THE STATE OF NEW HAMPSHIRE

Sullivan Superior Court
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Newport, NH 03773
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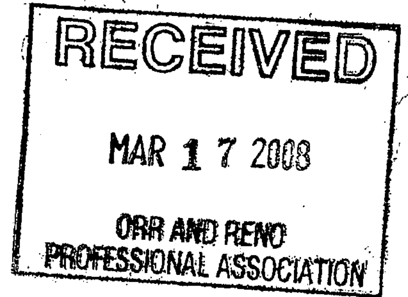

NOTICE OF DECISION

JAMES E BASSETT ESQ
ORR & RENO
PO BOX 3550
CONCORD NH 03302-3550

05-E-0071 Sullivan Cty Reg Rufuse Disp Dt Et al vs City of Claremont

Enclosed please find a copy of the Court's Order dated 3/11/2008 relative to:

Court Order

03/13/2008

James I. Peale
Clerk of Court

cc: JEFFREY A. MEYERS ESQ
DANA L. FLEMING ESQ
HONORABLE GEORGE L. MANIAS
WILLIAM MCGRAW

THE STATE OF NEW HAMPSHIRE

SULLIVAN, SS. SUPERIOR COURT MARCH 2008 TERM

DOCKET NO.
05–E–0071

SULLIVAN COUNTY REGIONAL REFUSE DISPOSAL DISTRICT
and
SOUTHERN WINDSOR–WINDHAM COUNTIES
SOLID WASTE MANAGEMENT DISTRICT,
d/b/a NH–VT SOLID WASTE PROJECT,

v.

CITY OF CLAREMONT

REPORT AND RECOMMENDATION

Plaintiffs are two municipal waste management districts, chartered under the laws of New Hampshire and Vermont, respectively. See RSA 53–B:7 (2003) and 24 V.S.A. 121 (2007). They seek an abatement of the 2004 real estate taxes imposed on a waste-to-energy plant located on 51 acres in Claremont. The plant is owned by the Wheelabrator Claremont Company, L.P. (hereinafter, Wheelabrator), a qualifying small power producer as defined in RSA 362–A:1-a (Supp. 2007). The plaintiffs owned the land and leased it to Wheelabrator until 2006, when Wheelabrator purchased it. Pursuant to terms of a contract with Wheelabrator, the plaintiffs were responsible for the payment of ad valorem taxes on the property through July 2007.

As set forth on the 2004 tax bill, Claremont assessed the property value, land plus buildings, at $14,932,200. From that amount, Claremont deducted $1,808,000 for the

pollution control equipment exemption, resulting in a net assessment of $13,124,200. The plaintiffs applied for an abatement. None was granted and this appeal followed.

The Court assigned the matter to be tried before the undersigned, sitting as a judicial referee pursuant to RSA 493-A:1-a (Supp. 2007).

Trial was held on November 5, 6, and 7. Plaintiffs presented three witnesses: Charles Lepore, the controller for Wheelabrator's Claremont facility and a sister facility in Concord; Stephen Traub, testifying as an expert; and Michael Durfor, a consultant for the plaintiffs. Plaintiffs offered 48 exhibits, including Traub's final appraisal. Defendant Claremont presented two witnesses: David McMullen, the city's assessor; and George Lagassa, testifying as an expert. Defendant offered 12 exhibits, including Lagassa's final appraisal.

In an abatement action, the test is whether the taxpayer is paying more than its proportional share of taxes. Stevens v. City of Lebanon, 122 N.H. 29, 32 (1982). To establish disproportionality, the taxpayer must show that its assessment is higher than the general level of assessment in the city. Appeal of Town of Sunapee, 126 N.H. 214, 217 (1984). The Department of Revenue Administration's equalization ratio for Claremont as of April 1, 2004 was 82.8 percent and the parties have stipulated to the accuracy of this figure. This relieves the plaintiff from the burden of establishing the general level of assessment. Appeal of City of Nashua, 138 N.H. 261, 266–67 (1994). Thus it was the plaintiffs' burden to prove that the property was valued at a higher level than the level generally prevailing.

