ARIZONA SUPREME COURT

MESQUITE POWER, LLC, a limited liability company, Plaintiff-Appellee- Petitioner, 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. CV-23-0016-PR Court of Appeals No. 1 CA-TX 22-0002 Arizona Tax Court No. TX2018-000928

AMICUS CURIAE BRIEF IN SUPPORT OF MESQUITE POWER, LLC'S PETITION FOR REVIEW

NEARHOOD LAW OFFICES, PLC
James R. Nearhood
Arizona Bar No. 004594
7537 E. McDonald Drive
Scottsdale, AZ 85250
Telephone: (480) 998-3525
jrn@nearhoodlaw.com

Attorneys for Amicus Curiae WSATR and NAPTR-TEC

DISCLOSURE OF SPONSORS

Pursuant to Ariz. R. Civ. App. P. Rule 16(b)(3), the Western States Association of Tax Representatives ("WSATR") and the National Association of Property Tax Representatives -Transportation, Energy, and Communications ("NAPTR-TEC") disclose they are the sponsors of this Amicus Curiae Brief in Support of Mesquite Power, LLC's Petition for Review ("Amicus Brief"). Mesquite Power, LLC is not a member of either WSATR or NAPTR-TEC.

The companies represented by WSATR and NAPTR-TEC have been and continue to be subject to tax under Arizona law and, until the issuance of the *Mesquite* Opinion, have generally not been subject to assessment on their intangible properties. The Opinion will have a considerable financial impact on many of these industries.

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I. The Court of Appeals' Opinion Impermissibly Allows Taxation of Intangible Property When Arizona's Statutory Framework Prohibits It.

In *Mesquite Power, LLC v. Arizona Dep't of Revenue*, No. 1 CA-TX 22-0002 (Dec. 20, 2022) ("Opinion") ¶27, the Court of Appeals addressed the question of "whether a tax valuation of real and personal property should consider intangible assets." The resolution of this issue should have been a simple "no" given the fact that Arizona law, on its face, only allows the Department of Revenue to tax the ***tangible*** property of a business that owns an electric generation facility:

> '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).

(Opinion ¶18) (emphasis added).

The plain language of this statute does not authorize the Department to determine the value of the tangible property comprising a generation facility based on whether the business owning the tangible facility also owns intangible property. If the Opinion is not reviewed and reversed by this Court, then tangible electric generation facilities will be valued disparately and in violation of the Arizona Constitution, depending on whether the owner also has other intangible assets. *In re America West Airlines, Inc.*, 179 Ariz. 528, 531 and 532 (1994) ("[P]roperty of

the same character must be taxed the same" and should be "based on one of the property's characteristics or uses--rather than a classification of owners.").

In this case, Mesquite is a business entity which owns both tangible and intangible assets. Its tangible assets include land and electric generating equipment that constitute a tangible "merchant plant." (Opinion ¶4). However, the merchant plant is not the same thing as the Mesquite business. The business consists of much more than just tangible property. It includes skilled workforce, contract rights, and other intangible assets.

One of the business's primary intangible assets discussed in this case is a power purchase agreement ("PPA") Mesquite negotiated with Southwest Public Power Resources Group ("SPPR"). In this PPA, SPPR agreed to make fixed, guaranteed payments to Mesquite in exchange for a promise that Mesquite would provide an agreed-upon capacity of electricity to SPPR. SPPR was obligated to make the guaranteed payments whether or not it actually requested any electricity in a given month. (Opinion ¶8). The PPA did not require Mesquite to provide the electricity from its merchant plant, but gave Mesquite the option to "purchase power on the open market to cover the capacity guarantee to SPPR." (Opinion ¶9). Consequently, the PPA had value to the Mesquite ***business*** whether or not it owned the tangible plant.

The Tax Court found that the PPA was intangible property that is not subject to Arizona property tax and held that it should not be included in the valuation of the tangible plant. (Opinion ¶12). On review, the Court of Appeals believed it needed to decide "whether a tax valuation of real and personal property should consider intangible assets" even though the relevant taxing provisions only permit assessment of "tangible property." (Opinion ¶27) and A.R.S. 42-14156(B)(2).

