

Application: 09-10-xxx  
Exhibit No.: \_\_\_\_\_  
Witness: Randall Rose

Application of San Diego Gas & Electric  
Company (U 902 E) for Approval Pursuant to  
Public Utilities Code Section 851 to Lease  
Transfer Capability Rights to Citizens Energy  
Corporation

**DIRECT TESTIMONY OF**  
**RANDALL ROSE**  
**SAN DIEGO GAS & ELECTRIC COMPANY**

**BEFORE THE PUBLIC UTILITIES COMMISSION**  
**OF THE STATE OF CALIFORNIA**  
**October 9, 2009**



1 **I. SUMMARY AND PURPOSE OF TESTIMONY**

2 The purpose of my testimony is to explain how the Development and  
3 Coordination Agreement, dated May 11, 2009, between San Diego Gas & Electric  
4 Company (“SDG&E”) and Citizens Energy Corporation (“Citizens”) has special tax  
5 implications due to the fact that the agreement has been characterized as a lease  
6 agreement. Under general tax principles, an amount received by a taxpayer as gross  
7 income must be taken into account in the year payment is received. However, when a  
8 lease agreement calls for prepaid rent, Internal Revenue Code Section 467 (“IRC §467”)  
9 requires the lessor and lessee to report the rents for tax purposes as they accrue and to  
10 take into account time value of money principles. Under a formula specified in IRC §467  
11 and the related regulations, rental revenues and expenses are accounted for tax purposes  
12 on an accrual basis and the taxable income and expenses are treated in a reciprocal  
13 manner by the parties. SDG&E and Citizens agreed to structure the transaction as an IRC  
14 §467 lease in order to obtain more certainty about the tax treatment that both parties  
15 desired and to spread the income and expense items for tax purposes over the life of the  
16 agreement.

17 **II. PRE-PAID RENT**

18 Citizens will pay SDGE an amount equal to all of the acquisition costs for the  
19 property subject to its leasehold interest up front as “prepaid rent.” SDG&E will  
20 amortize the prepaid rent into taxable income ratably over the 30-year lease term based  
21 on a rent schedule calculated under IRC §467 rules. Another requirement of IRC §467 is  
22 to treat the prepaid rent as a loan from the lessee to the lessor. Accordingly, to the extent  
23 the unamortized prepaid rent exceeds the cumulative rental payments due at the end of

1 each rental accrual period, the excess is deemed to be the outstanding loan balance. IRC  
2 §467 requires SDG&E and Citizens to establish a schedule showing the taxable interest  
3 income to be recognized by Citizens and the deductible interest expense to be recognized  
4 by SDG&E for each period. The loan bears interest at 110% of the “applicable federal  
5 rate,” as defined in IRC §467. The applicable rate is the long-term interest rate published  
6 by the U.S. Treasury Department.

7         The IRC §467 treatment does not change the total taxable income or expense to  
8 be recognized by SDG&E or Citizens compared to recognizing the prepaid rent as  
9 taxable upon receipt by SDG&E and deductible upon payment by Citizens, but it does  
10 change how the items of income and expense are labeled for tax purposes and the timing  
11 of their recognition. Each year, SDG&E’s net taxable income will be equal to the sum of  
12 its rental income and interest expense, while Citizens will recognize the reciprocal rental  
13 expense and interest income on its tax return. As a result, the net rental income less  
14 interest expense recognized by SDG&E over the 30-year life of the agreement will  
15 exactly equal Citizens’ prepaid rent. Accordingly, over the 30-year life of the lease,  
16 SDG&E and Citizens will have complementary tax treatment.

