

NOTICE OF CONFIDENTIALITY
A PORTION OF THIS TESTIMONY AND ATTACHMENT
HAS BEEN FILED UNDER SEAL

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

* * * * *

IN THE MATTER OF ADVICE NO. 961-)
GAS OF PUBLIC SERVICE COMPANY)
OF COLORADO TO REVISE ITS)
COLORADO PUC NO. 6-GAS TARIFF TO) PROCEEDING NO. 20AL-____G
INCREASE JURISDICTIONAL BASE)
RATE REVENUES, IMPLEMENT NEW)
BASE RATES FOR ALL GAS RATE)
SCHEDULES, AND MAKE OTHER)
PROPOSED TARIFF CHANGES)
EFFECTIVE MARCH 7, 2020)

DIRECT TESTIMONY AND ATTACHMENT OF NAOMI KOCH

ON

BEHALF OF

PUBLIC SERVICE COMPANY OF COLORADO

NOTICE OF CONFIDENTIALITY
A PORTION OF THIS TESTIMONY AND ATTACHMENT
HAS BEEN FILED UNDER SEAL

Confidential: Confidential Attachment NK-1
Redactions on Pages 39, 44, and 51

February 5, 2020

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LIST OF ATTACHMENTS

Confidential Attachment NK-1	Public Service Property Tax Calculation used for the Test Year
Public Attachment NK-1	Public Service Property Tax Calculation used for the Test Year

GLOSSARY OF ACRONYMS AND DEFINED TERMS

<u>Acronym/Defined Term</u>	<u>Meaning</u>
2017 Gas Phase I	Proceeding No. 17AL-0363G
ADIT	Accumulated Deferred Income Taxes which are sometimes also referred to as Deferred Tax Assets and Deferred Tax Liabilities
ARAM	Average Rate Assumption Method
Commission	Colorado Public Utilities Commission
DTA	Deferred Tax Asset
DTL	Deferred Tax Liability
DPT	Division of Property Taxation
FERC	Federal Energy Regulatory Commission
GAAP	Generally Accepted Accounting Principles
HTY	Historical Test Year
IRC	Internal Revenue Code
IRS	Internal Revenue Service
MACRS	Modified Accelerated Cost Recovery System
NOI	Net Operating Income
NOL	Net Operating Loss
PATH Act	Protecting Americans from Tax Hikes Act
Public Service or the Company	Public Service Company of Colorado
TABOR	Taxpayer Bill of Rights
TCJA	Tax Cuts and Jobs Act
Treasury	United States Department of the Treasury

<u>Acronym/Defined Term</u>	<u>Meaning</u>
Xcel Energy	Xcel Energy Inc.
XES	Xcel Energy Services Inc.

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DIRECT TESTIMONY AND ATTACHMENT OF NAOMI KOCH

**I. INTRODUCTION, QUALIFICATIONS, PURPOSE OF TESTIMONY, AND
RECOMMENDATIONS**

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Naomi Koch. My business address is 401 Nicollet Mall, Minneapolis,
Minnesota 55401.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT POSITION?

A. I am employed by Xcel Energy Services Inc. ("XES") as Director, Tax Reporting.
XES is a wholly-owned subsidiary of Xcel Energy Inc. ("Xcel Energy") and provides
an array of support services to Public Service Company of Colorado ("Public
Service" or the "Company") and the other utility operating company subsidiaries of
Xcel Energy on a coordinated basis.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THE PROCEEDING?

A. I am testifying on behalf of Public Service.

1 **Q. PLEASE SUMMARIZE YOUR RESPONSIBILITIES AND QUALIFICATIONS.**

2 A. As Director, Tax Reporting, I am responsible for overseeing federal and state
3 income, sales/use, and property tax compliance and accounting for all Xcel Energy
4 group companies, including Public Service. A description of my qualifications,
5 duties, and responsibilities is set forth after the conclusion of my testimony in my
6 Statement of Qualifications.

7 **Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?**

8 A. The purpose of my Direct Testimony is to address the impacts of income taxes,
9 normalization, updates to tax impacts of the Tax Cuts and Jobs Act ("TCJA"), a
10 specific issue related to sales tax, and property taxes on the cost of service. I
11 explain how these items are accounted for in the test year ending September 30,
12 2020 ("Test Year").

13 **Q. HOW ARE TAX ISSUES INCORPORATED INTO THE COMPANY'S TEST YEAR**
14 **IN THIS PROCEEDING?**

15 A. Most tax items are accounted for based on historical actual data that is available
16 at the time of filing. However, as I discuss later in my testimony, the Company
17 proposes to extend property tax recovery to 2021 based on 2020 plant-in-service,
18 in an effort to align property tax expense included in base rates with the plant-in-
19 service in the Test Year, and to reduce future property tax deferrals consistent with
20 the outcome of the Company's recent electric rate case (Proceeding No. 19AL-
21 0268E).

1 **Q. ARE YOU SPONSORING ANY ATTACHMENTS AS PART OF YOUR DIRECT**
2 **TESTIMONY?**

3 A. Yes, I am sponsoring the Confidential and Public versions of Attachment NK-1
4 (Public Service Property Tax Calculation used for the Test Year), which were
5 prepared under my supervision.

6 **Q. WHAT RECOMMENDATIONS ARE YOU MAKING IN YOUR DIRECT**
7 **TESTIMONY?**

8 A. First, regarding income taxes, I recommend that the Colorado Public Utilities
9 Commission ("Commission") calculate Public Service's income tax expense as
10 though Public Service had depreciated its assets on a straight-line book basis.
11 Second, I recommend that the Commission allow Public Service to make two
12 updates to its TCJA calculations that were previously approved by the Commission
13 in the Company's last gas Phase I rate case, Proceeding No. 17AL-0363G ("2017
14 Gas Phase I"). Third, I recommend that the Commission allow Public Service to
15 update its Test Year cost of service for a Colorado law change that will take effect
16 in January 2020. Finally, I recommend that the Commission allow Public Service
17 to recover the property tax expense, including the adjustments for changes to the
18 Test Year.

