

GENON MID-ATLANTIC, LLC  
(DICKERSON PLANT)

vs.

STATE DEPARTMENT OF  
ASSESSMENTS & TAXATION, et al

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IN THE

MARYLAND TAX COURT

Nos. 11-PP-OO-1344

13-PP-OO-0400 (2)

## MEMORANDUM AND ORDER

The appeals before the Court concern the 2009 and 2010 personal property assessments of the Dickerson Generation Station ("Dickerson") owned by a non-regulated utility generator (NUG) on the January 1, 2009 and 2010 dates of finality.

For both years, only the personal property assessment of the Dickerson plant is under appeal. The real property assessments of the plant for both years are not before the Court and are final at \$77,093,300.

For 2009 and 2010, the personal property at the plant is assessed at \$489,220,840 based on its original cost less depreciation. After exemption deductions for generation equipment and coal pollution control equipment, the actual assessed values for 2009 and 2010 are \$151,956,140 and \$140,426,400, respectively.

Genon Mid-Atlantic, LLC ("GenMa") is seeking a decrease of the assessments. The following tables represent the values that the parties are seeking:

2009	Genon	SDAT
Personal Property:	\$80,906,700	\$489,220,840
Less Exempt Personal Property:	\$44,074,079	\$337,264,700
Assessed Personal Property:	\$36,832,621	\$151,956,140

2010	Genon	SDAT
Personal Property:	\$72,906,700	\$585,157,776
Less Exempt Personal Property:	\$30,501,634	\$444,731,376
Assessed Personal Property:	\$42,405,066	\$140,426,400

For personal property tax assessment purposes the "value" of the personal property under Maryland Annotated Code, Tax-Property Section 8-107, refers to its "fair market value." In Maryland, the fair market value is that which "a willing purchaser would pay to a willing seller in the open market." See, e.g., *State Department of Assessments and Taxation v. Greyhound Computer Corp.*, 271 Md. 575, 586 (1974).

The Appraisal Institute's accepted definition of market value is similar to the Maryland definition and equally accounts for the role of a seller in the determination:

**Market Value:** The most probable price, as of a specified date, in cash, or in terms equivalent to cash, or in other precisely revealed terms for which the specified property rights should sell after reasonable exposure in a competitive market under all conditions requisite to a fair sale, with *the buyer and seller each acting prudently, knowledgeably and for self-interest* and assuming that neither is under undue duress.

Any accepted definition of market value, for purposes of this case in this Court, considers the perspective of *both the buyer and the seller*.

A determination of market value cannot be based solely upon an investment or from the perspective of the investor as it purposely ignores the counterbalancing force of the seller. Maryland courts have held that a hypothetical arm's-length transaction should consider the seller's perspective, as well. E.g., *St. Leonard Shores Joint Venture v. Supervisor of Assessments of Calvert County*, 307 Md. 441, 445-446 (1986), ("... for purposes of measuring full cash value, the assessor should assume that a willing buyer and a willing seller wish to engage in a hypothetical sale of the property to be assessed").

GenMa challenges the 2009 and 2010 personal property assessments of the Dickerson facility and contends that commencing in 2000, the electric generation market in the State of Maryland transitioned from a vertically integrated and monopolistic electric market to a competitive wholesale market, where electricity prices became determined by the basic economic principles of supply and demand. A stand-alone generation facility would be valued by buyers solely for its ability to generate revenue in excess of operating costs, at an expected rate of return, over a given period of time. Generation revenue is a function of the ability to provide electricity to the market at a price lower than the competition, while operating costs consist of both fixed and variable costs. Petitioner contends that during the years in question, there was a convergence of events that caused a fundamental change in the market and a decrease in the value of Dickerson which the State failed to recognize in its assessments.

GenMa contends that Dickerson was at a competitive disadvantage using subcritical technology, as it was much less efficient than both other coal plants (compare its 10,300 heat rate with Morgantown's 9,500 heat rate) and natural gas plants (heat rate of about 6,700/mmBtu). As a result, its net generation and net operating income declined by over thirty percent (30%) from 2005 to 2010.