In their written submissions and during trial, the parties highlighted several basic

issues, the resolution of which will focus the Referee's review of the voluminous evidence offered in the case, and therefore the Referee addresses these issues first.

APPLICABILITY OF THE DEMOULAS RULE

The most significant disagreement between the parties concerns the applicability of a rule first set forth in the dissent in Royal Gardens Co. v. City of Concord, 114 N.H. 668, 673 (1974), and subsequently adopted and applied in Demoulas v. Town of Salem, 116 N.H. 775, 781–82 (1976).

Demoulas involved a tax abatement proceeding brought by a shopping center. As recounted by the Supreme Court, the shopping center had argued to the board of tax appeals that, in applying the income approach for estimating the shopping center's fair market value, the board should recognize that

> Several leases for space in the shopping center were long term and ha[d] become very unprofitable for the shopping center due to changed economic conditions. Thus, the actual income derived from the property [was] less than capacity income. In its opinion denying an abatement, the board took the position that the market value of commercial rental property was based upon the capacity income the property could generate and not the actual income derived. Then it stated: "A long term lease for an unfavorable rent may impair the selling price but the valuation of the property for local taxation cannot vary with the managerial successes or failures of the owners."

Id. at 781 (emphasis added). The shopping center challenged the board's use of its theoretical income capacity rather than its actual income.

The Supreme Court noted that, although it had relied upon a rule which first appeared

in the dissent in Royal Gardens, the board's rejection of the actual-income approach was not erroneous as a matter of law:

> [T]he fact that the statement of the rule for unregulated property appeared in the dissent did not prevent the board from applying the rule in an appropriate case. We do not mean to suggest that consideration of actual income is improper in all cases. We hold only that, where the actual income from long term leases does not reflect the true value of the property because the leases were made in a time of boom or depression or as a result of poor management, the board may reject or give little weight to the capitalization of actual net income method.

Id. at 781–82.

The plaintiffs claim that Demoulas and Royal Gardens support their contention that Wheelabrator should be appraised without consideration taken for the effects of a 20-year power purchase agreement (PPA) which provides for guaranteed, above-market rates for the sale of electricity through July 2007. The City disagrees and maintains that the waste-to-energy plant at issue here is not the type of unregulated property to which the Demoulas rule can be fairly applied. The Referee agrees with the city, and finds unconvincing the plaintiffs' attempt to analogize a power plant operating under a PPA to a shopping center saddled with unfavorable long-term leases (Demoulas) or a privately owned housing complex which agreed to limitations upon its income to obtain federal financing and other economic advantages (Royal Gardens).

The rule which the plaintiffs ask the Court to apply is a "rule for unregulated property," Demoulas, 116 N.H. 781–82. The Referee finds that the Wheelabrator plant is regulated property for purposes of determining its fair market value.

Wheelabrator and other qualifying small power producers are subject to regulation and oversight by the Public Utility Commission and the Federal Energy Regulatory Commission. See, RSA ch. 362–A; 16 U.S.C. sec. 824a-3. Both experts agreed that the Wheelabrator plant owes its very existence to the regulatory framework which requires electric franchise utilities to buy electricity from qualifying small energy producers at predetermined rates under long-term contracts such as the one at issue here. Those requirements were established to implement a national and state policy to promote the development of alternate energy sources so as to reduce the nation's dependence on oil. See RSA 362–A:1 (Supp. 2007); 16 U.S.C. sec. 824a-3(a) and (b).

Not only was the regulatory framework at issue here an essential condition of the plant's original construction, but also, Wheelabrator's continuing transactions with franchise electric utilities (first CVEC, now PSNH) remain subject to Federal and State oversight and enforcement. This is evidenced by the PUC orders that were admitted in this case. For example, in a 2002 order the PUC exercised its jurisdiction over Wheelabrator and CVEC and ruled that the amount of electricity Wheelabrator could sell to CVEC under the terms of the PPA was limited to the specified capacity that was accepted by the PUC when it issued the 1983 rate order—regardless of whether the subsequently agreed-upon PPA reflected this limitation. The PUC ordered further proceedings to determine whether the resulting overcharge to CVEC's customers would be paid by Wheelabrator, CVEC, or both companies.

