S261885

In the Supreme Court of the State of California

| | |
|---|---|
| HGST, INC.,<br><br>Plaintiff and Appellant,<br><br>vs.<br><br>COUNTY OF SANTA CLARA,<br><br>Defendant and Respondent. | No. _____ |

# PETITION FOR REVIEW

After Decision by the Court of Appeal
State of California, Sixth Appellate District,
Numbered Therein No. H044904

County of Santa Clara
Honorable Theodore C. Zayner
(Superior Court No. 1-14-CV-263300)

PILLSBURY WINTHROP SHAW
PITTMAN LLP
KEVIN M. FONG (#91037)
CRAIG A. BECKER (#130900)
*BREANN E. ROBOWSKI (#267851)
2550 Hanover Street
Palo Alto, CA 94304-1115
Telephone: (650) 233-4500
Facsimile: (650) 233-4545

Attorneys for Plaintiff and Appellant
HGST, INC.

**CERTIFICATE OF INTERESTED ENTITIES OR PERSONS**
**INITIAL CERTIFICATE**

Plaintiff and Appellant HGST, Inc., certifies pursuant to Rule 8.208 of the California Rules of Court that the following entity has an ownership interest of 10 percent or more in HGST, Inc.:

| **Interested Entity** | **Nature of Interest** |
| --- | --- |
| Western Digital Corporation | HGST, Inc. is a wholly-owned indirect subsidiary of Western Digital Corporation. |

By: 

* BREANN E. ROBOWSKI 267851

Attorney for Plaintiff and Appellant HGST, INC.

## TABLE OF CONTENTS

Page(s)


PETITION FOR REVIEW ..... 9

ISSUES PRESENTED ..... 10

BACKGROUND: PROPERTY TAX ASSESSMENTS AND JUDICIAL REVIEW ..... 10

STATEMENT OF THE CASE ..... 15

A. Procedural History ..... 15

B. The Standard of Review Issue ..... 16

WHY REVIEW SHOULD BE GRANTED ..... 22

A. The Opinion's New Framework Deviates from *Bret Harte*, Contradicts *Sky River*, and Misinterprets *Dreyer's* ..... 22

1. The Opinion Upsets the *Bret Harte* Framework. ..... 22

2. The Opinion Directly Contradicts *Sky River*, Which Ruled that the *Bret Harte* Framework Applies to Challenges Involving an Element within a Valuation Approach. ..... 25

3. The Opinion Misinterprets *Dreyer's*, Creating Further Confusion and Illustrating the Importance of the *Bret Harte* Framework ..... 29

B. The Opinion Has Significant Practical Implications ..... 31

1. Nearly All Cases Would Be Decided Under the Substantial Evidence Test. ..... 31

2. Applying the Substantial Evidence Standard to Method Questions Would Nullify the Courts' Ability to Effectively Oversee the Property Tax System. ..... 32

a. The Assessment Appeals Board Is Granted Deference on Application Questions Because They Have Valuation Expertise, But They Have No Such

**TABLE OF CONTENTS – continued**


Expertise with Respect to Questions of Law Such as Method Questions. ..... 32

b. The Focus of a Substantial Evidence Review Is on the Quantum of Evidence, Which Is Inappropriate for Method Questions. ..... 33

c. Substantial Evidence Review Is Insufficient for Method Questions, Especially Against the Backdrop of the Lack of Evidentiary Rules at Board Hearings and the Presumption of Correctness Afforded the Assessor's Assessments. ..... 34

d. The Opinion Undercuts Judicial Oversight Previously Recognized as Critical by the Legislature. ..... 35

DE NOVO REVIEW SHOULD HAVE BEEN APPLIED HERE ..... 37

A. The Opinion Mischaracterized the Disputes as Questions of Fact and Neglected to Apply *Bret Harte*'s Two-Step Approach. ..... 37

B. The Single Company-Based Return Rate Method and Stipulation-Based Income Adjustment Factor Method Are Inherently Flawed. ..... 39

1. The Single Company-Based Method Used for the Return Rate Does Not Reflect the Fair Market Value of the Equipment at Issue. ..... 40

2. The Stipulation-Based Method Used for the Income Adjustment Factor Does Not Reflect the Fair Market Value of the Equipment at Issue. ..... 42

3. The Flaws of These Methods Are Inherent and Unrelated to the Facts of This Case. ..... 43

CONCLUSION ..... 44

## TABLE OF AUTHORITIES

Cases

*Bontrager v. Siskiyou County Assessment Appeals Board*
(2002) 97 Cal.App.4th 325 ..... 26

*Bret Harte Inn, Inc. v. City and Cty. of San Francisco*
(1976) 16 Cal.3d 14 ..... passim

*County of Orange v. Orange Cty. Assessment Appeals Bd.*
(1993) 13 Cal.App.4th 524 ..... 14, 42

*De Luz Homes, Inc. v. County of San Diego*
(1955) 45 Cal.2d 546 ..... 10, 33, 39, 42

*Dreyer's Grand Ice Cream, Inc. v. County of Kern*
(2013) 218 Cal.App.4th 828 ..... 29, 30, 31

*Elk Hills Power, LLC v. Board of Equalization*
(2013) 57 Cal.4th 593 ..... 14

*Firestone Tire & Rubber Co. v. County of Monterey*
(1990) 223 Cal.App.3d 382 ..... 13, 33

*Freeport-McMoran Resource Partners v. County of Lake*
(1993) 12 Cal.App.4th 634 ..... 15, 24, 33, 43

*Hunt-Wesson Foods, Inc. v. County of Alameda*
(1974) 41 Cal.App.3d 163 ..... 23, 33, 35

*ITT World Commun'ns, Inc. v. County of Santa Clara*
(1980) 101 Cal.App.3d 246 ..... 23, 26, 35

*Maples v. Kern County Assessment Appeals Board*
(2002) 96 Cal.App.4th 1007 ..... 15, 26

*Midstate Theatres, Inc. v. County of Stanislaus*
(1976) 55 Cal.App.3d 864 ..... 23

*Mission Housing Development Co. v. City and County of San Francisco*
(1997) 59 Cal.App.4th 55 ..... 33, 34, 35

*Norby Lumber Co. v. County of Madera*
(1988) 202 Cal.App.3d 1352 ..... 36, 41

*Pacific Grove-Asilomar Operating Corp. v. County of Monterey*
(1974) 43 Cal.App.3d 675 ..... 36

*Pacific Mutual Life Ins. Co. v. County of Orange*
(1985) 187 Cal.App.3d 1141 ..... 39, 42

*Prudential Ins. Co. v. City and Cty. of San Francisco*
(1987) 191 Cal.App.3d 1142 ..... 11

*SHC Half Moon Bay, LLC v. County of San Mateo*
(2014) 226 Cal.App.4th 471 ..... 14

*Sky River LLC v. County of Kern*
(2013) 214 Cal.App.4th 720 ..... passim

*Trailer Train Co. v. State Bd. of Equalization*
(1986) 180 Cal.App.3d 565 ..... 23

*Union Pacific Railroad Co. v. State Bd. of Equalization*
(1998) 231 Cal.App.3d 983 ..... 15, 24, 43

*Westinghouse Electric Corp. v. County of Los Angeles*
(1974) 42 Cal.App.3d 32 ..... 33

Constitution

California Constitution
Article XIII, Section 1 ..... 10, 39

California Constitution
Article XIII, Section 16 ..... 12

Statutes

California Evidence Code
Section 664 ..... 12

California Government Code
Section 15606(c)-(g) ..... 11

California Government Code
Section 15608 ..... 11

California Revenue and Taxation Code
Section 110.5 ..... 39

California Revenue and Taxation Code
Section 1601 *et seq*. ..... 12

California Revenue and Taxation Code
Section 1609..... 34, 35

California Revenue and Taxation Code
Section 169..... 11

California Revenue and Taxation Code
Section 5140..... 13

Regulations

California Code of Regulations
Title 18, Section 2(a)..... 10, 11

California Code of Regulations
Title 18, Section 3..... 11

California Code of Regulations
Title 18, Section 321(a)..... 12, 35

California Code of Regulations
Title 18, Section 324(a)..... 35

California Code of Regulations
Title 18, Section 4..... 12

California Code of Regulations
Title 18, Section 6..... 12

California Code of Regulations
Title 18, Section 6(e)..... 30

California Code of Regulations
Title 18, Section 8..... 12

Other Authorities

Assessors' Handbook
Section 501, *Basic Appraisal* ..... 12

Assessors' Handbook
Section 502, *Advanced Appraisal* ..... 19, 40

Assessors' Handbook
Section 504, *Assessment of Personal Property and Fixtures* ..... 17, 30

Assessors' Handbook
Section 582, *Explanation of the Derivation of Equipment Percent Good Facts* ..... 19

## PETITION FOR REVIEW

This Court's review is essential to resolving the applicable standard of review in property tax cases where the taxpayer challenges the method used by an assessment appeals board to establish an element within an overall valuation approach. The Court of Appeal's opinion in this case ("Opinion")[1] held that the substantial evidence standard of review applies in such circumstances, which deviates from the framework set forth by this Court in *Bret Harte Inn, Inc. v. City and Cty. of San Francisco* (1976) 16 Cal.3d 14 (*Bret Harte*). The Opinion also contradicts *Sky River LLC v. County of Kern* (2013) 214 Cal.App.4th 720 (*Sky River*), which held that the *Bret Harte* framework does apply to these types of challenges. Therefore, the Opinion undermines the *Bret Harte* framework and creates confusion as to its applicability.

The standard of review impacts virtually every local property tax case that comes before the courts. The Court's resolution of this important question of law is vital to maintain orderly and uniform review of property tax cases.

---

[1] A copy of the Court of Appeal's Opinion is attached hereto.

## ISSUES PRESENTED

1. Is the de novo standard of review required in considering challenges to the validity of the method used by a local assessment appeals board to establish an element within the overall valuation approach used in the property tax assessment at issue?

2. When using the cost approach to value equipment for property tax purposes, does the validity of the methods used to determine the return rate and the "income adjustment factor" present questions of law to be reviewed de novo by the courts?

## BACKGROUND: PROPERTY TAX ASSESSMENTS AND JUDICIAL REVIEW

Under the California Constitution and the Revenue & Taxation Code, taxable property in this State is subject to property taxation in proportion to its fair market value. *See* Cal. Const., art. XIII, § 1. Fair market value, or "full cash value," is defined as "the amount of cash or its equivalent that property would bring if exposed for sale in the open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other, and both the buyer and the seller have knowledge of all of the uses and purposes to which the property is adapted and for which it is capable of being used, and of the enforceable restrictions upon those uses and purposes." Revenue & Taxation Code ("R&TC") § 110(a); Cal. Code Regs., tit. 18 ("SBE Rule"), § 2(a) (same); *De Luz*

*Homes, Inc. v. County of San Diego* (1955) 45 Cal.2d 546, 562 (*De Luz Homes*) (same).

To promote uniformity in property tax assessments throughout the State, the Legislature has charged the State Board of Equalization ("SBE") with promulgating rules and regulations governing the assessment of property and with giving instruction, advice, and direction to the local county assessors concerning property assessment. Gov. Code §§ 15606(c)-(g) and 15608; *see* R&TC § 169. The resulting regulations have the force of law and are referred to as the SBE Rules.[2] *Prudential Ins. Co. v. City and Cty. of San Francisco* (1987) 191 Cal.App.3d 1142, 1152. The SBE also maintains a handbook, the "Assessors' Handbook," which serves as a "primary reference" and "basic guide" for local assessors and assessment appeals boards. *Id.* at 1155. While not binding, the Assessors' Handbook is afforded "great weight" and has been "relied upon by the courts in interpreting valuation questions posed by the state Constitution and statutes." *Id.*

The SBE Rules and Assessors' Handbook recognize three basic approaches to determining a property's fair market value—the comparable sales approach, the income approach, and the cost approach. SBE Rules 3,

---

[2] The SBE Rules are contained in Title 18 of the California Code of Regulations.

