Rocky Mountain Power
Docket No. 17-035-39
Witness: Nikki L. Kobliha

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF UTAH

ROCKY MOUNTAIN POWER

Rebuttal Testimony of Nikki L. Kobliha

October 2017

1 **Q. Please state your name, business address, and present position with PacifiCorp.**

2 A. My name is Nikki L. Kobliha and my business address is 825 NE Multnomah Street,
3 Suite 2000, Portland, Oregon 97232. My present position is Vice President, Chief
4 Financial Officer and Treasurer for PacifiCorp. I am testifying on behalf of Rocky
5 Mountain Power ("Company"), a division of PacifiCorp.

6 **QUALIFICATIONS**

7 **Q. Briefly describe your educational and professional background.**

8 A. I received a Bachelor of Business Administration with a concentration in Accounting
9 from the University of Portland in 1994. I became a certified public accountant in 1996.
10 I joined the Company in 1997 and have taken on roles of increasing responsibility
11 before being appointed Chief Financial Officer in 2015.

12 **Q. What are your responsibilities as Vice President, Chief Financial Officer and**
13 **Treasurer?**

14 A. I am responsible for all aspects of the Company's finance, accounting, income tax,
15 internal audit, Securities and Exchange Commission reporting, treasury, credit risk
16 management, pension, and other investment management activities.

17 **PURPOSE AND SUMMARY OF REBUTTAL TESTIMONY**

18 **Q. What is the purpose of your rebuttal testimony in this proceeding?**

19 A. In support of the Company's request that the Public Service Commission of Utah
20 ("Commission") approve its energy resource decision for wind repowering, my
21 testimony responds to the tax issues raised in the direct testimonies of Division of
22 Public Utilities ("DPU") witness Mr. Daniel Peaco, Office of Consumer Services
23 ("OCS") witnesses Mr. Gavin Mangelson, Mr. Philip Hayet, and Ms. Donna Ramas,

24 and Utah Association of Energy Users ("UAE") witness Mr. Kevin C. Higgins.

25 I provide a brief summary of the requirements that the Company must satisfy for
26 the repowered wind facilities to qualify for 100 percent of the federal production tax
27 credits ("PTCs"). I respond to specific issues raised by DPU, OCS, and UAE, and I
28 demonstrate that the Company has carefully managed the PTC-related risks associated
29 with the wind repowering project to ensure that the facilities qualify for 100 percent of
30 the PTC value. Specifically, I address the following:

31 • How the Company's safe-harbor wind-turbine components purchased in 2016
32 are sufficient to qualify the wind repowering project for 100 percent of the value
33 of available PTCs under the five-percent safe-harbor test;
34 • How the Company will meet the continuous construction requirement; and
35 • How the Company will meet the 80/20 test for repowered wind facilities.

36 In addition, I describe the Company's current high-level view of the likelihood of tax
37 reform, which provides the basis for Company witness Mr. Rick T. Link's tax-related
38 sensitivity analysis. This analysis shows that the wind repowering project still provides
39 a significant benefit to customers even with a major reduction in the corporate tax rate.

40 **Q. Please summarize your testimony.**

41 A. The customer benefits of the wind repowering project are demonstrated in the
42 economic analysis presented by Mr. Link. Because the project economics rely heavily
43 on tax benefits, the Company's due diligence involves thorough consideration of all the
44 tax-related risks associated with repowering.

45 The Company took a number of steps to ensure that the safe-harbor equipment
46 purchased in 2016 was sufficient to qualify the repowered facilities for 100 percent of

47 the PTC benefits. The Company can further mitigate any risks associated with the safe-
48 harbor purchases by transferring safe-harbor equipment among facilities and affiliates
49 to ensure that the customer benefits are maximized.

50 To minimize risks associated with the 80/20 test, which requires that the new
51 equipment installed represent at least 80 percent of the overall facility costs, the
52 Company has reasonably engaged a third-party expert firm to value the retained
53 equipment. Based on that valuation, and the fact that the value of the new equipment
54 will be known, the Company has largely mitigated the risk that the new projects will
55 not meet the 80/20 rule.

56 Finally, at this point, a change in the federal corporate income tax rate is highly
57 uncertain and, under the most likely compromise outcome, the change is unlikely to
58 eliminate the customer benefits. Moreover, any tax rate change will likely be known by
59 early 2018, before the Company moves forward with the wind repowering project.
60 Thus, the Company will evaluate changes in tax law as part of its overall reassessment
61 of the project economics before committing to repowering.

62 **BACKGROUND**

63 **Q. Please describe how a PTC is generated.**

64 A. The Internal Revenue Code ("IRC") provides that a wind facility will generate a PTC
65 equal to an inflation-adjusted 1.5 cents per kilowatt hour of electricity that is produced
66 and sold to a third-party for a period of 10 years commencing with the date the facility
67 is placed in service for income tax purposes. The current inflation-adjusted PTC rate
68 for electricity generated in 2017 is 2.4 cents per kilowatt hour.

