicators of value using the sales comparison approach. Mr. Simzyk included ten sales of power plants from California, Nevada, Arizona, and Texas in his report. Ex. 2 at 55-61. He grouped them based on whether the power plants were sold with or without a PPA. Mr. Simzyk gave significant consideration and weight to the sale of

Gila River Block 4 and the sale of the Subject Property in 2018. Mr. Simzyk analyzed and adjusted the transaction prices and found $100,000,000 to be a reasonable indicator of fair cash value for the Subject Property. Mr. Simzyk used the sales approach as a check to his income approach value.[7]

In his sales comparison analysis, Mr. Barreca used the two previous sales of the Subject Property (2015 and 2018) and the sale of Mesquite Block 1 (2013). Ex. 131 at 20. The Mesquite Block 1 sale did not include a PPA. Mr. Barreca adjusted the purchase prices, assigned a weight to each of the three sales, and found $421,000,000 to be the indicator of value using the sales comparison approach. Ex. 131 at 24. Mr. Barreca then used the result of the sales comparison approach in his weighted analysis.

The sales approach, like the cost approach, is not typically used by buyers and sellers valuing power plants because it is often difficult to find similar transactions. For example, Mr. Rhodes testified that in his experience parties to a sales transaction may look at other sales but the sales are not typically relevant to the parties' analysis. Moreover, the sales comparison approach requires adjustments to account for the nature of a given transaction. Given the challenges in finding similar transactions and the uniqueness of each power plant, the Court finds Mr. Simzyk's use of the sales approach solely as a check to his income analysis most appropriate.

Conclusion

Based on the application of standard appraisal methods and techniques Mr. Simzyk testified that the market value of the Subject Property as of the Valuation Date was $105,000,000. The Court found Mr. Simzyk's testimony persuasive. For the reasons set forth above, the Court declines to accept Mr. Barreca's weighted opinion of value of $432,000,000. Accordingly, the Court finds that Mesquite has presented evidence to overcome the presumption in A.R.S. § 42-16212(B). The Court finds the "market value" of the Subject Property to be $105,000,000 for the 2019 tax year.[8]

---

[7] Mr. Kevin Reilly testified that he has been involved in the valuation of over 200 power plants. He testified that he does not give weight to the sales comparison approach in valuations because of the unique nature of each power plant.

[8] The Court notes this value is consistent with the market value determined by the Tax Court for 2016 ($130,876,000) and 2017 ($99,714,000). Additionally, it is further supported by the testimony of Mr. Rhodes and Mr. Simzyk that the only difference between Mesquite's entire business selling for over $370,000,000 in 2015 and later selling for over $555,000,000 in 2018, was that the PPA terms changed to increase payments and delivery of electricity. The evidence

"Full cash value shall not be greater than market value regardless of the method prescribed to determine value for property tax purposes." A.R.S. § 42-11001(6). Accordingly, the Court finds the full cash value of the Subject Property to be $105,000,000 for the 2019 tax year.

IT IS ORDERED Plaintiff shall submit a form of order and any requests for any other statutory relief on or before **November 30, 2021**.

---

supports a conclusion that the Subject Property was the same with the exception of operational wear and tear.

Chris DeRose, Clerk of Court
*** Electronically Filed ***
07/03/2018 8:00 AM

APPENDIX THREE

THE SUPERIOR COURT OF THE STATE OF ARIZONA
IN THE ARIZONA TAX COURT

TX 2015-000095 06/28/2018

HONORABLE CHRISTOPHER WHITTEN

CLERK OF THE COURT
T. Cooley
Deputy

STATE OF ARIZONA DEPARTMENT OF REVENUE — KENNETH J LOVE

v.

MESQUITE POWER L L C — BART WILHOIT

MINUTE ENTRY

This case involves two separate, consolidated appeals. The appeals challenge the full cash value of Plaintiff's electric generation facility for the 2016 and 2017 tax years.