17         The following example illustrates this complementary tax treatment: assume  
18 Citizens makes an up-front payment to SDG&E equal to all the construction costs of the  
19 segment of the Sunrise Powerlink it will lease from SDG&E. SDG&E and Citizens  
20 would calculate the accrued rental income to be recognized each period using present  
21 value principles outlined in the regulations under IRC §467. Interest on the outstanding  
22 balance of the “IRC §467 loan” would also be calculated for each period. Over the life of  
23 the agreement, the net difference between the rental income less interest expense

1 recognized for tax purposes by SDG&E would equal the prepaid rent. Similarly, the net  
2 difference between the interest income less rent expense attributed to Citizens would also  
3 be equal to the prepaid rent. A calculation of the IRC §467 rents and interest based on  
4 the \$83 million of projected construction costs for the portion of the Sunrise Powerlink  
5 leased to Citizens is shown in Appendix 1 to this testimony.<sup>1</sup>

### 6 **III. DEFERRED TAXES**

7 The accumulated deferred federal and state income taxes resulting from the  
8 difference between federal tax depreciation computed using the Modified Accelerated  
9 Cost Recovery System (“MACRS”) specified in IRC §168 and state tax depreciation  
10 computed using the Asset Depreciation Range (“ADR”) system used by California versus  
11 normalized tax depreciation computed using the same life, method, and salvage  
12 assumption used to compute book depreciation have been included as an adjustment to  
13 rate base by SDG&E for purposes of establishing a baseline revenue requirement. For a  
14 more detailed discussion of rate base, see the testimony of SDG&E witness Michael  
15 Calabrese. Citizens also will adjust rate base for accumulated deferred federal and state  
16 income taxes based on the timing difference between the book and tax recognition of the  
17 lease amortization expense.

### 18 **IV. PROPERTY TAX TREATMENT**

19 The California State Board of Equalization (“SBE”) values utility property on a  
20 unitary basis as an entire operating system rather than valuing each individual component  
21 individually. It then allocates the system value among the affected counties according to  
22 a formula required by statute. However, beginning in 2007, property tax revenues  
23 generated by construction of new electric transmission property with a nameplate value

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<sup>1</sup> IRC §467 Rent Schedule, Appendix A

1 of 200,000 volts or greater is allocated entirely to the county in which the newly  
2 constructed property is located.<sup>2</sup> Accordingly, since the property subject to the  
3 agreement between SDG&E and Citizens is located wholly within Imperial County, that  
4 county will receive the entire share of new property tax revenue created by the  
5 assessment of Citizens' transmission capacity leasehold interest. The county  
6 auditor/controller then allocates property tax revenue among all the tax jurisdictions  
7 within the county based on a formula established after Proposition 13. The agreement  
8 between SDG&E and Citizens will have no impact on the allocation of property tax  
9 revenues to Imperial County or to the various tax jurisdictions within the county.

10 This concludes my direct testimony.

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<sup>2</sup> California Revenue and Taxation Code §100.95.

1 **V. QUALIFICATIONS**

2 My name is Randall G. Rose. I am employed by Sempra Energy as a Tax  
3 Director for Sempra Energy utilities. My business address is 101 Ash Street, HQ-07, San  
4 Diego, California 92101.

5 My current responsibilities include managing federal and state income tax  
6 compliance, reviewing tax accounting for the utilities, and preparing income tax  
7 calculations for regulatory filings.

8 I received a Bachelor's degree in Business Administration with an emphasis in  
9 Accounting from San Diego State University. I am a Certified Public Accountant  
10 ("CPA"), licensed in the State of California.

11 I have been employed by SDG&E and Sempra Energy since 1994. In addition to  
12 my current position as Director of Income Tax, I have served as Director of Tax  
13 Accounting and Regulatory Taxes, Manager of State Income Taxes, and Manager of  
14 Property and Sales Tax for SDG&E and Sempra Energy.

15 Prior to joining SDG&E, I served as a senior tax advisor to the elected member of  
16 the California State Board of Equalization from the 3<sup>rd</sup> District. In that function, I  
17 advised the board member on tax appeals cases and utility ad valorem tax assessments  
18 that came before the State Board of Equalization for administrative ruling.

