

ARIZONA SUPREME COURT

SAN DIEGO GAS & ELECTRIC
COMPANY,

Plaintiff/Appellee,

v.

ARIZONA DEPARTMENT OF
REVENUE, et al.,

Defendants/Appellants.

No. CV-23-0283-PR

Court of Appeals
No. 1 CA-TX 21-0008

Arizona Tax Court
No. TX2019-001758

DEFENDANTS' RESPONSE TO CROSS-PETITION FOR REVIEW

Kristin K. Mayes
Attorney General
Firm State Bar No. 14000
Jerry A. Fries
State Bar No. 011788
Assistant Attorney General
2005 North Central Avenue
Phoenix, AZ 85004
Telephone: (602) 542-8385
(602) 542-8444
Tax@azag.gov

Attorneys for Defendants/Appellants

INTRODUCTION

This Court should deny San Diego Gas and Electric Company (“San Diego”)’s Cross-Petition for Review for two reasons. First, if Defendants’ Petition for Review (“Petition”) is granted and the Court reverses the court of appeals’ Opinion in *San Diego Gas & Electric Co. v. Arizona Department of Revenue*, 1 CA-TX 21-0008, [2023 WL 6978591](#) (App. Oct. 24, 2023) (“Opinion”) that COR (cost of removal) Reserve monies¹ are lawful depreciation of plant in service (“Plant” or “Arizona Plant”) costs, San Diego’s Cross-Petition will be rendered moot. That is because the Cross-Petition solely concerns what is to be done with the -\$2,628,789 in excess depreciation that the COR Reserve ruling created—excess depreciation that will vanish if Defendants’ Petition prevails.

Alternatively, if the Court does not grant Defendants’ Petition, or if it grants and affirms the Opinion’s COR Reserve holding, the Court should deny review because there is no interplay whatsoever between the statutory formulas for valuing various components of transmission company property in Arizona as San Diego alleges. Its claim that the excess negative depreciation of plant in service in the amount of -\$2,628,789 should be applied to the 2020 statutory construction work in progress (“CWIP”) value of \$3,648,000, resulting in a final total full cash

¹ Monies set aside in a separate reserve account to pay for the plant’s removal at the end of its economic life.

value for its “Arizona Property” (Arizona Plant and Arizona CWIP) of \$1,019,473, lacks any support in the statute or in common law.

The Court—irrespective of its disposition of the Defendants’ Petition—should therefore deny the Cross-Petition and thereby decline San Diego’s invitation to compound the court of appeals’ legal error.

ISSUE PRESENTED FOR REVIEW

Does [A.R.S. § 42-14154](#) mandate that the excess negative depreciation that results from the Opinion’s COR Reserve ruling be applied to the Arizona CWIP value of \$3,648,000 that the Department determined pursuant to A.R.S. § 42-14154(C)?

REASONS WHY THE COURT SHOULD DENY REVIEW

I. The Court Should Deny Review Because the Court Should Reverse the Entire Basis for the Cross-Petition—the Opinion’s Holding that Accumulated COR Reserve Monies Are Lawful Straight-Line Depreciation of Plant Costs.

The Opinion holds that COR Reserve monies are lawful depreciation of plant in service costs, resulting in a 2020 full cash value for Plant of -\$2,628,789—\$48,817,396 in plant cost less \$51,446,185 in accumulated depreciation. (Opinion ¶ 18.) The tax court applied that excess -\$2,628,789 in depreciation to the

statutory CWIP value of \$3,648,000,² resulting in a final 2020 full cash value of San Diego's Arizona Property (Plant and CWIP) of \$1,019,473. (IR 95, at 2.)

The Opinion upheld the tax court's determination that COR Reserve monies are lawful depreciation of plant cost, but then held that the excess -\$2,628,789 in accumulated depreciation *could not* be applied to the statutory CWIP value. (Opinion ¶ 23.) The Opinion thus results in a final 2020 Arizona Plant value of \$0 and a final 2020 Arizona CWIP value of \$3,648,000. San Diego's Cross-Petition seeks to have the tax court's \$1,019,473 value reinstated. (Cross-Petition, at 9.)

If the Court grants Defendants' Petition and reverses the Opinion's holding that COR Reserve monies are lawful depreciation of plant costs, San Diego's Cross-Petition will be moot because the negative Plant value will disappear. In the case of reversal, as a matter of law, the 2020 Arizona Plant value would be set at \$18,463,000, and the 2020 Arizona CWIP value would remain at \$3,648,000 as the Opinion sets forth.

II. This Court Should Deny Review of the Cross-Petition Even if It Does Not Grant Defendants the Relief that Their Petition Is Seeking Because There Is No Legal Basis for Applying the Excess Negative Plant Depreciation to the Statutory CWIP Value.

San Diego's primary argument is that the company's entire transmission property must be valued via "a cost approach, which is a 'summation' method."

² Pursuant to A.R.S. § 42-14154(C), fifty percent (rounded) of the reported CWIP amount of \$7,296,049 spent and entered on San Diego's books as of 12/31/18.