1 **II. ACCOUNTING FOR INCOME TAXES**

2 **Q. WHAT IS THE PURPOSE OF THIS SECTION OF YOUR TESTIMONY?**

3 A. In this section, I discuss the calculation of Public Service's income tax expense
4 included in the cost of service. I also explain how the Accumulated Deferred
5 Income Tax ("ADIT") balance is created.

6 **A. Calculation of Income Taxes and ADIT**

7 **Q. DID YOU PARTICIPATE IN THE CALCULATION OF THE INCOME TAX**
8 **EXPENSE AND ADIT BALANCE INCLUDED IN PUBLIC SERVICE'S COST OF**
9 **SERVICE?**

10 A. Yes. Company witness Ms. Laurie J. Wold and I provided information to and
11 assisted Company witness Ms. Deborah A. Blair in the calculation of the income
12 tax expense and ADIT balances included in Public Service's cost of service, which
13 is provided as Attachment DAB-1 to the Direct Testimony of Ms. Blair. Along with
14 Ms. Wold, I ensured that the tax calculations were correct and in compliance with
15 United States Department of the Treasury ("Treasury") normalization rules, which
16 I will discuss in more detail later in my Direct Testimony.

17 **Q. WHAT STANDARDS DID YOU FOLLOW WHEN CALCULATING THE INCOME**
18 **TAX AND ADIT BALANCES?**

19 A. I followed Generally Accepted Accounting Principles ("GAAP"), the Federal Energy
20 Regulatory Commission ("FERC") Uniform System of Accounts, the Internal
21 Revenue Code ("IRC"), including associated Treasury Regulations and Internal
22 Revenue Service ("IRS") guidance, and precedent from the Commission
23 concerning the treatment of taxes in the Company's cost of service.

1 **Q. PLEASE DESCRIBE THE GENERAL PROCESS USED TO CALCULATE**
2 **PUBLIC SERVICE'S INCOME TAX EXPENSE FOR RATEMAKING PURPOSES.**

3 A. Public Service calculates its income tax expense through a multi-step process:

4 1. As discussed in greater detail in Ms. Blair's Direct Testimony, Public Service
5 determines its taxable income by summing its operating expenses,
6 including interest payments and straight-line book depreciation expense,
7 and then subtracting those operating expenses from total revenues to arrive
8 at the net income before income taxes.

9 2. Public Service next calculates the additions to or deductions from net
10 income that result from temporary and permanent tax differences. These
11 amounts are then added to the net income calculated above to arrive at
12 taxable income. If the taxable income is negative, it indicates a net
13 operating loss ("NOL") that can be carried forward (or backward) to offset
14 future taxable income.

15 3. Public Service's federal and state income tax rates are then applied to the
16 taxable income calculated above to arrive at current tax expense. Current
17 income tax expense and deferred income tax expense are added together.

18 **Q. IN THE SECOND STEP OF THAT PROCESS, YOU REFER TO "TEMPORARY**
19 **DIFFERENCES." PLEASE EXPLAIN HOW TEMPORARY DIFFERENCES**
20 **ARISE.**

21 A. Generally speaking, temporary differences arise when Public Service collects tax
22 expense from customers in one period but pays the associated tax expense to the
23 IRS in a different period. The most common example involves depreciation
24 expense, which is typically accelerated for tax purposes, but not for ratemaking
25 purposes. The use of accelerated depreciation reduces Public Service's taxable
26 income, which defers taxes until a later time. For purposes of setting rates,
27 however, Public Service calculates its tax expense as though it had used a
28 straight-line book depreciation method. Thus, Public Service recovers income tax

1 expense from customers on a “normalized” basis, which results in Public Service
2 collecting income tax expense that is not paid to the IRS until a later time. That
3 leads to the ADIT balance that I referenced earlier in my Direct Testimony.

4 **Q. PLEASE PROVIDE AN EXAMPLE OF HOW THE ADIT BALANCE ACCRUES.**

5 A. Suppose a utility had taxable income of \$1,000 and a federal income tax rate of
6 21 percent. In the absence of any other factors, the utility would collect \$210 from
7 its customers as federal income tax expense, and it would pay the IRS \$210 in
8 federal income taxes.

9 Now suppose the same facts, except that accelerated depreciation has
10 given the utility enough depreciation expense to offset the entire \$1,000 of taxable
11 income. The utility still collects the \$210 from its customers because of
12 normalization rules, but the tax laws allow the Company to defer payment of that
13 amount to the IRS until some later date. In effect, the utility is given an interest-
14 free loan from the federal government, but the utility must record that \$210 interest-
15 free loan as a deferred income tax liability, or ADIT.

16 **Q. DOES PUBLIC SERVICE EXPERIENCE TEMPORARY DIFFERENCES IN ANY**
17 **CONTEXT OTHER THAN ACCELERATED DEPRECIATION?**

18 A. Yes. Public Service experiences several non-plant temporary differences, such as
19 costs associated with pension expense, inventory reserves, and many other types
20 of expenses or revenues. Some of these temporary differences result in a deferred
21 tax asset (“DTA”), a prepayment of tax, and some result in a deferred tax liability
22 (“DTL”), a deferred payment of tax. The net cumulative amount represents Public
23 Service’s ADIT balance.

1 **Q. HOW IS THE ADIT BALANCE REFLECTED IN RATE BASE?**

2 A. The DTL balance will eventually have to be paid to the IRS and corresponding
3 state agencies because accelerated depreciation creates only a temporary timing
4 difference. That is why the DTL balance is considered to be a deferral of tax
5 liability, not a reduction of tax liability. Until the DTL balance is paid back to the
6 IRS and corresponding state agencies, it is used as a dollar-for-dollar reduction of
7 rate base. As discussed above, in effect, the utility is receiving an interest-free
8 loan from the federal government in the form of the DTL balance; therefore, it does
9 not need a return on an equivalent amount of rate base.

10 A similar adjustment is made for DTAs. Until Public Service receives the
11 deferred tax benefit from the IRS and corresponding state agencies, the DTA is
12 used as a dollar-for-dollar increase to rate base.

13 The ADIT reflected in rate base for this proceeding is presented by Ms. Blair
14 in her Attachment DAB-1, Schedule 100.

