

ORIGINAL

No. 42558-1-II

DIVISION II, COURT OF APPEALS
OF THE STATE OF WASHINGTON

GRAYS HARBOR ENERGY LLC

Plaintiff/Appellant,

v.

GRAYS HARBOR COUNTY

Defendant/Respondent.

FILED
COURT OF APPEALS
DIVISION II
2012 MAY 10 PM 1:33
STATE OF WASHINGTON
BY DEPUTY

ON APPEAL FROM THURSTON COUNTY SUPERIOR COURT
(Hon. Carol Murphy)

BRIEF OF APPELLANT

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I. INTRODUCTION

This is the second time this case has come before the Court. In *Grays Harbor Energy, LLC v. Grays Harbor County*, 151 Wn. App. 550, 213 P.3d 609 (2009), *review denied*, 168 Wn.2d 1014 (2010) (“*Grays Harbor I*”), this Court held that the power generating equipment of an electric generating plant owned by the Appellant, Grays Harbor Energy LLC, was to be assessed and taxed as personal property. The Court reversed decisions of the State Board of Tax Appeals and the Thurston County Superior Court, which had held that the equipment should be assessed and taxed as real property.

On remand to the Superior Court, Grays Harbor Energy moved for entry of a judgment for refunds of overpaid property taxes in the years 2005 to 2008, on the basis that a Department of Revenue rule (WAC 458-12-342(1)) does not authorize the assessment of personal property when a taxpayer’s property is in “new construction” status.¹ During all time periods covered by the former and current appeals, Grays Harbor Energy’s property was “new construction,” consisting of a partially built electric power generating plant that included power generating equipment. In the motion, Grays Harbor Energy asserted that this regulation precluded Respondent Grays Harbor Country from assessing and taxing the power generating equipment because this Court had ruled in *Grays Harbor I* that

¹ WAC 458-12-342(1) states in part:

New construction . . . shall be assessed at its true and fair value as of July 31 each year regardless of its percentage of completion. . . . New construction as used in this section refers only to real property

the equipment was properly classified as personal property, and the rule states that when property is “new construction” only the real property portion of that property may be assessed for property tax purposes.

Grays Harbor County opposed Grays Harbor Energy’s motion. The trial court denied the motion, holding without further explanation that the “rule does not apply here.”² The trial court did, however, certify the case to this Court for discretionary review because the court’s order “involves a controlling question of law as to which there is substantial ground for a difference of opinion and that immediate review of the order may materially advance the ultimate termination of the litigation” under RAP 2.3(b)(4). This Court granted review.

The question presented to the Court is whether Grays Harbor Energy’s personal property assets were subject to assessment and taxation while the power plant was still considered “new construction.” In *Grays Harbor I* this question was actually before the Court but no decision was rendered on the issue; hence, the question is again before the Court, this time for final resolution.

II. ASSIGNMENTS OF ERROR

1. The Thurston County Superior Court (trial court) erred when it ruled that WAC 458-12-342(1) has no application to the facts of the case.

2. The trial court erred in denying Grays Harbor Energy’s Motion for Entry of Judgment on Property Tax Refunds. CP 385.

² August 12, 2011, Verbatim Report of Proceedings (VRP) at 20.

III. STATEMENT OF ISSUES

The following issue pertains to all the assignments of error:

1. Applicability of WAC 458-12-342(1). Whether WAC 458-12-342(1) precludes assessment of personal property during “new construction” and whether the trial court erred in holding that WAC 458-12-342(1) had no application to the facts of this case.

IV. STATEMENT OF FACTS³

A. The Sale and Acquisition of the Grays Harbor Power Plant.

During the years in question (tax assessment years 2004-2007 and tax payment years 2005-2008) Grays Harbor Energy owned an incomplete non-operating, gas-fired combustion turbine electric generating plant.⁴ The property is located in Elma, Grays Harbor County, Washington, on a 22-acre site owned by Grays Harbor Energy, which became the owner on March 24, 2005 when its parent, Invenergy Grays Harbor LLC, purchased the member interests in the limited liability company that owned the 22-acre site and partially constructed plant from Duke Energy North America, LLC. *See* CP 46 (Donovan Declaration (March 13, 2007) ¶ 2).

Duke Energy began constructing the power plant in 2001 and suspended active construction in September 2002, due primarily to a

³ Except as otherwise noted, this Statement of Facts is based on the facts set forth in *Grays Harbor I*, 151 Wn. App. at 552-53.