Procedural History

A. 2016 Tax Year

The Arizona Department of Revenue ("ADOR") appeals from a decision by the Arizona State Board of Equalization (the "Board"), reducing ADOR's tax year 2016 statutory valuation of Mesquite Power, LLC's ("Mesquite") property, identified by taxpayer identification number 50-676 (the "Subject Property"), from a full cash value of $230,593,000 to $188,646,735.

ADOR contends the Board erroneously reduced the statutory value of the Subject Property based on "obsolescence," under A.R.S. §42-14156(A)(4).

Mesquite cross-appeals the Board's 2016 valuation, alleging that the statutory value of the Subject Property – even after making an adjustment for obsolescence – still exceeds the market value of the Subject Property, in violation of A.R.S. §42-11001(6).

B. 2017 Tax Year

ADOR set the full cash value of the Subject Property at $217,134,000 for tax year 2017. Mesquite directly appeals that valuation. Mesquite contends that (1) the statutory value of the Subject Property exceeds the market value of the Subject Property and (2) that ADOR again failed to properly adjust for any obsolescence under the statutory formula.

The parties' appeals for tax years 2016 and 2017 have been consolidated for trial.

Factual Background

On October 29, 2014, ArcLight Capital, LLC ("ArcLight") signed an agreement to purchase Mesquite from Sempra Generation ("Sempra") for $356,938,000. The parties agree that the sale was an "arms-length transaction." It was the result of ArcLight prevailing in a competitive, two-stage, open auction organized by the investment bank of Goldman Sachs on behalf of Sempra. The sale did not close until April 9, 2015.

The sale included all of the tangible real and personal property at issue in these appeals, and certain intangible assets that are not taxable.[1] The principal non-taxable, intangible asset is a "Power Purchase Agreement" ("PPA"), a contract with Southwest Public Power Resources Group ("SPPR") which reserves for SPPR 271 megawatts of Mesquite's generating capacity in exchange for approximately $34 million dollars annually for the next 24 years (until 2039).[2] Those payments guarantee recovery of all costs Mesquite incurs to produce electricity (including the price of natural gas and all operating costs), plus a profit. They are paid regardless of the amount of actual electricity that is sold under the PPA. Thus, these contracted payments under the PPA generate predictable, reliable cash flows that provides ArcLight with significant downside protection on its invested capital. The PPA is an asset which has some value.[3]

---

[1] Pursuant to A.R.S. §42-14156, the taxable property of an electric generation facility includes land, tangible personal property and real property improvements.

[2] In addition to the $356,938,000 sales price, ArcLight was required as part of the sale to pay an additional sum of $2 million dollars per year to a third party, British Petroleum, in order to guarantee to SPPR that ArcLight would perform its obligations under the PPA. As an alternative to this liability, ArcLight could have increased the purchase price by approximately $15 million dollars, with Sempra retaining that quasi-performance-bond. This additional cost, however, is related only to the PPA, not the value of the tangible, taxable property.

[3] Even ADOR's witness, Jeffrey Bodington, admitted that the PPA was an intangible asset, separate from the power generation facility, which had a value.

In addition to the 271 megawatts of pledged capacity under the PPA, Mesquite has approximately 354 megawatts of "merchant capacity," which represents potential sales of electricity into the wholesale power market at whatever price the market will bear. This merchant capacity enables ArcLight to earn an additional return on its investment.

Notably, the electricity needed to fulfill the PPA need not be produced by Mesquite. Instead, it can be purchased by Mesquite on the open market. Additionally, it is important to note that the PPA is severable and can be transferred separately from the ownership of the tangible personal property.

In order to comply with federal law, applicable accounting standards, and the purchase agreement, Mesquite was required to "allocate" the total $356,938,000 purchase price between the land, the tangible personal property and the PPA. In order to do so, it retained Daniel Beaulne, a very credible expert with a twenty-five year history of valuing power production facilities.[4]

Mr. Beaulne concluded that, as of the April 9, 2015 closing date, the real property and tangible personal property included in the transaction had a total value of $118,925,000, and the intangible PPA had a value of $238,013,000.

