

MIRANT MID-ATLANTIC, LLC, et al

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IN THE

vs.

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MARYLAND TAX COURT

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Nos. 09-RP-**CH**-0261 thru 0265

09-RP-**CH**-0280 thru 0284

SUPERVISOR OF ASSESSMENTS
OF CHARLES COUNTY, et al

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09-RP-**CH**-0294 thru 0298

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10-**PP**-OO-0587 and 0682

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MEMORANDUM AND ORDER

The property before the Court is an electricity generation plant owned by the Petitioner, a non-regulated utility generator (NUG), with a date of finality of January 1, 2008. The real property is assessed by the local Supervisor of Assessments and the personal property is assessed centrally by the Utility Valuation Unit of the Department of Assessments and Taxation. The real and a personal property assessment appeals have been consolidated into one case.

The real property consists of four contiguous parcels of approximately 600 acres known as the Morgantown Plant (Morgantown) and one parcel of 343 acres, which is located approximately five miles away and functions as the Faulkner Fly Ash Facility (Faulkner), a fly ash landfill. The assessment for Morgantown includes a 186 acre parcel, which functions as a buffer and is assessed as agricultural property, and a 19 acre wooded parcel valued at \$1,140,270 and \$550,100 respectively by the Department of Assessments. The assessment includes a 57 acre railroad right-of-way assessed at \$795,300. The 343 acre parcel that functions as the primary plant site is valued at \$92,579,900 for both land and improvements. The Faulkner Fly Ash facility

was originally assessed for \$7,372,100. The Department of Assessments has reissued its assessment to no value as a result of significant environmental mitigation costs.

The personal property at the plant has been assessed at \$1,164,649,000 based on its original cost less depreciation. After exemption deductions for generation equipment and coal pollution control equipment, the assessed value of the personal property at the plant is \$577,042,000. The total real and personal property assessment under appeal is \$679,484,670.

Mirant Mid-Atlantic, LLC, Mirant MD Ash Management, LLC and Mirant Corporation (“Mirant”) are seeking a decrease in the assessment. The Supervisor of Assessment for Charles County (“Supervisor”) and Charles County are seeking an increase in the assessment.

The following represents the values that each party in this appeal is seeking:

	<u>Petitioners</u>	<u>Supervisor</u>	<u>County</u>
Real Property:	\$ 96,903,086	\$ 130,069,000	\$ 173,947,852
Personal Property:	966,901,326	1,164,649,000	1,340,000,000
Less Exempt Property:	543,893,755	587,558,000	676,030,000
Assessed Personal Property:	423,007,571	577,042,000	663,970,000
Total (Real and Assessed Personal):	\$519,910,657	\$ 707,111,000	\$ 837,917,852

For real property tax assessment purposes, the “value” of the real property under Maryland Code Annotated, Tax-Property Section 8-102, 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." *Weil v. Supervisor of Assessments of Washington County*, 266 Md. 238, 246 (1972). The same definition applies for personal property assessment purposes. See, e.g., *State Department of Assessments and Taxation v. Greyhound Computer Corp.*, 271 Md. 575, 586 (1974); Maryland Code Annotated, Tax-Property Section 8-107.

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 probably 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*. The Court agrees with the Supervisor and the County that Petitioner's primary expert, Michael Remsha, applied the wrong definition of fair market value. Mr. Remsha limited his consideration to the perspective of an investor. The market value reflects a value from an objective perspective and takes into consideration both the buyer and seller. The concept of investment value attempts to discern the value from a subjective, investor's perspective without consideration of the seller's objectives.

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").

Mr. Remsha testified that he put himself in the position of a potential purchaser and forecasted certain operational financial data: net generation, electricity prices, fuel (coal) prices and operational expenses, including environmental requirements. He relied on Stoddard's projections for generation estimates, commodity prices and revenues over an eight year Discounted Cash Flow (DCF) term. He then used the expense history of the plant to project the fixed and variable costs. A large increase in emission expenses related to the anticipated but non-existing federal CO2 tax in 2012, which significantly increased expenses from \$48,000,000 annually in 2011 to \$219,000,000 in 2012. An increase in generation revenue caused an increase in the Gross Margin (revenue less energy cost) for those two years, but the Net Operating Income (NOI) did decrease from \$384,000,000 in 2011 to \$355,000,000 in 2012.