4, 6 and 8; Assessors' Handbook Section 501, *Basic Appraisal* (January 2002), pp. 73-110.[3] These basic approaches have many variations—each made up of different elements—with an array of different methods available to determine those elements.

If the taxpayer disagrees with the assessor's methodology or the resulting assessment, the taxpayer may challenge their assessment by filing an application for reduction in assessment with the local assessment appeals board. R&TC §§ 1601 et seq. The local assessment appeals board is a constitutional agency with the duty to "equalize the values of all property on the local assessment roll by adjusting individual assessments." Cal. Const., art. XIII, § 16.

Subject to certain exceptions set by law, the local assessment appeals board must assume "the assessor has properly performed his or her duties [known as the 'presumption of correctness']. The effect of this presumption is to impose upon the applicant the burden of proving that the value on the assessment roll is not correct, or, where applicable, the property in question has not been otherwise correctly assessed." SBE Rule 321(a); Evid. Code § 664.

---

[3] All sections of the Assessors' Handbook referenced herein are available on the SBE's website at https://www.boe.ca.gov/proptaxes/ahcont.htm.

Local assessment appeals board decisions are subject to judicial review. R&TC § 5140. "The trial court review of such a board's decision must determine both whether the board's findings are supported by substantial evidence, and whether it has committed any errors of law." *Firestone Tire & Rubber Co. v. County of Monterey* (1990) 223 Cal.App.3d 382, 387 (*Firestone*).

This Court established the framework for judicial review of assessment appeal board decisions over forty years ago. This Court drew an important distinction "between challenges to the result reached by the assessor after applying a sound valuation method and challenges to the validity of the method itself." *Bret Harte*, 16 Cal.3d at 23. This Court explained the distinction as follows:

> If the plaintiff claims only that the assessor and the Board of Equalization erroneously **applied a valid method** of determining full cash value, the decision of the board is equivalent to the determination of a trial court, and the trial court in turn may review only the record presented to the board. [Citations.] The trial court may overturn the board's decision only when no **substantial evidence** supports it, in which case the actions of the board are deemed so arbitrary as to constitute a deprivation of property without due process. [Citations.] On the other hand, when the taxpayer challenges the **validity of the valuation method itself**, the trial judge is faced with a **question of law**. [Citations.] That question, stated in terms of the more modern authorities discussed above, is whether the challenged method of valuation is **arbitrary, in excess of discretion, or in violation of the standards prescribed by law.** It is this test which we apply today. *Id*. (emphasis added).

Accordingly, it is "well established" that a challenge to the *application* of a valid method ("Application Question") presents a question of fact to be reviewed under the substantial evidence standard while a challenge to the *underlying validity* of a valuation method ("Method Question") presents a question of law to be reviewed de novo. *Elk Hills Power, LLC v. Board of Equalization* (2013) 57 Cal.4th 593, 606 (reaffirming the standard of review framework established in *Bret Harte*).

Under the *Bret Harte* framework, "[t]he selection of a particular method of valuation from among the valid methods rests in the Board's discretion." *County of Orange v. Orange Cty. Assessment Appeals Bd.* (1993) 13 Cal.App.4th 524, 530, 532 (*County of Orange*). However, a recognized method may not be valid in all circumstances. *SHC Half Moon Bay, LLC v. County of San Mateo* (2014) 226 Cal.App.4th 471, 489 (If "the challenged method will produce systemic errors if applied to properties in that class, the issue is not factual, but legal"). Therefore,

> [a] valuation method may be recognized as theoretically coherent and logical, yet be so inappropriate to the type of property being assessed as to ensure, for all properties of that general kind, that the results reached will not approximate fair market value. A claim of this kind could be termed a challenge to the 'application' of the method, presenting a factual question. But where the claim is that, due to the basic undisputed characteristics shared by an entire class of properties, the challenged method will produce systematic errors if applied to properties in that class, the issue is not factual but legal. The issue is not whether the assessor misunderstood or distorted the available data, but whether he or she chose an appraisal method which by its nature was

> incapable of correctly estimating market value. *Freeport-McMoran Resource Partners v. County of Lake* (1993) 12 Cal.App.4th 634, 641 (*Freeport-McMoran*) quoting *Union Pacific Railroad Co. v. State Bd. of Equalization* (1998) 231 Cal.App.3d 983, 992 (*Union Pacific*).

Furthermore, if the material facts are not in dispute, "what might otherwise appear to be a factual challenge, and therefore, subject to substantial evidence review, is actually a legal challenge." *Maples v. Kern County Assessment Appeals Board* (2002) 96 Cal.App.4th 1007, 1013 (*Maples*).

## STATEMENT OF THE CASE[4]

### A. Procedural History.

HGST, Inc. ("HGST") filed applications for reduction in assessment with the Santa Clara County Assessment Appeals Board ("AAB") largely to contest the Assessor's valuation of the hard disk drive manufacturing equipment it had recently purchased from IBM. (Opinion at 2. *See* 4 AR 10264.) The AAB heard the matter and found mostly in favor of the Santa Clara County Assessor ("Assessor"). (*Id.*)

HGST filed a refund action in superior court against the County of Santa Clara ("County") challenging the AAB's decision on several grounds. (*Id.*) The trial court was initially unable to determine the appropriate standard of review, but ultimately held "the substantial

[4] Citations to the record follow the following format: (vol. AR/AA/RT page) where "AR" is the Administrative Record, "AA" is the Appellant's Appendix and "RT" is the Reporter's Transcripts.

evidence standard applies to this case." (*Id.* at 5-6.) The trial court ruled in favor of the County on all causes of action thereby upholding the AAB's decision in favor of the Assessor. (*Id.* at 2.)[5]

HGST appealed, asserting several errors of law. (Opinion at 1-2.) The Court of Appeal upheld the trial court's ruling on each issue, except for one (*i.e.*, the interest issue) which is not contested herein.[6] (Opinion at 2.)

### B. The Standard of Review Issue.

The Court of Appeal decided several issues, but HGST seeks review of only one: the proper standard of review applicable to the return rate and income adjustment factor methodologies adopted by the AAB in their valuation of HGST's hard disk drive manufacturing equipment ("Equipment"). (Opinion at 6-12.)

The parties agreed on certain aspects of the overall approach to value the Equipment but disagreed as to the methods to be used for certain elements within that overall approach. (4 AR 8658:22-8660:6 and 8664:17-8667:11. *See also* Opinion at 7-8.) Specifically, for the overall approach, the parties agreed to use a particular variation of the cost

---

5 In its final statement of decision (2 AA 425-428), the trial court adopted its tentative statement of decision in its entirety (2 AA 352-376). (2 AA 427:26-28.)

6 No petition for rehearing was filed in the Court of Appeal.

approach, known as the "percent good" approach,[7] in which a number of elements are combined into a complicated formula to apply an appropriate measure of depreciation in order to determine the Equipment's present value.[8] (*Id.*) The parties agreed that the percent good approach requires determination of the following elements: the Equipment's appropriate economic life, "Iowa State Curve," return rate, and income adjustment factor. (4 AR 8658:22-8660:6 and 8664:17-8667:11.)

Only the latter two elements—the return rate and income adjustment factor—are still in dispute. (*See* Opinion at 6-8.) As to those two elements, the parties disagreed on the appropriate methods to be used. (4 AR 8665:11-8666:23. *See also* Opinion at 7-8.) This disagreement on the methods led the parties to different return rate and income adjustment factor percentages as summarized in the table below and further described in the paragraphs that ensue. (*Id.*)

---

[7] As the SBE describes, the percent good, as "a percentage, is the complement of depreciation. For example, if total depreciation is 20 percent, then percent good is 80 percent." Assessors' Handbook Section 504, *Assessment of Personal Property and Fixtures* (October 2002, reprinted January 2015), p. 77.

[8] Assessors' Handbook section 582 provides additional detail on percent good calculations. Assessors' Handbook Section 582, *The Explanation of the Derivation of Equipment Percent Good Factors* (February 1981, reprinted January 2015), pp. 9-10.

| SUMMARY OF DISPUTES RELATED TO ELEMENTS WITHIN THE PERCENT GOOD APPROACH | | | | | | |
|---|---|---|---|---|---|---|
| **ELEMENT** | **HGST** | | **ASSESSOR** | | **AAB** | |
| | **Method** | **Result** | **Method** | **Result** | **Method** | **Result** |
| Return Rate[9] | SBE-Based Method | 6.25% to 7.5% (varied by tax year) | Single Company-Based Method | 11% | Accepted Assessor's Position. | Accepted Assessor's Position. |
| Income Adjustment Factor[10] | Product-Based Method | 22% | Stipulation-Based Method | 12% | Accepted Assessor's Position. | Accepted Assessor's Position. |

With respect to the Equipment's return rate, HGST advocated that the appropriate method was to use the annual return rates published by the SBE for machinery and equipment ("SBE-Based Method"). (4 AR 8665:11-13 and 10284-10285. *See also* Opinion at 7.) The Assessor disagreed with this method and used a different method whereby it assumed

---

9 Within the percent good approach, the lower the property's return rate, the lower the resulting property value. Assessors' Handbook Section 582, *The Explanation of the Derivation of Equipment Percent Good Factors* (February 1981, reprinted January 2015), p.17 ("when the yield rate [*i.e.*, return rate] is increased the percent good is increased").

The return rate may also be referred to as the "discount rate." (Opinion at fn. 4.)

10 Within the percent good approach, the higher the property's income adjustment factor, the faster the decline in its presumed economic productivity and the lower the resulting property value. *See* Assessors' Handbook Section 582, *The Explanation of the Derivation of Equipment Percent Good Factors* (February 1981, reprinted January 2015), p. 20.

The income adjustment factor may also be referred to as the "income decline factor" or "annual decline factor." (Opinion at fn. 4.)

the Equipment's return rate was equal to the firm-wide return rate of a single, specific company, IBM ("Single Company-Based Method"). (*See* 4 AR 8665:14-18. *See also* Opinion at 7.) The Assessor calculated IBM's firm-wide return rate using the weighted average cost of capital (WACC) method.[11] (*Id.*)

The parties' different methods led them to different results. HGST's SBE-Based Method resulted in a 6.25% to 7.5% return rate depending on the tax year at issue, whereas the Assessor's Single Company-Based Method resulted in an 11% return rate for all tax years at issue. (4 AR 8665:11-18. *See also* Opinion at 7.)

The AAB adopted the Assessor's Single Company-Based Method and its 11% result. (4 AR 8667:18-19. *See also* Opinion at 7.)

As to the income adjustment factor, this element is intended to account for the decline in the Equipment's production of income over time. (*See* 4 AR 10266.) *See also* Assessors' Handbook Section 582, *The Explanation of the Derivation of Equipment Percent Good Factors*

---

[11] In the WACC method (also known as the band-of-investment method), the return rate is "developed by weighting the costs of a firm's permanent sources of financing—typically common stock, bonds, and, perhaps, preferred stock—obtained from capital market data, with the weights based on the relative market values of these components." Assessors' Handbook Section 502, *Advanced Appraisal* (December 1998, reprinted January 2015), p. 94.

The Assessor's WACC calculation for IBM is found at 4 AR 10022.

(February 1981, reprinted January 2015), p. 20. Specifically, "[w]ith high tech equipment [such as the Equipment at issue,] the income adjustment factor has been utilized to recognize the loss in value due to technological changes in the equipment that occur over time." (4 AR 8666:3-4.)

