

GENON MID-ATLANTIC, LLC

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IN THE

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MARYLAND TAX COURT

vs.

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Nos. 10-RP-CH-0743 & 0778

11-PP-OO-1343 & 1396

STATE DEPARTMENT OF  
ASSESSMENTS & TAXATION, et al

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13-PP-OO-0400 (1) & 0415

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## MEMORANDUM AND ORDER

The property before the Court is an electricity generation plant ("Morgantown") owned by a non-regulated utility generator (NUG) on the January 1, 2009 and 2010 dates of finality.

For the 2009 taxable year, there are both real and personal property assessments at issue. For 2010, only the personal property assessment of the Morgantown plant is under appeal; the real property assessment is not before the Court.

Morgantown's entire real property consist of four contiguous parcels of approximately 600 acres. For 2009, only a 343-acre parcel (account no. 05-017556) that functions as the primary plant site (the main plant parcel) is before the Court, currently assessed at \$137,086,500 for both land and improvements. This total assessment breaks down into a land assessment of \$28,729,500 and an improvements assessment of \$108,357,000.

For 2009 and 2010, the personal property at the plant is assessed at \$1,362,159,090 and \$1,578,506,140, respectively, 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 \$544,728,410 and \$493,138,290, respectively.

Genon Mid-Atlantic, LLC ("GenMA") is seeking a decrease in the assessments while Charles County, Maryland is seeking an increase. The following represents the values that parties in these appeals are seeking:

2009	<u>Petitioners</u>	<u>Supervisor</u>	<u>County</u>
Real Property:	\$29,058,243*	\$137,086,500*	\$166,500,000*
Personal Property:	\$169,399,756	\$1,362,159,090	\$1,273,500,000
Less Exempt Personal Property:	\$112,656,304	\$817,430,680	\$498,500,000
Assessed Personal Property:	\$56,743,452	\$544,728,410	\$775,000,000
Total (Real and Assessed Personal):	\$85,811,695*	\$681,814,910*	\$941,500,000*
<b>*Includes main plant site only.</b>			

2010	<u>Petitioners</u>	<u>Supervisor</u>	<u>County</u>
Real Property:	-----	-----	-----
Personal Property:	\$390,158,644	\$1,578,506,140	\$1,143,000,000
Less Exempt Personal Property:	\$289,540,756	\$1,085,367,850	\$615,000,000
Assessed Personal Property:	\$100,617,888	\$493,138,290	\$528,000,000
Total (Real and Assessed Personal):	\$100,617,888*	\$493,138,290*	\$258,000,000*
<b>*Includes no real property assessment.</b>			

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 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 real and personal property assessments of the Morgantown Generation Station (Morgantown”), an independent power producing (“IPP”) facility also known as a non-utility generator (“NUG”). GenMA 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 Morgantown which the State failed to recognize in its assessments.

GenMa’s value conclusions are significantly lower in these cases for 2009 and 2010 than in its challenge of the 2008 personal and real property assessments. Petitioner claims the values at issue in these proceedings reflect the fundamental changes that commenced in the second half of 2008 which were observable as of January 1, 2009. Thus, given these fundamental changes, the valuation as of January 1, 2009 and January 1, 2010 cannot be based on pre-2009 net operating income. Petitioner, through its expert witness, suggests the following fundamental changes:

- (1) coal plants being closed for environmental reasons and being replaced by combined cycle gas turbines;
- (2) a systemic decline in natural gas prices due to the effects of hydrofracking which increased the supply of natural gas in excess of its demand;
- (3) significant growth of demand side and demand response resources;
- (4) increases in efficiencies in and conservation of electricity use;
- (5) increases in renewable power resources (e.g. wind) due to Maryland's requirement for 22% of generation by renewables by 2022;
- (6) environmental uncertainties that particularly affected coal plants (CO<sub>2</sub> or greenhouse gas reduction measures); and
- (7) decreased electricity prices while at the same time coal prices returned to more historic levels on 2009, reducing the gross margin (or dark spread) at the dates of finality.

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 Morgantown's net operating income as

shown below:

Date of Finality	Fiscal Year	Morgantown Net Operating Income
1/1/2006	1/1/2005 to 12/31/2005	\$239,418,516
1/1/2007	1/1/2006 to 12/31/2006	\$135,943,954
1/1/2008	1/1/2007 to 12/31/2007	\$250,755,864
1/1/2009	1/1/2008 to 12/31/2008	\$344,618,571
1/1/2010	1/1/2009 to 12/31/2009	\$35,035,251

In addition, as a result of these fundamental changes, the facility leases associated with the subject property became an economic burden to Morgantown. Petitioner contends these fundamental changes in the market and the significantly reduced cash flows caused Morgantown's value to significantly decline as of the January 1, 2009 and 2010.