As of January 1, 2009 and January 1, 2010 ("Dates of Finality" or "DOF"), buyers/sellers valued generating facilities by computing Dickerson's future potential earnings to determine an appropriate purchase price. For the Subject Years, in addition to accounting for Dickerson's antiquated and inefficient technology, Petitioner through its expert witnesses suggests the Dickerson's purchase price would also have been

impacted by the following Energy Market Factors:

#### Energy Market Factors

- (1) Decline of natural gas prices: Due to the application of hydrofracking technology, by 2008, natural gas prices significantly declined and remained below historic levels thereafter, including as of each date of finality.
- (2) Commitments to reduce energy consumption: Between 2007 and 2010, the growth of demand side and demand response resources was tenfold.
- (3) Increased efficiency and conservation of electricity use: As shown in the US Department of Energy Annual Energy Outlook ("AEO") reports for 2005 through 2010, both energy demand and use growth curves significantly declined.
- (4) Increased renewable power resources: Most states required renewable portfolio standards as of each DOF. Maryland required 20% of the state's generation be from renewables by 2022.
- (5) Environmental uncertainties: For coal plants, in particular, Dickerson (due to its smaller units), uncertainties existed regarding CO<sub>2</sub> or greenhouse gas reduction measures and their impact on cash flows.
- (6) Coal plants are becoming obsolete: Coal plant closures were increasing (in particular of units similar in size to those at Dickerson). Coal plants were replaced and displaced by more efficient and economical combined cycle gas turbines ("CCGT").

As a result of these changes, coal plants were not being sold and new coal plants were not being planned for development as of the dates of finality; major capital expenditures at existing coal plants had ceased due to the uncertainty of

environmental issues (especially CO<sub>2</sub> or hydrocarbon regulation); and natural gas plants were replacing coal plants.

The underlying premise of Petitioner's case is that these alleged fundamental changes negatively impacted Dickerson's future potential earnings. The Petitioner relied on the following experts to challenge the personal property assessments: Kevin Reilly of American Appraisal Associates (AAA, appraiser); Christopher Russo of Charles River Associates (CRA, econometrics); and Michael Borgstadt of Burns & McDonnell (replacement cost for generation improvements).

Due to the alleged fundamental changes in the energy market, Petitioner claims that natural gas became the fuel of choice, while coal was no longer a desired source of energy, as of the valuation dates. GenMa's replacement cost study replaces the Dickerson plant with a gas plant, rather than a coal-fired plant. Such an approach would require Dickerson to be valued at something other than its highest and best use.

The Court disagrees that a gas plant replacement represented the highest and best use of Dickerson on either date of finality. There was simply no credible evidence that the plant should or would be retired. GenMa had invested hundreds of millions of dollars in the coal plant for pollution control equipment close to the periods of finality. The plant is ideally-located and fully compliant with all pollution control regulations, making it more valuable than non-compliant coal plants. Even with an increasing supply of natural gas through "fracking," a substantial market still exists for coal plants, which are the dominant supplier of energy in the United States, providing about 40% of the overall energy supply. A decrease in overall demand simply makes the more efficient plants like Dickerson more valuable to a potential purchaser.

Kevin Reilly of American Appraisal who testified as GenMa's primary expert also employed an income approach as well as a cost approach. His appraisal assembled the "contributions" from Borgstadt and Russo combined with some of his own adjustments. Mr. Reilly reduced his cost and income approaches by large, negative adjustments for what he determined, *solely from the standpoint of lessees*, to be "adverse" or unfavorable lease payments associated with the subject property. Using leases to detract value from a GenMa-owned electric generating plant is not an acceptable appraisal practice.