HGST argued that the appropriate method to calculate the income adjustment factor was to study the decline in prices of the hard disk drives produced by the Equipment ("Product-Based Method"). (4 AR 8666:7-9. *See also* Opinion at 8.) The Assessor disagreed with this method and instead, used the income adjustment factor previously agreed to in stipulated settlements reached with the Santa Clara County Assessor by certain taxpayer representatives in a different industry, the computer manufacturing industry ("Stipulation-Based Method"). (4 AR 8666:4-7. *See also* Opinion at 8.)

Again, the different methods led the parties to different results. HGST's Product-Based Method resulted in an income adjustment factor that reflects a 22% annual decline in income while the Assessor's Stipulation-Based "Method" resulted in an income adjustment factor that reflects a 12% annual decline in income. (4 AR 8666:4-9. *See also* Opinion at 7.)

The AAB adopted the Assessor's Stipulation-Based Method and its 12% result. (4 AR 8667:19. *See also* Opinion at 7 and 11.)

HGST challenged the methods adopted by the AAB for determining the return rate and income adjustment factor elements (*i.e.*, the Single Company-Based Method for the return rate and its adoption of the Stipulation-Based Method for the income adjustment factor). (1 AA 248-252. *See* also Opinion at 7-8.) The trial court treated these challenges as questions of fact subject to substantial evidence review. (Opinion at 8.) The Court of Appeal upheld the trial court's standard of review on appeal. (Opinion at 12.)

In reaching its decision, the Court of Appeal established a new framework for determining the standard of review when the taxpayer challenges the method used to determine an element within the overall valuation approach. Under the Opinion's new framework, the substantial evidence standard of review applies to both Method Questions and Application Questions *unless* there is a specific "rule of law that sets forth a method for determining" the element or "the specific rate or percentage" to be used for that element. (Opinion at 10 and 12.) In the absence of a mandated method or specified rate/percentage for the disputed element, the Opinion holds that the substantial evidence standard applies to all issues related to the disputed element. *See Id.*

## WHY REVIEW SHOULD BE GRANTED

If left standing, the Opinion will have far-reaching legal and practical implications. The Court's review of this Opinion is essential to restoring the applicability of the *Bret Harte* framework; avoiding confusion among the courts who otherwise will be left the impossible task of reconciling the Opinion with the clear precedent set in *Bret Harte* and *Sky River*; and ultimately, reinstating proper judicial oversight of the property tax system.

### A. The Opinion's New Framework Deviates from *Bret Harte*, Contradicts *Sky River*, and Misinterprets *Dreyer's*.

#### 1. The Opinion Upsets the *Bret Harte* Framework.

The *Bret Harte* framework does two important things. First, it draws a clear line between challenges to the validity of a method (*i.e.*, Method Questions) and challenges to the application of a valid method (*i.e.*, Application Questions). *Bret Harte*, 16 Cal.3d at 23. Second, it assigns different standards of judicial review to each. All Method Questions are reviewed de novo as questions of law; Application Questions are subject to substantial evidence review as questions of fact. *Id.*

Under this framework, courts must take a two-step approach. First, the court must perform a de novo review of all Method Questions to determine whether the AAB's chosen methods were valid. Second, if

methods are found valid, the court must then determine whether substantial evidence supports the manner in which the AAB applied the approved methods (Application Questions).

Numerous courts have explicitly recognized this two-step approach. *Trailer Train Co. v. State Bd. of Equalization* (1986) 180 Cal.App.3d 565, 582-583 (*Trailer Train*) ("The trial court, after considering the *Bret Harte* case, indicated that it would apply the independent judgment test to the extent that Trailer Train challenged the validity of the method the Board employed, but that it would review all other issues using the substantial evidence test. The trial court's careful application of these differing standards of review is precisely that set out in *Bret Harte*.").[12]

---

[12] *Hunt-Wesson Foods, Inc. v. County of Alameda* (1974) 41 Cal.App.3d 163, 177 ("In performing its function of reviewing the record of the assessment appeals board the trial court must focus on two issues which are separate and distinct but are occasionally obscured. '…[T]he function of the superior court is to examine that administrative record to determine whether the board's findings are supported by substantial evidence and whether the board has committed any errors of law [Citations].' [Citation.] These issues are closely related but require separate identification."); *Midstate Theatres, Inc. v. County of Stanislaus* (1976) 55 Cal.App.3d 864, 884 ("Although the basic thrust of appellant's arguments go to the legality of the methods used by the assessor and adopted by the board, appellant also argues that the board's decision was not supported by substantial evidence. The questions of the legality of methods and substantial evidence are distinct."); *ITT World Commun'ns, Inc. v. County of Santa Clara* (1980) 101 Cal.App.3d 246, 252 ("In reviewing an assessment, a challenge to the result reached by an assessor after applying a sound valuation method is to be distinguished from a challenge to the validity of the method itself.")

California courts have been reviewing local property tax cases under this framework for over forty years. Yet, the Opinion strays from that clear directive and upsets the *Bret Harte* framework in two regards.

First, it severely limits the de novo review afforded under the *Bret Harte* framework. Whereas *Bret Harte* provides for de novo review of *all* Method Questions, the Opinion takes a much narrower view. When the challenge involves a Method Question, the Opinion provides that de novo review is limited to only instances in which the challenged method directly violates a method or rate prescribed by law. This constricts de novo review to only the most egregious and blatant violations of law, which renders judicial review of Method Questions nearly meaningless.

In effect, the Opinion forces courts to assume that any method that does not contravene prescribed law is per se valid. However, it does not follow that where the law is silent as to a particular method or rate, any method may be used. Rather, it has long been held that "[a] valuation method may be recognized as theoretically coherent and logical, yet be so inappropriate to the type of property being assessed as to ensure, for all properties of that general kind, that the results reached will not approximate fair market value." *Freeport-McMoran*, 12 Cal.App.4th at p. 641 quoting *Union Pacific*, 231 Cal.App.3d at p. 989.

Second, the Opinion abandons *Bret Harte*'s two-step approach under which Method Questions and Application Questions are reviewed

separately under the de novo and substantial evidence standards, respectively. The Opinion, instead, collapses Method Questions and Application Questions together into a single a substantial evidence review except for the rare circumstances in which the method or rate to be used for the element in dispute is prescribed by law.

Thus, the framework outlined by the Opinion stands in stark contrast to the framework carefully crafted by this Court in *Bret Harte*.

### 2. The Opinion Directly Contradicts *Sky River*, Which Ruled that the *Bret Harte* Framework Applies to Challenges Involving an Element within a Valuation Approach.

The Opinion also directly contradicts *Sky River*, which expressly found that the *Bret Harte* framework must be applied to challenges involving an element within a valuation approach. *Sky River*, 214 Cal.App.4th at 725-731.

Much like this case, in *Sky River*, the parties agreed on the appropriate methods to be used for all but one element. They agreed to use the income approach as the overall valuation approach, as well as the band-of-investment method to determine the element of the return rate within that income approach. *Id.* at 727-728. The only dispute was what type of income tax rate—the marginal or average tax rate—should be used to convert the after-tax discount rate to a before-tax discount rate. *Id.* at 728.

Again, similar to the case here, the County in *Sky River* argued the substantial evidence standard applied to the dispute over the tax rate element because "the parties agree[d] on the methodology and disagree[d] only on the factual data to 'plug in' to make the calculations." *Id.* The taxpayer, on the other hand, argued that "the dispute relate[d] to one element of the methodology—the appropriate income tax rate to apply to the conversion—rather than to factual matters, so the de novo standard of review applie[d]." *Id.*

In reaching its decision, the court reviewed the precedent set by this Court in *Bret Harte*, as well as a string of appellate cases decided thereunder,[13] and concluded that the tax rate dispute raised two distinct questions to be reviewed separately under different standards of review. *Id.* at 731. The Method Question as to the appropriate type of income tax rate—average or marginal—to be used within the income approach presented a question of law to be reviewed de novo. *Id.* Once the court

---

[13] In addition to *Bret Harte*, the court in *Sky River* analyzed *Bontrager v. Siskiyou County Assessment Appeals Board* (2002) 97 Cal.App.4th 325 (question of whether to use the taxpayer's effective interest rate as recommended by the SBE or the market interest rate when calculating the band-of-investment to be used in the income approach held to be a question of law); *Maples,* 96 Cal.App.4th 1007 (same); *ITT World Commun'ns, Inc. v. County of Santa Clara* (1980) 101 Cal.App.3d 246 (question of whether the SBE was required to impose a replacement cost new less depreciation limit on the value produced by its income approach held to be a question of law).

ruled on the appropriate type of tax rate, it could then turn to any Application Questions as to the precise percentage dictated by that type of rate. *Id.*

Specifically, the court in *Sky River* explained its rationale as follows:

> We conclude that plaintiffs are correct, and the issue presented constitutes a question of law as to an element of the chosen method to be used in calculating the market value of the property. **Which income tax rate should be used—the marginal rate or an average rate—is a question about the method of calculating the appropriate conversion rate. The exact percentage to be used for that rate would be a question of fact to be determined by the board based on the evidence presented.** Determining which rate should be used does not present a question about the facts specific to plaintiffs' case or the data to insert when calculating the value of the property. Rather, it presents a question about the methodology prescribed by SBE rules for calculation of the property value. *Id.* (emphasis added).

Ultimately, the court found that the marginal income tax rate was the appropriate type of tax rate because "the average rate did not represent a relevant rate a potential purchaser of the property would take into consideration in determining the price it was willing to pay for the property" and it was inconsistent with SBE guidance in the Assessors' Handbook. *Id.* at 737. The court did not reach the Application Question of the appropriate specific marginal income tax rate percentage to be used.[14] *Id.*

*Sky River* closely mirrors the facts of this case. Here, the parties' dispute was limited to two elements within an agreed upon valuation

---

[14] Since the court's de novo review rejected the AAB's chosen method, the case was remanded for application of the proper method for the income tax rate. *Id. Sky River*, 214 Cal.App.4th at 741-742.

approach—the return rate and income adjustment factor within the percent good approach. The parties presented conflicting methodologies for both elements—the SBE-Based Method versus the Single Company-Based Method for the return rate and the Product-Based Method versus the Stipulation-Based Method for the income adjustment factor. HGST argue[d] that the proper numbers are dictated by the methodologies set forth in the SBE's Assessor's Handbook." (Opinion at 10.)

Thus, as recognized in *Sky River*, each disputed element presented two distinct questions subject to different standards of review. The Method Questions of whether the AAB's Single Company-Based Method and Stipulation-Based Method were valid are questions of law that should have been reviewed de novo. Once the validity of those methods had been addressed, the Application Questions of whether substantial evidence supported an 11% return rate and a 12% income adjustment factor under the approved methods should have been reviewed separately under the substantial evidence test. As *Sky River* illustrates, de novo review is required irrespective of whether the Method Questions contravene a method or rate prescribed by law.

The Opinion failed to apply this two-step approach. Instead, it reviewed the Method Questions and Application Questions together for substantial evidence, without first conducting a de novo review as to the validity of the underlying methods. As a result, the Opinion applied only

the substantial evidence standard and never reached the preceding question of whether the AAB's underlying Single Company-Based Method and the Stipulation-Based Method were valid methods. This demonstrates the peril of stepping away from the two-step *Bret Harte* framework.

### 3. The Opinion Misinterprets *Dreyer's*, Creating Further Confusion and Illustrating the Importance of the *Bret Harte* Framework.

The Opinion misinterprets *Dreyer's Grand Ice Cream, Inc. v. County of Kern* (2013) 218 Cal.App.4th 828 (*Dreyer's*) because it again neglected to interpret the case in the context of the *Bret Harte* framework.