The Court of Appeals concluded that, [b]ecause the [PPA] influences the purchase price a willing buyer would pay for the property . . . , the proper valuation should reflect the effect of the [PPA]." (Opinion ¶30). This conclusion is erroneous and is not supported by the evidence relied on by the Court of Appeals. The court noted that the vice president of Mesquite's current owner testified that the company "would have never bought Mesquite's ***business*** without the Purchase Agreement." *Id.* This evidence supports the conclusion that the PPA influences the price the willing buyer would pay for the ***business***, but it does not support the conclusion that it influenced the price a willing buyer would pay for the tangible property--the merchant plant.

II. The Court of Appeals Erred When It Interpreted "Current Usage" To Expand The Authority of Taxing Entities.

Because applicable taxing provisions do not permit the assessment of Mesquite's intangible property, the Court of Appeals relied instead on the statutory requirement that "[c]urrent usage shall be included in the formula for reaching a

determination of full cash value." A.R.S. §42-11054(C)(1). "Current usage" is only defined as "the use to which property is put at the time of valuation by the assessor or the department." A.R.S. § 42-11001.4. "Use," however, is not defined. *Qasimyar v. Maricopa County*, 250 Ariz. 580, 588 ¶27 (App. 2021). Thus, the Court of Appeals' conclusion that the PPA "contributes to the plant's cash flows and current usage" is nothing more than a rhetorical conclusion wholly lacking in analysis as to how the PPA impacts or establishes the "current usage" or "use" of the property. It also conflates cash flow with current usage.

A. The Court of Appeals failed to construe "current usage" in favor of the taxpayer as required by law.

Inasmuch as the court's conclusion depends on an interpretation of "current usage" or "use," the court should have applied long-standing rules of statutory interpretation and construed "usage" or "use" ***in favor of the taxpayer***. *General Motors Corp. v. Maricopa County*, 237 Ariz. 337, 339¶9 (App. 2015). Instead, the Court of Appeals interpreted "current usage" to permit the Department to value taxpayer's property at $196 million even though the Tax Court concluded that the taxable, tangible property was only worth $105 million. The court's conclusion directly conflicts with its own finding that "if the [PPA] no longer existed, ***it would change nothing about the plant*** or its ability to produce the same electrical capacity." (Opinion ¶21) (emphasis added).

The Court of Appeals' decision is not based on any definition of "usage" or "use" that supports the ***expansion*** of governmental taxing authority to include intangible property. In fact, the court ignored its own prior interpretation of "use" to mean the "objectively verifiable, physical use or activity on the property." *General Motors*, 237 Ariz. 337, 341 ¶21. In *General Motors,* the Court of Appeals rejected the county's decision to more than double an assessment of property used by GM as an automotive proving ground on the sole basis that GM had sold the property to a company that anticipated redeveloping the property at some future date. GM leased the property from the new owner, but continued to use it as an automotive proving ground. Alleging that a "change of use" had occurred, the county refused to rollover the 2007 full cash value of the subject property ($89,000,961) to the 2008 tax year, instead determining a new full cash value of $187,824,386. *Id.* at 338 ¶4. The court concluded that the rollover statute "functions as a valuation (or classification) statute. As such, it is subject to liberal construction" in favor of the taxpayer. *Id.* at 339 ¶9 (citations omitted). Because "use" had not been defined in the rollover statute, the Court of Appeals concluded that "use" should be "objectively verifiable" and "focus[] directly on the property itself." *Id.* at 341 ¶¶21 and 22.

Like the rollover statute, the "current usage" requirement "functions as a valuation (or classification) statute." *Id.* at 339 ¶9; *see also Qasimyar*, 250 Ariz. at

588 ¶27. "As such, it is subject to liberal construction" "in favor of the taxpayer and against the government." *General Motors*, 237 Ariz. at 330 ¶¶ 8 and 9. However, the Opinion interpreted "current usage" so expansively that it allows the Department to circumvent express statutory limitations on its taxing authority. Instead of interpreting "current usage" to ***limit*** the authority of taxing entities, the court concluded that "current usage" actually ***expands*** the Department's authority such that intangible property "must be considered" as "enhanced value," even though it is ***not*** subject to assessment under unambiguous statutory provisions. (Opinion ¶35).