19 I have previously testified before this Commission as an expert witness.

# Appendix 1

**Appendix 1**

Lessor: SDG&E  
 Lessee: Citizens  
 Interest Rate: 0.97% 110% LT AFR 10/07

IRC §467 Loan and Imputed Interest Computations:

Rent Accrual Period	Rent Allocation	Pre-Payment	Allocated Rent	Fraction* (B/A)	Proportional Rent	IRC § 467 Interest	IRC § 467 Rent	IRC § 467 Loan Balance	Net IRC § 467 Income (Loss)
1	\$1,173,600	\$83,000,000	\$1,173,600	1.000000	\$1,173,600	805,100	(\$1,173,600)	\$83,000,000	(\$368,500)
2	1,173,600		1,173,600	1.000000	1,173,600	801,526	(1,173,600)	82,631,500	(372,074)
3	1,173,600		1,173,600	1.000000	1,173,600	797,916	(1,173,600)	81,883,743	(375,683)
4	1,173,600		1,173,600	1.000000	1,173,600	794,272	(1,173,600)	81,504,415	(379,328)
5	1,173,600		1,173,600	1.000000	1,173,600	790,593	(1,173,600)	81,121,408	(383,007)
6	1,173,600		1,173,600	1.000000	1,173,600	786,878	(1,173,600)	80,734,686	(386,722)
7	1,173,600		1,173,600	1.000000	1,173,600	783,126	(1,173,600)	80,344,213	(390,473)
8	1,173,600		1,173,600	1.000000	1,173,600	779,339	(1,173,600)	79,949,952	(394,261)
9	1,173,600		1,173,600	1.000000	1,173,600	775,515	(1,173,600)	79,551,866	(398,085)
10	1,173,600		1,173,600	1.000000	1,173,600	771,653	(1,173,600)	79,149,920	(401,947)
11	1,173,600		1,173,600	1.000000	1,173,600	767,754	(1,173,600)	78,744,074	(405,846)
12	1,173,600		1,173,600	1.000000	1,173,600	763,818	(1,173,600)	78,334,292	(409,782)
13	1,173,600		1,173,600	1.000000	1,173,600	759,843	(1,173,600)	77,920,534	(413,757)
14	1,173,600		1,173,600	1.000000	1,173,600	755,829	(1,173,600)	77,502,764	(417,771)
15	1,173,600		1,173,600	1.000000	1,173,600	751,777	(1,173,600)	77,080,941	(421,823)
16	1,173,600		1,173,600	1.000000	1,173,600	747,685	(1,173,600)	76,655,026	(425,915)
17	1,173,600		1,173,600	1.000000	1,173,600	743,554	(1,173,600)	76,224,980	(430,046)
18	1,173,600		1,173,600	1.000000	1,173,600	739,382	(1,173,600)	75,790,763	(434,218)
19	1,173,600		1,173,600	1.000000	1,173,600	735,170	(1,173,600)	75,352,333	(438,429)
20	1,173,600		1,173,600	1.000000	1,173,600	730,918	(1,173,600)	74,909,651	(442,682)
21	1,173,600		1,173,600	1.000000	1,173,600	726,624	(1,173,600)	74,462,675	(446,976)
22	1,173,600		1,173,600	1.000000	1,173,600	722,288	(1,173,600)	74,011,363	(451,312)