(Cross-Petition, at 2.) In other words, the -\$2,628,789 in excess depreciation that the Opinion’s COR Reserve ruling created is to be run through a valuation scheme to obtain one final value for all of San Diego’s property in Arizona. San Diego contends that this is true pursuant to both the statutory valuation formula for transmission property and case law. (*Id.* at 2-4, 5-9.) Neither argument is valid.

A. None of the Valuation Methods for Various Components of Transmission Property that Section 42-14154 Prescribes Are Related to Each Other.

The underlying “facts” that San Diego sets forth in the chart on page 3 (“Chart”) of its Cross-Petition are little more than subterfuge. San Diego attempts to make it appear that land rights³—that is, the costs and accumulated depreciation relating to them—are relevant in this matter, but land rights are specifically excluded from taxation under [A.R.S. § 42-14154\(G\)\(8\)](#). That subsection defines “plant” as “all property that is situated in this state and that is used or useful for the transmission or distribution of electric power or distribution of natural gas. *Plant does not include land rights, material and supplies and licensed vehicles.*” (Emphasis added.)

Notwithstanding this statutory exclusion of land rights from the definition of “plant,” San Diego included land rights and their value in the “Original Plant in

³ The land rights involved are largely easements over land on which San Diego’s transmission lines are located.

Service Cost” line on the Chart (\$53,035,587)⁴ (Cross-Petition, at 3), making it appear that plant in service cost exceeds the \$51,992,185 in “accumulated depreciation”—Life Depreciation and COR Reserves—reported to the Department. Later in the Chart, San Diego removes the cost of the land rights (less their accumulated depreciation) to reflect the fact that land rights are not valued for taxation purposes in Arizona. (*Id.*) In other words, San Diego admitted that land rights and their value are irrelevant to Arizona’s statutory valuation of transmission plant in service, which is defined as original cost less accumulated straight-line depreciation related to that cost. San Diego included the land rights simply to make it appear that its Arizona CWIP can be influenced by the claimed negative value of its Arizona Plant—that is, to make it appear that valuing its Arizona Plant and its Arizona CWIP is simply a “summation” exercise.

San Diego cites the record below to support its Chart, noting that “[a]ll these numbers came directly from SDG&E’s tax return, and *all were used by ADOR in its valuation of SDG&E’s property.*” (*Id.* at 3 n.7; emphasis added.) The italicized statement is untrue. The information that San Diego cited below to support its Chart came from a document that Mr. Asay, Director of Corporate Tax at San

⁴ \$48,817,396 in plant costs + \$4,218,191 in original land cost rights.

Diego's parent company, had prepared to support San Diego's Motion for Summary Judgment. (IR 8 [Ex. A, ¶ 10.]⁵)

Defendants detailed how the Department had valued San Diego's Arizona transmission property for the 2020 tax year to support their summary-judgment motion. (IR 57, at 13-17.) It began by reducing San Diego's claimed \$53,035,587 in plant cost by the company's reported \$4,218,191 in land costs because land costs and their accumulated depreciation are statutorily irrelevant to the statutory valuation of Plant. (IR 57 at 13, ¶¶ 12-15.)

San Diego's statement that its Chart represents the statutory valuation method for all of its Arizona property and that it was "used by the ADOR in its valuation of SDG&E's property"⁶ is untrue. The book value of San Diego's Arizona land rights has no relevance to valuing San Diego's Plant and CWIP, both of which are governed by clear, distinct statutory methods. The Chart that Mr. Asay prepared does not establish otherwise.

⁵ "I prepared the Exhibit A chart to illustrate the correct calculation of the statutory full cash value in accordance with the valuation method prescribed by A.R.S. §42-14154, based on the Tax Return filed by SDG&E with ADOR." (IR 8 [Ex. A, ¶ 10].)

⁶ (Cross-Petition, at 3 n.7.)

B. The Statutory Valuation of CWIP Is as Unrelated to the Valuation of Plant as Land Values Are to Plant.

The Chart’s purpose is to deceive by making it appear that the alleged -\$2,628,789 Plant value that includes COR Reserve monies as alleged accumulated depreciation of plant costs flows through and affects the statutory CWIP value—an argument that the Opinion rejected. (Opinion ¶ 23.) Defendants explained the true nature of San Diego’s claim in their Petition (at 5), specifically:

Arizona Plant Cost	\$48,817,396
(less) Accumulated Depreciation	<u>\$51,446,185</u> -\$ 2,628,789
(plus) CWIP Value	<u>\$ 3,648,024</u>
(equals) Arizona Property’s 2020 full cash value	<u>\$ 1,019,474</u>

The statutory CWIP value—the value to be placed on the Yuma County tax roll⁷—is “fifty percent of the amount spent and entered on the taxpayer’s accounting records as of December 31 of the preceding calendar year.” [A.R.S. § 42-14154\(C\)](#). San Diego reported \$7,296,049 in CWIP on its books under that statute, and the Department valued the company’s Arizona CWIP at \$3,648,000 (rounded down) for the 2020 tax year pursuant to it. (IR 57, at 13, ¶ 11.)

