Q. Please state your name, business address and present position with Rocky Mountain Power (the Company).

A. My name is Jonathan D. Hale. My business address is PacifiCorp, 825 NE Multnomah, Suite 1900, Portland, Oregon 97232. My current position is Senior Tax Director.

Qualifications

Q. Mr. Hale, please briefly describe your education and business background.

A. I received a Masters in Tax from Brigham Young University in 1995. I am a certified public accountant in Oregon and Washington. I was employed at Deloitte Tax LLP for 10 years. I joined PacifiCorp in 2005 as Tax Director. In June 2006 I was promoted to Senior Tax Director.

Q. Please describe your present duties.

A. I am responsible for all aspects of the Company's income tax function including: compliance, accounting, financial and management reporting, issues resolution, planning, and tax related regulatory filings.

Purpose of Testimony

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

A. I respond to the testimony of Mr. Kevin Higgins, testifying on behalf of the UAE Intervention Group and Wal-Mart Stores, Inc. Mr. Higgins proposes an increase in the projected Domestic Production Activity Deduction included in this case. I also respond to the testimony of Ms. Donna DeRonne on behalf of the Committee of Consumer Services (CCS) regarding potential increases in Bonus Depreciation under the Economic Stimulus Package of 2008. Finally, I respond to the testimony of Mr. Brill of the Division of Public Utilities (DPU) and Ms. Cheryl Murray of CCS on the Company's proposed change to normalization.

Q. Please summarize your testimony.

A. I explain that the Domestic Production Activity Deduction should reflect an amount that corresponds with the final determined revenue requirement in this case. I also explain, however, that the calculation of the Domestic Production Activity Deduction has become a moot issue in this case because the Company is not able to recognize this deduction with Bonus Depreciation available to it in 2008.

My testimony sponsors the adjustment for Bonus Depreciation for this case. I outline the net revenue requirement impact of removing the Domestic Production Activity Deduction and adding Bonus Depreciation.

Finally, I provide support for the Company's proposed change from 40 percent normalization of book basis differences to 100 percent normalization of book basis differences related to property depreciation. This change lowers revenue requirement in this case by approximately $13 million. The Company proposes to change normalization in this manner only if the Commission accepts the change in the 40 percent to 100 percent normalization on an ongoing basis, not just for this case. If the Commission wants further review of this issue, it should reject the proposal and increase revenue requirement by $13 million to reflect continued adherence to 40 percent normalization.

Income Tax Domestic Production Activities Deduction

Q. Please provide background on the Domestic Production Activity Deduction.

A. The Domestic Production Activity Deduction was enacted in October 2004 through the American Jobs Creation Act of 2004. The deduction is permanent (*i.e.*, there is no corresponding book deduction in the current or future year). It is based on a percentage of the Net Production Taxable Income. For 2008 and 2009 that percentage is 6 percent. The definition of the net production taxable income has not yet been defined in the law or regulations for a fully integrated electric utility. The Company's method of calculation has evolved since the law was first introduced, based on the electric utility industry's understanding of the methodology anticipated to be preferred by the Internal Revenue Service (IRS).

Q. What considerations informed the development of the Domestic Production Activity Deduction for this case?

A. This deduction is tied to the amount of Net Production Taxable Income in the case, not to the retail Company pre-tax income. This means that any adjustment to revenue requirement should correlate the Net Production Taxable Income to the Domestic Production Activity Deduction. The Company based the Domestic Production Activity Deduction on the relationship between: (i) the last filed federal tax return Total Company Net Taxable Income; and (ii) the Production Activity Income used in the calculation of the Domestic Production Activity Deduction for that tax return.

Q. How is the Domestic Production Activity Deduction calculated in this rate case?

A. The Domestic Production Activity Deduction is built on the ratio of the Production Activity Income in the last filed federal tax return to the Total Company Net Taxable Income from the last filed federal tax return. Since the majority of the additions placed in service are production related, the Tax Bonus Depreciation will alter this ratio. The calculation of the ratio above is adjusted to remove the tax depreciation entirely from the numerator and the denominator so that the actual amount of production related tax depreciation including Tax Bonus Depreciation is included in calculating the Domestic Production Activity Deduction. This more appropriately reflects the level of Production Taxable Income.

Q. Does Mr. Higgins apply a different calculation to determine the Domestic Production Activity Deduction?

A. No. Mr. Higgins advocates for a deduction of $12 million based upon the Company's estimated deduction for the twelve months ending June 2008. This estimate was based on the same calculation but used a different Total Company Net Taxable Income. The Domestic Production Activity Deduction must be based on Net Production Taxable Income set by the Commission in this case using a calendar year 2008 test period. It should not be based on the estimated income for a different period with no relationship to what the Company will be able to recognize on its federal tax return.

Q. Has Mr. Higgins correctly stated the Company's projected pre-tax income as a number in excess of $825 million before a rate increase?