23	1,173,600		1,173,600	1.000000	1,173,600	717,910	(1,173,600)	73,555,673	(455,690)
24	1,173,600		1,173,600	1.000000	1,173,600	713,490	(1,173,600)	73,095,563	(460,110)
25	1,173,600		1,173,600	1.000000	1,173,600	709,027	(1,173,600)	72,630,991	(464,573)
26	1,173,600		1,173,600	1.000000	1,173,600	704,521	(1,173,600)	72,161,911	(469,079)
27	1,173,600		1,173,600	1.000000	1,173,600	699,971	(1,173,600)	71,688,282	(473,629)
28	1,173,600		1,173,600	1.000000	1,173,600	695,376	(1,173,600)	71,210,059	(478,223)
29	1,173,600		1,173,600	1.000000	1,173,600	690,738	(1,173,600)	70,727,196	(482,862)
30	1,173,600		1,173,600	1.000000	1,173,600	686,054	(1,173,600)	70,239,650	(487,546)
31	1,173,600		1,173,600	1.000000	1,173,600	681,325	(1,173,600)	69,747,375	(492,275)
32	1,173,600		1,173,600	1.000000	1,173,600	676,550	(1,173,600)	69,250,325	(497,050)
33	1,173,600		1,173,600	1.000000	1,173,600	671,728	(1,173,600)	68,748,453	(501,872)
34	1,173,600		1,173,600	1.000000	1,173,600	666,860	(1,173,600)	68,241,713	(506,740)
35	1,173,600		1,173,600	1.000000	1,173,600	661,945	(1,173,600)	67,730,058	(511,655)
36	1,173,600		1,173,600	1.000000	1,173,600	656,982	(1,173,600)	67,213,440	(516,618)
37	1,173,600		1,173,600	1.000000	1,173,600	651,970	(1,173,600)	66,691,810	(521,629)
38	1,173,600		1,173,600	1.000000	1,173,600	646,911	(1,173,600)	66,165,121	(526,689)
39	1,173,600		1,173,600	1.000000	1,173,600	641,802	(1,173,600)	65,633,323	(531,798)
40	1,173,600		1,173,600	1.000000	1,173,600	636,643	(1,173,600)	65,096,366	(536,957)
41	1,173,600		1,173,600	1.000000	1,173,600	631,435	(1,173,600)	64,554,201	(542,165)
42	1,173,600		1,173,600	1.000000	1,173,600	626,176	(1,173,600)	64,006,777	(547,424)
43	1,173,600		1,173,600	1.000000	1,173,600	620,866	(1,173,600)	63,454,043	(552,734)
44	1,173,600		1,173,600	1.000000	1,173,600	615,504	(1,173,600)	62,895,947	(558,096)
45	1,173,600		1,173,600	1.000000	1,173,600	610,091	(1,173,600)	62,332,438	(563,509)
46	1,173,600		1,173,600	1.000000	1,173,600	604,625	(1,173,600)	61,763,463	(568,975)
47	1,173,600		1,173,600	1.000000	1,173,600	599,106	(1,173,600)	61,188,969	(574,494)
48	1,173,600		1,173,600	1.000000	1,173,600	593,533	(1,173,600)	60,608,902	(580,067)
49	1,173,600		1,173,600	1.000000	1,173,600	587,906	(1,173,600)	60,023,209	(585,693)