In *Dreyer's*, the court summarized the standard of review as follows:

> There was no dispute at the administrative proceeding or the trial court that the cost method of valuation applied, or that it required reductions for certain items, including underutilization, if applicable. Defendant acknowledged that underutilization was a consideration, and it presented evidence showing that there was a discussion between assessor's office and plaintiff's representatives regarding whether the adjustment applied; defendant also presented evidence that it prepared a calculation of an underutilization adjustment, based on the numbers provided by plaintiff, but determined the adjustment was not warranted. The board found that the assessor carefully considered making the adjustment, but determined it was not warranted. Thus, **the issue before the trial court was not one of the law: Whether the cost method of valuation mandated making an underutilization adjustment in an appropriate case. Rather, the issue was one of fact: Whether on the evidence presented the board could conclude that plaintiff failed to satisfy its burden of proving an underutilization adjustment was appropriate in this case. The trial court properly applied the substantial evidence standard of review.** *Dreyer's*, 218 Cal.App.4th at 837-838 (emphasis added).

The Opinion quotes the language emphasized above and then, reasons that *Dreyer's* applies to this case as follows: "the AAB's decision to apply the 11 percent rate of return and 12 percent income adjustment factor were fact-specific choices analogous to the board's decision not to use the underutilization adjustment in *Dreyer's*." (Opinion at 9.)

To fully appreciate the decision in *Dreyer's*, it is necessary to place the dispute in context. The parties had agreed to use the cost approach. *Dreyer's*, 218 Cal.App.4th at 837. They agreed that economic obsolescence is an element within that approach and that the underutilization method was the appropriate method to determine the economic obsolescence element. *Id.; see also* SBE Rule 6(e). Therefore, the case focused on the application of the facts to the agreed upon underutilization method. In essence, all Method Questions had been resolved by agreement of the parties and the court had moved on to the Application Questions.

The underutilization method is based on certain case-specific facts. Specifically, whether "(1) there is excess capacity, (2) that is beyond the control of a prudent operator and (3) recognized in the market. (SBE Assessors' Handbook, *supra*, Section 504, at p. 79)." *Dreyer's*, 218 Cal.App.4th at 837. The question before the *Dreyer's* court was whether the taxpayer had sufficiently proved these facts. This is an Application Question, which the *Dreyer's* court properly reviewed under the substantial evidence standard.

The case at issue here is one step behind the *Dreyer's* case. Unlike *Dreyer's*, the parties do not agree on the method to be used to determine the return rate and income adjustment factor elements. For that reason, it was inappropriate for the Opinion to jump to the Application Questions of the specific return rate and income adjustment factor percentages before addressing the Method Questions of the appropriate methods by which to determine those percentages.

*Dreyer's* provides yet another example where the standard of review analysis becomes clear when placed in the context of this Court's *Bret Harte* framework, but may be easily confused, as was done here, when analyzed outside that framework.

### B. The Opinion Has Significant Practical Implications.

#### 1. Nearly All Cases Would Be Decided Under the Substantial Evidence Test.

The Opinion's new framework virtually eliminates the de novo review for methods used to determine elements within a valuation approach.

The property tax valuations reviewed by the courts are often complex. While the three basic approaches to value—comparable sales approach, the income approach, and the cost approach (SBE Rules 3, 4, 6 and 8)—are well defined at a high level, each approach is made up of a series of different elements whose rate or methods of calculation are not

typically prescribed by law. Given as much, very few cases will meet the Opinion's requirement that the element's method or rate be prescribed by law before de novo review is granted. The Opinion allows the vast majority of Method Questions to fall to substantial evidence review.

Therefore, without this Court's review, the Opinion will cause the standard of review to regress to the first half of the twentieth century when the courts' review of Method Questions was "quite limited." *See Bret Hart*e, 16 Cal.3d at 21-22 (discussing how the stringent standards of the first half of the twentieth century gave way to the more modern "trend towards less drastic requirements where aggrieved taxpayers have sought to set aside [property tax] assessments").

### 2. Applying the Substantial Evidence Standard to Method Questions Would Nullify the Courts' Ability to Effectively Oversee the Property Tax System.

Moreover, applying the substantial evidence standard to Method Questions raises a number of policy concerns and leaves the courts unable to effectively oversee the property tax system.

#### a. The Assessment Appeals Board Is Granted Deference on Application Questions Because They Have Valuation Expertise, But They Have No Such Expertise with Respect to Questions of Law Such as Method Questions.

Assessment appeals boards are afforded great deference with respect to Application Questions under the substantial evidence standard because

they are regarded as having "special expertise in property valuation." *Mission Housing*, (1997) 59 Cal.App.4th at 72-73 quoting *Westinghouse Electric Corp. v. County of Los Angeles* (1974) 42 Cal.App.3d 32, 42, fn. 6. There is no rationale for affording the board the same deference with respect to legal issues. The board has no such expertise in matters of law. And therefore, its legal errors, whether caused by "'arbitrariness, abuse of discretion, or failure to follow the standards prescribed by the Legislature are legal matters subject to judicial correction." *Id.* citing *Bret Harte*, 16 Cal.3d at 22 and *De Luz Homes*, 45 Cal.2d at 564.

**b. The Focus of a Substantial Evidence Review Is on the Quantum of Evidence, Which Is Inappropriate for Method Questions.**

Moreover, substantial evidence is the wrong standard by which to adjudge the validity of a method.

In a substantial evidence review, the courts' focus is on the "quantum of evidence before the board" rather than the legal substance of such evidence. *Hunt-Wesson Foods, Inc. v. County of Alameda* (1974) 41 Cal.App.3d 163, at 177 (*Hunt-Wesson*). The substantial evidence standard allows for only "very limited reweighing of the evidence"; requires only some credible evidence where, as the Opinion notes, even a single witness' controverted testimony may be sufficient substantial evidence. *Firestone*, 223 Cal.App.3d at 387-388 (substantial evidence requires only that a "reasonable man, acting reasonably, *might* have reached the [same]

decision" based on the evidence in the record and the inference drawn from it (emphasis original)); *Mission Housing*, 59 Cal.App.4th at 72-73. (Opinion at 12.) That being the case, substantial evidence review is not the appropriate standard for matters of law such as Method Questions.

**c. Substantial Evidence Review Is Insufficient for Method Questions, Especially Against the Backdrop of the Lack of Evidentiary Rules at Board Hearings and the Presumption of Correctness Afforded the Assessor's Assessments.**

The lack of evidentiary rules at assessment appeal board hearings and the presumption of correctness in favor of the Assessor's assessments already weaken taxpayers' ability to correct erroneous assessments. Stripping taxpayers of their right to obtain de novo review of Method Questions leaves them with no clear path to correct erroneous assessments.

The rules of evidence do not apply in assessment appeals board hearings. R&TC § 1609. "Any relevant evidence may be admitted if it is the sort of evidence on which reasonable persons are accustomed to rely in the conduct of serious affairs, regardless of the existence of any common law or statutory rule which might make improper the admission of such evidence over objection in civil actions." *Id.* Therefore, evidence is permitted without laying a formal foundation, without demonstrating its authenticity, and without the avoidance of hearsay (as was done in this case with respect to the stipulations the Assessor relied on as their "method" for

the income adjustment factor). *See id.; Hunt-Wesson*, 41 Cal.App.3d at 171 (noting "concern might be expressed that evidence would be admitted before the board without significant weight, e.g., hearsay matters."). At the end of the day, it is up to board to weigh all the unfiltered "evidence" in order to arrive at its decision. SBE Rule 324(a).

Also, outside of limited exceptions, the SBE rules direct the board to assume the assessor has correctly assessed all property, placing the burden of proof on the taxpayer to affirmatively demonstrate that the assessment was incorrect. SBE Rule 321(a); *Mission Housing*, 59 Cal.App.4th at 83-84. In fact, "the assessor is not required to go forward with any evidence, but may stand on the presumption of correctness of the assessment." *ITT World Commun'ns, Inc. v. County of Santa Clara* (1980) 101 Cal.App.3d 246, 252.

Layering the substantial evidence standard on top of a property tax system that is already designed to protect the existing assessment leaves the taxpayer with little recourse to correct erroneous assessments.

**d. The Opinion Undercuts Judicial Oversight Previously Recognized as Critical by the Legislature.**

Indeed, the Legislature has previously blamed "the breakdown in property tax administration in California… [on] the lack of an effective means for administrative appeal and *judicial review of assessments*." *Hunt-Wesson*, 41 Cal.App.3d at 171 (emphasis original) citing an Assembly

Report published ten years before *Bret Harte* was decided. The courts' ability to exercise independent judgment on questions of law, such as the validity of the AAB's valuation methods, serves as an important check on the efficacy of the property tax system.

Consequently, several courts refer to the "taxpayer's right" to de novo review, finding "[w]hen a board of equalization [*i.e.*, assessment appeals board] purports to decide a question of law …, a taxpayer has the right to resort to the courts for determination of such question." *E.g.*, *Norby Lumber Co. v. County of Madera* (1988) 202 Cal.App.3d 1352, 1363 (*Norby*) quoting *Pacific Grove-Asilomar Operating Corp. v. County of Monterey* (1974) 43 Cal.App.3d 675, 681.

The Opinion's new framework largely deprives the taxpayer of this "right" and forecloses critical judicial oversight of the property tax system.

## DE NOVO REVIEW SHOULD HAVE BEEN APPLIED HERE

### A. The Opinion Mischaracterized the Disputes as Questions of Fact and Neglected to Apply *Bret Harte*'s Two-Step Approach.

The Court of Appeal should have applied de novo review to HGST's contentions regarding the return rate and income adjustment factors. HGST's contentions were aimed squarely at the validity of the methods adopted by the AAB—the Single Company-Based Method for the return rate and Stipulation-Based Method for the income adjustment factor.

The Opinion incorrectly focused on the difference in percentages advocated by the parties—6.25% to 7.5% versus 11% for the return rate and 12% versus 22% for the income adjustment factor. (Opinion at 7-9 and 11.) However, the Opinion's focus was misplaced. HGST's argument was not that IBM's firm-wide return rate was something other than 11%, but rather that the Single Company-Based Method was per se invalid as a means to calculate the Equipment's specific return rate. Likewise, HGST's argument was not that certain taxpayer representatives had previously agreed to some income adjustment factor other than 12% or that those stipulations did not exist, but rather that the Stipulation-Based Method was per se invalid as a means to calculate the specific income adjustment factor

for the Equipment at issue. These were method contentions, not contentions aimed at the resulting percentages.[15]

The Opinion's overly narrow view of the de novo standard forced it to incorrectly review the AAB's methods under the deferential substantial evidence standard merely because HGST pointed to SBE guidance in the Assessors' Handbook but did not cite "any *rule of law* that sets forth a method for determining the income adjustment factor [or return rate] in any manner contrary to the AAB's decision" or any "*law* requiring a specific rate or percentage in applying the return rate or income adjustment factors." (Opinion at 10 and 12.) As explained below, the AAB's Single-Company Based Method and Stipulation-Based Method were not invalid because they contravened prescribed law but rather were inherently invalid because they violate fundamental property tax principles. The Court of Appeal's incorrect reliance on the substantial evidence standard to review Methods Question led it to uphold patently erroneous valuation methods which further demonstrates the need for de novo review of *all* Method Questions as required by this Court's decision in *Bret Harte*.

---

15 Moreover, to the extent that the Court of Appeal believed HGST's contentions raised both Method Questions as to the validity of the AAB's methods and Application Questions as to the appropriate percentages, it should have addressed these questions separately under the appropriate standards of review in accordance with the *Bret Harte* framework.

### B. The Single Company-Based Return Rate Method and Stipulation-Based Income Adjustment Factor Method Are Inherently Flawed.