15 **B. ADIT Related to Pension**

16 **Q. IN THE PREVIOUS SECTION YOU PROVIDE PENSION AS AN EXAMPLE OF**
17 **NON-PLANT ADIT. HOW IS PENSION ADIT CALCULATED?**

18 A. Similar to the process used for calculating regulatory taxable income that was
19 discussed earlier in my Direct Testimony, federal corporate income tax returns
20 start with book net income. Net income is then adjusted by temporary and
21 permanent tax adjustments in order to arrive at taxable income. Included in Public
22 Service's net income is an adjustment for pension which, for book purposes, is
23 expensed over the employee's service life. For tax purposes, pension is deducted

1 as cash is paid to the pension trust. This difference in timing of the deduction
2 results in a temporary tax difference, thus a DTA or DTL.

3 **Q. DOES PUBLIC SERVICE HAVE A DTA OR A DTL RELATED TO PENSION?**

4 A. As it relates to pension, Public Service has a net DTL.

5 **Q. HOW DID THIS DTL ARISE?**

6 A. Company witness Mr. Richard R. Schrubbe discusses the timing of pension
7 expense and pension funding in greater detail in his Direct Testimony, but as of
8 September 30, 2019, Public Service has been required to fund the pension trust in
9 advance of having to record the related pension expense, resulting in a prepaid
10 pension asset. Due to the timing of the pension deductibility discussed above,
11 Public Service has been allowed a deduction for tax purposes, sooner than what
12 has been recognized for book purposes, resulting in a DTL. Public Service
13 effectuates this tax adjustment by adding back the pension expense reflected in
14 net income and deducting the amount of cash paid to the pension trust. The sum
15 of this add-back and deduction has resulted in a net deduction and DTL, which will
16 reverse as pension expense is recorded for book purposes.

17 **Q. HOW DO PUBLIC SERVICE'S PENSION REGULATORY OFFSETS AFFECT**
18 **ITS ADIT?**

19 A. As presented by Mr. Schrubbe in his Attachment RRS-6, Public Service's prepaid
20 pension asset for regulatory purposes is net of several regulatory offsets. These
21 regulatory offsets were taxable to Public Service at the time they were recorded,
22 which reduced Public Service's pension-related DTL.

1 **Q. USING THE “REGULATORY AMORTIZATION” AS AN EXAMPLE, PLEASE**
2 **PROVIDE CONTEXT AS TO WHY THE REGULATORY OFFSETS ARE**
3 **TAXABLE.**

4 A. As discussed in Mr. Schrubbe’s Direct Testimony, the settling parties in
5 Proceeding No. 15AL-0135G agreed Public Service would be allowed to amortize
6 the Legacy Prepaid Pension Asset over a 15-year period. As Public Service has
7 received the amortization from customers, it has been recorded as a regulatory
8 liability. The receipt of this amortization was considered income for tax purposes,
9 reducing Public Service’s pension-related DTL. This reduction to the DTL will
10 reverse as the regulatory liability unwinds.

11 **C. Federal and State Income Tax Rates**

12 **Q. WHAT INCOME TAX RATE IS PUBLIC SERVICE USING IN THIS**
13 **PROCEEDING?**

14 A. Public Service is using a 21 percent federal corporate income tax rate and
15 a 3.6640 percent composite state income tax rate.

16 **Q. IS THIS A CHANGE FROM THE TAX RATES PUBLIC SERVICE USED IN ITS**
17 **PRIOR GAS RATE CASES?**

18 A. For federal income tax, no. Public Service’s overall revenue requirement in its
19 2017 Gas Phase I was adjusted to account for the December 2017 passage of the
20 TCJA, which reduced the federal corporate income tax rate from 35 percent to 21
21 percent effective January 1, 2018. However, Public Service’s composite state tax
22 rate has changed somewhat because it now includes a small percentage for
23 California related to its energy trading in that state.

1 **Q. HOW WAS THE 3.6640 PERCENT COMPOSITE STATE INCOME TAX RATE**
2 **CALCULATED?**

3 A. Public Service calculated its composite rate based on the state income tax returns
4 it must file. State income tax returns generally require multi-state companies to
5 apportion their income between states. For Colorado and California, the
6 apportionment rates are based on a ratio of Public Service's sales in each state
7 compared to Public Service's sales everywhere. These apportionment rates are
8 then applied to the respective states' income tax rates. Because state income
9 taxes are deductible for federal purposes, this apportioned state income tax rate
10 is reduced by the associated federal benefit. The apportioned state income tax
11 rates are then added together to arrive at Public Service's composite state income
12 tax rate.

13 For the Test Year, Public Service is using its last filed returns (i.e., its 2018
14 income tax returns) to estimate its apportionment and tax rate. Based on these
15 returns, 99.1527 percent of Public Service's taxable income is apportioned to
16 Colorado and 0.5334 percent is apportioned to California.

17 Public Service's federal income tax rate plus composite state income tax
18 rate can be reconciled as follows:

1

**Table NK-D-1:
Composite State Income Tax Rate**

	State Apportionment	Jurisdictional Tax Rate	Apportioned Tax Rate (columns A x B)	Federal Deduction for State Taxes (column C x- 21 percent)	Composite Income Tax Rate (column C + D)
Federal	N/A	21%	21%	N/A	21%
California	0.5334%	8.84%	0.0472%	-0.0099%	0.0373%
Colorado	99.1527%	4.63%	4.5908%	-0.9641%	3.6267%
Total State Income Tax Rate					3.6640%
Total Composite Income Tax Rate					24.6640%

2 **Q. WHAT COLORADO INCOME TAX RATE IS PUBLIC SERVICE PROPOSING TO**
3 **USE IN THIS PROCEEDING?**

4 A. Public Service is proposing to use 4.63 percent.

5 **Q. DOES THE 4.63 PERCENT COLORADO INCOME TAX RATE INCORPORATE**
6 **THE 0.13 PERCENT TAXPAYER BILL OF RIGHTS (“TABOR”) REFUND¹?**

7 A. No. The 2019 Colorado TABOR surplus was partially refunded to taxpayers by
8 reducing the 2019 corporate income tax rate to 4.50 percent. However, this
9 temporary reduction only applied to 2019. I note that Fiscal Year 2018-2019 was
10 the first time that the temporary income tax rate reduction was used as a Tabor
11 refund mechanism, and there is no indication that it will recur in 2020 or beyond.