Valuation

Market value is "that amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts." *Business Realty of Arizona, Inc. v. Maricopa County*, 181 Ariz. 551, 553 (1995).

"Market value is generally determined through three common appraisal approaches: capitalizing the income stream ('income method'), estimating replacement cost less depreciation ('cost method'), and estimating market value by comparable sales ('sales comparison method')." *Bus. Realty of Arizona, Inc. v. Maricopa County*, 181 Ariz. 551, 553–54, 892 P.2d 1340, 1342–43 (1995). Any of these, or some hybrid of them, may be applied by the taxing authority or the courts. *Magna Inv. & Development Corp. v. Pima County*, 128 Ariz. 291, 293-95 (App. 1981). However, if the taxpayer challenges the assessor's choice of method, it must show that its alternative method is appropriate under the circumstances. A.R.S. § 42-16212(B); *Eurofresh, Inc. v. Graham County*, 218 Ariz. 382, 386 ¶ 17 (App. 2007).

---

[4] ADOR makes much of the fact that Mr. Beaulne's reports did not conform to the Uniform Standards of Professional Appraisal Practice ("USPAP"). It is clear that his report was not required to comply with USPAP and ADOR does not suggest how any areas of noncompliance with USPAP had a negative effect on his analysis.

A. Determining the Proper Valuation Method

While the replacement method and the sales comparison method might be used to arrive at the fair market value of a power generating facility in theory, Mesquite has shown that the best, most accurate method to approximate a real-world value of the Subject Property is the income approach.

Mesquite's expert, Mr. Beaulne, has valued over one hundred power generating facilities in his career. In the vast majority of those valuations, he has done so using the income approach.

The buyer (ArcLight), the seller (Sempra) and the seller's broker (Goldman Sachs) in the April 9, 2015 transaction were all very sophisticated traders in power generation facilities. All three used the income approach to value Mesquite.

Mark Tarini, a partner at ArcLight who was directly involved in the decision to purchase Mesquite, testified that, as a member of ArcLight's "transaction team," he has purchased approximately one hundred power generating facilities and sold between fifty-five and sixty. In assessing each of these transactions, he has almost always valued the property using the income approach because it best reflects the amount at which the property will actually sell in an open market. He used the income approach to value the Subject Property in late 2014.

Mesquite's proffer that an income approach is most reliable for valuation is more than litigation posturing; it is more than a litigant choosing the valuation method that yields the best result for it. In the real world, within months of the two relevant dates for valuation,[5] the Subject Property was actually transferred between two very sophisticated players in an arms-length exchange. The valuation approach used by both the buyer and seller in that transaction was, in fact, the income approach. The Court puts a great deal of weight on the fact that, outside the ethereal, hypothetical world of lawyers and experts in courtrooms and in academia debating appropriate valuation methods, outside the vacuum of learned treatises commenting on accepted practices, and with hundreds of millions of dollars at stake, two very sophisticated real-world actors both used the income approach to determine Mesquite's value.

The cost approach is not generally used by buyers or sellers to value power generation facilities for many reason. Among those are that it focuses too much on the sunk costs of building the facility and not enough on the potential future value to an owner or potential buyer

[5] The sale closed approximately three months after the tax year 2016 valuation date and nine months before the tax year 2017 valuation date.

and that adjusting a cost method based value for obsolesce is very difficult and yields unreliable results. [6]

Similarly, the sales comparison method is rarely used in these type of transactions because finding similar transactions is difficult. None of the experts in this case advocate, to any degree at all, a valuation of the Subject Property using the sales comparison method.

B Applying the Income Approach to the Subject Property

ArcLight retained Mr. Beaulne to determine the market value of the Subject Property as of January 1, 2015 and January 1, 2016, the relevant dates for the tax years in this case. Mr. Beaulne used an income approach, and, more specifically, a discounted cash flow method, in determining that the fair market values of the Subject Property were $130,876,000, as of January 1, 2015, and $99,714,000, as of January 1, 2016. He considered using the cost method and the sales comparison method, but determined that neither would yield reliable results.