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 Interest Rate: 0.97% 110% LT AFR 10/07

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Rent Accrual Period	Rent Allocation	Pre-Payment	Allocated Rent	Fraction* (B/A)	Proportional Rent	IRC § 467 Interest	IRC § 467 Rent	IRC § 467 Loan Balance	Net IRC § 467 Income (Loss)
50	1,173,600		1,173,600	1.000000	1,173,600	582,225	(1,173,600)	59,431,834	(591,375)
51	1,173,600		1,173,600	1.000000	1,173,600	576,489	(1,173,600)	58,834,723	(597,111)
52	1,173,600		1,173,600	1.000000	1,173,600	570,697	(1,173,600)	58,231,820	(602,903)
53	1,173,600		1,173,600	1.000000	1,173,600	564,849	(1,173,600)	57,623,069	(608,751)
54	1,173,600		1,173,600	1.000000	1,173,600	558,944	(1,173,600)	57,008,413	(614,656)
55	1,173,600		1,173,600	1.000000	1,173,600	552,982	(1,173,600)	56,387,794	(620,618)
56	1,173,600		1,173,600	1.000000	1,173,600	546,962	(1,173,600)	55,761,156	(626,638)
57	1,173,600		1,173,600	1.000000	1,173,600	540,883	(1,173,600)	55,128,440	(632,717)
58	1,173,600		1,173,600	1.000000	1,173,600	534,746	(1,173,600)	54,489,586	(638,854)
59	1,173,600		1,173,600	1.000000	1,173,600	528,549	(1,173,600)	53,844,535	(645,051)
60	1,173,600		1,173,600	1.000000	1,173,600	522,292	(1,173,600)	53,193,227	(651,308)
61	1,173,600		1,173,600	1.000000	1,173,600	515,974	(1,173,600)	52,535,601	(657,626)
62	1,173,600		1,173,600	1.000000	1,173,600	509,595	(1,173,600)	51,871,597	(664,004)
63	1,173,600		1,173,600	1.000000	1,173,600	503,154	(1,173,600)	51,201,152	(670,445)
64	1,173,600		1,173,600	1.000000	1,173,600	496,651	(1,173,600)	50,524,203	(676,949)
65	1,173,600		1,173,600	1.000000	1,173,600	490,085	(1,173,600)	49,840,688	(683,515)
66	1,173,600		1,173,600	1.000000	1,173,600	483,455	(1,173,600)	49,150,543	(690,145)
67	1,173,600		1,173,600	1.000000	1,173,600	476,760	(1,173,600)	48,453,703	(696,840)
68	1,173,600		1,173,600	1.000000	1,173,600	470,001	(1,173,600)	47,750,104	(703,599)
69	1,173,600		1,173,600	1.000000	1,173,600	463,176	(1,173,600)	47,039,680	(710,424)
70	1,173,600		1,173,600	1.000000	1,173,600	456,285	(1,173,600)	46,322,366	(717,315)
71	1,173,600		1,173,600	1.000000	1,173,600	449,327	(1,173,600)	45,598,093	(724,273)
72	1,173,600		1,173,600	1.000000	1,173,600	442,301	(1,173,600)	44,866,794	(731,298)
73	1,173,600		1,173,600	1.000000	1,173,600	435,208	(1,173,600)	44,128,402	(738,392)
74	1,173,600		1,173,600	1.000000	1,173,600	428,046	(1,173,600)	43,382,848	(745,554)
75	1,173,600		1,173,600	1.000000	1,173,600	420,814	(1,173,600)	42,630,062	(752,786)
76	1,173,600		1,173,600	1.000000	1,173,600	413,512	(1,173,600)	41,869,974	(760,088)
77	1,173,600		1,173,600	1.000000	1,173,600	406,139	(1,173,600)	41,102,513	(767,461)
78	1,173,600		1,173,600	1.000000	1,173,600	398,694	(1,173,600)	40,327,607	(774,905)
79	1,173,600		1,173,600	1.000000	1,173,600	391,178	(1,173,600)	39,545,185	(782,422)
80	1,173,600		1,173,600	1.000000	1,173,600	383,588	(1,173,600)	38,755,174	(790,012)
81	1,173,600		1,173,600	1.000000	1,173,600	375,925	(1,173,600)	37,957,499	(797,675)
82	1,173,600		1,173,600	1.000000	1,173,600	368,188	(1,173,600)	37,152,087	(805,412)
83	1,173,600		1,173,600	1.000000	1,173,600	360,375	(1,173,600)	36,338,862	(813,225)
84	1,173,600		1,173,600	1.000000	1,173,600	352,487	(1,173,600)	35,517,749	(821,113)
85	1,173,600		1,173,600	1.000000	1,173,600	344,522	(1,173,600)	34,688,672	(829,078)
86	1,173,600		1,173,600	1.000000	1,173,600	336,480	(1,173,600)	33,851,552	(837,120)
87	1,173,600		1,173,600	1.000000	1,173,600	328,360	(1,173,600)	33,006,312	(845,240)
88	1,173,600		1,173,600	1.000000	1,173,600	320,161	(1,173,600)	32,152,874	(853,439)
89	1,173,600		1,173,600	1.000000	1,173,600	311,883	(1,173,600)	31,291,157	(861,717)
90	1,173,600		1,173,600	1.000000	1,173,600	303,524	(1,173,600)	30,421,081	(870,076)
91	1,173,600		1,173,600	1.000000	1,173,600	295,084	(1,173,600)	29,542,566	(878,515)
92	1,173,600		1,173,600	1.000000	1,173,600	286,563	(1,173,600)	28,655,529	(887,037)
93	1,173,600		1,173,600	1.000000	1,173,600	277,959	(1,173,600)	27,759,888	(895,641)
94	1,173,600		1,173,600	1.000000	1,173,600	269,271	(1,173,600)	26,855,559	(904,329)
95	1,173,600		1,173,600	1.000000	1,173,600	260,499	(1,173,600)	25,942,458	(913,101)
96	1,173,600		1,173,600	1.000000	1,173,600	251,642	(1,173,600)	25,020,500	(921,958)
97	1,173,600		1,173,600	1.000000	1,173,600	242,699	(1,173,600)	24,089,599	(930,901)
98	1,173,600		1,173,600	1.000000	1,173,600	233,669	(1,173,600)	23,149,668	(939,931)
99	1,173,600		1,173,600	1.000000	1,173,600	224,552	(1,173,600)	22,200,620	(949,048)