12 The corporate income tax rate returns to 4.63 percent in 2020. Because this

¹ Generally speaking, the TABOR Amendment to the Constitution of the State of Colorado limits the amount of revenue the state can retain. If a surplus is collected, it is returned to taxpayers by way of a TABOR refund.

1 change is non-recurring it should not be incorporated in the Test Year revenue
2 requirement. Further, because 4.63 percent is the rate that is forecasted to be in
3 effect in 2020, when the rates proposed in this case become effective, the 4.63
4 percent was used in this proceeding.

5 **Q. WHY IS IT APPROPRIATE TO RECOVER CALIFORNIA STATE INCOME**
6 **TAXES FROM COLORADO CUSTOMERS?**

7 A. The California state income taxes incurred by Public Service are a result of Public
8 Service trading energy in California. The trading margin benefits from these
9 energy trades are shared with Colorado customers through the Electric Commodity
10 Adjustment. As a result, it is appropriate for the applicable California state income
11 taxes for these energy trades to be reflected in Colorado customer rates.

12 **Q. DOES PUBLIC SERVICE TRADE ENERGY IN STATES OTHER THAN**
13 **COLORADO AND CALIFORNIA?**

14 A. Yes.

15 **Q. DOES PUBLIC SERVICE PAY STATE INCOME TAXES TO THESE OTHER**
16 **STATES AS A RESULT OF ITS ENERGY TRADING?**

17 A. No. For income taxes, California treats energy as an intangible, which is different
18 than how other states treat energy. As a result, the California energy sales do not
19 qualify for an exemption allowed in other states, resulting in Public Service's
20 energy sales in California being taxable while similar sales in other states are
21 exempt from state taxes. Therefore, there are no additional taxes for Public
22 Service to recover from these other states in which trading occurs.

1 **Q. WHY IS IT APPROPRIATE TO USE AN ELECTRIC-DRIVEN STATE INCOME**
2 **TAX RATE IN THIS GAS PROCEEDING?**

3 A. Corporate income taxes are calculated on a total Company basis. This means that
4 Public Service files its electric, gas, thermal, and non-utility segments together –
5 they cannot be distinguished in its tax returns. In other words, because Public
6 Service's electric business requires it to file in California, the taxable incomes
7 driven by electric, gas, thermal, and non-utility are all included in Public Service's
8 California tax return.

9 **Q. HAS PUBLIC SERVICE INCLUDED A CALIFORNIA TAX RATE IN OTHER**
10 **PROCEEDINGS BEFORE THE COMMISSION?**

11 A. Yes. Public Service included California in its composite income tax rate in its
12 recent electric rate case (Proceeding No. 19AL-0268E). The Commission
13 approved this approach during its deliberations in the Phase I rate case for that
14 proceeding.

15 **Q. IS ALL OF PUBLIC SERVICE'S INCOME TAXED IN CALIFORNIA?**

16 A. No. Although Public Service's total Company taxable income is technically
17 included in its California return, this income is allocated between its various states
18 using the apportionment ratios described above. As a result, only 0.5334 percent
19 of Public Service's total Company taxable income is taxed in California. Similarly,
20 because Public Service does business outside of Colorado, it pays Colorado
21 income taxes on only 99.1527 percent of its total Company taxable income. Once
22 these apportionment ratios are applied to Public Service's respective state tax
23 rates, and the federal impacts are added, Public Service has a 24.6640 percent

1 composite income tax rate. This composite income tax rate is used when
2 accounting for the tax expense on all of Public Service's taxable income and is
3 similarly being applied in the cost of service in this proceeding.

4 **Q. ARE PUBLIC SERVICE'S GAS CUSTOMERS PAYING FOR ALL OF PUBLIC**
5 **SERVICE'S INCOME TAX EXPENSES?**

6 A. No. Public Service's retail gas customers only pay a retail jurisdictional share of
7 its federal and state income taxes, which further underscores that these taxes are
8 appropriately included in the Public Service Gas Department cost of service.

1 **III. THE ROLE OF NORMALIZATION IN UTILITY RATEMAKING**

2 **Q. WHAT IS THE PURPOSE OF THIS SECTION OF YOUR TESTIMONY?**

3 A. In this section, I explain the steps that Public Service took as part of its federal
4 income tax calculation to avoid violating tax normalization rules. These steps are
5 necessary to avoid normalization violations.

6 **Q. PLEASE EXPLAIN WHAT “NORMALIZATION” MEANS IN THE CONTEXT OF**
7 **UTILITY ACCOUNTING.**

8 A. Normalization refers to a method of accounting in which the tax benefits associated
9 with depreciation of utility assets are spread over the same period that the costs
10 of those assets are recovered from customers. For example, if rates are set based
11 on straight-line book depreciation, the federal income tax expense included in
12 those rates must also be calculated as though the utility used straight-line book
13 depreciation. The difference between the federal income tax expense calculated
14 using accelerated depreciation and the federal income tax expense calculated
15 using straight-line book depreciation is recorded as a DTL. The cumulative DTL
16 balance serves as an offset to rate base, and customers are, in essence, paid a
17 return at the Company’s weighted average cost of capital for any DTL included in
18 the Company’s rate base.

19 **Q. WHAT IS THE SOURCE OF THE TAX NORMALIZATION RULES?**

20 A. Tax normalization rules come from various sources including the IRC, Treasury
21 Regulations, and related guidance provided by the IRS, such as a Private Letter
22 Ruling. Specifically, Congress set out normalization for public utilities in IRC

1 § 168(i)(9)-(10), which provides that in order to use a normalization method of
2 accounting with respect to public utility property:

3 [T]he taxpayer must, in computing its tax expense for purposes of
4 establishing its cost of service for ratemaking purposes and reflecting
5 operating results in its regulated books of account, use a method of
6 depreciation with respect to such property that is the same as, and a
7 depreciation period for such property that is no shorter than, the
8 method and period used to compute its depreciation expense for
9 such purposes.

10 The rule requiring a utility to calculate federal income tax expense on a normalized
11 basis is Section 1.167(l)-1 of the Treasury Regulations.