It is true, as the plaintiffs point out, that Wheelabrator and other "qualifying small power producers" are exempt from the rate-setting and other financial and organizational

regulations that apply to electric utilities, see RSA 362–A:2 (1995). However, the exemption itself presupposes submission to a complex certification and regulatory regime which is focused on a primary function of the plant—the production and sale of electricity. Moreover, the issue should not be decided based on a formalistic application of the term "public utility." Considering the reasons behind the Demoulas rule, as well as the stated terms of the rule itself, the Referee concludes that Wheelabrator is not the kind of "unregulated property" to which the Demoulas rule should be applied. In particular, the waste-to-energy plant cannot be fairly appraised without reference to the long-term PPA which was integral to the decision to build it. That contract cannot reasonably be likened to a lease "made in a time of boom or depression or as a result of poor management," 116 N.H. at 782.

Moreover, the plaintiffs have not cited any New Hampshire or foreign cases in which the Demoulas rule or its equivalent was applied to a power-generating facility operating under a PPA. The Southern Railway Company case, 328 S.E.2d 235 (N.C. 1985), cited by plaintiffs, did not involve an electric power plant. In fact, the North Carolina Court of Appeals distinguished and declined to follow Southern Railway, for reasons similar to those outlined above, in a case involving an electric power plant. See In the Matter of Westmoreland–LG&E Partners, 622 S.E.2d 124, 131 & n.1 (N.C. App. 2005) (where income received under the PPAs was an integral part of market for taxpayer's property, any assessment must factor in the revenue streams received under these PPAs). A similar distinction was made by the Maine Supreme Judicial Court in UAH–Hydro Kennebec, L.P. v. Town of Winslow, 921 A.2d 146, 151–53 & n.7 (Me. 2007)

(rejecting small power producer's argument that its long-term PPA should not have been considered in assessing the value of the plant, distinguishing an earlier case involving the appraisal of a shopping center).

The Referee's conclusion that the PPA is relevant to Wheelabrator's fair market value in this case is based on the evidence of regulation here and the Referee's reading of Demoulas and Royal Gardens. However, the cited North Carolina and Maine cases provide an additional degree of assurance that the conclusion is correct.

The PPA was not the only contract at issue in this case. The parties also disagreed as to the significance of the Amended and Restated Waste Disposal Agreement of 1995 between Wheelabrator and the two plaintiff municipal waste districts.

This comprehensive 54-page document, which superceded the original Waste Disposal Agreement dating back to 1985, sets forth the rights and responsibilities of Wheelabrator and the Districts in connection with the waste-to-energy plant. See Plaintiffs' Exhibit 43. Benefits accruing to the Districts included the right to deliver to the plant a specified quantity of waste per year for incineration according to a below-market tipping fee schedule. Benefits to Wheelabrator included the Districts' acceptance of liability for all real estate taxes, for a significant portion of any new taxes, and for a significant portion of capital expenditures. The Districts also agreed to accept responsibility for the disposal of residual ash produced by the Company free of any disposal charge to the extent the ash was attributable to District waste. The agreement by its terms was binding on any successor to either party. It was set to expire July 1, 2007.

In addition to this Agreement, there was also a lease agreement whereby the Districts leased the 51 acres to Wheelabrator for $100 a year. Upon expiration of the basic lease term on July 1, 2007, Wheelabrator had the option to renew it for two 10-year terms at a rate deemed appropriate for undeveloped land subject to use as a resource recovery facility.

The plaintiffs' expert concluded that all these agreements, which he called "internal contracts," were irrelevant to the fair market value of the facility because they would simply go away in the event of a hypothetical sale. According to Traub's analysis, the hypothetical buyer would assume full liability for real estate taxes, new taxes, and capital expenditures, ash disposal, and market-based rents commencing on April 1, 2004, even though pursuant to terms of the Restated Agreement, the facility owner or its successor or assignee had no actual liability for real estate taxes and ash disposal costs for District waste, only partial liability for other taxes and capital improvements, and only nominal ground rent, until July 1, 2007.