A. No. Mr. Higgins' calculation of $825 million refers to pre-tax book income before taking into account Schedule M differences of $398 million, interest expense deductions for tax of approximately $289 million and Tax Bonus depreciation. These adjustments reduce pre-tax income for calculating the Domestic Production Activity Deduction to approximately $137 million, the amount used to calculate the deduction included in the Company's original filing.

Q. Has the Total Company Net Taxable Income for this case decreased?

A. Yes. As updated in the Company's rebuttal filing, the appropriate level of Total Company Net Taxable Income for this case before the final Commission's order in this case is now the $86.6 million as shown in Exhibit RMP___(SRM-1R-RR) p. 2.20, Line 1287. Once the final number, as determined by this Commission, is known, the Domestic Production Activity Deduction will need to be calculated again based on the final ordered number.

Q. Has the proper level of the Domestic Production Activity Deduction become moot in this case?

A. Yes. Given the revised level of Total Company Net Taxable Income after the addition of the Tax Bonus Depreciation, the $3 million Domestic Production Activity Deduction in the case is reduced to zero. As set forth in Internal Revenue Code §199(a)(1), the deduction is limited to "the lesser of - (A) the qualified production activities income of the taxpayer for the taxable year, or (B) taxable income (determined without regard to this section) for the taxable year."

With a Total Company Net Taxable Income of zero or less, there can be no Domestic Production Activity Deduction.

Bonus Depreciation

Q. Ms. DeRonne testifies for CCS that the Company should have updated the filed case for the newly enacted Economic Stimulus Act of 2008 to include Bonus Depreciation. What is the Company's position on Ms. DeRonne's recommendation?

A. To ensure that rates in this case reflect the most accurate information available on the Company's costs, the Company accepts CCS's recommendation. The Company could not reasonably have included this information earlier in the case because the Economic Stimulus Act of 2008 was not enacted until February 13, 2008.

Q. How have you determined the Bonus Depreciation for this case?

A. Since the enactment of the Economic Stimulus Act of 2008 in mid-February, the Company has been actively researching the estimated in-service dates of qualified additions for 2008 and 2009 to determine the best means for capturing the maximum benefit from this Act. This is a collaborative effort on the part of many departments to ensure that the decisions for putting property in service to take full advantage of this benefit are complete and accurate. There are several criteria that have to be met such as:

1. the property's original use must be with the Company;
2. the property must be placed in service after December 31, 2007 and before January 1, 2009, but only if no binding written contract with respect to the

acquisition or construction of the property is in effect before January 1, 2008;

3. the property must qualify for MACRS (the Internal Revenue Code and related regulations prescribe the standard tax depreciation system known as Modified Accelerated Costs Recovery System, or MACRS) with a recovery period of 20 years or less;
4. there is a limited extension period for property placed in service after January 1, 2009, which must have a tax depreciable life of 10 years or longer, a construction period exceeding one year, cost exceeding $1 million, and in service date prior to January 1, 2010, and finally only costs incurred prior to January 1, 2009 are eligible to the extent criteria 1 through 3 are also met in full.

Q. What is your estimate for Bonus Depreciation?

A. Based on the Additions in the December 2008 rate base in the case, an estimated $220 million tax basis in plant qualifies for Bonus Depreciation. The estimated Bonus Depreciation deduction on which deferred tax expense would have to be normalized was calculated as $110 million. Updating the case for the actual in-service additions through February 2008, with the addition of Bonus Depreciation, the estimated net change to Tax Depreciation is an increase of $75.6 million. The corresponding net change to the deferred tax expense is an increase of $29.9 million.

Q. How does this impact the Domestic Production Activity Deduction?

A. As noted above, the Domestic Production Activity Deduction is reduced to zero since the Bonus Depreciation, which factored into other taxable income computations, creates a loss for federal taxable income purposes in this case. Utah's net change to Total Income Tax Expense for removing the Production Activity Deduction but adding in the deduction for Tax Bonus Depreciation is a revenue requirement increase of $964,000.

Full Normalization of Deferred Income Taxes

Q. Please explain full normalization.

A. Full normalization is the concept of providing deferred tax expense to completely offset all book and tax timing differences occurring in current tax expense. The term "normalization" evolved with respect to utilities because income taxes computed on the normalization basis caused reported net income to appear "normal", as if the utility had not adopted a tax return method of calculating its tax expense. Full normalization is more properly cost-based for ratemaking purposes than flow-through, because it more equitably allocates tax costs over time to generations of consumers the tax benefits and costs of utility property investments.

Q. What is flow-through?

A. Flow-through is the term used for passing through in the current period the impacts of book and tax timing differences to income, with no offset of deferred tax expense.