To project income for an electric generating plant, Mr. Reilly utilizes a program called Russo's Aurora model. Aurora is very sensitive and one incorrect input could impact the entire output. The Court finds that the Arurora model may be flawed and cannot comfortably be considered by the Court. Mr. Reilly's income approach adopted questionable revenue and fuel cost projections. The adoption of those revenues and fuel cost projections resulted in Mr. Reilly's unreasonably low income approach valuations for 2009 and 2010 and does not persuade the Court.

Mr. Reilly did not consider the projections made internally by GenMa in its UAMs, which are used to make business decisions. He failed to make use of any of the independent goodwill impairment studies done specifically for GenMa by Deloitte and incorporated into the company's 10Ks. Moreover, he failed to review any of GenMa's 10Ks themselves, which are held out to Wall Street and its buyer universe. The Reilly/Russo projections in GenMa's income approach made no attempt to explain the Petitioner's business projections which were done concurrent with the date of finality. Consequently, the projection and model that Reilly/Russo used produced

consistently lower revenue than what the company had projected at the relevant times.

Mr. Reilly's No Lease Discounted Cash Flows ("No Lease DCF's") income approach relies on a high CAPEX figure of \$144 million in the first year of his analysis to account for the installation of the pollution control equipment, producing a negative net cash flow. In doing so, Mr. Reilly significantly reduced the net cash flow from operations in the crucial first year of his DCF without "...capturing revenue that would have been available" because of this expenditure. Since the cost of these new pollution control assets contributed well beyond the 10 year time span covered by the 2009 DCF, a third-party willing buyer/seller on the date of finality would have appropriately amortized or "spread that capital expenditure" over said time span.

In addition, Mr. Reilly's 2009 No Lease DCF's factored in the negative impact of a carbon tax beginning in 2014 but an internal memorandum dated January 29, 2009 clearly showed that GenMa's own in-house projections at that time was that the impact of the carbon tax would not begin in 2014, but rather in 2018. There is no reasonable basis to conclude that Congress would act to regulate carbon emission by way of a carbon tax as of the date of finality.

Mr. Reilly's 5% risk factor which was added to this overall discount rate as used in his DCF's is not supported by the evidence. Mr. Reilly's justification which was based on increases in the price of natural gas and carbon tax legislation requires speculation.

SDAT's expert, Laura Kittel, who is primarily responsible for the Department's Utility Valuation Unit, has personally valued the personal property at Dickerson every year since the plant was sold as a NUG in 2000. In fact, Ms. Kittel has

either valued or supervised the valuation of every public utility in Maryland since deregulation of the electric industry in 2000. Statutory law and regulations both require original cost less depreciation (OCLD) to be used public utility assessments. Ms. Kittel supported her personal property assessment with an appraisal using the three universally accepted approaches to value. GenMa had invested hundreds of millions of dollars for pollution control equipment in Maryland within a time period close to the dates of finality. Moreover, coal-fired electric generation was a significant contributor to the PJM electric generation market on the focus dates, delivering approximately 50% of the overall power. Thus, Ms. Kittel properly determined that the highest and best use of the subject property on January 1, 2009 and 2010 was clearly a continuation of the existing coal fired generation plant.

Ms. Kittel's income approach relied on the income and expenses as provided by the taxpayer for 2007 and 2008. She stabilized the NOI at \$120,000,000 (or \$72,000,000 after deducting taxes of \$48,000,000) and employed the bond yield plus risk model to develop the cost of equity and cost of debt. She selected a capitalization rate of 9.36% which produce a value of \$469,230,769.

Ms. Kittel's cost approach was based on the publicly reported construction costs of 5 new plants fueled by coal. Costs of gas-fired projects were referenced in her appraisal to value Dickerson's 3 CT units. The 5 plants established a cost range of \$1.02 million to \$3.79 million per megawatt. She determined that the most appropriate cost of construction was \$3,000,000 per megawatt and applied that rate to the three coal-fired units at Dickerson. She then determined that a 60 year life projection for the plant was appropriate and consistent with Beck's Independent Engineer's Report



prepared prior to the 2000 purchase for the specific purpose of providing support for the greater than 30 year lease term to the 4 leasing entities. Based on the current life of the Dickerson plant, she used 77% and 82% depreciation on the three units. A similar analysis was done for Dickerson's three combustion turbine (CT) units to determine their cost value to be \$102,350,714. That produced a total cost approach valuation of \$598,993,861.