12 **Q. EARLIER YOU REFERENCED STRAIGHT-LINE DEPRECIATION. WHAT IS**
13 **STRAIGHT-LINE DEPRECIATION?**

14 A. Straight-line depreciation is a method of depreciation that recovers the cost of an
15 asset in equal amounts each year over the asset's expected productive life. As is
16 the case in most jurisdictions, the Commission uses straight-line book depreciation
17 for the purpose of computing a utility's depreciation expense in Colorado.

18 **Q. WHAT IS YOUR UNDERSTANDING OF WHY CONGRESS ENACTED THE**
19 **NORMALIZATION REQUIREMENTS?**

20 A. It is my understanding that Congress's primary purpose in allowing accelerated
21 depreciation was to stimulate investment in capital assets, such as electricity
22 production, transmission, and distribution assets. If a utility were required to
23 immediately pass through all tax benefits resulting from accelerated depreciation
24 using flow-through accounting, utilities would have decreased incentives to invest
25 in the capital assets that give rise to accelerated depreciation. Additionally, using
26 flow-through accounting would create intergenerational inequity because current

1 customers would receive a benefit that should be spread over the life of the asset.
2 Accordingly, Congress set out normalization treatment, which requires that federal
3 income tax expense be calculated for ratemaking purposes as though the utility
4 had depreciated its assets on a straight-line book basis.

5 **Q. DID PUBLIC SERVICE RECOGNIZE ACCELERATED DEPRECIATION IN THE**
6 **CALCULATION OF FEDERAL INCOME TAX EXPENSE INCLUDED IN THE**
7 **TEST YEAR COST OF SERVICE?**

8 A. No. To remain in compliance with the normalization rules, Public Service
9 calculated the federal income tax expense included in its cost of service using
10 straight-line book depreciation.

11 **Q. WHY SHOULD A REGULATORY COMMISSION SUPPORT FOLLOWING THE**
12 **NORMALIZATION RULES FOR RATEMAKING PURPOSES?**

13 A. While Congress does not prohibit regulators from using other methods to set rates,
14 both the utility and its customers would be adversely affected if the utility were to
15 receive a regulatory order that led to a violation of the normalization rules. When
16 a normalization violation occurs, the utility is no longer allowed to use accelerated
17 depreciation. In addition, the taxes that have been deferred as a result of the prior
18 accelerated depreciation must be paid to the federal government more quickly than
19 they would be in the absence of the normalization violation.

20 **Q. HOW WOULD THOSE PENALTIES AFFECT THE UTILITY'S CUSTOMERS?**

21 A. Both of those circumstances would reduce the DTL balance, which would increase
22 the rate base on which customers pay a return. Therefore, a normalization
23 violation would very likely result in higher rates for utility customers. In light of the

1 potential loss of accelerated deductions and for other reasons, Colorado and
2 virtually all other jurisdictions have adopted the normalization method of tax
3 accounting for rate setting purposes.

4 **Q. WHAT IS YOUR RECOMMENDATION WITH RESPECT TO HOW THE**
5 **COMMISSION SHOULD CALCULATE PUBLIC SERVICE'S INCOME TAX**
6 **EXPENSE?**

7 A. Based on the normalization requirements and the adverse consequences that
8 would result if those requirements are not followed, I recommend that the
9 Commission calculate Public Service's income tax expense as though Public
10 Service had depreciated its assets on a straight-line book basis. This is the basis
11 on which income tax expense is included in Ms. Blair's cost of service.

1 **IV. UPDATES TO THE TCJA**

2 **Q. WHAT IS THE PURPOSE OF THIS SECTION OF YOUR TESTIMONY?**

3 A. In this section of my Direct Testimony, I provide updates to the TCJA impacts
4 agreed to in the Company's 2017 Gas Phase I.

5 **Q. WHAT SPECIFICALLY CHANGED SINCE THAT PROCEEDING?**

6 A. Since that filing, there have been two key updates to the TCJA impacts presented
7 in the Company's 2017 Gas Phase I. First, the Treasury and IRS issued guidance
8 in September 2019 enabling utilities to take bonus depreciation. Second, the
9 amount of non-plant and NOL excess ADIT changed slightly. Each issue will be
10 discussed in greater detail below.

11 **A. Bonus Depreciation**

12 **Q. WHAT IS BONUS DEPRECIATION?**

13 A. Bonus depreciation is a type of accelerated depreciation that allows for the
14 immediate expensing of a percentage of the cost of eligible assets.

15 **Q. WHAT BONUS DEPRECIATION GUIDANCE WAS PROVIDED UNDER THE**
16 **TCJA?**

17 A. Based on the guidance available at the time Public Service's 2017 Gas Phase I
18 was filed, utilities were no longer eligible to use bonus depreciation for assets
19 placed in service after December 31, 2017. Although the law provided for bonus
20 depreciation for "qualified property" placed in service before January 1, 2023,
21 "qualified property" was defined to exclude public utility property. Therefore,
22 regulated public utility property appeared to no longer be eligible for bonus

1 depreciation after December 31, 2017. However, utility property continued to
2 qualify for Modified Accelerated Cost Recovery System ("MACRS") depreciation.

3 **Q. DID THE TREASURY ISSUE GUIDANCE RELATED TO BONUS**
4 **DEPRECIATION AFTER THE PASSAGE OF THE TCJA?**

5 A. Yes. In August 2018, the Treasury issued proposed bonus depreciation
6 regulations. These proposed regulations confirmed that the 100 percent bonus
7 depreciation afforded to some companies in the TCJA was not available for public
8 utility property placed in service after 2017. The guidance in these proposed
9 regulations, however, was limited to full expensing (i.e., 100 percent bonus
10 depreciation), which for public utility property had to be placed in service prior to
11 2018 and did not address other levels of bonus depreciation.

12 **Q. WAS ANY ADDITIONAL GUIDANCE ISSUED AFTER AUGUST 2018?**

13 A. Yes. On September 13, 2019, the Treasury and the IRS released final regulations²
14 and additional proposed regulations³ under section 168(k) of the IRC. The final
15 regulations finalized the proposed regulations issued in August 2018 that are
16 discussed above. Additional proposed regulations were issued at the same time.

17 **Q. WHAT DID THESE ADDITIONAL PROPOSED REGULATIONS ADDRESS?**

18 A. Among other things, the additional proposed regulations addressed the extent to
19 which public utilities may qualify for bonus depreciation. These additional
20 proposed regulations provide that public utility property under construction as of

² Treas. Reg. § 168(k) (2019) (Treasury Decision 9874).