HGST argued that both the AAB's Single Company-Based Method and Stipulation-Based Method were invalid not because they contradicted a specific method or rate prescribed by law, as the Opinion requires, but because neither method comports with the mandated fair market value standard. *Prudential Insurance*, 191 Cal.App.3d at 1149 ("A cardinal principle of property taxation is that property is taxable at its 'fair market value.'" (Cal. Const., art. XIII, § 1; [R&TC] § 110.5).").

The fair market value standard unequivocally requires the assessment to reflect the fair market value of the Equipment itself and without regard for its particular owner. *Id.*; *De Luz Homes*, 45 Cal.2d at 566; *Pacific Mutual Life Ins. Co. v. County of Orange* (1985) 187 Cal.App.3d 1141, 1149.

### 1. The Single Company-Based Method Used for the Return Rate Does Not Reflect the Fair Market Value of the Equipment at Issue.

The Single Company-Based Method is designed to calculate the overall return rate of a single company, IBM, not the Equipment at issue. Thus, even if the Assessor executed its calculation perfectly to arrive at IBM's firm-wide return rate, it still would have failed to calculate a return rate specific to the Equipment. It instead would have calculated the combined return rate of all of IBM's business endeavors, products, services, and assets, both tangible and intangible. IBM is a large, diversified company with a multitude of products, services, business lines, and equipment types,[16] such that tying its firm-wide return rate to any one of these factors, let alone specific equipment, would be impossible.[17, 18]

---

[16] According to the Assessor's evidence, "IBM is the world's largest information technology provider (hardware, software and services) with 1999 revenues of more than $87 billion and is the worldwide leader in e-business solutions. The company has more than 300,000 employees and does business in more than 160 countries." (4 AR 9461.)

[17] The Opinion references the County's argument that it used IBM as part of "a 'pure play' or 'comparable company variation' of the WACC method" as described in the Assessors' Handbook. (Opinion at 11.) This is a farce.

The "pure play" or "comparable company" WACC method requires the appraiser to locate "*several* publicly traded, *single-product* companies in the *same line of business* as the project or property being valued." *Id.* quoting Assessors' Handbook Section 502, *Advanced Appraisal* (December 1998, reprinted January 2015), p. 95 (emphasis added). The AAB's Single Company-Based Method meets none of these parameters: it is based on a single company, not "*several* publicly traded" companies; IBM has

(1 RT 121:4-122:16.) Moreover, since IBM sold the Equipment to HGST in 2002, the Equipment at issue would not have even been included within the pool of assets reflected in IBM's 2003 firm-wide return rate that the AAB adopted. (*Id.*; 4 AR 10159. *See also* Opinion at 2.)

The AAB's Single Company-Based Method is also founded on the faulty premise that IBM's firm-wide return rate was an appropriate measure of the return rate for the Equipment because IBM had recently owned the Equipment before selling it to HGST. (Opinion at 7.) This method causes the same property to have different values in different hands. For example,

---

multiple services and products and is not a "*single-product*" company; and IBM was not in the "*same line of business*" as the project or property being valued because it had sold its hard disk drive business to HGST before becoming the focus of the Assessor's return rate method. (1 RT 121:4-122:16.) Therefore, in substance, the Assessor's method is not a "pure play" or "comparable company variation."

The Opinion failed to review the validity of the AAB's Single Company-Based Method because it incorrectly assumed the method was valid and proceeded with a substantial evidence review. Merely labelling a calculation as a recognized method does not make it so. *E.g.*, *Norby*, 202 Cal.App.3d 1352 (the board adopted the assessor's calculation believing it was based on the "replacement cost method," however, the court conducted an independent review of the method and found that it was not the replacement cost method as labelled but was an arbitrary method that could not be upheld on appeal). If the Court of Appeal had conducted an independent review of the AAB's Single Company-Based Method, it would have found that the method was not a "pure play" or "comparable company" method as labelled by the Assessor.

[18] The Assessors' Handbook specifically admonishes against using a firm-wide return rate when the property being valued has a different risk profile than the firm. Assessors' Handbook Section 502, *Advanced Appraisal* (December 1998, reprinted January 2015)), p. 95.

had the Equipment at issue been owned by Seagate, it would have a different property tax value merely because Seagate's firm-wide return rate differs from IBM's firm-wide return rate.[19] Fundamental property tax principles do not allow for the same equipment to have different assessable values in different hands and thus, the Single Company-Based Method is inherently invalid. *See De Luz Homes*, 45 Cal.2d at 566; *Pacific Mutual*, 187 Cal.App.3d at 1149; *County of Orange*, 13 Cal.App.4th at 533.

By valuing the Equipment based on IBM's firm-wide return rate, the AAB adopted a method that neither reflects the fair market value of the Equipment itself nor does so in a manner that is distinct from its owner.

### 2. The Stipulation-Based Method Used for the Income Adjustment Factor Does Not Reflect the Fair Market Value of the Equipment at Issue.

The AAB's Stipulation-Based Method used for the income adjustment factor suffers from similar problems. The AAB adopted the Assessor's 12% income adjustment factor because "it had been agreed to by computer manufacturers' industry representatives in past hearings." (Opinion at 11.)

---

[19] Seagate's firm-wide return rate per the Assessor's calculation was 12.04%. (4 AR 10023.)

The referenced stipulations relate to types of equipment other than hard disk drive manufacturing equipment and thus, have no bearing on the fair market value of the Equipment at issue.

Perhaps even more importantly, use of stipulations by other parties on different equipment used in a different industry during a different time period offends the principle of fairness and deprives HGST of due process. To recognize other taxpayers' unrelated stipulations as a valid valuation method sets a dangerous precedent and illustrates why the courts' independent review is critical.

### 3. The Flaws of These Methods Are Inherent and Unrelated to the Facts of This Case.

The fundamental flaws described above are not specific to the facts of this case. Instead, both the Single Company-Based Method and Stipulation-Based Method are by their very "nature [ ] incapable of correctly estimating market value." *Freeport-McMoran*, 12 Cal.App.4th at 641 quoting *Union Pacific*, 231 Cal.App.3d at 989.

There is no set of facts under which the firm-wide return rate of a single large, diversified company with many products, services, and lines of business could be capable of appropriately reflecting the return rate of a specific type of equipment, especially when the company did not even own any of the equipment type at issue.

Similarly, there is no set of facts under which stipulations by a different party in a different industry related to different types of equipment at different periods in time could ever properly reflect the income adjustment factor of unrelated Equipment.

Since these errors are not dependent on the specific facts at hand, they must be recognized as questions of law meriting de novo review and the Opinion erred in treating them as questions of fact subject to only substantial evidence review.

## CONCLUSION

For the foregoing reasons, this Court should grant review.

Respectfully submitted,

PILLSBURY WINTHROP SHAW
PITTMAN LLP
BREANN E. ROBOWSKI

By: 

*BREANN E. ROBOWSKI 267851

Attorneys for Plaintiff and Appellant
HGST, INC.

## CERTIFICATE OF WORD COUNT

(California Rules of Court 8.204(c))

The text of this brief consists of 8,232 words, not including tables of contents and authorities, the Certificate of Interested Entities, and this certificate, as counted by Microsoft Word, the computer program used to prepare this brief.

By: 

*BREANN E. ROBOWSKI 267851

Attorneys for Plaintiff and Appellant
HGST, INC.

# OPINION

Filed 2/27/20

**CERTIFIED FOR PUBLICATION**

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SIXTH APPELLATE DISTRICT

| | |
|---|---|
| HGST, INC.,<br><br>Plaintiff and Appellant,<br><br>v.<br><br>COUNTY OF SANTA CLARA,<br><br>Defendant and Respondent. | H044904<br>(Santa Clara County<br>Super. Ct. No. 1-14-CV-263300) |

Appellant HGST, Inc. (HGST) filed an action against the County of Santa Clara (the County) seeking a refund for business property taxes paid on machinery, equipment, fixtures, and other personal property located in San Jose. Among other things, HGST claimed the Santa Clara County Assessment Appeals Board (the AAB) erroneously overassessed the value of the property. After a four-day trial, the trial court issued a statement of decision and entered judgment in favor of the County.

HGST raises four contentions on appeal. First, HGST contends the trial court erred by reviewing the entire case in blanket fashion under a substantial evidence standard rather than examining each individual claim to determine which standard of review should apply to that issue. Second, HGST contends the trial court erroneously failed to review certain legal challenges to the valuation methodology applied by the AAB. Third, HGST contends the trial court erred by upholding the AAB's decision not to apply the "purchase price presumption" set forth in Revenue and Taxation Code

section 110.[1] Fourth, HGST contends the trial court erred by upholding the imposition of interest on the escape assessments under section 531.4.

For the reasons below, we conclude the first three of HGST's claims are without merit, but we hold the trial court erred by upholding the imposition of interest under section 531.4. We will reverse in part and remand for further proceedings on the cause of action challenging the imposition of interest.

## I. FACTUAL AND PROCEDURAL BACKGROUND

HGST bought the property at issue from IBM for $2.4 billion in 2002. The property primarily consists of fixtures, machinery, and equipment for the manufacturing of hard disk drives. The Santa Clara County Assessor annually imposed escape assessments on the property from 2003 through 2008.[2]

HGST challenged the assessor's findings through multiple applications to the AAB. After hearings on the matter, the AAB issued findings and conclusions in 2012 largely adopting the assessor's findings of fact. In 2013, HGST filed a claim for a refund of $15 million with the Santa Clara County Board of Supervisors, which denied the claim.

In 2014, HGST filed an action against the County in the superior court seeking a refund for the taxes paid. The first amended complaint sets forth 17 causes of action alleging various errors in the AAB's methods and factual findings. The trial court held four days of hearings in 2015. In 2016, the court filed a statement of decision ruling against HGST and entering judgment in favor of the County on all counts.

HGST timely appealed.

---

[1] Subsequent undesignated statutory references are to the Revenue and Taxation Code.

[2] This appeal covers assessments issued for tax years 2003/2004, 2004/2005, 2005/2006, 2006/2007, and 2007/2008.

## II. DISCUSSION

### *A. The Trial Court's Standard of Review*

HGST contends the trial court erred by applying the substantial evidence standard of review to the AAB's entire decision in a "blanket" or "wholesale" fashion. HGST argues that the trial court should have reviewed certain claims de novo because those claims presented questions of law, not fact—e.g., issues of statutory interpretation and challenges to the AAB's methodology. The County argues the trial court properly applied the substantial evidence standard of review to each claim on an individual basis.

#### *1. Standards of Review Applied by Trial Courts*

A trial court reviewing an appeals board's rulings on tax assessments applies different standards of review, analogous to those applied by a court of appeal when reviewing a trial court's rulings. And like a court of appeal, the trial court applies a substantial evidence standard of review to findings of fact. (*Prudential Ins. Co. v. City and County of San Francisco* (1987) 191 Cal.App.3d 1142, 1148.) "The taxpayer has no right to a trial de novo in the superior court to resolve conflicting issues of fact as to the taxable value of his property." (*Norby Lumber Co. v. County of Madera* (1988) 202 Cal.App.3d 1352, 1362.)

By contrast, "when a board of equalization purports to decide a question of law, the decision is reviewed de novo." (*Maples v. Kern County Assessment Appeals Bd.* (2002) 96 Cal.App.4th 1007, 1013 (*Maples*).) "[I]nterpretation of statutes and administrative regulations are quintessential issues of law." (*Mission Housing Development Co. v. City and County of San Francisco* (1997) 59 Cal.App.4th 55, 73.) Furthermore, "where the taxpayer attacks the validity of the valuation method itself, the issue becomes a question of law subject to de novo review." (*Elk Hills Power, LLC v. Board of Equalization* (2013) 57 Cal.4th 593, 606.) The question for the trial court is then "whether the challenged method of valuation is arbitrary, in excess of discretion, or

in violation of the standards prescribed by law." (*Bret Harte Inn, Inc. v. City and County of San Francisco* (1976) 16 Cal.3d 14, 23 (*Bret Harte Inn*).)