Ms. Kittel considered a market approach that relied on the sales of coal-fired plants, two in Pennsylvania, one in New Jersey and three in Texas. The parameters set by the sales supported a price of \$1.2 million per megawatt for conventional coal-fired units. After a similar analysis, she used \$500,000 per megawatt for the two gas-fired CT units and \$200,000 per megawatt for the single oil fire CT. After adding the pollution control construction in progress of \$222,176,900, Ms. Kittel reached a total market valuation of \$700,015,900.

Correlating the total value, Ms. Kittel reviewed the results of the approaches and concluded that the total value of Dickerson in 2009 was approximately \$653,245,650. The removal of the uncontested 2009 real property assessment from this total (\$77,093,300) supported a personal property value of \$489,220,840.

Ms. Kittel employed a similar exercise in reaching a 2010 total personal property value of \$595,709,050.

The Court concludes that Ms. Kittel properly valued Dickerson's personal property on both dates of finality by assuming its hypothetical sale from *both* "a willing buyer and a willing seller" perspective. From a potential willing buyer's perspective, she considered documents held out by GenMa to the universe of potential buyers. These

documents represented GenMa's best estimates based on its best information about Dickerson's performance. From a willing seller's perspective, Ms. Kittel considered documents internally generated by GenMa based on its best information about Dickerson's performance. These included GenMa's Unified Asset Models (UAMs) (SE 6, 7), which are "all projections" of "gross margin" done internally, which represent GenMa's "...five year operating plan that is presented to [their own] board" and used to give guidance to Wall Street and the universe of potential buyers.

Ms. Kittel also provided a fourth alternate method of valuation by considering the income stream of the lease payments to the operating owners and calculating the present value of the income stream. She added the property at the plant that is owned by Mirant-Mid Atlantic and not included in the lease to the lease value. Applying the discount rate of 9.36%, the total full cash value yielded by the alternate method was \$613,931,550.

She also considered from a seller's perspective GenMa's SFAS Nos. 142, 144 and ASC 350/360 reports which are done by DeLoitte, an "outside" or "independent specialist" engaged "...because they have market expertise and knowledge of how to do these valuations." Finally, she considered from a seller's perspective Beck's Independent Engineer's Report prepared expressly for GenMa and the specific purpose of supporting the greater than 30 year lease term to the 4 leasing entities.

The Court agrees with Ms. Kittel's criticism of Mr. Reilly's appraisal. There was no convincing evidence to replace a coal plant with a gas plant in the cost approach when "[t]here's nothing obsolete about the Dickerson coal technology." Secondly, it is inappropriate in the appraisal process to represent that the lease

payments merely represent "financing" without including the lease payments as a significant contributor to the fair market value of Dickerson. Finally, Mr. Reilly's No Lease DCF analysis was not persuasive given the speculative assumptions and variables presumed necessary to utilize the Aurora model.

The Court concludes that the Supervisor's personal property assessments for Dickerson were correctly determined after a measured consideration of all three approaches and an additional alternate approach.

Accordingly, it is this 14<sup>th</sup> day of October, 2015, by the Maryland Tax Court ORDERED that the assessments are **AFFIRMED**.

cc: K. Donald Protor, Esq.  
Mark D. Lansing, Esq.  
Peter J. Crossett, Esq.

**CERTIFIED TRUE COPY**  
**TEST:** John T. Hearn, Clerk

**NOTICE:** You have the right of appeal from the above Order to the Circuit Court of any County or Baltimore City, wherein the property or subject of the assessment may be situated. The Petition for Judicial Review **MUST** be filed in the proper Court within thirty (30) days from the date of the above Order of the Maryland Tax Court. Please refer to Rule 7-200 et seq. of the Maryland Rules of Court, which can be found in most public libraries.