69 **Q. Under current income tax law, the PTC is being phased out. Please explain the**
70 **phase-out process.**
71 A. The Protecting Americans from Tax Hikes Act of 2015 ("PATH Act") was signed into
72 law on December 18, 2015, and retroactively extended and phased out the PTC for
73 wind facilities that began construction before January 1, 2020. For a wind facility that
74 began construction before January 1, 2017, the credit generated by the wind facility is
75 a full 100 percent of the PTC. For a wind facility that begins construction in 2017, the
76 credit is reduced by 20 percent (*i.e.*, the facility receives 80 percent of the full PTC).
77 For a wind facility that begins construction in 2018, the credit is reduced by 40 percent
78 (*i.e.*, the facility receives 60 percent of the full PTC). For a wind facility that begins
79 construction in 2019, the credit is reduced by 60 percent (*i.e.*, the facility receives 40
80 percent of the full PTC). For a wind facility that begins construction after December
81 31, 2019, there is no PTC available.
82 **Q. When does "construction" begin for a wind facility?**
83 A. Internal Revenue Service ("IRS") Notice 2013-29 provides a taxpayer with two
84 methods to establish that construction of a wind facility has begun. First, the taxpayer
85 can begin physical work of a significant nature. Physical work can include both on-site
86 and off-site work, either performed by the taxpayer or by another person subject to a
87 binding contract.
88 Second, a taxpayer can pay or incur five percent or more of the eventual total
89 cost of the qualified wind facility. This is known as the five-percent safe harbor. The
90 Company is using this five-percent safe-harbor method to qualify for 100 percent of
91 the PTC. The Company purchased and took delivery and title to sufficient wind turbine

92 components in December 2016 to meet the five-percent safe harbor and to show that
93 physical construction of the wind facilities that will be repowered began before
94 January 1, 2017, and thus qualify the repowered facilities for 100 percent of the PTC.
95 In addition to the requirement that the wind facility begin construction before
96 January 1, 2017, to qualify for 100 percent of the PTC, the wind facility must also
97 satisfy the continuity-of-construction requirement.
98 **Q. Please explain the continuity-of-construction requirement.**
99 A. The wind facility must be under continuous construction from the time physical
100 construction begins until the wind facility is placed in service. Whether a taxpayer
101 satisfies the continuity-of-construction requirement is determined based on the relevant
102 facts and circumstances surrounding the timing of the physical work to be performed
103 on the wind facility. The IRS has issued limited guidance on what facts and
104 circumstances might be considered to meet this requirement. For example, the IRS has
105 provided a list of non-exclusive "excusable" disruptions and delays deemed to be
106 beyond the control of the taxpayer and therefore acceptable reasons that would support
107 the taxpayer's contention that it has maintained a continuous program of construction.
108 These acceptable delays include weather-caused delays, permit delays outside of the
109 control of the taxpayer, and supply shortages, among others.
110 The IRS has, however, also created a continuity-of-construction safe harbor (the
111 "calendar safe harbor"). If a taxpayer places a facility in service by the end of a calendar
112 year that is not more than four calendar years after the calendar year during which
113 construction of the wind facility began, the facility will satisfy the continuous-
114 construction requirement by virtue of the calendar safe harbor. Accordingly, if

115 construction of a wind facility began in December 2016, as long as the facility is placed
116 in service by December 31, 2020, the facility will meet the continuity-of-construction
117 requirement.

118 The Company will have all repowered wind facilities placed in service by
119 December 31, 2020, and therefore will qualify for the 100 percent PTC under the four-
120 year calendar safe harbor.

121 **Q. Are there other requirements that must be met for the repowered wind facilities**
122 **to qualify for PTCs?**

123 A. Yes. The repowered wind facilities must meet the IRS 80/20 test to qualify for PTCs.

124 **Q. What is the IRS "80/20" test?**

125 A. A repowered wind facility may qualify as a new asset and originally placed in service
126 for purposes of starting a new 10-year PTC-production period even if it contains some
127 used property, provided the fair market value of the used property is no more than 20
128 percent of the facility's total value (the cost of the new property plus the value of the
129 used property).

130 **PTC RISK CONSIDERATIONS**

131 **Q. DPU witness Mr. Peaco raises the concern that for some of the Company's**
132 **facilities being repowered, the Company may have purchased insufficient**
133 **equipment to qualify under the five-percent safe harbor if there are cost overruns.**
134 **(Peaco Direct, lines 653 - 667.) Do you believe that this is a material risk?**

135 A. No. As described in the rebuttal testimony of Company witness Mr. Timothy J.
136 Hemstreet, the Company's due diligence included extensive analysis to ensure that the
137 Company will meet the five-percent safe-harbor test at each facility.