A taxpayer may also claim that although the appeals board chose a valid method of valuation, the board *misapplied* the chosen method. In that case, the trial court applies a substantial evidence standard based on a review of the administrative record, without taking new evidence. "Where the taxpayer claims a valid valuation method was improperly applied, the trial court is limited to reviewing the administrative record. [Citation.] The court may overturn the assessment appeals board's decision only if there is no substantial evidence in the administrative record to support it." (*Maples*, *supra*, 96 Cal.App.4th at p. 1013.) However, "[w]hether a taxpayer is challenging 'method' or 'application' is not always easy to ascertain." (*Ibid*.)

***2. The Trial Court Properly Applied the Substantial Evidence Standard of Review to Individual Claims Where Required***

HGST contends the trial court improperly applied the substantial evidence standard of review to the entire matter in "blanket" fashion. HGST concedes that certain claims it raised were factual, properly requiring review under the substantial evidence standard. But HGST contends the trial court should have determined the proper standard of review on an issue-by-issue basis. For example, as set forth in Section II.B. below, HGST claims it also contested the valuation methodology itself, requiring de novo review by the trial court.

As the County points out, the trial court determined and applied the standard of review on an issue-by-issue basis. In its statement of decision, the court addressed each of the 17 causes of action in turn and applied the standard of review to each claim independently. For example, in ruling on the first cause of action—a strictly procedural

claim about the timeliness of the assessor's raise letters[3]—the relevant dates were not in dispute; the court simply looked to the applicable regulations to determine that the assessor acted in a timely fashion. The court did not review this claim under a substantial evidence standard. By contrast, in considering other causes of action on a claim-by-claim basis, the court expressly applied a substantial evidence standard of review to each claim independently, e.g.: "SINCE THE THIRD CAUSE OF ACTION CHALLENGES FINDINGS OF FACT AND SUBSTANTIAL EVIDENCE SUPPORTS THE AAB'S DECISION, THE COUNTY IS ENTITLED TO JUDGMENT."

HGST focuses on an introductory section in the trial court's statement of decision in which the court stated, "Having now reviewed the Administrative Record, heard the testimony of the parties, and considered the arguments of counsel, the Court now concludes that *the substantial evidence standard applies to this case,* and no evidence outside of the Administrative Record is admissible for consideration by this Court." (Italics added.) HGST contends the italicized portion of that sentence shows the court applied the substantial evidence standard of review in "wholesale" fashion to the entire case.

HGST ignores the context of this statement, wherein the trial court was ruling on the scope of the evidence under its review. When a taxpayer claims an appeals board improperly applied a valid valuation method, the trial court is limited to reviewing the administrative record for substantial evidence. (*Maples*, *supra*, 96 Cal.App.4th at p. 1013.) Here, HGST had argued prior to the hearing that it was "entitled to submit 'new evidence at trial' " because HGST's claims went beyond a challenge to the application of the valuation method. The County argued otherwise and moved to exclude the introduction of any new evidence. At the start of the hearing, the trial court ruled that it

[3] The assessor issued multiple "raise letters" increasing the assessed value of the property. In this appeal, HGST does not challenge the trial court's ruling on this cause of action.

was unable to determine whether HGST was entitled to submit new evidence based on the nature of its claims. Accordingly, the court tentatively ruled that HGST could introduce testimony at the hearing, and the court reserved ruling on whether new evidence could be considered in making a final determination. After the hearing, the court found in its statement of decision that, having considered the proffered new evidence, the court's review was limited to the administrative record under a substantial evidence standard. In other words, the court's statement was an evidentiary ruling, not a blanket application of the same standard of review to the entire case. As a practical matter, because the trial court applied the substantial evidence standard to most of HGST's claims, it was not inaccurate for the trial court to characterize its role as applying that standard to "this case." Nonetheless, as explained above, the court did analyze each claim on an issue-by-issue basis and it applied the standard of review to each claim independently of the others.

Accordingly, we conclude this claim is without merit. As to whether the court incorrectly determined or improperly applied the standard of review for any specific claims, we consider those arguments below.

***B. The Trial Court's Review of the AAB's Valuation Methodology***

In its complaint, HGST alleged multiple causes of action, among others, challenging the AAB's valuation of the machinery and equipment located in San Jose. In several causes of action, HGST claimed the AAB used the wrong discount rate and the wrong income adjustment factor in its calculations. The trial court determined that these claims constituted challenges to the AAB's findings of fact, and the court upheld the AAB's findings under a substantial evidence standard of review. HGST contends these claims constituted challenges to the validity of the AAB's valuation methodology and that the trial court erred by reviewing the AAB's findings for substantial evidence rather than reviewing them de novo as questions of law. The County contends these claims

constitute challenges to the AAB's factual findings, and that the trial court properly upheld those findings as supported by substantial evidence.

***1. Background***

The parties agree that the AAB properly applied the "Cost Approach" method of valuation. (See Cal. Code Regs., tit. 18, § 6.) They disagree, however, on the details of that approach. The Cost Approach method relies on a formula for estimating the value of the machinery and equipment at issue. The valuation formula under the Cost Approach incorporates two factors, among others: the rate of return on the property, and the income adjustment factor.[4] The AAB applied an 11 percent rate of return, but HGST asserted the rate should have been between 6.25 percent and 7.5 percent. Similarly, the AAB applied an income adjustment factor of 12 percent, but HGST asserted it should have been 22 percent.

In its findings and conclusions, the AAB summarized the evidence adduced on these factors as follows. First, the AAB noted that the parties agreed that the Cost Approach provided the proper methodology, and that "considerable testimony was presented" regarding the specifics of the methodology. As to the rate of return, HGST's expert relied on the "mass appraisal recommendations" provided by the State Board of Equalization (SBE) to arrive at rates ranging between 6.25 percent and 7.5 percent, depending on the particular lien date. By contrast, the assessor presented "weighted average cost of capital" calculations for IBM and other large hard disk drive manufacturers in the same industry as HGST. Because IBM had recently owned the equipment in question, the assessor relied on its estimate of 11 percent for IBM. After reviewing the evidence, the AAB adopted the 11 percent rate of return.

---

[4] The briefs and the record sometimes refer to the "discount rate" when referencing the rate of return. Similarly, the income adjustment factor is sometimes referred to as the "income decline factor" or "annual decline factor." Any differences in the terminology or meanings of these terms are immaterial to this appeal.

As to the income adjustment factor, the AAB summarized the testimony from HGST's expert, who provided a scatter gram to support a 22 percent adjustment factor based on the declining prices of disk drives. The AAB noted that this estimate was based on the product produced by the equipment in question, not the equipment itself. The assessor's expert further noted that HGST's expert had failed to consider sales volume. The assessor's expert opined that this failure resulted in an inaccurate estimate because when a highly technical product is new to the market, the price is high but the sales volume is very low. The assessor presented alternative estimates based on several previous hearings in which computer industry representatives had agreed to a 12 percent income adjustment factor. The assessor also relied on producer price index data on hard disk drive manufacturers as published by the Bureau of Labor Statistics. The AAB adopted the assessor's estimate of 12 percent for the income decline factor.

The trial court reviewed the record on these issues under a substantial evidence standard of review and found the AAB's findings to be supported by substantial evidence.

### *2. The Trial Court Properly Ruled That the AAB's Findings Are Supported by Substantial Evidence*

HGST contends that its challenges to the AAB's use of an 11 percent rate of return and a 12 percent income adjustment factor constitute challenges to the valuation methodology itself, not the AAB's findings of fact. HGST relies on the SBE Assessors' Handbook as persuasive authority under the holdings set forth in *Sky River LLC v. County of Kern* (2013) 214 Cal.App.4th 720 (*Sky River*). HGST argues that the trial court therefore erred by reviewing these claims under a substantial evidence standard rather than reviewing them de novo as questions of law.

But HGST's own pleadings are inconsistent on this point. The complaint alleges in the fourth cause of action that the AAB utilized an improper valuation methodology, but it also alleges the rate of return and income adjustment factor are *findings based on*

*an invalid application* of that method. The thirteenth cause of action alleges the AAB's use of the 11 percent rate of return and 12 percent income adjustment factor constituted "erroneous factual findings" that were "not based on substantial evidence." As noted above, an appeals board's factual findings and alleged *misapplication* of a valuation method are subject to review for substantial evidence. (*Dreyer's Grand Ice Cream, Inc. v. County of Kern* (2013) 218 Cal.App.4th 828, 835 (*Dreyer's*); *Maples, supra*, 96 Cal.App.4th at p. 1013.)

Notwithstanding the language in the complaint, the trial court properly reviewed the AAB's decision to use the 11 percent rate of return and 12 percent income adjustment factor for substantial evidence. In doing so, the trial court relied on *Dreyer's*, *supra*, 218 Cal.App.4th 828. In *Dreyer's*, as in this case, the taxpayer challenged the trial court's use of the substantial evidence standard of review. The parties agreed on the overall "cost approach" valuation method but disagreed about the use of an adjustment factor for underutilization. (*Id.* at pp. 837-838.) The taxpayer argued on appeal that the issue presented a question of law, such that the trial court should have considered it de novo. The Court of Appeal acknowledged that " '[w]hether a taxpayer is challenging "method" or "application" is not always easy to ascertain,' " but the court ultimately held it to be an issue of fact, not law. "[T]he issue before the trial court was not one of law: Whether the cost method of valuation mandated making an underutilization adjustment in an appropriate case. Rather, the issue was one of fact: Whether on the evidence presented the board could conclude that plaintiff failed to satisfy its burden of proving an underutilization adjustment was appropriate in this case. The trial court properly applied the substantial evidence standard of review." (*Id.* at p. 838.) Here, the trial court ruled that the AAB's decision to apply the 11 percent rate of return and 12 percent income adjustment factor were fact-specific choices analogous to the board's decision not to use an underutilization adjustment in *Dreyer's*. We agree; these decisions were not matters of law. Regardless of whether they are more properly characterized as findings of fact or

an "application" of the valuation method, the trial court properly reviewed them under the substantial evidence standard.

HGST relies primarily on *Sky River*, *supra*, 214 Cal.App.4th 720. In *Sky River*, the parties agreed on the overall valuation methodology, but disagreed on one element of that methodology. In converting from an after-tax discount rate to a before-tax discount rate, the parties disagreed about whether the assessor should have selected an average corporate income tax rate or a combined federal and state marginal tax rate. (*Id.* at p. 728.) The Court of Appeal held that this was a matter of law reviewable de novo because it was a dispute over the validity of the method itself. "Which income tax rate should be used—the marginal rate or an average rate—is a question about the method of calculating the appropriate conversion rate." (*Id.* at p. 731.) The court went on to note, however, that "*[t]he exact percentage to be used for that rate would be a question of fact* to be determined by the board based on the evidence presented." (*Ibid.*, italics added.) Here, the disputed issues were much closer to the latter type of dispute, wherein the parties each presented expert testimony about the exact numbers the assessor should have used in applying the method. The trial court's ruling here was therefore in accord with *Sky River*.