Mr. Beaulne's conclusions about the value of the Subject Property for the 2016 and 2017 tax years are credible. While his opinions are, by their nature, dependent upon matters which are subject to differences of opinion – such as appropriate discount rates, the accuracy of projected operating expenses and revenues and similar judgments - none of the assumptions made by Mr. Beaulne are problematic. The fact that Mr. Beaulne mixed the sources of information he relied upon in making assumptions about future operating expenses and future revenue is of only slight concern to the Court, as his explanation for doing so is reasonable.

ADOR retained Steven Barreca to give an opinion on the market value of the Subject Property. Mr. Barreca is also a very competent appraiser, with an impressive history of valuing various types of property, including property related to telecommunications and utility companies. Although he has valued approximately twenty power generation facilities, mostly in rate regulated jurisdictions,[7] he does not have nearly as extensive a background or as much experience in the valuation of such facilities as do Mr. Beaulne, Mr. Reilly or Mr. Tarini. He admits that he has little to no knowledge about the valuation methods used by actual buyers and sellers of power generation facilities.

---

[6] Kevin Reilly, Mesquite's rebuttal witness, has valued between one and two hundred power generation facilities. He values such facilities using an income approach. Infrequently he also uses the cost approach, but only to verify the reliability of the results arrived at using an income approach. He has never valued a power generation facility using a cost approach.

[7] Mesquite is not regulated by the Arizona Corporation Commission.

Mr. Barreca performed three variations of a cost approach to value the Subject Property for each of the two tax years.[8] These included (1) replacement cost new less depreciation ("RCNLD") using the U.S. Energy Information Agency's ("EIA") overnight capital costs, (2) RCNLD using trended historical cost, and (3) original cost less depreciation ("OCLD").[9] Mr. Barreca also performed a direct capitalization income approach to obtain a value.

For the reasons above, the Court does not find opinions based upon the use of the three variations of a cost method to be persuasive, as the cost approach is not the valuation method employed, even in small part, by actual buyers and sellers of power generation facilities in a real world setting. Specifically, the value of the Subject Property, on the relevant dates, is clearly best determined using the income approach.

Mr. Barreca's opinion of the value of the Subject Property using the income approach is unpersuasive.[10] He used the "direct capitalization" method in employing the income approach. That is one of four standard and accepted methods of computing value under the income approach generally, but is problematic as applied in the Subject Property for several reasons. The discounted cash flow method is more appropriate than a direct capitalization methodology in determining value for properties with less stable cash flow streams, such as power generation facilities.[11] Additionally, the direct capitalization method assumes a stable cash flow for the property that will extend in perpetuity, but (1) Mr. Barreca did not account for any of the long

---

[8] Mr. Barreca's values, using these cost methods were:

RCNLD using EIA for 2016 tax year – $496,009,952
RCNLD using EIA for 2017 tax year – $499,772,685
RCNLD using trended historical cost for 2016 tax year – $417,322,407
RCNLD using trended historical cost for 2017 tax year – 418,355,386
OCLD in 2016 tax year – $297,019,483
OCLD in 2017 tax year – $352,022,000

[9] The source of the original cost information used by Mr. Barreca, although the Court has determined that it is the cost information that must be used in computing the value under the statutory valuation method pursuant to A.R.S. under A.R.S. §42-14156(A)(6)(d)(i), was suspect. No investigation as to its accuracy was undertaken.

During discovery Mesquite produced a five-page document that it identified as the "Mesquite Power Fixed Asset Listing." Although this information seems highly relevant to determining the original cost information, the origin of this information is completely unknown. Who created it, why, when and using what information are all unanswered questions.

[10] Mr. Barreca's value of the Subject Property using the income approach were $377,069,846 for the 2016 tax year and $405,066,223 for the 2017 tax year.