Mr. Remsha also utilized Mirant's budgeted capital expenses for Future Environmental Capital Expenditures in 2008, 2009 and 2010 of \$268,000,000, \$131,000,000 and \$70,000,000. Although the capital structure of Mirant was financed, Mr. Remsha deducted the entire cost when budgeted rather than assume that part of the expense would be financed. Therefore, the 2008 investor/owners would have significantly less potential return in 2008 than the 2011 investor/owners would have after completion of the environmental upgrades. Further, he did not amortize any of the

cost of these new assets which he indicated had life expectancy of 30-50 years because Mirant reflected those expenses in its budget for those years. By failing to amortize these expenses, Mr. Remsha improperly reduced the Pre-Tax Cash Flow From Operations in the first three years of the DCF.

Petitioner's expert projected income for eight years and then used the average of the last five years to determine the reversion. Through the reversion, his DCF projected cash flow beyond 20 or 30 years into perpetuity, but he intentionally buffered the growth at the end of his eight year projection because the increase over that time could not be maintained. Therefore, Petitioner has failed to capitalize an appropriate growth rate to future cash flows.

Petitioner's Income Approach also achieved a lower value by employing inflated discount and capitalization rates. Mr. Remsha indicated that the discount rate used in his DCF must match the risk inherent in his cash flow, and since he did not subtract property or income taxes, he made adjustments to his yield rate. Initially, he determined that the effective property tax rate was 2.6% which he added to his discount rate of 18.1% to reach his final rate of 20.7%. But that rate was based on the comparison of the actual taxes to the assessment after the application of the \$587,000,000 exemption. At the Court's suggestion, Mr. Remsha utilized the correct effective rate as determined by the 2007 value before exemptions, which resulted in an increase in his income valuation to \$1,226,300,000 and his final value to \$1,050,000.00.

Petitioner's Cost Approach contains a number of flaws which achieves a reduced below market valuation. Mr. Remsha's Cost Approach begins with David Crean's \$3.4 billion cost to replace the existing plant with a modern, state of the art

plant, which included two cooling towers instead of the existing flow-through cooling system. Mr. Remsha made adjustments so that he could determine the cost difference between the two cooling towers and the existing flow-through system. He then subtracted that difference (\$52,000,000) from the replacement cost of the entire plant so that only the value of the flow-through system remained. However, Mr. Remsha made no adjustment for the fact that the cheaper flow-through system was indefinitely replacing the more expensive cooling tower system in Crean's model.

Petitioner claims the plant suffered from 51% physical depreciation, although the plant was in "good" condition and had a 38 year remaining useful life in 2006. Mr. Remsha indicated a 51% physical depreciation based on an Average Service Life of 49 years and remaining useful life of 24 years. Mirant's internal documents suggest a longer remaining useful life and cash flows through 2045. This leaves approximately 38 more years of remaining useful live from the valuation date.

The County's expert witness, Mr. Sim, testified that a 24 year useful life was not reasonable. Mr. Sim stated that he has not seen any plant retired simply because it was 60 years old. "And in power plants in general the whole purpose of this is you keep renewing them. If you've got a new turbine in there and a new boiler in there, I mean, I don't know a plant today that's got its original boiler. You replace wall to wall tubes the whole time on a regular basis. ... There's plants out there 60, 70 years old that are still operating efficiently and make a lot of money." Day 5 Transcript, pages 195-196.

After additional deductions for economical and functional obsolescence, Mr. Remsha concluded the cost value of Morgantown to be \$870.7 million. He then

added Mr. Ronald Lipman's land value of \$12.3 million to reach the total cost valuation of \$883,100,000. His final correlation of the income valuation and cost valuation was \$1,063,804,412. Mr. Remsha allocated the total value among Federal Energy Regulating Commission (FERC) accounts so he could apply the applicable exemptions and determine a value equivalent to the assessment. After applying exemptions, Mr. Remsha determined a value of \$614,768,743 compared to the Department's assessment of \$679,484,670

Respondent Supervisor's expert, Laura Kittel, who is primarily responsible for the Utility Valuation Unit, supported the personal property assessment with an appraisal using the three approaches to value. After reviewing the electricity generation totals for 2004 through 2007, Kittel relied on the income and expenses from 2006 and 2007, which were the only years provided by Mirant. Kittel's average NOI was \$193,000,000, but she used a conservative projection of \$150,000,000.