Defendant's expert, on the other hand, factored the Restated Agreement and the lease into account for purposes of his appraisal, in addition to the PPA. As Lagassa explained in his written appraisal:

> [T]he project is built on a myriad of inter-related and mutually supporting contracts which provide for above market power sales rates [the PPA], guaranteed below market take or pay tipping fees, negligible (below market) ground rent, and municipal customer assumption of ash disposal costs and real estate taxes, we submit that the business contracts and contract prices are inseparable from the hard assets themselves. Industry-wide, such mutually supporting and interrelated contracts are common practice, and neither this nor any other WTE power plant would be built in the absence of such agreements. Therefore, in appraising the value of

> the Wheelabrator-Claremont WTE facility by the income approach we believe the impact of all such contracts must be considered.

Dft.'s Exh. B at 38. Lagassa's trial testimony on this point was to the same effect.

The Referee finds that Lagassa's approach is more realistic than Traub's. The interests of Wheelabrator and the Districts are no doubt mutual in many respects. Nevertheless they remain legally separate entities—Wheelabrator answerable to its partners, parent companies, or shareholders; the Districts to their constituent towns and cities. In this respect it is misleading to call the contracts "internal." These disparate interests cannot simply be disregarded in appraising the plant. Any potential buyer would take into account the value of the contract rights that it could expect to take by way of assignment, as well as any contractual liabilities that bound the seller; and the potential seller would necessarily expect consideration given to the value of its rights assignable by contract.

Moreover, Lagassa testified without contradiction that the kinds of contracts at issue here are commonplace in the industry. Therefore it seems unreasonable to assume that a knowledgeable buyer and seller would calculate fair-market value of the plant while ignoring the contractual rights and liabilities that make such plants viable.

THE VALUE OF THE EXEMPTION FOR POLLUTION CONTROL EQUIPMENT

Another dispute concerns the exemption for pollution control equipment. The plaintiffs contend that the exemption is a fixed dollar amount equal to the full value allowed by the Department of Environmental Services (DES) when it was first granted. The defendant counters that such equipment must be depreciated like any other physical asset, and that

only the actual value of the equipment may be exempted from local property taxes in any given year. The Referee finds that the defendant's position is consistent with the plain language of the statute as well as its intent.

The statute provides in pertinent part that:

> The taxing authorities shall each year separately appraise and describe the facility and related real estate and cause such appraisal and description to appear in their inventory. In accordance with the provisions of this section, the taxing authority shall exempt from the taxes levied under this chapter the appraised value of the facility and any real estate necessary therefor, or the exempt percentage thereof, determined by the department....

RSA 72:12-a, V (emphasis added). If the plaintiffs' interpretation were the correct one, there would be no reason for an annual appraisal of the pollution control facility; the taxing authority could simply use the value submitted to the Department of Environmental Services when the exemption (or percentage thereof) was initially evaluated and approved.

Granting a non-depreciating exemption amount would also be contrary to the intent of the statute—"to create tax incentives for industry to construct pollution control facilities," Appeal of Public Service Co. of New Hampshire (PSNH), 124 N.H. 79, 84 (1983) (construing earlier version of the statute). If the tax benefit of a pollution control facility remained constant over time notwithstanding ordinary depreciation, the owner of such facility would have less incentive to make further capital investments to modernize or replace it with new and improved equipment.

Moreover, in PSNH, although the issue was not squarely before it, the Supreme Court assumed that the dollar amount of the exemption for pollution control facilities would be

subject to depreciation:

> [B]ecause of the likely depreciation of a water pollution control facility, the average taxable value—hence, the tax savings—of such a facility would likely be lower over a twenty-five-year exemption period which began to run at the conclusion of construction, than it would be over a twenty-five-year period beginning immediately, during construction.

Id. at 85 (emphasis added).

As an alternative basis for their claim of entitlement to a full exemption, the plaintiffs argue that, because Claremont allowed them the original value of the exemption in 2004, the city cannot now take the position that the value of exemption should have been reduced for depreciation. Plaintiffs rely on LSP Association v. Town of Gilford, 142 N.H. 369 (1997), and Pheasant Lane Realty Trust v. City of Nashua, 143 N.H. 140 (1998).