[11] Even ADOT's witness, Jeffrey Bodington testified that the incremental income method (aka discounted cash flow method) was better than the direct capitalization method in valuing the Subject Property.

term capital expenditures that would be required to keep Mesquite operational, and (2) power generation facilities such as the Subject Property do not operate in perpetuity, they have finite life-spans. Finally, although the PPA clearly has some value, Mr. Barreca did nothing to adjust the cash flow he used to remove income attributable to the PPA.

Mr. Barreca used a weighted combination of the differing valuation approaches to conclude that the fair market value of the Subject Property was $428,000,000 in tax year 2016 and $416,000,000 in tax year 2017.[12] For the above reasons, the Court declines to accept these opinions.

ACCORDINGLY, The Court finds the "market value" of the Subject Property to be $130,876,000 for the 2016 tax year and $99,714,000 for the 2017 tax year.

Statutory Valuation Issues

Electric generating facilities are statutorily valued pursuant to A.R.S. § 42-14156, which is similar, but not identical, to a cost approach valuation. For the 2016 and 2017 tax years, the task of determining the value of the Subject Property under A.R.S. § 42-14156 was given to Frank Dudley. The parties dispute whether Mr. Dudley correctly performed this task.

The parties' disputes about whether the assessed value for the 2016 and 2017 tax years, using the statutory method, are moot. Under any argument by either party, the statutorily derived value exceeds the market value. Pursuant to A.R.S. §42-11001(6), "[f]ull cash value shall not be greater than market value regardless of the method prescribed to determine value for property tax purposes."

Conclusion

---

[12] There are several examples that, although not individually determinative, illustrate the unreliability of Mr. Barreca's analysis:

1. Mr. Barreca opined values were $71 million and $59 million more, respectively, then the actual base price paid for all of the tangible property **and** the PPA, combined, in an arms-length transfer within months of the tax valuation dates.

2. No matter the approach he used, Mr. Barreca found that the value of Subject Property actually increased by millions or tens of millions of dollars from the 2016 to the 2017 tax year, even though he ultimately agrees with the Plaintiff that the value of the Subject Property decreased over that time.

3. The variations in value found by Mr. Barreca was immense. Under the three different cost assumptions Mr. Barreca used, his values varied from $297 million to $496 million dollars for the 2016 tax year and from $352 million to $499 million dollars in the 2017 tax year.

ACCORDINGLY, the Court finds the full cash value of the Subject Property to be $130,876,000 for the 2016 tax year and $99,714,000 for the 2017 tax year.

APPENDIX FOUR

Reproduced below is an excerpt from IR-110, the Purchase Price Allocation for Southwest Generation's acquisition of the Mesquite Power, LLC's entire business, which was received into evidence at trial:

Based on our analysis described herein and information provided by Management, we estimate the Fair Value of the Subject Assets as of the Valuation Date, to be reasonably estimated as follows:

	Values in ($000s)			
Facility	Plant & Equipment	Land	SPPA PPA	ArcLight Toll
Mesquite 2	73,000	1,367	454,565	25,000

IR-110, Bates number: MESQUITE(928)00043; *see also* IR-111: 25-31 (purchase price allocation from the prior purchase of Mesquite's business by ArcLight Capital from Sempra Energy in 2015), valuing the tangible assets at $118,925,000, and the pre-amendment PPA at $238,013,000.

These valuations went into the audited financials of each new owner and were the basis for Mesquite's reporting its "acquisition cost" of the taxable property to ADOR under A.R.S. §42-14156(A)(6)(d). (IR-161—98:2-99:17; IR-98:3 [2016 and 2017 audited financial statements, showing separate values of the plant at $108,364,000 for 2016 and $102,855,000 for 2017, and the value of the pre-amendment PPA at $211,567,000 and $221,184,000 respectively]).