⁴ Under Washington’s property tax system, taxes are levied and collected after values have been assessed on January 1 of the preceding year. Tax bills are issued in February of the year following the assessment year and are payable in two installments, April 30 and October 31, of the tax payment year. *See* RCW 84.56.020; *see also Transamerica Title Insurance Company v. Hoppe*, 26 Wn. App. 149, 153, 611 P.2d 1361 (1980). Thus, taxes assessed on January 1, 2004, were payable on April 30 and October 31, 2005; taxes assessed on January 1, 2005, were payable on April 30 and October 31, 2006, and so forth.

downturn in demand as well as unfavorable economic conditions in the power generation industry. *See* CP 48 (Donovan Declaration (March 13, 2007) ¶ 9). Duke concluded all construction suspension activities and equipment preservation by January 2003. *Id.*⁵

In January 2004, Duke announced plans to divest itself of several power generating facilities, one of which was the partially constructed Grays Harbor plant. CP 48 (Donovan Declaration (March 13, 2007) ¶ 10). On December 27, 2004, Duke and Invenergy entered into a binding Purchase and Sale Agreement for the member interests in the limited liability company that owned the project. *See* CP 46 (Donovan Declaration (March 13, 2007) ¶ 2).⁶ The purchase price was \$21 million.⁷ *Id.* The sale was completed with the final closing on March 24, 2005. *Id.*

⁵ In the early 2000s, the U.S. power generation industry, in particular gas-fired combustion turbine capacity, was overbuilt, leading to many project curtailments (like the Grays Harbor project) and cancellations. CP 49 (Donovan Declaration (March 13, 2007) ¶ 11). In the state of Washington alone, there were other non-economic power generation projects other than Grays Harbor in either partial construction curtailment (Mint Farm in Cowlitz County) or in a non-economic operating state (Chehalis Power in Lewis County, which was a completed power plant in operation). *Id.* Further, at the time the Grays Harbor project was purchased from Duke Energy, a large quantity of power-generating equipment was available from developers, power companies, and on the used market through dealers and brokers. *Id.* Gas-fired combustion turbine-based power plants were being built globally and there was a relatively active market for generator sets. *Id.* In fact, Grays Harbor Energy's parent had in storage at the time of acquiring this project six (6) gas-fired combustion turbines similar to the equipment at Grays Harbor, which could be sold, moved, and deployed just about anywhere in the world. *Id.*

⁶ At the time, the limited liability company that owned the project was known as Duke Energy Grays Harbor, LLC. CP 46 (Donovan Declaration (March 7, 2007) ¶ 2). After the sale, the name was changed to Grays Harbor Energy LLC. *Id.* at CP 47 (¶ 6).

⁷ The Purchase and Sale Agreement provided in Section 2.2 for certain contingent payments to be made by Grays Harbor Energy to Duke Energy if Grays Harbor Energy elected to complete construction of the power plant or further develop the Grays Harbor project. *See* CP 285. Construction did resume in early 2007 (*see* CP 188 (Donovan Dec. (June 29, 2011)) ¶ 10) and Grays Harbor Energy paid Duke an additional \$12 million in full settlement of the contingent payment provisions of the Purchase and Sale Agreement.

B. The Status of the Power Plant As “New Construction.”

As stated, at the time Grays Harbor Energy acquired the project the partially constructed power plant had previously been put in preservation or “lay-up” mode by Duke Energy in order to maintain the plant’s assets. CP 52 (Donovan Declaration (March 13, 2007) ¶ 17). The facility remained in this state until early 2007 when Grays Harbor Energy restarted construction. *See* CP 188 (Donovan Declaration (June 29, 2011) ¶ 10).

The primary assets acquired, and the major financial consideration in the acquisition of the incomplete power plant from Duke Energy, were the two partially assembled General Electric 7241FA combustion turbine generators. CP 52 (Donovan Declaration (March 13, 2007) ¶ 18). These assets were intended to be the primary power-generating engines of the plant, and at the time of the Purchase and Sale Agreement executed on December 27, 2004, were state-of-the-art equipment that still remained desirable in the secondary equipment marketplace. *Id.* Grays Harbor Energy’s intent was to hold these assets with the option to complete construction if future economic and market conditions changed or until a desirable offer was presented to sell the gas turbine generator parts. *Id.* The purchase price paid to Duke Energy, in the amount of \$21 million, reflected the estimated amount at the time that the two gas-fired combustion turbines could bring in a negotiated sale in the open market if a decision was made to permanently cancel the project, less other costs to close down the project. CP 52 (Donovan Declaration (March 13, 2007)

¶ 19). Had the project been cancelled, the remainder of the equipment would have been scrapped. *Id.*⁸

C. Grays Harbor Energy's Tax Refund Claims.

This dispute concerns the plant while it was in a partially constructed state on the four tax assessment dates, January 1 of 2004, 2005, 2006, and 2007, in question. On each of those dates the plant was inoperable and estimated to be 56 percent complete. CP 49 (Donovan Declaration (March 13, 2007) ¶ 12). At the time the project was acquired, there were parts and equipment located on the site, on a 22-acre lay-down area across the road from the site, and in three rented warehouses. CP 187 (Donovan Declaration (June 29, 2011) ¶ 6). Following Grays Harbor Energy's purchase of the property, the parts and equipment were consolidated into two storage warehouses and onto the site. *Id.*⁹