³ Prop. Treas. Reg. § 168(k), 84 Fed. Reg. 50,152 (Sept. 24, 2019) (Proposed Regulation 106808-19).

September 27, 2017, and placed in service after 2017, may continue to qualify for bonus depreciation as it existed prior to the enactment of the TCJA.

Q. WHAT BONUS DEPRECIATION WAS AVAILABLE PRIOR TO THE ENACTMENT OF THE TCJA?

A. The bonus depreciation enacted under the Protecting Americans from Tax Hikes Act ("PATH Act"), enacted in 2016, was available prior to the TCJA. Under the PATH Act, the bonus depreciation percentage was 50 percent for eligible property placed in service during 2015, 2016, and 2017; 40 percent for property placed in service in 2018; and 30 percent for property placed in service in 2019. Certain longer production-period property placed in service in 2020 may also be eligible for bonus depreciation.

Q. DOES THIS MEAN THAT PUBLIC SERVICE PROPERTY PLACED IN SERVICE IN 2018 AND 2019 IS NOW ELIGIBLE FOR BONUS DEPRECIATION?

A. Yes. As a result of the proposed regulations issued in September 2019, Public Service property placed in service in 2018 and 2019 is eligible for bonus depreciation, consistent with the percentages provided above under the PATH Act.

Q. ALTHOUGH THESE REGULATIONS ARE "PROPOSED," IS PUBLIC SERVICE ALLOWED TO ACT ON THEM?

A. Yes. Prior to adoption, proposed regulations may be withdrawn or modified at any time. In the meantime, a taxpayer may choose to rely on these proposed regulations.

1 **Q. HOW IS PUBLIC SERVICE GOING TO EFFECTUATE AND RESPOND TO THIS**
2 **CHANGE?**

3 A. In order for Public Service to recognize the benefit of this bonus depreciation as
4 soon as possible, which in turn benefits customers by reducing Public Service's
5 tax liability, Public Service filed for a Change in Accounting Method with the IRS in
6 2019. This will enable Public Service to receive the bonus depreciation benefits
7 for property placed in service in 2018 and 2019 as part of its 2019 income tax
8 return.

9 Ms. Wold provides additional detail in her Direct Testimony around the
10 bonus depreciation for the Test Year. Ms. Blair discusses in her Direct Testimony
11 how these numbers are included in the revenue requirement in this proceeding.

12 **B. Excess ADIT**

13 **Q. WHAT IS EXCESS ADIT?**

14 A. As discussed earlier in my Direct Testimony, the TCJA reduced the federal
15 corporate income tax rate from 35 percent to 21 percent, beginning on January 1,
16 2018. The reduction in the corporate tax rate gave rise to "excess" ADIT because
17 the deferred income tax expense collected in prior years' rates was based on a 35
18 percent tax rate, but utilities will pay the deferred taxes to the IRS at a 21 percent
19 rate. The difference between the amounts collected and the amounts to be paid
20 is the "excess" ADIT.

1 **Q. WHAT WAS THE BASIS FOR THE AMOUNT OF EXCESS ADIT INCLUDED IN**
2 **THE COST OF SERVICE IN THE COMPANY'S 2017 GAS PHASE I?**

3 A. The excess ADIT included in that proceeding was based on the 2016 historical test
4 year used by the Commission to establish new rates in that case.

5 **Q. DID THESE NUMBERS CHANGE AFTER THE CONCLUSION OF THE 2017**
6 **GAS PHASE I?**

7 A. Yes. Public Service has updated its non-plant and NOL excess ADIT from the
8 2016 HTY to December 2017,⁴ the date of the TCJA enactment. As a result, the
9 non-plant excess ADIT benefit decreased from (\$8.4 million) to (\$6.6 million), a
10 reduction of \$1.8 million, and the NOL excess ADIT detriment increased from
11 \$29.8 million to \$42.8 million, an increase of \$13 million.

12 **Q. HAS THE COMMISSION PREVIOUSLY APPROVED SIMILAR UPDATES?**

13 A. Yes. The Commission approved similar estimate-to-actual updates in its
14 deliberations in the Company's recent electric rate case (Proceeding No. 19AL-
15 0268E) and in a recent Advice Letter filing by Atmos Energy Corporation
16 (Proceeding No. 19AL-0736G).

17 **Q. WHAT IS PUBLIC SERVICE PROPOSING TO DO WITH THESE**
18 **DIFFERENCES?**

19 A. Public Service is proposing to recover the reduced excess non-plant ADIT benefit
20 over three years, and the NOL ADIT over 52 years.

⁴ Per Public Service's 2017 federal income tax return filed in September 2018.

1 **Q. HOW WERE THESE PERIODS SELECTED?**

2 A. The NOL ADIT is assigned 52 years because it is protected under the Treasury's
3 normalization rules and 52 years is Public Service's average life under the Average
4 Rate Assumption Method ("ARAM"). All non-plant ADIT is assigned three years
5 because it is a reasonable compromise between quickly recovering the costs from
6 customers, without creating undue hardship for customers. This is consistent with
7 other proposed amortizations, as Ms. Blair describes.

8 **Q. WHAT DO YOU MEAN WHEN YOU STATE THAT THE NOLS ARE**
9 **"PROTECTED" UNDER THE TREASURY'S NORMALIZATION RULES?**

10 A. Public Service's use of accelerated depreciation (e.g., bonus depreciation and
11 MACRS) resulted in Public Service experiencing NOLs in previous years.
12 Because Public Service's NOLs were driven by accelerated depreciation, the
13 Treasury has held that the NOL carryforward should be treated consistent with
14 plant-related DTL in rate cases and is protected by the Treasury's normalization
15 rules. Normalization rules require the amortization to be returned to customers in
16 a manner that is consistent with the life of the asset(s) in question.