⁷ All of San Diego’s 2020 Arizona CWIP is located in Yuma County, and all is within the Yuma County School District’s borders.

Section 42-14154(C)—the sole statute that addresses valuing CWIP—contains no statutory reduction to CWIP for accumulated depreciation—whether its own or the alleged excess depreciation related to plant in service. San Diego’s argument that the \$3,648,000 statutory CWIP value in Yuma County should be lowered by excess COR Reserve monies set aside for the future removal of transmission lines in Maricopa County (or anywhere else) is ludicrous and has no support whatsoever under [A.R.S. § 42-14154\(C\)](#) or the entirety of that statute.⁸ Nothing in that statute remotely supports San Diego’s “summation” argument.

III. Arizona Case Law Does Not Support San Diego’s “Summation” Argument.

San Diego argues that the Opinion’s refusal to apply the excess plant depreciation to CWIP contravenes this Court’s ruling in *Transamerica Development Co. v. County of Maricopa*, [107 Ariz. 396](#) (1971), wherein the Court held that a taxpayer’s property must be valued as a unit. (Cross-Petition at 6-9.)

Transamerica did not involve statutory valuations of various property components but rather the valuation of a shopping center by a county assessor for the 1969 tax year using standard appraisal methods. The parties had litigated the previous year’s value and had arrived at a \$2,165,540 settlement. [107 Ariz. at 397](#).

⁸ Assuming that San Diego had no CWIP on its books for the 2020 tax year, under its “summation” theory, it would presumably be seeking to have a value of -\$2,628,789 placed (collectively) on the tax rolls in Maricopa and Yuma Counties for the company’s Arizona Plant.

When putting that settled value on the 1968 tax roll, the State attributed \$1,247,780 of that value to the land and \$917,760 to the improvements. *Id.*

When valuing the property for the subsequent 1969 tax year, the State kept the \$1,247,780 value for the land from the 1968 settlement on the tax roll, but increased the improvement value to \$1,258,385, resulting in a final 1969 full cash value of \$2,506,165 for the shopping center. *Id.* Transamerica appealed that value, but offered only appraisal testimony concerning the value of the improvements, stating that it was content with the State’s land value of \$1,247,780 rolled over from the 1968 tax year. *Id.*

This Court held that it was inappropriate to appeal and present evidence regarding only the value of the improvements. *Id.* at 399. Instead, in a case involving the valuation of improved real property using standard appraisal methods, the Court found that “when questioning the reasonableness of property valuation for assessment purposes, property valuation must be considered one subject, not to be broken into separate components of land and improvements.” *Id.*

This case involves the *statutory* valuations of two different components of electric transmission property, not the reasonableness of the assessor’s valuation of improved real property using standard appraisal methods. In [A.R.S. § 42-14154](#), the Legislature itself has broken out different components of electric transmission properties and has applied different valuation methods to each—including straight-

line depreciation for plant in service and 50% of book cost for CWIP. These methods have nothing to do with each other. *Transamerica's* holding regarding how improved real property is to be valued by county assessors using standard appraisal methods—land and improvements as a unit—has no relevance here.

IV. There Is No Separation of Powers Issue.

San Diego argues that the Opinion raises a separation of powers issue by holding that the Legislature intended to make COR Reserve monies lawful depreciation of plant costs, but then refusing to give effect to that holding (and to legislative intent) by applying the excess COR Reserve monies to San Diego's 2020 CWIP value under San Diego's "summation" valuation theory. (Cross-Petition, at 7-8.) The argument is without merit.

Over the course of several decades and in hundreds of cases, Arizona courts have decided challenges to the legality of many types of taxes and tax valuations, and this case is no different. The fact that the Opinion upholds Defendants' argument that the Legislature inarguably mandated a \$3,648,000 full cash value for the Arizona CWIP (50% of book cost) and that the alleged excess depreciation relating to plant cost cannot statutorily be applied to lower that statutory value is well within a court's purview.

It is the Opinion's unprecedented⁹ holding that accumulated COR Reserve monies represent accumulated straight-line depreciation of plant costs that has led to San Diego's claim below and in its Cross-Petition that the excess negative depreciation should be applied to lower its 2020 statutory CWIP value. Once this Court reverses that holding, San Diego's separation of powers argument and the entirety of its Cross-Petition will vanish like the morning mists off Coronado Island.

CONCLUSION

For the foregoing reasons, the Court should deny San Diego's Cross-Petition for Review.

Respectfully submitted this 29th day of December, 2023.

Kristin K. Mayes
Attorney General

/s/ Jerry A. Fries
Jerry A. Fries
Assistant Attorney General
Attorneys for Defendants/Appellants

⁹ Defendants have been unable to identify any instance in the country where a state legislature has legislated negative property values for taxation purposes, whether for real or for personal property.