⁸ It turned out that even the two combustion turbine generators had little or no value in the used equipment market. In mid-2005, shortly after Grays Harbor Energy acquired the plant, Mr. Donovan, the Project Director, was asked to look into the various options for the facility and he devised three possible scenarios for the partially constructed plant. CP 187-88 (Donovan Declaration (June 29, 2011) ¶ 8). One option was to complete construction but this was impractical without a contract to purchase the power to be generated by the plant. *Id.* The second option was to move the equipment to a location where the plant could be built. *Id.* This was also not feasible given the market conditions. *Id.* at CP 187-88. The third option was to scrap the plant in its entirety and sell the turbine generators, which up to that point it was thought were the only equipment that had any real value in the marketplace. *Id.* at CP 188. But, the Project Director also found that at the time the demolition costs and cost to pack and move the turbine generators was equal to or more than the value of the marketable machinery as scrap. *Id.*

⁹ On January 20, 2007, following the decision to restart construction and complete the plant, JH Kelly was given limited notice to proceed to mobilize on the site and commence an inventory of parts and equipment. CP 188 (Donovan Declaration (June 29, 2010) ¶ 10). The number of individual pieces of parts and equipment stored on the site and in the two nearby warehouses was estimated to be in the thousands. *Id.* In February 2007 construction work resumed and in April 2007, JH Kelly was given fully notice to proceed to complete the plant. *Id.*

In each of the tax assessment years in question (2004-2007) Grays Harbor County assessed the plant in the amount of \$97,748,130, the assets of which were all classified as real property.¹⁰ In the years 2005 to 2008 Grays Harbor Energy paid the following property taxes to Grays Harbor County, based on taxes assessed in the years 2004 to 2007, respectively:

2005	\$1,334,340
2006	\$1,350,948
2007	\$ 300,321
2008	<u>\$ 277,759</u>
TOTAL	\$3,263,277 ¹¹

D. The Procedural History of the Case.

As noted, during all tax assessment and tax payment years in question Grays Harbor County classified Grays Harbor Energy's property as real property. Grays Harbor Energy disputed this classification and

¹⁰ The tax assessments issued for the years 2006 and 2007, representing the value upon which Grays Harbor Energy paid property taxes in the years 2007 and 2008, was in the reduced amount of \$20,956,458. These reduced assessments were made pursuant to RCW 84.52.018, which states in pertinent part as follows:

Whenever any property value . . . is appealed to the state board of tax appeals or court of competent jurisdiction and the dollar difference between the total value asserted by the taxpayer and the total value asserted by the opposing party exceeds one-fourth of one percent of the total assessed value of property in the county, the assessor shall use only that portion of the total value which is not in controversy for purposes of computing the levy rates and extending the tax on the tax roll When the state board of tax appeals or court of competent jurisdiction makes its final determination, the proper amount of tax shall be extended and collected for each taxing district if this has not already been done.

Because Grays Harbor Energy had appealed the 2006 and 2007 assessments and the appealed value apparently represented more than one-fourth of one percent of the total county assessed value, the assessments for the years 2007 and 2008 were made under RCW 84.52.018, in the reduced amount of \$20,956,458.

¹¹ CP 173 (Appendix A to Plaintiff Grays Harbor Energy LLC's Motion for Entry of Judgment on Property Tax Refunds).

contended that the property should be classified pursuant to RCW 84.12.280.¹² This Court agreed that under RCW 84.12.200(4),¹³ RCW 84.12.200(12)¹⁴ and RCW 84.12.280, “all of [Grays Harbor Energy’s] operating property, other than its land and buildings, should be assessed and taxed as personal property.” *Grays Harbor I*, 151 Wn. App. at 554 (bracketed inclusion added).

Following this Court’s decision in *Grays Harbor I*, the County petitioned the Supreme Court for review, which was denied (168 Wn.2d 1014 (2010)). Thereafter on March 16, 2010, this Court issued its Mandate and the case was remanded back to the trial court for further

¹² RCW 84.12.280 classifies the real and personal property of certain “public utilities,” including “electric light and power companies,” as follows:

. . . all of the operating property other than lands and buildings of electric light and power companies, . . . shall be assessed and taxed as personal property.

¹³ RCW 84.12.200(4) defines an “electric light and power company” to mean:

. . . any person owning, controlling, operating or managing real or personal property, used or to be used for or in connection with or to facilitate the generation, transmission or distribution of electricity in this state, and engaged in the business of furnishing, transmitting, distributing or generating electrical energy for light, heat or power for compensation as owner, lessee or otherwise.