In support of her capitalization rate, Kittel considered the capitalization rate utilized by Deloitte in its 2007 Goodwill Impairment Study for Petitioner. In that study, she used a DCF model with four different estimates of the cost of equity, a CAPM model and a bond yield plus risk model. She also relied on respected sources such as Valueline, Moody's, Mergent Bond Index and Standard and Poor's. Ultimately, she selected a capitalization rate of 10% for the subject because it was a non-regulated utility generator (NUG). The application of that rate to the NOI produced a value of \$1.5 billion.

Ms. Kittel's Cost Approach was based on the publicly reported construction costs of new plants. The five plants establish a range of \$1.02 million to

\$3.79 million per megawatt. She relied most heavily on the Dominion project because it was a conventional coal-fired plant. She determined that the most appropriate cost of construction was \$3,000,000 per megawatt (MW) and applied that rate to the two coal-fired units at Morgantown. She then determined that a 60 year life was appropriate and consistent with Beck's Independent Engineer's Report prepared prior to Petitioner's 2000 purchase for the specific purpose of providing support of the 34 year lease term to the seven leasing entities. Based on the current life of the Morgantown plant, she used 38% and 40% depreciation on the two units, depending upon the actual year of construction. This approach produced a valuation of \$713,000,000 and \$748.8 million for the two units. A similar analysis was done for the combustion turbine (CT) units to determine the cost valuation of them to be \$21.3 million. That produced a total Cost Approach valuation of \$1.483 billion.

Respondent Supervisor considered a Market Approach that relied on sales of coal units, two in Pennsylvania, one in New Jersey and three in Texas. Ms. Kittel testified that it was important to look at sales after deregulation. The first four of her sales had been used in a study for the General Assembly before the commencement of this case and had been vetted by Mr. Glen Walker (Charles County's expert appraiser) functioning as an outside appraiser. The parameters set by the sales supported a price of \$1.5 million per megawatt for conventional coal-fired units. After a similar analysis, she used \$220,000 per megawatt for the CT units, which produced a total market value estimate of \$1.9 billion for the Morgantown Electric Generation Plant.

Ms. Kittel then reviewed the results of the three approaches and concluded that the value of Morgantown was approximately \$1.5 billion. Kittel reviewed

all of the relevant documents and made appropriate allocations and adjustments in determining the assessments. She personally has valued the personal property at Morgantown every year since the plant was sold to Petitioner in 2000 as a NUG. In fact, Ms. Kittel has valued every public utility in Maryland since the deregulation of the electricity industry in 2000 and her testimony was credible.

Mr. Roy Sleeman, Chief Commercial Assessor for DAT, only valued the real property and explained the distinction in Maryland between real and personal property. Originally, the entire generation plant was valued by the Utility Valuation Section, but after deregulation, the real property is valued by the local supervisor and the personal property is valued by the utility assessors. Sleeman valued the improvements by using the Marshall Swift Valuation Service (MS) for individual industrial buildings. He used the proper indexes to adjust the values to the 2008 date of finality. He reviewed the rates in and around Washington, D.C., in both Maryland and Virginia, to determine the appropriate indexing rate. Sleeman considered the original Beck Report to determine the useful life of the leased property at the original acquisition in 2000 and described Petitioner's in-house maintenance procedures as strenuous. Mr. Sleeman relied on the impairment studies prepared by Deloitte to establish original useful life estimates of 60 to 80 years and then estimated the remaining useful life of Morgantown at 37 years. In order to recognize the heavy wear and tear of industrial use, he used 34% and 45% on the existing real property structures. His Cost Approach, which updated the assessed value to the date of finality, produced a value of \$99,339,000 for the improvements.

Mr. Sleeman valued the land using market sales with important valuation

characteristics, including industrial zoned property on 100 plus acres, water access for both transportation and cooling purposes, certificate of public necessity, rail access, well and septic access to the power grid and the continuation of a present use. He conceded that it was difficult finding sales with similar characteristics.

Mr. Sleeman's appraisal included nine land sales. He indicated that his primary goal was to establish a primary land rate and concluded that the primary site was 100 acres with a value of \$150,000 per acre. Mr. Sleeman valued the fee ownership of the railroad line, not just a right-of-way, at \$75,000 per acre because that rail line contributed dramatically to the value of that site. His analysis resulted in a land value of \$30,730,000.

Mr. Sleeman reviewed the value of Faulkner and after considering the evidence of extensive mitigation costs in the near future, he reduced its value to zero.