17 **Q. DOES THE TCJA PRESCRIBE THE METHOD THAT PUBLIC SERVICE MUST**
18 **USE TO FLOW THESE TAX BENEFITS BACK TO RATEPAYERS?**

19 A. Yes. Section 1561 of the TCJA prescribes the use of ARAM for protected ADIT if
20 the appropriate asset vintage records are available, or an alternative method for
21 certain public utility property if such records are not available. Because Public
22 Service's asset vintage records are available, Public Service is required to use
23 ARAM for protected ADIT. Any entity subject to normalization accounting will be

1 required to flow back tax benefits arising from plant-related protected items (e.g.,
2 accelerated depreciation) using ARAM.

3 **Q. IS PUBLIC SERVICE PROPOSING TO RECOVER THE EXCESS ADIT**
4 **RELATED TO NOL USING SPECIFIC CLASSES OF ASSETS UNDER ARAM?**

5 A. No. Although the NOL carryforward was driven by plant-related accelerated
6 depreciation, it would be administratively impracticable to tie the NOL to specific
7 classes of assets as required by ARAM. Therefore, Public Service is proposing to
8 recover the excess ADIT related to the NOL over 52 years, which is the average
9 ARAM life of these assets.

10 **Q. WHAT WOULD BE THE CONSEQUENCE OF AN IMMEDIATE FLOW-**
11 **THROUGH OF EXCESS DEFERRED TAXES ASSOCIATED WITH**
12 **PROTECTED ITEMS?**

13 A. The TCJA prescribes the return of the excess ADIT to be calculated using ARAM
14 if ARAM is known. Not following this approach would result in a normalization
15 violation. As discussed earlier in my testimony, violating normalization
16 requirements would disqualify Public Service from using accelerated depreciation,
17 thereby increasing the rate base on which Public Service's customers pay a return.
18 Therefore, I recommend that the Commission allow the NOL-related DTA to be
19 recovered from customers, using the method discussed above.

20 **Q. DOES THE TCJA PRESCRIBE A METHOD FOR FLOWING BACK OR**
21 **RECOVERING THE EXCESS ADIT RELATED TO NON-PLANT ITEMS?**

22 A. No. There is no statutorily-required method for recovering or returning the excess
23 ADIT related to non-plant items, such as pension. However, Public Service is

1 proposing to recover or flow back this excess ADIT, as applicable, over the periods
2 discussed above. This proposal is consistent with how Public Service has included
3 these types of DTAs and DTLs in rate base in Public Service's prior reviews before
4 the Commission. Further, recovery of the regulatory asset reflects excess tax
5 benefits previously received by customers but now payable to Public Service, and
6 the regulatory liability reflects excess tax benefits previously received by Public
7 Service but now payable to customers. Therefore, it is appropriate to recover from,
8 or return to, customers these excess ADIT balances.

9 **Q. ARE THE ASSUMPTIONS PUBLIC SERVICE HAS MADE REGARDING THE**
10 **EFFECTS OF THE FEDERAL TAX LEGISLATION AND RECENT PROPOSED**
11 **REGULATIONS SUBJECT TO CHANGE?**

12 A. Yes. As with all rate case information, Public Service is providing its Direct
13 Testimony based on the best information available at the time the Direct Testimony
14 is developed. Public Service anticipates that Congress or the Treasury may
15 continue issuing guidance and regulations, which may clarify or change the
16 interpretation of pieces of the legislation. If any new information were to emerge,
17 Public Service would update its data at the appropriate time during this rate case
18 or in a future rate case as appropriate.

V. COLORADO VENDOR FEE LAW CHANGE

Q. WHAT TOPIC DO YOU DISCUSS IN THIS SECTION OF YOUR DIRECT TESTIMONY?

A. In this part of my Direct Testimony, I discuss the Colorado law change related to vendor fees, enacted in 2019 as part of Colorado House Bill 19-1245.

Q. WHAT CHANGED REGARDING VENDOR FEES AS A RESULT OF THIS LEGISLATION?

A. Prior to January 1, 2020, a retailer who collected state sales tax was allowed to retain three and one third percent of the state sales taxes collected as compensation for the retailer's expenses incurred in collecting and remitting the tax (vendor fee). As a result of this new legislation, beginning January 1, 2020, the vendor fee increased to four percent and there is a \$1,000 monthly cap on the vendor fee. This limit applies regardless of the number of the retailer's locations.

Q. HOW DOES THIS IMPACT PUBLIC SERVICE?

A. Public Service currently shares the vendor fees it receives with customers. As a result of the monthly cap, Public Service will earn significantly less in vendor fees beginning in 2020. For the twelve months ending September 30, 2019, Public Service gas earned \$508,979 in vendor fees. Of this total, Public Service is forecasting to retain \$191,676 for gas in 2020, a \$317,303 reduction from the total vendor fees earned for the twelve months ending September 20, 2019.

1 **Q. WHAT ARE YOU PROPOSING IN THIS RATE CASE?**

2 A. Ms. Blair provides more detail in her Direct Testimony, but Public Service is
3 proposing to reduce the vendor fee benefit shared with customers by the \$317,303
4 referenced above.

5 **Q. WHY IS IT APPROPRIATE TO ADJUST THE COST OF SERVICE FOR THIS**
6 **RECENT LAW CHANGE?**

7 A. The law was enacted on May 17, 2019 and took effect on January 1, 2020. As a
8 result of this change in the law, Public Service will collect significantly less in
9 vendor fees beginning in 2020 and when the rates proposed in this case become
10 effective. It would be unfair to set rates going forward based on the old law that is
11 no longer in effect, and using the amounts recorded for the twelve months ended
12 September 30, 2019, would substantially overstate the vendor fee benefit received
13 by Public Service in the Test Year.

VI. PROPERTY TAXES

Q. WHAT IS THE PURPOSE OF THIS SECTION OF YOUR DIRECT TESTIMONY?

A. The purpose of this section of my Direct Testimony is to support the property tax expense included in the Company's cost of service in this proceeding.