¹⁴ RCW 84.12.200(12) defines “operating property” to mean:

. . . all property, real and personal, owned by any company, or held by it as occupant, lessee or otherwise, including all franchises and lands, buildings, rights-of-way, water powers, motor vehicles, wagons, horses, aircraft, aerodromes, hangars, office furniture, water mains, gas mains, pipe lines, pumping stations, tanks, tank farms, holders, reservoirs, telephone lines telegraph lines, transmission and distribution lines, dams, generating plants, poles, wires, cables, conduits, switch boards, devices, appliances, instruments, equipment, machinery, landing slips, docks, roadbeds, tracks, terminals, rolling stock equipment, appurtenances and all other property of a like or different kind, situate within the state of Washington, used by the company in the conduct of its operations; and, in case of personal property used partly within and partly without the state, it means and includes a proportion of such personal property to be determined as in this chapter provided.

proceedings. CP 31-37. On remand, the parties stipulated to the consolidation of two proceedings that were before the trial court, which were designated as Thurston County Cause Numbers 06-2-00957-3 and 08-2-01551-1. These two proceedings covered four consecutive tax assessment years, 2004 through 2007, and tax payment years, 2005 through 2008, which are the years at issue now before the Court in this appeal.¹⁵

On July 1, 2011, Grays Harbor Energy filed a Motion for Entry of Judgment on Property Tax Refunds. CP 158-185. Grays Harbor Energy asked the trial court to enter a judgment in its favor for \$3,210,806 (plus interest pursuant to RCW 84.69.100) for property taxes overpaid to Grays Harbor County in the years 2005 to 2008. CP 158.¹⁶ In its motion Grays Harbor Energy asserted that Department of Revenue rule WAC 458-12-342(1) precluded the assessment of personal property when property is “new construction.” CP 164-171. And, since Grays Harbor Energy paid property taxes on the personal property in the years 2005 to 2008, it was owed a refund of these taxes because this Court had declared all of the

¹⁵ See CP 38-41. The remand from this Court included an appeal of tax assessment years 2005 and 2006 and payment years 2006 and 2007. This part of the former appeal was a petition for judicial review pursuant to the Administrative Procedures Act (APA) (RCW 34.05.510 through RCW 34.05.598) and RCW 82.03.180 under Thurston County Cause No. 07-2-00883-4 from orders of the Washington State Board of Tax Appeals. After the remand from this Court, the trial court (upon stipulation of the parties) further remanded the APA proceeding back to the Board, where it was eventually dismissed since the years at issue in 07-2-00883-4 (assessment years 2005-2006/tax years 2006-2007) were subsumed within, and already being addressed by, this appeal.

¹⁶ A calculation of the partial refund by year was submitted by Grays Harbor Energy to the trial court and it is in the record at CP 173.

power generation equipment to be personal property in *Grays Harbor I*. Grays Harbor Energy alleged it had overpaid its property taxes in the amount of \$3,210,806, again because its personal property should not have been subject to assessment in the years 2004 to 2007. *Id.* Grays Harbor County opposed the motion, arguing that WAC 458-12-342(1) does not exempt personal property from assessment and taxation even when it represents new construction. CP 219-263.

The trial court heard Grays Harbor Energy's motion on August 12, 2011. The court denied the motion, ruling that WAC 458-12-342(1) "does not apply here." VRP 20. In the course of the hearing the parties agreed that the proper interpretation of WAC 458-12-342 was a controlling question of law as to which there was substantial ground for a difference of opinion and immediate review of the trial court's order would materially advance the ultimate termination of this litigation. VRP 20-22.¹⁷ The trial court then entered an order, certifying the case to this Court for discretionary review under RAP 2.3(b)(4), provided either party sought review of the order. CP 385-86. The order was entered on the same day as the hearing, August 12, 2011. *Id.* On September 8, 2011, Grays Harbor

¹⁷ The trial court did have a concern that even with a certification to this Court there were still factual questions that remained in the case, which might otherwise preclude review by an appellate court. VRP at 20. Those factual issues were the value of Grays Harbor Energy's real property assets – land and buildings. *Id.* Actually, there was no dispute as to the value of the land in each of the four (2004-2007) tax assessment years, but there was also no agreement on the value of the partially constructed buildings in those years. VRP at 21-22. Nevertheless, the parties did agree that any dispute over the value of the buildings was "geometrically smaller" than the value of the power generation machinery and equipment and that it would still "promote judicial efficiency" by resolving the taxability of that property first. VRP at 22. The trial court agreed and the certification was made. VRP 22 (lines 14-20).

Energy filed a Notice for Discretionary Review. CP 387-390. On November 10, 2011, the Commissioner granted discretionary review.