Under this interpretation, other exempt intangible property will now be subject to taxation as an "enhancement" even when direct taxation is prohibited. *See e.g.* A.R.S. 42-14403(B)(4) (an assessment of "cellular or wireless telecommunications companies . . . does not include the value of any license that is issued by the federal communications commission."). The Opinion should be reviewed and reversed by this Court inasmuch as it violates long-standing principles of statutory interpretation and represents a fundamental change to Arizona tax law that conflicts with legislative intent as set forth in unambiguous statutory provisions. *General Motors*, 237 Ariz. at 339 ¶8.

B. The Court of Appeals conflated "cash flows" and "current usage."

The Court of Appeals rationalizes its decision to characterize the PPA as "contribut[ing] to . . . current usage," by warning that Mesquite's valuation "approach would conclude that fully-subscribed power plants hold *no* value." (Opinion ¶34). That concern is unwarranted and provides no basis for ignoring applicable law and interpretive principles. First of all, the Court of Appeals acknowledged that the income approach "uses the projected future cash flows ***of the property*** to determine its present value." (Opinion ¶38). This characterization of the income approach is consistent with the Tax Court's explanation that, "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." (Electronic Index of the Record ["IR"] 86 at 5, n.2) (emphasis added).

This is also consistent with the Court of Appeals' acknowledgement that the PPA "does not require that Mesquite provide electricity to SPPR from the Mesquite plant," (Opinion ¶9); and that Mesquite has unilateral discretion, "[i]f it chooses" to "purchase power on the open market to cover the capacity guarantee to SPPR." *Id*. Based on those undisputed acknowledgements, if the plant is fully shut down and unable to generate electricity (or even razed to the ground), Mesquite will still be able to provide power to SPPR under the PPA. These undisputed facts cannot

be reconciled with the Court of Appeal's "conclu[sion] that the [PPA] enhances the value of Mesquite's taxable property." (Opinion ¶35).

For those reasons, Mesquite's expert "valued the plant as a merchant base load plant competing in the market by selling energy at wholesale prices." (IR 86 at 7). If Mesquite had wanted to "avoid taxes by sequestering its value into an untaxable contract," as suggested by the court, it would not have attributed ***any*** income to the plant. (Opinion ¶34). The hypothetical income approach was necessary to isolate the value of the property from the value of the business because the PPA reflected above-market pricing that was not reflective of the value of the merchant power plant.[1]

By conflating a company's "cash flow" with the "current usage" of taxable property, the value of taxable, tangible property will now be measured by contractual agreements that generate value for the business even when those tangible properties are not required for performance under the contract. The Court of Appeals' novel interpretation of "current usage" will now allow assessments to include intangible value resulting from the company's business acumen even when

[1] The Court of Appeals' finding that the taxpayer's expert witness was incompetent was also driven by its erroneous interpretation of "current usage" and violates the applicable standard of review that requires the appellate court to "'defer to the trial court's factual findings as long as the record supports them.'" (Opinion ¶ 16, *quoting In re the Gen. Adjudication of All Rts. To Use Water in the Gila River Sys. & Source*, 198 Ariz. 330, at 337 ¶ 15 (2000)).

it is unrelated to the operation of the physical assets. Physically identical properties should not be assessed differently based on whether one owner has more valuable, intangible assets or is able to negotiate better contracts than the other owner. For the same reason, a power plant should not be assessed at a lower value when an owner is locked into a below-market contract. The tangible properties have the same fair market value, unaffected by the intangible contracts.

The Court of Appeals' interpretation of the term "current usage" to allow consideration of intangible property that contributes to cash flow also violates the Arizona Constitution and the plain language of Arizona's statutory definition of fair market value. Under this new definition, the value of tangible property would be unique and disparate, not because there are classifications recognizing certain differences, but solely because each owner has a different business value. The number of classifications under the court's interpretation of "current usage" will be limited only by the number of unique owners of similar properties. In short, this interpretation would convert fair market value (value between the typical buyer and seller) to investment value (the value to a particular investor as he/she uses the property) and would violate the Arizona Constitution. *In re America West Airlines, Inc.*, 179 Ariz. at 531-532.