LSP Association held that if a municipality fails to correct an error of undervaluation within the established time constraints, the error is irremedial and the superior court is without power to adjust the tax upward. Likewise, Pheasant Lane held that a city had no authority to collect a supplemental tax assessment on property that it had mistakenly under-assessed. Neither case addressed the question whether, in an abatement proceeding brought by a taxpayer, a municipality may show the court that the tax at issue was under-assessed, solely for purpose of countering the claim of disproportionality.

Claremont is not asking the Court to increase the 2004 assessment, but is simply attempting to show that the assessment was not disproportionate as compared with the general level of assessment within the city. The city's position here is not at odds with LSP Association or Pheasant Lane.

Moreover, to the extent the plaintiffs rely on estoppel, they have failed to establish at least two of the four elements of such theory:

> First, a false representation or concealment of material facts made with knowledge of those facts; second, the party to whom the representation was made must have been ignorant of the truth of the matter; third, the representation must have been made with the intention of inducing the other party to rely upon it; and fourth, the other party must have been induced to rely upon the representation to his or her injury.

Thomas v. Town of Hooksett, 153 N.H. 717, 721 (2006).

The evidence at trial was that the city assessor simply misinterpreted the statute and was unaware that the exemption should have been depreciated, thus there was no false representation and no concealment of material facts. Also, given that the plaintiffs appealed the 2004 tax assessment, it can hardly be said that they relied upon it. Neither is there any evidence of any injury resulting from the error, since the city is not seeking to increase the 2004 assessment.

APPRAISAL OF FAIR MARKET VALUE

Both experts considered three methods of valuation: income, cost, and comparable sales. However, as a result of the absence of a sufficient number of sales for the comparable cost approach, and because the plant is an income-producing property, both appraisers relied primarily on an income methodology. Traub used direct capitalization in his income analysis, whereas Lagassa used a discounted cash flow analysis. It appears to the Referee that either approach—direct capitalization or discounted cash flow—is acceptable as a general

proposition.

Consistent with his belief that the Demoulas rule applied to this appraisal, Traub's primary analysis, the so-called "market-rates scenario," ignored the effects of the PPA and the contracts between Wheelabrator and the Districts as to income and expenses. Apparently at the plaintiffs' request, he also prepared a "contract-rates scenario" analysis which accounted for the increased revenue due to the remaining years of the PPA, but still ignored the effects of the other contracts. In his market-rates scenario, Traub inferred a single stabilized figure for annual income and expenses, to which he applied a capitalization rate to derive an indicated fair market value of $9,813,512 before deductions for tax exempt pollution control equipment, the anticipated cost of a pollution control upgrade, and the value of non-taxable mobile equipment. After these deductions, Traub's adjusted fair market value was $5,619,512. In the contract-rates scenario, Traub's stabilized annual revenue estimate increased but annual expense was left unchanged. The resulting indicated fair market value estimate was $14,978,112 before the above-cited deductions and, after the deductions, $10,784,112.

For reasons already stated, the Referee finds that the terms of the PPA and the agreements between Wheelabrator and the Districts are relevant to the determination of the fair market value of the Wheelabrator plant. Traub's market-rates appraisal, entirely ignoring the effects of these contracts, is therefore not reliable. Traub's "contract analysis" in which he took account of the PPA income but ignored Wheelabrator's contracts with the Districts is also found to be not reliable. As explained above, the Referee finds that the

value of these contracts would be reflected in a sale between a knowledgeable buyer and seller, particularly with regard to expenses borne by the Districts.

Not only was Traub's analysis flawed due to his assumption that the Demoulas rule applied, but also, his end results before equalization—especially, the market value scenario—were questionable from a commonsense perspective as well. The net book value of the facility in 2004, calculated by Wheelabrator's independent outside accounting firm and accepted by its owners, was $17,567,000. If either of Traub's indicated fair market value appraisals—$9,813,512 (market) or $14,978,112 (contract)—was accurate, standard accounting procedures would dictate that Wheelabrator disclose the facility as an impaired asset, which was not done in any of Wheelabrator's audited financial statements.