Mr. Sleeman valued the Morgantown property based on the long term leases, which originally lasted for 34 years. Mr. Sleeman concluded that the lease represented an arm's-length transaction at its inception and, therefore, he did a cash flow analysis of the lease. He properly determined that the maintenance and capital projects (related to the Maryland Healthy Air Act) required by the lease would extend the life of the assets beyond the lease term. By escalating the cost of acquisition plus the cost of capital expenditures for pollution equipment through the term of the lease at 2% per year and then discounting that value back to the present at 8%, Sleeman accurately determined the reversion value. The present value of the lease income plus a reversionary value of the leased property totaled \$1.265 billion to which he added land value and the value of the CT units of \$105,000,000 for a total value of \$1.365 billion.

By subtracting the personal property assessment, Mr. Sleeman opined a real property value of \$199,000,000.

Mr. Sleeman's market analysis considered three sales of coal-fired plants. With market adjustments to each sale, he determined a range of \$1.637 million to \$1.712 million per megawatt. Mr. Sleeman's megawatt analysis considered the need for pollution control devices and subtracted Mirant's projected cost of \$605,000,000 to reach a value of \$1.571 billion for the plant. He subtracted the personal property assessment to reach a value of \$407,000,000 for the real property. Mr. Sleeman opined that he used these sales to set a market expectation of value for these units and to support the contention that the capital expenditures for pollution control will not result in a reduction of value.

The assessed 2006 value of the real estate was \$102,442,670. The value of these improvements was updated under Marshall Swift to the 2008 date of finality to \$99,339,000 with a land value for the plant site of \$30,730,000 for a total of \$130,069,000, excluding Faulkner. The value of the two other necessary sites, the railroad ROW and the 19 acre buffer were set at \$75,000/acre and \$35,000/acre, respectively, for a final value of \$4,543,950 and \$667,800.

Mr. David Crean, although not an appraiser, prepared a Replacement Cost Survey on behalf of Petitioner. Mr. Crean's cost numbers and his allocation of property to FERC accounts were significant aspects of the appraisal done by Mr. Remsha.

Mr. Crean did not perform an appraisal of Morgantown, but rather he estimated the bricks and mortar cost of a modern replacement plant as opposed to the

existing 37 year old plant. Crean made a number of assumptions regarding the physical replacement plant and the cooling system that raise a number of questions with respect to the cost survey used by Mr. Remsha in his appraisal.

Mr. Robert Stoddard, an economist from Charles River Associates, provided a report and testified as an expert regarding future revenue and cost projections for Morgantown. Additionally, Mr. Stoddard testified as to the positive attribute of Morgantown's water access location on the Potomac near Washington, DC, where electricity prices are higher. He opined that the Morgantown plant was a little newer, had better heat rates and was more strategically located than some other plants.

Mr. Ronald Lipman provided a land valuation but admitted that he had no experience valuing electricity generation plants and could not give an opinion as to the highest and best use of the subject property as developed. Mr. Lipman's appraisal report valued the underlying land as vacant with the highest and best use being a variety of heavy industrial uses.

Mr. William Sims, who testified for Charles County, had experience operating Morgantown and was in charge of all construction and maintenance for PEPCO's generation plants. Mr. Sims said Morgantown was in excellent condition in 2000 and that this condition was maintained because it was number one in the country in heat rated efficiency in 2004-2005. He stated that he would buy the Morgantown plant over building a new plant for several reasons. The technology difference between the existing Morgantown plant and a replacement plant would be minimal. Morgantown has a healthy cash flow; the site already has all the necessary attributes, including access to water, rail and transmission lines; it has all the assets for expansion and it

does not have any construction problems, new technology risks, or start up issues. Mr. Sims' testimony supports the testimony and opinion of Ms. Kittel and Mr. Sleeman.

Mr. Glen Walker, who specializes in the valuation of utility properties and electric generation property, testified for Charles County. Mr. Walker determined that the highest and best use of the subject property was as a generation plant. His Cost Approach was derived from a replacement cost estimate utilizing cost estimates from Ventex.

For depreciation purposes, Mr. Walker indicated that real estate has a longer life than personal property components. There was no credible evidence to suggest that Morgantown was not properly maintained. He concluded a life expectancy for the real estate of 75 years and for the personal property, 60 years for the coal units and 40 years for the CT units with an effective age for the plant of 22 years. This produced depreciation of 37%, 29% and 55%, respectively. Mr. Walker then applied functional and external depreciation. He determined that Morgantown was comparable to its competitive peers and concluded that the value of the plant was \$1.38 billion.