**Appendix 1**

Lessor: SDG&E  
 Lessee: Citizens  
 Interest Rate: 0.97% 110% LT AFR 10/07

IRC §467 Loan and Imputed Interest Computation:

Rent Accrual Period	Rent Allocation	Pre-Payment	Allocated Rent	Fraction* (B/A)	Proportional Rent	IRC § 467 Interest	IRC § 467 Rent	IRC § 467 Loan Balance	Net IRC § 467 Income (Loss)
100	1,173,600		1,173,600	1.000000	1,173,600	215,346	(1,173,600)	21,242,366	(958,254)
101	1,173,600		1,173,600	1.000000	1,173,600	206,051	(1,173,600)	20,274,817	(967,549)
102	1,173,600		1,173,600	1.000000	1,173,600	196,666	(1,173,600)	19,297,883	(976,934)
103	1,173,600		1,173,600	1.000000	1,173,600	187,189	(1,173,600)	18,311,473	(986,410)
104	1,173,600		1,173,600	1.000000	1,173,600	177,621	(1,173,600)	17,315,494	(995,979)
105	1,173,600		1,173,600	1.000000	1,173,600	167,960	(1,173,600)	16,309,855	(1,005,640)
106	1,173,600		1,173,600	1.000000	1,173,600	158,206	(1,173,600)	15,294,461	(1,015,394)
107	1,173,600		1,173,600	1.000000	1,173,600	148,356	(1,173,600)	14,269,217	(1,025,244)
108	1,173,600		1,173,600	1.000000	1,173,600	138,411	(1,173,600)	13,234,029	(1,035,188)
109	1,173,600		1,173,600	1.000000	1,173,600	128,370	(1,173,600)	12,188,799	(1,045,230)
110	1,173,600		1,173,600	1.000000	1,173,600	118,231	(1,173,600)	11,133,430	(1,055,368)
111	1,173,600		1,173,600	1.000000	1,173,600	107,994	(1,173,600)	10,067,825	(1,065,606)
112	1,173,600		1,173,600	1.000000	1,173,600	97,658	(1,173,600)	8,991,863	(1,075,942)
113	1,173,600		1,173,600	1.000000	1,173,600	87,221	(1,173,600)	7,905,504	(1,086,379)
114	1,173,600		1,173,600	1.000000	1,173,600	76,683	(1,173,600)	6,808,588	(1,096,916)
115	1,173,600		1,173,600	1.000000	1,173,600	66,043	(1,173,600)	5,701,032	(1,107,557)
116	1,173,600		1,173,600	1.000000	1,173,600	55,300	(1,173,600)	4,582,732	(1,118,300)
117	1,173,600		1,173,600	1.000000	1,173,600	44,452	(1,173,600)	3,453,584	(1,129,147)
118	1,173,600		1,173,600	1.000000	1,173,600	33,500	(1,173,600)	2,313,484	(1,140,100)
119	1,173,600		1,173,600	1.000000	1,173,600	22,441	(1,173,600)	1,162,325	(1,151,159)
120	1,173,600		1,173,600	1.000000	1,173,600	11,275	(1,173,600)	(0)	(1,162,325)
<b>Totals</b>	<b>\$140,831,979</b>	<b>\$63,000,000</b>	<b>\$140,831,979</b>		<b>\$140,831,979</b>	<b>57,831,979</b>	<b>(\$140,831,979)</b>		<b>(\$63,000,000)</b>

Present Value      A      \$63,000,000      B      \$63,000,000      See Fraction Computation Above \*

Rent Allocation      \$1,173,600