The Petitioner relied on the following experts to challenge the real and personal property assessments: Kevin Reilly of American Appraisal Associates ("AAA") (valuation of improvements); Robert Stoddard of Charles River Associates ("CRA") (electric and fuel price projections); Michael Borgstadt of Burns & McDonnell (replacement cost for generation improvements), and M. Ronald Lipman of Lipman Frizzell & Mitchell LLC (land value).

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 Morgantown Station with a gas plant, rather than a coal-fired plant, even though the cost of the fuel with the gas plant exceeds that of the coal plants by over \$573 million dollars over the remaining life of the plant. Mr. Borgstadt prepared a replacement cost survey which was relied on by Mr. Reilly to develop a replacement cost of a natural gas fired plant.

The Court disagrees that a gas plant replacement represented the highest and best use of Morgantown on either date of finality. The Morgantown plant is recognized as one of the most efficient coal-fired plants in the region and is one of the top 20 coal plants in the United States. 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 Morgantown 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, Stoddard and Lipman 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. Although the leases were merely an acquisition financing tool, Mr. Reilly failed

to value both the leased and non-leased portions of Morgantown. Mr. Reilly conceded that the lessors under the leases would be hypothetical sellers on either date of finality, yet he only analyzed the leases from the lessees' perspective. The Court considers the failure to value the leased property a fundamental appraisal error in determining the fair market value of the property for ad valorem tax purposes.

The Court finds that GenMA's cost approach is not credible and that because parts of GenMa's income approach that factor in the "lease liability" is likewise not credible, the only potentially viable portion of GenMa's presentation is its fallback or sensitivity analysis, the so-called NO LEASE DICOUNTED CASH FLOWS ("DCF's"). Mr. Reilly's NO LEASE DCF's income approach relies upon cash flow estimates that are in most cases less than half of the real time forecasts by GenMa itself. The unreasonably low cash flow forecasts are attributable to Mr. Reilly's reliance upon the report of Mr. Stoddard. Mr. Stoddard's 10-year projections as opposed to the appropriate 20 year period are not only significantly lower than the GenMA forecasts in the first ten years but these forecasts fail to capture the rise in electricity prices in the later years due to rising gas prices which result in a low reversion value developed by Mr. Reilly. The truncated 10 year forecast results in a lower valuation of the property.

To project income for an electric generating plant, Mr. Stoddard utilizes a program called Aurora. The Aurora model 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 Mr. Stoddard's 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.

Roy Sleeman, Chief Commercial Assessor for the State Department of Assessments and Taxation ("SDAT"), valued the real property for 2009 and for that year only the land and improvements of the main plant account. Mr. Sleeman testified that GenMa had invested over \$600 million for pollution control equipment at Morgantown within a time period close to the dates of finality and there was no evidence that GenMA planned to tear down the existing profitable coal plant. He concluded that the highest and best use of the subject property on January 1, 2009 was a continuation of the existing coal fired generation plant. The Court agrees.

Mr. Sleeman valued the improvements by using the Marshall Swift Valuation Service for individual industrial buildings. He considered the original Beck's Independent Engineer's Report done for the taxpayer when the plant was acquired in 2000 to determine the useful life of the leased property and recognized that the Petitioner was properly maintaining the subject property. His reliance on in-house impairment studies prepared for the taxpayer by Deloitte established an estimated remaining useful life of Morgantown of 37 years. In order to recognize the heavy wear and tear of industrial use, he used 17% to 30% depreciation of the existing real property structures. His cost approach, which updated the assessed value to the date of finality, produced a value of \$109,519,442 for the improvements. Mr. Sleeman's cost approach produced a higher value than the 2009 current assessed value of the main plant parcel improvements at \$108,356,500.

Mr. Sleeman valued the land using seven land sales with important valuation characteristics, including timing of the sales, industrially zoned property, water

access for transportation and cooling purposes, rail access and size. Although it was challenging to find large land sales with similar characteristics to Morgantown, Mr. Sleeman concluded that the primary site was 100 acres with a value of \$200,000 per acre and a 2009 land value of \$34,000,000 for the main plant. Correlating the total real property value of the main plant parcel in 2009, Mr. Sleeman's final conclusion of value for both land and improvements on January 1, 2009 was \$150,000,000.