Q. How are deferred tax expenses developed on depreciation related differences?

A. Accelerated tax depreciation is a reduction to current tax expense. The book depreciation is an addition for tax purposes to mathematically reverse its effects from book income. The net impact of both of these adjustments (add book depreciation and subtract tax depreciation) is, in the early years of a property's useful life, a reduction to current tax expense. Therefore the deferred tax expense needs to be an increase in deferred tax expense to offset (normalize) the current tax expense reduction. So, to calculate the deferred tax expense, the book depreciation is subtracted from the tax depreciation, in a full normalization scenario, creating a net debit to the deferred expense account. In later years of a property's useful life, tax depreciation goes to zero, while book depreciation continues. During this later period, the deferred income tax previously accumulated will reverse as credits to income tax expense with corresponding reductions of accumulated deferred income taxes.

Q. Is the Utah jurisdiction a full normalization jurisdiction?

A. No. The only portion of timing differences that do not have 100 percent deferred tax expense provided are the book basis differences related to depreciable property. The book basis differences only have 40 percent of deferred taxes provided.

Q. Please explain what 40 percent of deferred taxes provided means.

A. First, it needs to be emphasized that the book basis differences are the only differences to which the 40 percent is presently applied by the Commission. All other book-tax method and life depreciation differences related to property are 100 percent normalized, as required by IRS regulations. As an example, AFUDC is a book basis difference and is only 40 percent normalized. What this means is that for a book in-service addition of $10 million, the AFUDC is assumed to be 8 percent of that in-service addition, or $800,000. Assume that the total in service book addition is then $10.8 million. Assume this asset is a steam plant with a book life of 40 years depreciated for book purposes on a straight-line basis. The book depreciation of each year would be $270,000. The AFUDC portion of the $270,000 book depreciation is $20,000 (*i.e.*, $800,000 divided by 40 years). The $20,000 is the first year of book depreciation on the AFUDC basis difference of $800,000. The first year of book depreciation of $20,000 is subtracted from the AFUDC basis difference of $800,000 to yield a $780,000 book-tax difference on a balance sheet basis. The 40 percent normalization level is applied to the $780,000 difference for the year in service of this asset. The book basis negative deferred tax expense would be $780,000 times the tax rate of 37.951 percent, or approximately $296,000. Applying the 40 percent normalization to that result equals $118,000 for the negative deferred tax expense related to the book basis difference. On the other hand, if the book basis difference in this example were 100 percent normalized as opposed to 40 percent, the negative deferred tax expense on the book basis difference would be the $296,000. That is a reduction in net deferred tax expense of approximately $178,000, or the difference between the book basis deferred at 100 percent versus 40 percent ($296,000 vs. $118,000). This illustrates that to move to 100 percent normalization is a net benefit to the customers in this case.

Q. What happens to the benefits going forward?

A. While the benefit realized in the first year drops off, on a cumulative basis, customers continue to see a benefit. Additionally, as new investments are brought into rate base, the normalization process begins for those new assets, with customers again realizing benefits in the first year.

Q. Are there any other points that need to be raised?

A. Yes, matching of costs and tax benefits is better achieved, as full normalization provides deferred tax expense for every timing related current tax expense, so that no timing difference flows through to total tax expense. With full normalization the tax expense is matched to the book expense, unlike the lack of matching under a flow-through method. The tax expense under flow-through in the example above would reflect an additional current tax expense related to the $4,554 with no deferred tax offset. Full normalization also normalizes tax costs throughout the useful life of the underlying asset, so that no disparity in tax cost exists among generations of rate payers served by the underlying asset.

Q. Please summarize how customers benefit from the proposed change in normalization percentages.

A. The proposed change produces a $13 million revenue requirement reduction in this case. Longer-term, the proposed change will help smooth the first year revenue requirement impact associated with bringing new resources into rate base. As Mr. Walje testifies, the Company is in the midst of an unprecedented capital investment program. The proposed change will mitigate potential rate spikes associated with the Company's increasing rate base.

Q. What are the options available to the Commission in deciding this issue?

A. The Commission has the following two options:

- The Commission could move to full normalization and the current case would be correct as it stands.

- The Commission could reject the move to full normalization and increase the revenue requirement by $13 million. This decision would leave the basis differences at a 40 percent level.

Q. What does the Company recommend?

A. The Company believes that the Commission should adopt the first option, accept the adjustment as proposed and move to full normalization in the current case. No additional adjustments would be needed to the case as it stands currently. Alternatively, if the Commission is uncomfortable with this approach because parties want time to review the adjustment, then the Commission can reject the adjustment, increase the case by $13 million and take up the issue at another time.

Q. It appears that parties to the case want the benefit of the $13 million revenue requirement reduction but they are not willing to accept change to full normalization which produces this reduction. Can they accept one without the other?

A. No. The Commission cannot in good faith accept the $13 million benefit in this case, but then decide in the next case that the underlying tax treatment should be reversed and continue on at 40 percent normalization. This kind of result-oriented switching in approaches would violate fundamental ratemaking principles of matching, consistency and fairness. Additionally, from a practical perspective, case-specific changes in normalization could produce significant tracking and auditing challenges, since the Company's regulatory tax models assume general consistency in normalization conventions.

Q. Does this conclude your testimony?

A. Yes.