In his appraisal, Appellants' expert also added-together these separate valuations of tangible and intangible assets in his sales comparison approach, showing the value of Mesquite's entire business enterprise. (IR-117:22, Table 2)

APPENDIX FIVE

All the evidence below was cited to the Court of Appeals in Mesquite's Answering Brief at pages: 15, 17, 19-21, 41-43, and 48-55.

1) In its ruling, the Tax Court noted Mr. Simzyk's inclusion of an adjustment to the discount rate based on the small size of the business and the further risk of a stand-alone asset were standard appraisal methods and techniques, as testified by both of Mesquite's experts, Mr. Simzyk and Kevin Reilly, ASA. (IR-86:7, fn.5; IR-162—162:25-163:5)

2) In its ruling, the Tax Court ruled Mr. Simzyk's opinions necessarily involved subjective determinations, but constituted competent evidence derived from standard appraisal methods and techniques, and also that Appellants did not present competent evidence to the contrary:

> Mr. Simzyk's testimony as to the Subject Property's tax year 2019 market value is competent evidence of the market value of the Subject Property. Mr. Simzyk applied standard appraisal methods and techniques using the income approach. Defendants did not present competent evidence to the contrary. The Court found Mr. Simzyk's testimony persuasive. (IR-86:8-9)

3) Mr. Simzyk testified there were two types of extra risk when looking at the only the Subject Property: (1) a small company size premium, and (2) additional unsystematic risk associated with dealing with a single asset. (IR-162—173:1-18) None of these risks were taken into account elsewhere. (*Id*., 173:19-174:16) Mr. Simzyk added 10.37% of additional

risk to his weighted average cost of capital (WACC): 5.37% for a small company size premium, and 5.0% for additional asset-specific risks, resulting in a total cost of equity of 18.2%. (IR-89:74-75; IR-162—187:13-20)

4) David Rhodes (Mesquite's representative, and the only witness who ever purchased or sold a power plant) testified the discount rate (or cost of equity) would be around 20% for a stand-alone power plant—almost 2% higher than the 18.2% Mr. Simzyk used (inclusive of the additional risk premium). (IR-161—62:3-15; 68:2-21; 69:9-11)

5) The small company risk premium Mr. Simzyk used came directly from Duff & Phelps' "Cost of Capital Navigator" based on the size of Mesquite. (IR-162—179:22-180:23) Determining the small company risk premium in that manner is a standard appraisal method and technique. (*Id.*, 180:24-181:4) Mr. Simzyk used the analogy of investing in a large, liquid, diversified mutual fund versus directly investing in a company worth $100 million dollars and how much riskier the latter would be. (IR-162—174:17-175:9) Investors in a small capital market enjoy higher returns at the cost of greater risk. (*Id.*, 177:11-20) Small companies have more risk because of size, lack of diversification and lack of liquidity. (IR-163:60:2-7)

6) The small company risk premium does not account for additional risk beyond size. (IR-162, 175:14-177:8) Because the issue is the value of a *particular asset*, an additional risk adjustment for that specific asset is necessary. (*Id.*, 177:21-178:11; 182:9-:16) Stand-alone assets are riskier because there is only one asset. (IR-163—60:8-15; 44:17-45:5; 49:1-6) Without taking into account this additional risk for a stand-alone asset, an appraiser would value the wrong thing. (*Id.*, 178:12-16) Because Arizona law only values the tangible assets, there is a need to match the risks to the cash flows for the asset being valued. (*Id.*, 181:5-22)

7) Mr. Simzyk also testified *Guide to Business Valuations* by Fishman, Pratt, Griffith and Wilson (which he described as authoritative) states the additional risk factor ranges from 3-15%. (IR-162—178:17-179:21) Mr. Simzyk's additional risk premium lies at the lower end of this range.

8) Another "learned treatise" referenced by all the experts who testified at trial, was *Valuing Machinery and Equipment*, which includes an example of how to calculate the cost of equity using the capital asset pricing model (CAPM) that adds an additional risk premium for site-specific risks. That illustration is reproduced as Exhibit B to Mesquite's Answering Brief.