138 In addition, IRS rules allow the Company to purchase and transfer 2016 safe-
139 harbor equipment from one of its Berkshire Hathaway Energy affiliates—
140 MidAmerican Energy Company or Berkshire Hathaway Energy Renewables. Transfer
141 of PTC safe-harbor equipment among the affiliates within a consolidated taxpayer is
142 allowed, and the transferred equipment retains the ability to be used as safe-harbor
143 equipment for PTC qualification.

144 Finally, the five-percent safe-harbor test is not an all-or-nothing test. Qualifying
145 five-percent safe-harbor wind-turbine components ("PTC Components") can be used
146 to meet the five-percent safe-harbor test for individual turbines until they are exhausted
147 when the total project costs of those individual repowered turbines exceeds 20 times
148 the safe-harbor amount. For example, if, as a result of cost overruns, the Company only
149 has enough PTC Components available to qualify 65 out of 66 turbines at a repowered
150 wind facility, instead of all 66, the Company would allocate the PTC Components as
151 necessary to cover the costs of 65 of the turbines and would use newly acquired
152 equipment to repower the remaining turbine. The Company would then have 65
153 repowered turbines that qualify for 100 percent PTC and only one that does not.

154 **Q. Mr. Peaco also cites permitting and financing risks that could delay these project**
155 **and threaten their ability to qualify for PTCs. (Peaco Direct, lines 692 - 695.) Are**
156 **these risks material?**

157 A. No. As discussed in Mr. Hemstreet's rebuttal testimony, there is no material risk due to
158 any permitting delay because most of the facilities to be repowered are already
159 approved and the others are expected to have no issues.

160 Regarding financing risks, the Company credit rating is more than sufficient to
161 provide financing at commercially reasonable terms, and neither General Electric
162 International, Inc. (“GE”) nor Vestas-American Wind Technology, Inc. (“Vestas”) have
163 raised any issues about the Company’s ability to financially perform under the
164 contracts.

165 **Q. Turning to the 80/20 test, Mr. Peaco argues that the Company has not performed**
166 **any analysis of the risks of not meeting this requirement. (Peaco Direct, lines 738**
167 **- 741.) Is this a fair criticism?**

168 A. No. Mr. Peaco identifies two types of risk related to qualifying under the 80/20 test: the
169 risk that “the Company’s interpretation of the fair market value of the retained
170 components is not accepted by the IRS;” and the risk that “if the costs of the repowering
171 are less than expected, the new equipment might not comprise 80% of the value of the
172 facility.” (Peaco Direct, lines 732 - 735.)

173 To address the first risk, the Company engaged Ernst and Young LLP to provide
174 an independent determination of the fair market value (“FMV”) of the retained
175 components (*e.g.*, the tower and foundation of the wind turbine generator (“WTG”)) at
176 each wind facility that will remain in place and be reused in connection with the
177 repowering initiative. Ernst and Young LLP is a qualified independent appraiser who
178 will apply Uniform Standards of Professional Appraisal Practice (“USPAP”) in
179 measuring the FMV of the retained components. Ernst and Young LLP has indicated
180 that rate base amount (*i.e.*, the net book value of the retained components reduced by
181 the accumulated deferred income taxes) can be a key determinant of the FMV for
182 property owned by a regulated enterprise, a conclusion with which the Company

183 agrees, based on the experiences of its affiliates in dealing with the IRS on other
184 valuations of public utility property.

185 Ernst and Young LLP has provided preliminary values, which will be finalized
186 in the final valuation reports that will be issued contemporaneously with the in-service
187 date of the repowered equipment.

188 Regarding the second risk, Mr. Hemstreet demonstrates in his rebuttal
189 testimony that there is no risk regarding the value of the new components that are to be
190 provided under the repowering contracts because the Company is using actual costs–
191 which are largely subject to fixed price contracts–to measure the 80-percent value. Mr.
192 Hemstreet also addresses how the Company has assessed the risk that the final costs
193 are less than expected.

194 **Q. Does any other DPU witness address the Company's ability to meet the 80/20 test?**

195 A. Yes. DPU witness Mr. David Thomson also addresses this issue and concludes, in
196 contrast to Mr. Peaco, that the "Company will generally be able to meet the provisions
197 of the IRS 80/20 rule." (Thomson Direct, lines 88 - 89.)