Mr. Walker considered three sales in his Market Approach. For the coal fired units, his market analysis resulted in a \$1,700 per kilowatt value which produced a total value of \$2.04 billion for Morgantown. After deducting for the cost of environmental upgrades, that approach produced a plant value of \$1.5 billion.

In Mr. Walker's income approach he used two methods, the direct cap and discounted cash flow. Using the actual 2006 and 2007 I&E and the budget for 2008, he determined the EBITDA for each year. Mr. Walker then used a multiple of seven, which is equivalent to a cap rate of 14.3%, to determine a range of \$2.1 billion to \$2.5 billion.

Deducting pollution control expenses, Mr. Walker conservatively estimated the value as \$1.5 billion. Mr. Walker then reconciled his three valuation methods and concluded \$1.475 billion as the value of Morgantown and Faulkner.

The subject property is a unique site with a long list of important characteristics that support its current use. The Morgantown site is large enough to support the plant and provide adequate buffer and room for expansion. The rail access which is currently used for the delivery of coal and the water access utilizes a flow-through cooling system which requires access to large volumes of water to cool the operation. In addition, the Potomac River provides access for transportation purposes and Petitioner was in the process of constructing a \$28,000,000 coal delivery pier on the date of finality. The new pier provides flexibility for coal delivery and reduces operational risk. The Court agrees with Mr. Sleeman that these locational attributes are relevant market indicators. Mr. Sleeman conceded that none of his land comparables had all of the characteristics important to Morgantown, but stated that his sales were the most relevant value indicators in a market without directly comparable sales. He properly established a land rate of \$150,000 per acre which he applied to the primary site of 100 acres and placed a \$75,000 value on the rail related land. He applied secondary and tertiary values to supporting and buffer lands and determined that the Morgantown site had a \$30,730,000 land value. Mr. Sleeman's analysis should be distinguished from Mr. Lipman's appraisal. Mr. Lipman simply valued industrial land in Southern Maryland which lacked the unique characteristics of the Morgantown site.

Mr. Sleeman adjusted the 2006 Marshall Swift improvement valuation to January 1, 2008. Mr. Sleeman's improvement valuation of \$99,339,074 reflects the

relevant market of other generation plants. The Court finds that the total real property value as of January 1, 2008 is \$130,069,000.

The Petitioner's personal property valuation has not persuaded the Court to reduce the assessment prepared by Ms. Kittel. Ms. Kittel's personal property assessment is consistent with Petitioner's financial records as reported to the Department of Assessments and other government agencies. Every public utility and NUG is valued based on long term administrative practices. Under DAT's uniform approach for valuing personal property, Ms. Kittel reviews the annual 17G form, which Petitioner is required to file, plus Petitioner's annual report and any other SEC or PSC filings. The personal property valuation considers the original cost of the assets, including the capital expenditures in any given year, and then utilizes a 30 year depreciation schedule for the long-lived generation equipment and other regulatory rates for specified property. A personal property assessment for Morgantown, plus each of the seven lease entities in the amount of \$1,164,649,600 is supported by this long standing practice. Ms. Kittel performed an income analysis by utilizing the actual income and expenses reported by Petitioner to develop a conservative net operating income of \$150,000,000.

A capitalization rate of 10% is supported by Deloitte's 2007 Goodwill Impairment Study (9.7% rate). Capitalizing \$150,000,000 of net operating income by 10% produces an income valuation of \$1.5 billion. Consequently, Ms. Kittel's appraisal presented for this Court supports the assessed value of \$1,164,649,600. Moreover, based upon the Court's previous question and reservation regarding the Petitioner's expert testimony and methodologies, there is no justification for a decrease in the

assessment. Finally, the Court notes that the County's case supports the revised assessment of the Department of Assessments but does not justify a larger increase in the assessment

Accordingly, it is this 25th day of *January*, 2012, by the Maryland Tax Court ORDERED that the Court hereby affirms the personal property assessment of \$577,042,000 (\$1,164,649,000 less exemption of \$587,558,000) and increases the real property assessment to \$130,069,000 for a total assessment of \$707,111,000.

CC: K. Donald Proctor, Esq.
James L. Thompson, Esq.
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Kent Finkelsen, Administrator

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.