V. STANDARD OF REVIEW

The trial court treated Grays Harbor Energy's Motion for Judgment on Property Tax Refunds as "a motion for summary judgment." VRP 19. "Summary judgment is reviewed de novo." *American Best Food, Inc. v. Alea London, Ltd.*, 168 Wn.2d 398, 404, 229 P.3d 693 (2010) (citing *Liberty Mut. Ins. Co. v. Tripp*, 144 Wn.2d 1, 10, 25 P.3d 997 (2001)). The interpretation of an agency rule is a question of law also reviewed de novo. See *Cobra Roofing Service, Inc. v. Department of Labor & Industries*, 122 Wn. App. 402, 409, 97 P.3d 17 (2004) ("[w]e interpret agency regulations as if they were statutes"); *Western Washington Operating Engineers Apprenticeship Committee v. Washington State Apprenticeship and Training Council*, 130 Wn. App. 510, 518, 123 P.3d 533 (2005) ("[w]e review the regulations and statutes . . . de novo").

VI. SUMMARY OF ARGUMENT

This case has always been about the classification of property as either real or personal. In *Grays Harbor I* this Court reversed orders of the Board of Tax Appeals and trial court, which had upheld Grays Harbor County's tax assessment of Grays Harbor Energy's "power-generating equipment as real property." 151 Wn. App. at 552. The Court held that all of Grays Harbor Energy's "property, other than its land and buildings, should be assessed and taxed as personal property." *Id.* at 554. At that

time, the Court could also have decided the secondary issue presented under WAC 458-12-342: whether Grays Harbor Energy's personal property was even subject to assessment and taxation while the project was in "new construction" status. The issue was before the Court, but was neither addressed nor ultimately resolved. *See* Brief of Appellant filed with this Court on June 18, 2008, at 9, 11 and 58, and Reply Brief of Appellant dated September 17, 2008, at 22, n.7.¹⁸

On remand, the trial court upheld the County's assessment and taxation of Grays Harbor Energy's personal property during the "new construction" period, ruling that WAC 458-12-342 did "not apply." VRP at 20. The trial court did not provide any explanation as to why the rule did not apply. Now the parties are again before this Court in a second appeal over an issue that the Court needs to finally and conclusively decide in order to terminate this litigation once and for all.

WAC 458-12-342(1) is clear and unambiguous. It states that "[n]ew construction . . . shall be assessed at its true and fair value as of July 31 each year regardless of its percentage of completion" and that "[n]ew construction . . . refers only to real property." WAC 458-12-342(1). The clear and unambiguous language of this rule allowed for the assessment and taxation of Grays Harbor Energy's real property – land and buildings – while the property was "new construction." Equally clear

¹⁸ The Brief of Respondent Grays Harbor County filed July 21, 2008, did not respond to Grays Harbor Energy's allegations regarding WAC 458-12-342(1), so it is possible this Court assumed there was no dispute as to the assessment and taxation of personal property once the property's characterization was decided.

and unambiguous is the rule's implication that new construction that is classified as *personal property* is *not* subject to assessment and taxation. The underlying reason for this policy is straightforward: because the value or highest and best use of income-generating assets (like power generating equipment) is not realized until those assets are fully deployed, *i.e.*, installed and operational. Prior to full deployment and use, such assets have little or no value, and that also is what the undisputed evidence before the trial court demonstrated.

During all assessment years (2004-2007) and tax years (2005-2008) in question, the personal property power generation equipment at issue here was partially assembled and inoperable and, had the project been terminated, all of this equipment would have been scrapped. This is a clear indication that the property had no value in its inoperable, "new construction" status. There is a reason WAC 458-12-342(1) allows county assessors to assess only real property during "new construction" for property tax purposes, and this case is a classic example of that principle in action.

VII. ARGUMENT

A. **WAC 458-12-342 is Clear and Unambiguous in Its Directive for the Assessment and Taxation of Only Real Property During "New Construction."**

The Department of Revenue has adopted rules for assessors to aid them in the assessment of real and personal property. *See* WAC chapter 458-12. One such rule, WAC 458-12-342 (sometimes referred to as "Rule 342"), addresses "new construction" or as it is commonly known,

“Construction In Progress” (CIP). This rule states in pertinent part as follows:

New construction covered under the provisions of RCW 36.21.070 and 36.21.080, and defined in WAC 458-19-005(2)[p], shall be assessed at its true and fair value as of July 31st each year regardless of its percentage of completion. In instances when new construction continues after July 31 of any year, the increase in value of the property due to the new construction that occurs between August 1 of that year through July 31 of the following year is added to the assessment roll as “new construction” in the following year. *New construction as used in this section refers only to real property, as defined in RCW 84.04.090 and further defined in WAC 458-12-010, and also to improvements, as described in WAC 458-12-005(4), located on leased public land, for which a building permit was issued or should have been issued pursuant to chapter 19.27, 19.27A, or 19.28 RCW or other laws providing for building permits.*

WAC 458-12-342(1) (emphasis added).