Mr. Sleeman also did a cash flow analysis of 7 long term leases entered into in 2000. He concluded that they represented arm's-length transactions at their inception and determined that the maintenance and capital projects (related to the Maryland Healthy Air Act) required by the leases would extend the life of the assets beyond the lease term. By discounting the cash flow generated by the lease payments back to the present at 6%, he accurately determined their present value *from the perspective of the lessors/owners as required by Maryland assessment law*. The present value of the leases plus a reversionary value of the leased property totaled \$954,235,285, to which he added the land value (\$34M) and the value of the CT units (\$62M), for a value of \$1,050,235,285. He then added to this the \$600M cost of the scrubber improvements made in 2009 for an estimated value of \$1,650,000,000. Deducting a remaining compliance cost of \$150,000,000 yielded a total value under the lease residual approach of \$1,500,000,000. By subtracting the 2009 personal property value, Mr. Sleeman's residual real property value is \$137,841,000. The 2009 current assessed value of the only real property assessment account under appeal is \$137,086,500.

SDAT's expert, Laura Kittel, who is primarily responsible for the



Department's Utility Valuation Unit, has personally valued the personal property at Morgantown 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. Ms. Kittel supported her personal property assessment with an appraisal using the three universally accepted approaches to value. GenMA had invested over \$600 million for pollution control equipment at Morgantown 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 2006 through 2008. She stabilized the NOI at \$170,000,000 and employed the bond yield plus risk model to develop the cost of equity. She selected a capitalization rate of 9.36% which produce a value of \$1.8 billion.

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 the peaker 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 two coal-fired units at Morgantown. 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 7 leasing entities. Based on the current life of the Morgantown plant, she used 63% and 62% depreciation on the two units. A similar analysis was done for the combustion turbine to determine their cost value to be \$17,550,000. That produced a total cost approach valuation of \$1.417 billion.

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 \$1.6 million per megawatt for conventional coal-fired units. After a similar analysis, she used \$200,000 per megawatt for the CT units, which produced a total market value estimate of \$2.0 billion for the Morgantown plant. Correlating the total value, Ms. Kittel reviewed the results of the three approaches and concluded that the total value of Morgantown in 2009 was approximately \$1.5 billion. The removal of the 2009 real property assessment from this total (\$137,086,500) supported a personal property value of \$1,362,159,090.

Ms. Kittel employed a similar exercise in reaching a 2010 total personal property value of \$1,578,506,140. In her 2010 income approach, Ms. Kittel relied on the income and expenses as originally reported by GenMA on Form 17-G for four years: 2006 through 2009. The average NOI was \$217,274,361, but she actually chose a conservative stabilized NOI of \$190,000,000. The Court concludes that Ms. Kittel properly valued Morgantown'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 Morgantown's performance. From a

willing seller's perspective Ms. Kittel considered documents internally generated by GenMa based on its best information and estimates. These included GenMa's Unified Asset Models (UAMs) (SE 20, 22), which are "all projections" of "gross margin" done internally which represent GenMa's "...five year operating plan that's presented to [their own] board." 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 7 leasing entities.

Mr. Gleen C. Walker, who specializes in the valuation of utility properties and electric generation property, testified for Charles County and submitted an appraisal addressing both years using all three commonly accepted valuation approaches. Mr. Walker determined that for both years, the highest and best use of Morgantown was its current use being continued as a coal generation plant. His cost approach was derived from a replacement cost of a coal plant utilizing cost estimates from Ventex. All of the internal engineering reports and risk reports he reviewed "...suggested that the facility was in good condition, well maintained and, ..., in a good state of repair." 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 27 and 28 years, respectively. This produced depreciation of 45-47% for the personal property and 36-37% for the realty. 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 \$1,453,000,000 and \$1,660,000,000, respectively.

In Mr. Walker's income approach, he used two methods, the direct cap and DCF. In his direct cap, using the actual 2008-2009 I&E, 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 value of \$1,700,000,000 for 2009 and \$1,260,000,000 for 2010. Finally, Mr. Walker did a series of DCFs to establish the values of Morgantown which resulted in reconciled values of \$1,535,000,000 for 2009 and \$1,355,000,000 for 2010. He then reconciled all three valuation methods and concluded the values as set forth on the chart.

The Court agrees with the SDAT's experts and Mr. Walker in their 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 Morgantown 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 Morgantown.

The Court concludes that the Supervisor's assessments for Morgantown were correctly determined after a measured consideration of all three approaches to value generating property. The County's expert testimony and argument confirm the Supervisor's assessments. Petitioner's analysis of Morgantown's value of real and personal property was not convincing. However, the Court is not persuaded that the County's alternate exemption allocation method is appropriate for assessment purposes and finds that GenMA is entitled to a partial exemption equal to 95% of the



assessment of the pollution control equipment. Accordingly, it is this  
18<sup>th</sup> day of February, 2015, by the Maryland Tax Court  
ORDERED that the assessments are **AFFIRMED**.

**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.