198 **CONSIDERATIONS RELATED TO FEDERAL CORPORATE INCOME TAX**
199 **REFORM**

200 **Q. Mr. Peaco, along with OCS witnesses Mr. Mangelson, Mr. Hayet, and Ms. Ramas,**
201 **and UAE witness Mr. Higgins, argue that the economic value of the wind**
202 **repowering project may be adversely impacted if the federal corporate income tax**
203 **rate decreases. How do you respond to this concern?**

204 A. There is currently a great deal of discussion about the possibility of federal tax reform,
205 but very little certainty over whether Congress will act. Various frameworks are
206 circulating, including President Trump's brief outline for tax reform, the GOP Tax

207 Reform 2016 blueprint, and a tax reform framework developed by administration and
208 Congressional leaders. To be clear, Congress is not currently considering specific
209 legislative proposals because no bills have been introduced, only broad concepts, and
210 it appears that Republicans in Congress are not united in their view of the essential
211 components of tax reform.

212 In addition, there are deep divisions between Republicans and Democrats in
213 Congress regarding the goals of tax reform. Republicans will likely need to use budget
214 reconciliation to pass any tax reform bill in the Senate, which requires only a simple
215 majority of votes when associated with temporary budget measures rather than the 60
216 votes required for permanent tax law changes. Normally, 60 Senators are required to
217 end debate in the Senate. This generally means that 60 votes are required to pass
218 legislation in the Senate versus a bare majority of 51 votes (50 in case of a tie with the
219 Vice President casting the deciding vote). However, under the Senate Rules, the
220 reconciliation process can be used to pass budgetary legislation, like tax reform, with a
221 bare majority of the Senate. An important caveat is that the budget-reconciliation
222 process cannot be used if the legislation creates an increase in the deficit after 10 years.
223 Preliminary analysis of the various proposals indicates that the framework proposals
224 are likely to increase the deficit unless high economic growth rates are achieved. This
225 may make it impossible to use the reconciliation process to enact tax reform, creating
226 further uncertainty as to the potential for tax reform to be enacted. In addition,
227 controversy exists between and within the two political parties about how items such
228 as the deduction for state and local taxes should be addressed.

229 Based on the deep political divisions between the two parties on the goals of
230 tax reform and the large economic impact surrounding all the major areas of tax reform,
231 the Company believes that at this time it is pure speculation to try to determine the
232 ultimate outcome of tax reform in 2017. Therefore, for purposes of modeling a tax
233 sensitivity for repowering, the Company assumed a congressional compromise on the
234 corporate income tax rate, reducing the rate to 25 percent versus the current 35 percent
235 corporate income tax rate.

236 **Q. Messrs. Peaco and Hayet perform economic analysis of the repowering project**
237 **assuming a 15 percent federal corporate income tax rate. (Peaco Direct, lines 761**
238 **- 771; Hayet Direct, lines 365 - 379.) Is a 15 percent tax rate a reasonable**
239 **assumption?**

240 A. No. Based on the current political dynamics, the Company does not believe that the
241 federal corporate income tax rate will be reduced to 15 percent, which is more than a
242 50 percent reduction from the current tax rate.

243 **Q. Under the most likely schedule for tax reform legislation, will the Company have**
244 **time to assess tax changes before irrevocably committing to the wind repowering**
245 **project?**

246 A. Yes. The Company believes that the window for Congress to enact tax reform
247 legislation is likely to close by early 2018 given the run-up to the mid-term
248 Congressional elections. Thus, in early 2018, the Company will likely know the
249 outcome of potential legislative changes that might impact corporate tax rates and
250 impact the customer value of the repowering project. Because the Company does not
251 expect to execute a turbine supply contract with Vestas until early 2018 nor issue a

252 retrofit work order under the GE contract until after that time, the Company will not be
253 committed to the repowering project before knowing the outcome of the ongoing
254 discussions on tax reform.

255 As discussed further in Mr. Hemstreet's testimony, the Company negotiated terms
256 in the GE master retrofit agreement that provide an off-ramp in the contract before
257 issuance of a retrofit work order if tax law changes diminish the value of the projects.
258 Thus, the Company does not expect to make irrevocable contractual commitments to
259 the wind repowering project until the likely outcome of legislative tax reform proposals
260 are known.

261 **Q. Does the Company believe that tax reform will impact the phase-out of the PTCs?**

262 A. No. Even if tax reform is passed, the Company does not believe it will impact the
263 existing phase-out of the PTC previously enacted by the PATH Act.

264 **Q. Has the Company accounted for the possibility of a lower 25 percent federal**
265 **income tax rate in its updated economic assessment of the wind repowering**
266 **project?**

267 A. Yes. As discussed by Mr. Link in his rebuttal testimony, the Company has evaluated
268 the wind repowering project under a scenario that reflects a potential adjustment to the
269 corporate tax rates and found that the project still provides customer benefits.

270 **Q. Does this conclude your rebuttal testimony?**

271 A. Yes.