WAC 458-19-005, cited in Rule 342, repeats the definition of “new construction” as follows:

“New construction” means the *construction or alteration of any property for which a building permit was issued, or should have been issued, under chapter 19.27, 19.27A, or 19.28 RCW or other laws providing for building permits, which results in an increase in the value of the property.*

WAC 458-19-005(2)(p) (emphasis added).

Based on these regulations county assessors are limited in their ability to assess “new construction” because this term is defined to mean construction “for which a building permit was issued.” WAC 458-12-342(1); 458-19-005(2)(p). The rule explicitly states that “new construction” for purposes of assessment and taxation means “only . . . real property.” WAC 458-12-342(1). “Real property” is further defined in RCW 84.04.090 and WAC 458-12-010, to include all “property which

the law defines or the courts may interpret, declare and hold to be real property under the letter, spirit, intent and meaning of the law for the purposes of taxation.”¹⁹ This Court has already ruled that Grays Harbor Energy’s equipment is personal property and only land and buildings are real property. *Grays Harbor I*, 151 Wn. App. at 552, 554.

“As in statutory interpretation, where a regulation is clear and unambiguous, words in a regulation are given their plain and ordinary meaning unless a contrary intent appears.” *Silverstreak, Inc. v. Dep’t of Labor & Industries*, 159 Wn.2d 868, 881, 154 P.3d 891 (2007) (citing *In re Estate of Little*, 106 Wn.2d 269, 283, 721 P.2d 950 (1986); *Hewson Constr., Inc. v. Reintree Corp.*, 101 Wn.2d 819, 826, 685 P.2d 1062 (1984)). The plain language of WAC 458-12-342(1) includes several provisions.

- First, the terms of the rule apply to “new construction.”
- Second, when property is new construction, the assessment date (normally January 1 each year) is extended to July 31, and any increase in value of the property due to “new construction” between January 1 through July 31 of that year may be assessed as if the new

¹⁹ The undisputed evidence before the trial court showed that building permits were required for the major structures (administration, warehouse, water treatment, and gas regulation buildings) on the site. See CP 67 (Donovan Declaration (April 6, 2011) ¶ 25); CP 368 (Donovan Declaration (August 3, 2011) ¶ 4). There were some other structures on the property, but those were associated with the power generation equipment, which were considered part of the electrical plant and exempt from building permit requirements. *Id.* (CP 368 ¶ 5).

construction or value was present and in existence on January 1. WAC 458-12-342(1).

- Third, any “increase in value of the property due to the new construction that occurs between August 1 of that year through July 31 of the following year is added to the assessment roll as ‘new construction’ in the following year.” *Id.*

- Finally, the rule clearly and unambiguously defines the “new construction” that may be assessed and taxed: “New construction as used in this section refers only to real property” *Id.*

Courts “will give great deference to an agency’s interpretation of its own properly promulgated regulations, ‘absent a compelling indication’ that the agency’s regulatory interpretation conflicts with legislative intent or is in excess of the agency’s authority.” *Silverstreak*, 159 Wn.2d at 884 (citing *Marquis v. City of Spokane*, 130 Wn.2d 97, 111, 922 P.2d 43 (1996); *Port of Seattle v. Pollution Control Hearings Bd.*, 151 Wn.2d 568, 593, 90 P.3d 659 (2004); *Everett Concrete Prods., Inc. v. Dep’t of Labor & Indus.*, 109 Wn.2d 819, 823, 748 P.2d 1112 (1988)). This deference is given to an agency’s interpretation of its regulations because the agency has expertise and insight gained from administering the regulation that the reviewing court does not possess. *Silverstreak*, 159 Wn.2d at 885 (citing *Port of Seattle*, 151 Wn.2d at 593; *Lockheed Shipbuilding Co. v. Dep’t of Labor & Indus.*, 56 Wn. App. 421, 429-30; 783 P.2d 1119 (1989)). Because the Department of Revenue’s interpretation in WAC 458-12-342 neither conflicts with legislative intent nor exceeds the scope of its

authority, it should be given proper deference here. *See Silverstreak, supra.*

B. Grays Harbor Energy’s Personal Property Was Not Subject to Assessment or Taxation While the Property Was Considered “New Construction” Under the Clear and Unambiguous Language of WAC 458-12-342.

This Court previously declared and held that under RCW 84.12.280 all of Grays Harbor Energy’s property, other than land and buildings, is to be assessed and taxed as personal property. *Grays Harbor I*, 151 Wn. App. at 554. When this decision and Rule 342(1) are read together, the correct conclusion is readily apparent: Grays Harbor Energy’s land and buildings – the real property – were the only property that could be properly assessed and taxed while the property was in a “new construction” state.