III. The Court Of Appeals' Reliance On *Viola* Is Misplaced.

Because applicable taxing provisions clearly do not permit the assessment of Mesquite's intangible property, the Court of Appeals instead relied on *Maricopa County v. Viola,* 251 Ariz. 276 (App. 2021), a low-income housing tax credits ("LIHTC") case. *Viola* is inapposite.

The property at issue in *Viola* was a low-income housing complex. The *Viola* court distinguished the LIHTC property from conventional apartment complexes because "the LIHTC restrictions do not just restrict rental income, they restrict an owner's ***use*** of the property:"

> An LIHTC property cannot be valued as if it were a conventional apartment complex because it is not and cannot be used as such. ***The 'use' of an LIHTC property is not simply that of a conventional apartment complex.*** The restrictions subject LIHTC properties to continuing government mandates that impose operational and compliance costs, periodic monitoring, on-site inspections, and compliance reviews. . . . The restrictions also limit who can live in LIHTC properties to those with a certain income or who meet other classifications (i.e., homeless, mentally ill, domestic violence victims, physically disabled).

Id. at 280 ¶15 (emphasis added). The *Viola* Court concluded that "assessors should treat LIHTC properties differently from conventional complexes ***because they are different***." *Id.* at 281 ¶17.

Importantly, the *Viola* Court equated the restrictions on low-income housing with the recreational ***use*** restrictions in *Recreation Centers of Sun City, Inc. v. Maricopa County*, 162 Ariz. 281 (1989), which restrictions had been equated to

"zoning and subdivision restrictions that limit the use of land." *Viola*, 251 Ariz. at 280 ¶15. The *Viola* Court's discussion of *Recreation Center* is instructive here because the Arizona Supreme Court held that the non-profit deed restriction--that impacted the property's ability to generate income--"did 'not impact the type of use to which the property may be put' and did not destroy the property's value." *Id.* at 280 ¶14. In contrast, "the restriction requiring the property be used for recreation purposes . . . . must be considered in the valuation process." *Id.* at 280 ¶15. Thus, it was not the "restrict[ion on] rental income" that was significant, but the "restrict[ion on] an owner's use of the property." *Id.* Notably, in discussing the deed restriction requiring recreational use of the property, this Court held that "[t]he department must consider 'current usage' when valuing property." *Recreation Center*, 162 Ariz. at 290. In contrast, the statutory "current usage" requirement was never referenced in the Court's discussion of the nonprofit deed restriction.

The *Viola* Court concluded that, because "[a]n LIHTC property cannot be valued as if it were a conventional apartment complex," the complex's actual restricted rental rates could be used to determine value, rather than market rates. *Viola*, 251 Ariz. at 280 ¶15. However, the court did not require use of the restricted rental rates to determine value. *Id.* at 281 ¶17. It merely stated that "[v]aluing an LIHTC property based on actual income generated by the restricted rents is

potentially simpler than valuing a property based upon a theoretical market rental rate." *Id.*

The difference between *Viola* and *Mesquite* is that LIHTC properties were not comparable to conventional apartment complexes whereas a power plant that sells power using PPAs is no different from a power plant that does not have PPAs. Unlike the governmental restrictions in *Viola* that were found to "restrict an owner's use of the property," the PPAs, by themselves, do not affect ***use*** of the property. *Id.* at 280 ¶15. The Court of Appeals erred when it concluded that "[p]arallel reasoning applies here." (Opinion ¶30).

IV. The Court Of Appeals' Interpretation Of "Current Use" Conflicts With Other Recent Decisions By The Same Court.

Rule 23(d)(3) of the Arizona Rules of Civil Appellate Procedure, identifies several reasons why this Court should grant a Petition for Review including when "there are conflicting decisions by the Court of Appeals." In the Opinion, the Court of Appeals concluded that the PPA enhances the value of Mesquite's taxable property because it "contributes to the plant's . . . current usage." (Opinion ¶35). This interpretation of "current usage" conflicts with several prior decisions by the same court, including its interpretation of "use" in *General Motors*. *See* Section I, *supra.*

In *Burns v. Herberger*, 17 Ariz. App. 462, 467 (1972) overruled on other grounds by *Golder v. Dep't of Revenue, State Bd. of Tax Appeals*, 123 Ariz. 260