As the County accurately points out, there is no law requiring a specific rate or percentage in applying the rate of return or income adjustment factors. HGST argues the proper numbers are dictated by the methodologies set forth in the SBE Assessors' Handbook. But HGST concedes that the Handbook is not legally binding authority; rather, some courts have cited to it as persuasive authority. More to the point, however, HGST points to nothing in the Handbook that would require the use of HGST's preferred numbers. Rather, HGST relies on one section in the Handbook, which discusses methods for deriving the rate of return using the weighted average cost of capital (WACC) for a firm. The Handbook admonishes that "a particular project's cost of capital should reflect the risk of that project, which may or may not reflect the average risk of the firm. Some projects considered by a given firm will be of above-average risk; some will be of below-

average risk. Thus, the firm's WACC is not the correct discount rate for the firm to use when valuing a project that differs from the average risk of the firm." (SBE Assessors' Handbook (Dec. 1998) § 502, Advanced Appraisal, p. 95.) Citing to this last sentence in isolation, HGST maintains that the AAB failed to apply this methodology because the AAB used a firm-wide rate of return of 11 percent for IBM.

As the County points out, however, the remainder of the cited passage from the SBE Assessor's Handbook allows for such an approach, which it describes as a "pure play" or "comparable company variation" of the WACC method. The Handbook states, "In this variation of the [method], the appraiser attempts to find several publicly traded, single-product companies in the same line of business as the project or property being valued." (SBE Assessors' Handbook (Dec. 1998) § 502, Advanced Appraisal, p. 95.) As HGST's own expert acknowledged, this was the approach used by the assessor. HGST's expert disputed the AAB's selection of IBM as a comparable company, but he did not dispute that the comparable company method was a proper method. Whether a company such as IBM is an appropriately comparable company to rely upon as a source of data for this method is not a matter of law; it is a factual determination, and nothing in the Handbook or any other source of authority cited by HGST specifies a different method.

Similarly, HGST attacks the AAB's selection of an income adjustment factor of 12 percent as a methodological failure. As noted above, HGST's expert put forth an estimate of 22 percent, and the assessor introduced testimony to undermine the expert's analysis. The AAB settled on the 12 percent rate because it had been agreed to by computer manufacturers' industry representatives in past hearings. HGST argues that this method was arbitrary and in excess of the assessor's discretion, citing *Bret Harte Inn, supra,* 16 Cal.3d at p. 25. In that case, the California Supreme Court upheld a trial court's determination that an assessor had erroneously applied an arbitrary 50 percent depreciation factor. But the assessor there had not provided any basis for the number. By contrast, here the AAB considered the competing testimony of the assessor's expert

and HGST's expert, each of whom provided abundant analysis to support their respective positions. The AAB weighed the parties' evidence and credited the assessor's testimony.

The trial court appropriately applied the substantial evidence standard of review to the AAB's findings. HGST does not cite any rule of law that sets forth a method for determining the income adjustment factor in any manner contrary to the AAB's decision. The trial court noted this lack of authority, finding that HGST's expert could not identify a statute, property tax rule, or Handbook provision that mandated the use of HGST's preferred rate. Furthermore, the AAB's reliance on the testimony of a single witness constitutes substantial evidence sufficient to support its findings. (See *City and County of San Francisco v. Givens* (2000) 85 Cal.App.4th 51, 56 [witness's testimony sufficient to constitute substantial evidence].) We conclude this claim is without merit.

### *C. Application of Revenue and Taxation Code Section 110(b)*

HGST contends the trial court erred by upholding the AAB's decision not to apply the purchase price presumption set forth in section 110(b). The County contends the trial court correctly applied the substantial evidence standard of review to affirm the AAB's finding that the purchase price presumption did not apply. Among other things, the County points out that HGST failed to submit the mandatory change in ownership statement required under section 110(c) as a predicate to the application of the purchase price presumption.

#### *1. Legal Principles*

Generally, property in California is taxed based on its fair market value. "All property is taxable and shall be assessed at the same percentage of fair market value. When a value standard other than fair market value is prescribed by this Constitution or by statute authorized by this Constitution, the same percentage shall be applied to determine the assessed value. The value to which the percentage is applied, whether it be the fair market value or not, shall be known for property tax purposes as the full value." (Cal. Const., art. XIII, § 1.)

Section 110 defines "fair market value" as "the amount of cash or its equivalent that property would bring if exposed for sale in the open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other, and both the buyer and the seller have knowledge of all of the uses and purposes to which the property is adapted and for which it is capable of being used, and of the enforceable restrictions upon those uses and purposes." (§ 110, subd. (a).)

Subdivision (b) of section 110 sets forth the following "purchase price presumption," providing in part: "For purposes of determining the 'full cash value' or 'fair market value' of real property, other than possessory interests, being appraised upon a purchase, 'full cash value' or 'fair market value' is the purchase price paid in the transaction unless it is established by a preponderance of the evidence that the real property would not have transferred for that purchase price in an open market transaction. The purchase price shall, however, be rebuttably presumed to be the 'full cash value' or 'fair market value' if the terms of the transaction were negotiated at arms length between a knowledgeable transferor and transferee neither of which could take advantage of the exigencies of the other. 'Purchase price,' as used in this section, means the total consideration provided by the purchaser or on the purchaser's behalf, valued in money, whether paid in money or otherwise." (§ 110, subd. (b).)

Subdivision (c) of section 110 requires the taxpayer to submit certain information within a required change of ownership statement: "For real property, other than possessory interests, the change of ownership statement required pursuant to Section 480, 480.1, or 480.2, or the preliminary change of ownership statement required pursuant to Section 480.4, shall give any information as the board shall prescribe relative to whether the terms of the transaction were negotiated at 'arms length.' *In the event that the transaction includes property other than real property, the change in ownership statement shall give information as the board shall prescribe disclosing the portion of the purchase price that is allocable to all elements of the transaction. If the taxpayer fails to*

*provide the prescribed information, the rebuttable presumption provided by subdivision (b) shall not apply*." (§ 110, subd. (c), italics added.)

### *2. The Trial Court Did Not Err in Affirming the AAB's Decision Not to Apply the Purchase Price Presumption*

As set forth above, if the transaction involves property other than real property, subdivision (c) of section 110 requires the taxpayer to provide a change in ownership with certain prescribed information. Failure to provide this statement results in the elimination of the purchase price presumption.

The trial court made the following finding on this point: "Although HGST claims that the Purchase Price Presumption is applicable, it failed to offer into evidence either the change in ownership statement or the preliminary change in ownership statement during the AAB proceedings. Given this failure of proof, the Purchase Price Presumption is not applicable as a matter of law." The County contends that the trial court properly found that HGST's failure to provide such a statement precluded the application of the purchase price presumption.

HGST does not identify or cite to any change in ownership statement in the record; HGST implicitly concedes that it provided no express change in ownership statement. Instead, HGST argues that, although it did not provide any form setting forth a change in ownership statement, it provided the underlying information required by such a statement. HGST contends this is all that is required to enjoy the benefit of the purchase price presumption, based on an isolated reading of the final sentence in subdivision (c): "If the taxpayer fails to provide the prescribed information, the rebuttable presumption provided by subdivision (b) shall not apply." (§ 110, subd. (c).)

We are not persuaded. "[W]e start with the language of the statute, 'giv[ing] the words their usual and ordinary meaning [citation], while construing them *in light of the statute as a whole* and the statute's purpose [citation].' " (*Apple Inc. v. Superior Court* (2013) 56 Cal.4th 128, 135, italics added.) Reading the statute as a whole, section 110

requires more than the bare submission of information to trigger application of the purchase price presumption; it instructs the taxpayer to provide "the change of ownership statement required pursuant to Section 480, 480.1, or 480.2, or the preliminary change of ownership statement required pursuant to Section 480.4 . . . ."[5] The sentence preceding the final sentence of subdivision (c) states that "the change in ownership statement shall give information as the board shall prescribe disclosing the portion of the purchase price that is allocable to all elements of the transaction." The reference to "prescribed information" in the final sentence of subdivision (c) clearly refers to the information as furnished within the change of ownership statement.

HGST does not identify any statements, documents, or forms that would comply with this requirement. Accordingly, the trial court's ruling is supported by both the record and the law, and we affirm it regardless of the standard of review. Even under HGST's preferred interpretation, the statute requires the taxpayer to provide information "disclosing the portion of the purchase price that is allocable to all elements of the transaction" when the transaction includes property other than real property. (§ 110, subd. (c).) HGST fails to cite any such information in the record.

HGST argues that the County waived this argument by raising it for the first time in the trial court, and that it could have provided the required statement if the County had requested one during the AAB hearings. But section 110 affirmatively places the burden on the taxpayer to provide the statement necessary for application of the purchase price assumption. The statute put HGST on full notice of the requirement. We find no waiver by the County. We conclude this claim is therefore without merit.

---

[5] As the parties point out, the Board of Equalization provides forms and instructions for these purposes. We hereby grant HGST's motion for judicial notice of the existence of these forms and the accompanying legislative history documents. (Evid. Code, § 452.)

### *D. Imposition of Interest*

HGST contends the trial court erroneously upheld the imposition of interest against HGST under section 531.4. HGST argues that the AAB failed to address the issue and failed to make the factual findings necessary to determine whether—or how much—interest should be assessed. The County contends the trial court properly upheld the AAB's imposition of interest under sections 506 and 531.4.

#### *1. Background*

Section 531 provides, in part: "Escape assessments made as the result of an owner's failure to file a property statement *as herein provided* shall be subject to the penalty and interest imposed by Sections 463 and 506, respectively." (§ 531, italics added.) Section 531 is in Article 4, "Property Escaping Assessment," which sets forth subsequent code sections defining various categories of escape assessments and the conditions under which penalties and interest may be imposed. These code sections include section 531.4.

The AAB's findings and conclusions did not cite to any code section in Article 4 as a basis for issuing escape assessments or imposing interest. The trial court's statement of decision cited only to section 531 and section 506 as a basis for imposing interest. Although there is some ambiguity in the record about exactly which code section authorized the imposition of interest in this matter, the County took the position at oral argument that section 531.4 provided the operative authority. HGST agrees.

Section 531.4 specifically provides for interest when an assessee fails to accurately report property used in a business, trade, or profession: "When an assessee files with the assessor a property statement or report on a form prescribed by the board with respect to property held or used in a profession, trade or business and the statement fails to report any taxable tangible property accurately, regardless of whether this information is available to the assessee, to the extent that this failure causes the assessor not to assess the property or to assess it at a lower valuation than he would enter on the roll if the

property had been reported to him accurately, that portion of the property which is not reported accurately, in whole or in part, shall be assessed as required by law. If the failure to report the property accurately is willful or fraudulent, the penalty and interest provided in Sections 504 and 506 shall be added to the additional assessment; otherwise only the interest provided in Section 506 shall be added." (§ 531.4.) Section 506 imposes interest "at the rate of three-fourths of 1 percent per month from the date or dates the taxes would have become delinquent if they had been timely assessed to the date the additional assessment is added to the assessment roll." (§ 506.) Both parties agree that no penalties were imposed under section 531.4, and there was no claim that HGST acted willfully or fraudulently. Interest was imposed based solely on the last clause in section 531.4.

The AAB's statement of findings and conclusions made no findings of fact regarding the imposition of interest or whether HGST had failed to accurately report its property within the meaning of section 531.4. The eleventh cause of action in HGST's complaint alleged that the assessor improperly imposed "penalty interest" on unpaid assessments and that the AAB erroneously failed to remove the interest under section 506. At trial, the County's expert testified to the process for calculating interest and clarified that because there was no finding of willful failure to report the property, only interest (and no penalty) was applicable to the unpaid taxes under section 531.4. The expert testified that imposition of interest was not within the AAB's jurisdiction and that interest is added automatically to any escape assessment if the assessee neglects to report property or "it was not valued correctly."