The County originally classified Grays Harbor Energy’s “operating equipment and buildings as real property.” *Grays Harbor I* at 552. This characterization extended not only to land, buildings and all partially installed power generation equipment, but to other parts and equipment that were at the site or stored in one of the warehouses rented by Grays Harbor Energy. *See* CP 187 (Donovan Declaration (June 29, 2011) ¶¶6, 7).²⁰ This was error under the clear and unambiguous ruling of this

²⁰ During the years in question, Grays Harbor County made no assessment against Grays Harbor Energy for personal property taxes; the only assessments were for real property. If personal property was subject to assessment and taxation during the new construction phase, then all of the equipment and parts laid out at the site and stored in the two warehouses – clearly and unequivocally personal property – would have been assessed and taxed by the County as personal property, which it unmistakably has not assessed or taxed.

Court, since none of this equipment was considered to be real property in the first instance under RCW 84.12.280. And, because it was not real property, it could not be assessed or taxed as new construction under WAC 458-12-342(1).

1. The Undisputed Facts Show That Grays Harbor Energy's Property Was "New Construction" During All Assessment and Taxation Years in Question.

On each of the assessment dates at issue here (January 1, 2004, 2005, 2006, and 2007) the status of the Grays Harbor power plant was clearly and unequivocally "new construction." This fact was confirmed by this Court:

The property at issue here is a non-operating power plant owned by GHE covering 22 acres in Elma, consisting of three buildings, a cooling tower, and [three] generators variously powered by steam, exhaust, and gas combustion. The primary power-generating turbine generators sit outdoors on bare ground. Workers can easily disconnect, disassemble, and move the modular generators.

In 2001, the prior owner, Duke Energy North America, LLC, began constructing a gas-powered electrical facility. It stopped construction in 2002 after a downturn in demand. GHE purchased the facility and Duke Energy's interests in the project and assumed some of Duke Energy's obligations. GHE paid approximately \$21 million for the plant, intending to finish construction and begin generating electricity.

Grays Harbor I, 151 Wn. App. at 552. These facts were also confirmed by the undisputed testimony of the Project Director of the Grays Harbor plant:

. . . [B]eginning in January 2003, when Duke completed shutdown, and through February 2007, when GHE restarted construction, the plant was in one constant state or condition: deferred construction and in lay-up mode. Because the plant was only partially constructed, none of the power generation equipment

was operational, and that equipment included thousands of pieces in inside storage or laid out at the site property.

CP 188 (Donovan Declaration (June 29, 2011) ¶ 12).

2. That “New Construction” Subject to Assessment and Taxation Does Not Include Personal Property Is a Rule of Common Sense and Reasonableness.

Under the Department of Revenue’s rule for “new construction” (WAC 458-12-342(1)) only real property was subject to assessment and taxation. Stated differently, the Department’s regulation does not allow personal property to be assessed or taxed while the facility is CIP (construction in progress). The regulation is a rule of reason and common sense. The full value of personal property, in particular machinery like power generation equipment, is not realized until it is fully installed, fully operational, and fully utilized in the business for which it is employed. This principle of valuation is acknowledged by the International Association of Assessing Officers (IAAO), which recognizes that:

. . . market value is defined by value-in-exchange, that is, the value to the next buyer as of the lien date, and highest and best use principles. The highest and best use of an asset will likely be *as fully installed and operational to its maximum productivity.*

Standard on Valuation of Personal Property (2005) at 8 (emphasis added).

On the other hand, personal property that is not fully installed and operational to its maximum productivity is, for all practical purposes, not only useless but without value in the market place. This principle of “value-in-exchange” is made abundantly clear by the facts and circumstances of this case. In an unrefuted declaration submitted to the

trial court during prior proceedings, Mr. Donovan had this to say about the inoperable power generation machinery and equipment:

At the time of the execution of the [Purchase and Sale Agreement] on December 27, 2004, and on each of the tax assessment dates in question . . . there was no specific intention on . . . Grays Harbor Energy's part to resume construction. . . . [T]he purchase price (\$21 million) reflected the estimated amount that the two gas-fired combustion turbines could bring in a negotiated sale in the open market if the decision was made to permanently cancel the construction project, less other costs of closure of the Project. Had the latter scenario played itself out, *the remainder of the equipment would likely have been scrapped.*

See CP 52 (Exhibit 1, Donovan Declaration (March 13, 2007) (¶ 19) (bracketed inclusions and emphasis added).

The statement – had the construction project been permanently canceled the equipment (other than the combustion turbines) would have been scrapped – recognizes (as does WAC 458-12-342(1) and the IAAO statement) that the personal property machinery and equipment has little or no value unless and until the equipment is fully installed and operating. This is precisely the reason why Rule 342(1) states that only real property should be taxed during “new construction” (*i.e.*, CIP).

C. The Statute and Rule at Issue in This Appeal Impose a Tax and Any Ambiguity in Their Language Must Be Interpreted in Favor of the Taxpayer, Grays Harbor Energy, Under the Rules of Construction Interpreting Tax Statutes.