(1979), the Court of Appeals held that "all property subject to Ad valorem taxation was to be appraised at its fair market value, considering not its 'highest and best use', but the current usage to which it was being placed." The court held that it was "well established" "[t]hat the legislature can constitutionally classify property for tax purposes ***based upon the use to which the property is put***." *Id.* at 468 (emphasis added). Thus, in determining the "current usage" of the subject property, the court looked to the statutory classification of property used for "agricultural purposes."[2]

In *Krausz ex rel. KGC Tr. I v. Maricopa Cnty.*, 200 Ariz. 479 (App. 2001), the Court of Appeals rejected the taxpayers' claim that "current usage" allows a court to make inferences about a property's classification when the applicable statutes do not make that distinction. The court held, "we must be guided by the language of the governing classification statutes themselves, rather than by the interpretation offered by Taxpayers." *Id.* at 481 ¶8.

The Court of Appeals continued to follow this line of reasoning in *Qasimyar*, when it held that a change of use had occurred when the prior use and the current use of the subject properties were based on specific, distinct classifications. The Court, quoting *Krausz*, held that, "[i]n determining a property's classification, 'we

[2] The court also relied on the Director's guidelines defining "agricultural use," having concluded that those guidelines were prepared under the proper delegation of legislative authority. *Id.*

must be guided by the language of the governing classification statutes themselves." *Id*. at 585 ¶13. Thus, it concluded that, "***when two classes encompass distinctive and mutually exclusive uses***, changing between those classes may, as a matter of law, constitute a 'change in use' that triggers Rule B." *Id.* at 586 ¶17. The Court went on to observe that "'[c]urrent usage' is ***merely*** 'the use to which property is put at the time of valuation by the assessor or the department.'" *Id.* at 588 ¶27 (emphasis added).

In other words, "current usage" requires consideration of the appropriate statutory classification of the subject property at the time of valuation. The Court of Appeals explained that "the definition of 'current usage' 'controls the ***timing*** of the determination of the relevant use,' but neither defines 'use' nor confines the concept of property use *only* to the valuation process." *Id.*, *quoting Krausz ex rel. KGC Trust I v. Maricopa County*, 200 Ariz. at 481 ¶ 6 (App. 2001). Because the legislature had created "distinctive and mutually exclusive" categories of "use" of residential properties--defining "use" for purposes of those classifications--the Court held that there was a "change in use" that required application of Rule B to determine the FCV of the properties.

The expansive interpretation of "current usage" in the Opinion conflicts with prior decisions by the Court of Appeals because there are no "distinctive and mutually exclusive" classifications for merchant power plants depending on

whether they use PPAs to sell power. Just as the "use" of property did not depend on whether an automotive proving ground was owned or leased, the "current use" of the subject property as a merchant power plant does not depend on whether the owner also has other valuable intangible contracts.

The Court of Appeals has interpreted "use" and "current use" in past decisions in a manner that supports the decision of the Tax Court. The Opinion conflicts with those prior decisions and should be reviewed by this Court.

CONCLUSION

Based on the arguments set forth in this brief and in Mesquite Power LLC's Petition for Review, the Court should grant review and reverse the Opinion.

Respectfully submitted this 8th day of March, 2023.

NEARHOOD LAW OFFICES, PLC

By: *James R. Nearhood*
James R. Nearhood
Attorney for Amicus Curiae
WSATR and NAPTR-TEC

CERTIFICATE OF COMPLIANCE

1. This certificate of compliance concerns the Amicus Curiae Brief in Support of Mesquite Power, LLC's Petition for Review, and is submitted under Rule 16(b)(4).

2. The undersigned certifies that the brief to which this Certificate is attached uses type of at least 14 points, is double-spaced, and contains 3495 words.

3. The document to which this Certificate is attached, exclusive of the caption, Disclosure of Sponsors, Table of Contents and Table of Citations, does not exceed the applicable word limit that is set by Rule 23 (g)(2) as referenced by Rule 16(d)(1).

By: *James R. Nearhood*
James R. Nearhood
Attorney for Amicus Curiae
WSATR and NAPTR-TEC