The trial court's statement of decision rejected HGST's claim and set forth the basis for this ruling, noting first that section 506 is not a "penalty" provision, and stating that section 506 mandates interest "shall" be added to any taxes relating to property that escaped assessment. The trial court did not address section 531.4. The court relied upon the testimony of the County's expert and applied a substantial evidence standard of review to conclude that sufficient evidence—i.e., the issuance of escape assessments—

supported the imposition of interest. In other words, the trial court concluded that because the AAB had found HGST owed tax as a matter of fact, the law required the imposition of interest.

***2. The Trial Court Misapplied Revenue and Taxation Code Section 531.4***

HGST contends interest should not have been imposed under section 531.4 because there was no finding that HGST failed to accurately report its property within the meaning of that section. HGST claims that, to the contrary, it submitted property statements accurately listing all the property at issue. The County contends that the phrase "failure to report the property accurately" in section 531.4 means that the assessee must accurately report the cost of those assets, and that merely providing a list of them is insufficient to avoid interest. The County takes the same position set forth by the trial court—that the AAB's issuance of escape assessments necessarily implies that HGST failed to accurately report its property, such that the only "finding" necessary under section 531.4 is the fact that escape assessments were properly issued. The County cites no authority for this interpretation apart from the plain language of section 531.4.

Regardless of the precise meaning of the phrase "failure to report the property accurately" in section 531.4, that section does not automatically authorize the imposition of interest based solely upon the issuance of any escape assessment. The issuance of an escape assessment does not necessarily imply that the assessee failed to report its property accurately within the meaning of section 531.4. "Property that has 'escaped' assessment was underassessed, not assessed at all, or was incorrectly valued, misclassified, etc., resulting in an under or overassessment." (*Apple Computer, Inc. v. County of Santa Clara Assessment Appeals Bd.* (2003) 105 Cal.App.4th 1355, 1362, citing *American Airlines, Inc. v. County of San Mateo* (1996) 12 Cal.4th 1110, 1127.) When property escapes assessment, the assessor has a constitutional duty to issue escape assessments "even though the taxpayer has accurately reported the cost or value figures." (*Bauer-Schweitzer Malting Co. v. City and County of San Francisco* (1973) 8 Cal.3d 942,

945 (*Bauer-Schweitzer*).) In *Bauer-Schweitzer*, an assessor undervalued the taxpayer's property by using an improperly low assessment ratio. After the assessor was indicted for misconduct, escape assessments were issued on the undervalued property, even though the taxpayer had accurately reported the cost of its property to the assessor and there was no evidence of wrongdoing by the taxpayer. (*Id.* at p. 944.) The California Supreme Court upheld the issuance of escape assessments under section 531, notwithstanding the taxpayer's accurate reporting. (*Id.* at p. 947.) The high court noted that the version of section 531.1 in effect at the time authorized escape assessments as the result of "a failure by the taxpayer to report accurately the cost of the property," but the court added, "Admittedly, such was not the situation here." (*Id.* at p. 947, fn. 3.)

Lower courts have since held that an escape assessment may be properly issued as the result of a previous mistake by the assessor. (*Hewlett-Packard Co. v. County of Santa Clara* (1975) 50 Cal.App.3d 74 (*Hewlett-Packard*).) In *Hewlett-Packard*, the taxpayer gave the assessor "all information required by law or requested by him" regarding the property at issue. (*Id.* at p. 77.) The assessor, however, misclassified some of the equipment and underassessed it as a result. Later, another auditor discovered the mistake, and the assessor issued escape assessments to recover the additional taxes. On appeal, the taxpayer argued "it is inequitable to affix additional tax liability on a taxpayer where he has fully and accurately reported the cost of his property and the assessor has honestly, though mistakenly, failed to assess the property to the fullest extent provided by law." (*Id.* at p. 81.) Citing *Bauer-Schweitzer*, *supra*, the Court of Appeal rejected this argument and upheld the issuance of escape assessments.

These cases make clear that the mere issuance of an escape assessment does not necessarily imply the taxpayer failed to report its property accurately. Accordingly, it was error for the trial court to conclude that substantial evidence supported the imposition of interest under section 531.4 based solely upon the fact that escape assessments were properly issued.

The County asserts that abundant evidence showed HGST failed to report its property accurately. The County points out that HGST's business property statements reported the cost of the assets based on 45 percent of IBM's net book value at the time of the purchase. The AAB found thousands of assets were booked with a stated value of just one dollar. The AAB found these reported costs were not accurate evidence of the full cash value of the assets. But section 531.4 is limited to the assessment of property "to the extent that [the assessee's failure to report any tangible property accurately] causes the assessor not to assess the property or to assess it at a lower valuation than he [or she] would enter on the roll if the property had been reported to him [or her] accurately . . . ." (§ 531.4.) Section 531.4 mandates "that portion of the property which is not reported accurately, in whole or in part, shall be assessed as required by law." (§ 531.4.) It is that "additional assessment" that is subject to the imposition of interest under section 531.4. The AAB made no findings on what portion of the property was reported accurately or to what extent the escape assessments were caused by HGST's purported failure to report the property accurately under section 531.4. The County does not cite any evidence to support such a finding. Before interest can be imposed as the result of an escape assessment, the assessor must introduce evidence of the factual predicates required under the code section authorizing the specific type of escape assessment that triggers the interest. (See *Beckman Instruments, Inc. v. County of Orange* (1975) 53 Cal.App.3d 767, 777 (*Beckman Instruments*) [appeals board made implied findings and trial court made express findings on the factual predicates for imposition of interest under section 531.3].)

On this record, we cannot determine how much interest was ostensibly imposed as a result of HGST's failure to report property accurately under section 531.4, and we cannot determine what substantial evidence would support such an imposition. For these reasons, we will reverse the judgment.

HGST contends we must remand the matter to the AAB to find the statutorily required facts. The County contends the imposition of interest does not fall within the AAB's jurisdiction. (See Cal. Code Regs., tit. 18, § 302, subd. (a) [establishing the board's functions].) But section 531.4 is not concerned solely with the imposition of interest; rather, it sets forth the factual predicates for issuing escape assessments under that code section, and it then imposes interest on those assessments. The AAB has the power to make findings on the factual predicates required to issue escape assessments under section 531.4, and the trial court has the power to review those findings under a substantial evidence standard of review. (See *Beckman Instruments, supra*, 53 Cal.App.3d at p. 777 [reviewing findings of fact necessary to support imposition of interest under section 531.3].) We will remand the matter for further proceedings.

## III. DISPOSITION

We reverse the trial court's order entering judgment for the County on the eleventh cause of action. The judgment is affirmed in all other respects. The matter is remanded to the trial court with directions to remand the matter to the Santa Clara County Assessment Appeals Board. Consistent with this opinion, the Board shall make any findings required under Revenue and Taxation Code section 531.4 to determine interest on any escape assessments. The parties shall bear their own costs on appeal.

_____
Greenwood, P.J.

WE CONCUR:

_____
Grover, J.

_____
Danner, J.

HGST, Inc. v. County of Santa Clara
No. H044904

| | |
|---|---|
| Trial Court: | Santa Clara County Superior Court<br>Superior Court No.: CV263300 |
| Trial Judge: | The Honorable Theodore C. Zayner |
| Attorney for Plaintiff and Appellant,<br>HGST, INC: | Charles John Moll III<br>Troy M. Van Dongen<br>McDermott Will & Emery, LLP |
| Attorneys for Defendant and Respondent,<br>County of Santa Clara: | James R. Williams,<br>County Counsel<br><br>Douglas M. Press,<br>Assistant County Counsel<br><br>Steve Mitra,<br>Assistant County Counsel<br><br>G. Allen Brandt,<br>Deputy County Counsel<br><br>Ward Penfold,<br>Deputy County Counsel |

## CERTIFICATE OF SERVICE

I, Breann E. Robowski, the undersigned, hereby declare as follows:

1. I am over the age of 18 years and am not a party to the within cause. I am a partner at Pillsbury Winthrop Shaw Pittman LLP in the City of Palo Alto, California.

2. My email and business addresses are breann.robowski@pillsburylaw.com and 2550 Hanover Street, Palo Alto, California 94304.

3. On May 6, 2020, at 1442 S. Winchester Blvd., San Jose, California 95128, I served the following documents:

**PETITION FOR REVIEW**

on the parties listed below:

OFFICE OF THE COUNTY COUNSEL
SANTA CLARA COUNTY
James R. Williams, County Counsel (james.williams@cco.sccgov.org)
Douglas M. Press, Assistant County Counsel (douglas.press@coo.sccgov.org)
Steve Mitra, Assistant County Counsel (steve.mitra@cco.sccgov.org)
G. Allen Brandt, Deputy County Counsel (allen.brandt@cco.sccogov.org)
70 West Hedding Street, East Wing,
Ninth Floor
San Jose, California 95110-1770

☒ **(BY ELECTRONIC SERVICE):** By transmitting via e-mail the document listed above to the email addresses provided above.

☒ **(BY MAIL):** I caused the envelope, with postage thereon fully prepaid, to be mailed by U.S. Postal Service Certified Mail Return Receipt Requested through the services provided by The UPS Store located at 1442 S. Winchester, Blvd. in San Jose, California.

I further declare that I served a copy of the **PETITION FOR REVIEW** on:

Hon. Theodore C. Zayner
Santa Clara County Superior Court
191 North First Street
San Jose, CA 95113

Clerk for the Court of Appeal
Court of Appeal of the State of California,
Sixth Appellate District
333 West Santa Clara Street
Suite 1060
San Jose, CA 95113

☒ **(BY MAIL):** I caused each envelope, with postage thereon fully prepaid, to be mailed by U.S. Postal Service Certified Mail Return Receipt Requested through the services provided by The UPS Store located at 1442 S. Winchester, Blvd. in San Jose, California.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on May 6, 2020, at San Jose, California.

Breann E. Robowski

**SENDER: *COMPLETE THIS SECTION***

- **Complete items 1, 2, and 3.**
- **Print your name and address on the reverse so that we can return the card to you.**
- **Attach this card to the back of the mailpiece, or on the front if space permits.**

1. Article Addressed to:

Hon. Theodore C. Zayner
Santa Clara County, Superior Court
191 North First Street
San Jose, CA 95113

9590 9402 5869 0038 0536 63

7019 2280 0000 3117 8971

***COMPLETE THIS SECTION ON DELIVERY***

A. Signature

X Kim Fabian ☐ Agent ☐ Addressee

B. Received by *(Printed Name)* | C. Date of Delivery

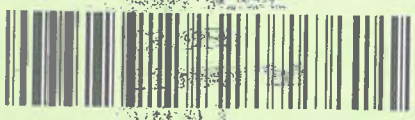
D. Is delivery address different from item 1? ☐ Yes
If YES, enter delivery address below: ☐ No

3. Service Type

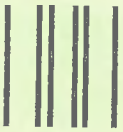
- ☐ Adult Signature
- ☐ Adult Signature Restricted Delivery
- ☐ Certified Mail®
- ☐ Certified Mail Restricted Delivery
- ☐ Collect on Delivery
- ☐ Collect on Delivery Restricted Delivery
- ☐ Mail
- ☐ Mail Restricted Delivery (over $500)
- ☐ Priority Mail Express®
- ☐ Registered Mail™
- ☐ Registered Mail Restricted Delivery
- ☐ Return Receipt for Merchandise
- ☐ Signature Confirmation™
- ☐ Signature Confirmation Restricted Delivery

PS Form 3811, July 2015 PSN 7530-02-000-9053 Domestic Return Receipt

USPS TRACKING #



9590 9402 5869 0038 0536 63



First-Class Mail
Postage & Fees Paid
USPS
Permit No. G-10

United States
Postal Service

• Sender: Please print your name, address, and ZIP+4® in this box•

Breann Robowski
Pillsbury Winthrop Shaw Pittman
2550 Hanover St.
Palo Alto, CA 94304