Under RCW 84.40.020, “All personal property in this state *subject to taxation* shall be listed and assessed every year, with reference to its value and ownership on the first day of January of the year in which it is assessed” (emphasis added). RCW 84.40.020 is a tax-imposition statute. As a tax-imposing statute, if there is any doubt or ambiguity as to the

statute's meaning, it must be construed in favor of the taxpayer (Grays Harbor Energy) and against the taxing power (Grays Harbor County). See *Mac Amusement Co. v. Dep't of Revenue*, 95 Wn.2d 963, 966, 633 P.2d 68 (1981); *Foremost Dairies, Inc. v. State Tax Comm'n*, 75 Wn.2d 758, 453 P.2d 870 (1969); *Buffelen Lumber & Mfg. Co. v. State*, 32 Wn.2d 40, 43, 200 P.2d 509 (1948). Moreover, if there is any ambiguity in WAC 458-12-342(1) it, too, must be construed in favor of the taxpayer and against the taxing power because “[r]ules of statutory construction apply to administrative rules and regulations.” *Overlake Hospital v. Dep't of Health*, 170 Wn.2d 43, 51-52, 239 P.3d 1095 (2010) (quoting *City of Seattle v. Allison*, 148 Wn.2d 75, 81, 59 P.3d 85 (2002)).

WAC 458-12-342(1) is a reasonable interpretation of the statutory requirement to list and assess all personal property *subject to taxation*. RCW 84.40.020. The rule makes a clarification with respect to new construction (CIP) – that “[n]ew construction . . . refers only to real property” – and the clear implication of this statement is that personal property is not assessable or taxable. In fact, there is no place to even report new construction on the personal property listing form that must be filed with the County each year for tax assessment purposes. See CP 71-93, which are personal property reporting forms filed by Grays Harbor Energy with the County for assessment year 2006.²¹ Therefore, the

²¹ Prior to 2007 the value of all property owned by Grays Harbor Energy was listed under the value of the two combustion turbine generators (CTGs), and all other items are listed with a value of zero. As noted, at the time of the acquisition, it was anticipated that the CTGs could be sold or moved to another site in another state, and that the balance of the property would not be used and it would be sold for scrap. See CP 187-88 (Donovan) (Footnote continued on next page.)

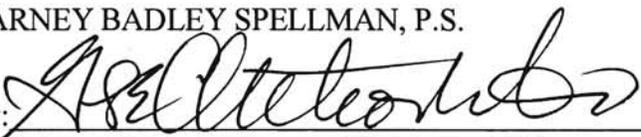
personal property at the Grays Harbor plant was not assessable in the years 2004 to 2007, or taxable in the years 2005 through 2008, under the clear and unambiguous language of WAC 458-12-342(1). The only property that *was* subject to assessment and taxation during those years was the real property (land and buildings) under RCW 84.12.280.

VIII. CONCLUSION

This Court should rule that the plain language of WAC 458-12-342(1) precludes assessment of personal property during “new construction.” This regulation applies to all personal property, including power generation equipment, which this Court ruled in *Grays Harbor I* should be assessed and taxed as personal property. The Court should reverse the trial court’s summary judgment order and remand for further proceedings, including confirmation of the calculation of the refund owed to Grays Harbor Energy by Grays Harbor County for property taxes paid on personal property in the years 2005 to 2008.

RESPECTFULLY SUBMITTED this 10th day of May, 2012.

CARNEY BADLEY SPELLMAN, P.S.

By: 
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Dec. (June 29, 2011) ¶ 8). Thus, the total value listed for the CTGs was the total purchase price of the personal property when it was acquired in 2005, and because of the nature of the electronic form all other lines continue to show a value of zero instead of breaking out this purchase price between all of the items or showing “included in above.” Allocating the value only to the CTGs is also allowed under Generally Accepted Accounting Principles (GAAP).

ORIGINAL

NO. 42558-1-II

DIVISION II, COURT OF APPEALS
OF THE STATE OF WASHINGTON

GRAYS HARBOR ENERGY LLC,

Plaintiff/Appellant,

v.

GRAYS HARBOR COUNTY,

Defendant/Respondent.

DECLARATION OF
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DIVISION II

I, Patti Saiden, hereby declare as follows:

On May 10, 2012, I caused to be served via U.S. Mail, a true and correct copy of the Appellant's Opening Brief *along with a copy of the Verbatim Report of Proceedings for the August 12, 2011 motion hearing and Declaration of Service* upon the following:

James G. Baker, Senior Deputy
Grays Harbor County Prosecuting Attorney
102 W Broadway, Room 102
Montesano, WA 98563
Email: Jbaker@co.grays-harbor.wa.us

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

DATED this 10th day of May, 2012.



Patti Saiden, Legal Assistant