Lagassa's income appraisal was based on a 15-year income and expense analysis which took into account the effects of the remaining years of the PPA and Wheelabrator's contracts with the Districts. Starting in 2007, his analysis showed the effects of the termination of all these contracts on both income and expenses. Lagassa estimated the cost of capital in the waste industry, from which he derived a discount factor. Applying this to the annual net operating income figures resulted in a net present value, as of the tax date, of $14,101,761. To this figure Lagassa added $2,303,083 reflecting the reversion value of the property at the end of the 15-year holding period, for a total fair market value of $16,404,845.

Lagassa's appraisal was reasonable as to its assumptions and analysis and the Court accepts it, subject to the following qualifications.

Lagassa's final appraisal, Exhibit B, was completed December 11, 2006. Traub's,

Exhibit 7, was completed June 18, 2007. By the time of trial in November 2007, Lagassa (and possibly Traub) became aware of certain errors in both appraisals, errors due to a variety of causes none of which suggested carelessness or inexpertise. At trial it was established that these errors warranted corresponding upward adjustments in the appraisal figures.

Because the Referee finds that Traub's appraisals are not reliable due to their failure to consider the effects of the PPA and other contracts, it is not productive to go through the upward adjustments that would have to be made to his figures. Lagassa's appraisal, on the other hand, provides a reliable basis for an accurate appraisal, subject to upward adjustments to account for certain errors made by both appraisers.

First, both experts overstated the property-tax expense by approximately $154,000. Adjusting for this error increases the property's fair market valuation by approximately $1,350,000. Second, both experts made errors with respect to the pollution control upgrades required for compliance with clean air standards. Under terms of the 1995 Amended and Restated Agreement, the Districts were responsible for 81 percent of the cost of these expenditures. Neither expert allowed for this cost shifting in his final appraisal report. Proper consideration of it results in an increase in fair market value of at least $1,500,000. Applying the two adjustments just described to the fair market value of $16,404,845 from Lagassa's report gives a fair market value of $19,254,845. There was evidence of additional upward adjustments that could have been made either to Lagassa's or Traub's appraisals or both; however, the Referee does not make any finding as to them, because to do so would not affect the outcome of this case.

CONCLUSION

Based on the foregoing, the Referee finds that the fair market value of the property as of the tax date was at least $19,254,845. The value of the exempt pollution control equipment, after depreciation, was $1,109,000, according to the uncontradicted testimony of defendant's expert, which the Referee finds to be a reasonable estimate, as it tracked the depreciation of the facility as a whole. The fair market value of the property after deducting the exempt property was therefore at least $18,145,845. Applying the 82.8 percent equalization ratio to this number yields an assessed value of at least $15,024,759, which is more than the city's assessment of $13,124,200.

Given the finding that the fair market value of the plant and property as of the tax date, adjusted by the applicable equalization ratio, exceeded the city's assessment, the Referee concludes that the plaintiffs are not entitled to an abatement, and recommends that their petition be dismissed.

The Referee's recommendations on the parties' requests for finding of fact and rulings of law are as follows:

Plaintiffs' Requests for Findings of Fact and Rulings of Law

Granted: 1–20, 36, 42–43

Denied: 21–33, 37, 39–41, 48–49

Neither granted nor denied (see Report and Recommendation): 34–35, 38, 44–47

Defendant's Requests for Findings of Fact

Granted: 1–12, 13 (except 5% should be 5.3%), 14–23, 24 (1st sentence only), 25–27, 28 (1st sentence only), 29–41, 44, 46–47.

Denied: none

Neither granted nor denied (see Report and Recommendation): 24 (2nd sentence), 28 (second sentence), 42–43, 45

Defendant's Requests for Rulings of Law

Granted: 1–3, 5–6, 7 (except last sentence), 8–14, 16–19

Denied: none

Neither granted nor denied (see Report and Recommendation): 4, 7 (last sentence), 15

DATED: March 11, 2008

G. G. Monias
JUDICIAL REFEREE