Q. DO YOU DISCUSS HOW THE COMPANY PROPOSES TO TRACK AND DEFER PROPERTY TAX EXPENSES?

A. No. Company witness Mr. Steven Berman discusses those issues in his Direct Testimony.

Q. WHAT AMOUNT OF PROPERTY TAXES IS THE COMPANY INCLUDING IN THE TEST YEAR COST OF SERVICE?

A. From a property tax expense perspective, I arrive at the level of property tax in the cost of service by utilizing the forecast for property tax expense for calendar year 2021 (i.e., plant-in-service as of January 1, 2021). The total Company property tax expense for calendar year 2021 is forecasted to be approximately \$237 million, which is then allocated by Company witness Ms. Blair as described briefly below and included in the cost of service. Utilizing the property tax expense for calendar year 2021 (based on plant-in-service as of January 1, 2021) aligns the expense with the capital additions driving that expense in 2020, which are included in the Test Year. This approach also reduces future property tax deferral amounts, consistent with the approach approved during Commission deliberations in the Company's recent electric rate case (Proceeding No. 19AL-0268E).

1 **A. Property Tax Overview**

2 **Q. PLEASE PROVIDE AN OVERVIEW OF HOW PROPERTY TAXES ARE**
3 **DETERMINED FOR THE COMPANY.**

4 A. As explained in greater detail below, Public Service's property tax liability is
5 determined based on total Company assessed values and the levy rates set by the
6 various local jurisdictions within Colorado, such as counties, school districts, fire
7 protection districts, metropolitan districts, and conservation districts. To calculate
8 tax, the county treasurers apply a tax rate to the assessed value of Company plant.
9 Tax rates are set annually by the individual taxing entities, and the Company does
10 not control the level of these tax rates. Tax rates may increase or decrease but
11 tend to increase more often than decrease. Additionally, because the Company's
12 plant balance represents the property that is subject to property tax, the tax can be
13 expected to increase as the plant balance increases.

14 **Q. HOW DOES THE COMPANY'S PAYMENT OF PROPERTY TAXES BENEFIT**
15 **COLORADO COMMUNITIES AND RATEPAYERS?**

16 A. All of the revenue generated by the property taxes paid by Public Service remain
17 at the local level to help fund many valuable public services. Property taxes are a
18 significant source of local government revenue, and the majority of property tax
19 revenue is used to fund K-12 public school districts. The remainder supports local
20 services provided by counties, special districts, and, to a lesser degree, cities and
21 towns, including county road maintenance, fire protection, police, water and sewer
22 infrastructure, libraries, and other local services.

Q. CAN YOU PROVIDE ADDITIONAL DETAIL REGARDING WHO BENEFITS FROM THE PROPERTY TAX THE COMPANY PAYS?

A. Yes. Colorado school districts and counties are the largest recipients of the property tax dollars, with school districts receiving approximately 52.5 percent of all dollars and counties receiving approximately 27 percent. A list of the top five school districts and counties by percentage of total property tax paid is as follows:

<u>School District</u>	<u>Percentage</u>
Denver School District (0880)	7.8%
Jefferson School District (1420)	6.4%
Pueblo School District (2690)	4.1%
Mapleton School District (0010)	4.0%
Brush School District (2395)	3.7%

<u>County</u>	<u>Percentage</u>
Denver County	4.6%
Adams County	4.1%
Pueblo County	3.8%
Jefferson County	3.1%
Morgan County	2.1%

Q. WHY IS THIS RELEVANT TO THE COMPANY'S PROPERTY TAX DISCUSSION IN THIS RATE CASE?

A. Property taxes are a significant component of Public Service's cost of service in any given year. It is helpful to keep in mind that the taxes are not only mandated by various governmental units; they are intended to provide benefits to and support services to Colorado residents, including individuals and families in the areas served by Public Service.

1 **Q. HOW DOES PUBLIC SERVICE ALLOCATE A PORTION OF THE TOTAL**
2 **COMPANY PROPERTY TAX EXPENSE TO THE GAS DEPARTMENT?**

3 A. Once the appropriate level of property tax expense is determined, Ms. Blair
4 allocates the property tax expense to each utility department (i.e., electric, gas,
5 and steam) and to non-utility activities during the process of developing the cost of
6 service study. After the tax is allocated to the Gas Department, a certain amount
7 of those property taxes is further allocated to the retail jurisdiction.

8 **Q. WHAT LEVEL OF PROPERTY TAX EXPENSE WAS INCLUDED IN BASE**
9 **RATES AND APPROVED IN THE 2017 GAS PHASE I?**

10 A. The level of property tax included in base rates in the 2017 Gas Phase I, based on
11 a 2016 HTY, was \$34.7 million (gas retail). The total Company equivalent amount
12 of property tax expense that was the basis for the amount included in base rates
13 as a result of the 2017 Gas Phase I was \$165.9 million.

14 **Q. WHAT WAS THE PROPERTY TAX EXPENSE FOR THE COMPANY FOR 2018?**

15 A. The total Company tax liability for 2018 was \$195.43 million based on the property
16 tax bills from the various taxing jurisdictions, such as counties, school districts, fire
17 protection districts, metropolitan districts, and conservation districts. This is the
18 latest year for which the Company has actual property tax bills. The payments
19 were made at the end of April 2019.

20 **Q. WHAT PROPERTY TAX EXPENSE IS ANTICIPATED FOR 2019 AND 2020?**

21 A. Public Service is forecasting \$201.57 million of property tax expense related to
22 2019 and \$224.17 million of property tax expense related to 2020.

1 **Q. IS THE PROPERTY TAX EXPENSE INCURRED BY THE COMPANY**
2 **FORECASTED TO INCREASE FOR 2021?**

3 A. Yes. The property tax expense for calendar year 2021 (based on plant-in-service
4 as of January 1, 2021) is forecasted to be approximately \$237.02 million (Total
5 Company), an increase of \$41.59 million since 2018, the latest year of actual tax
6 amounts.

7 **Q. WHAT IS DRIVING THE \$41.59 MILLION INCREASE IN PROPERTY TAX**
8 **EXPENSE?**

9 A. The \$41.59 million increase is largely due to increases in Company plant and the
10 weighted average net operating income ("NOI"). Secondary factors include a
11 decrease in the income capitalization rate and an increase in the equalization
12 factor. These concepts are discussed in greater detail below. This projected
13 increase does not, however, incorporate any changes in the effective tax rate,
14 which we also expect to increase as discussed below.

15 **Q. WHAT IS THE FORECAST WITH RESPECT TO THE COMPANY'S NOI?**

16 A. Public Service has forecasted total Company NOI to increase by [REDACTED]
17 or [REDACTED] by 2021. The NOI to capitalize (the three-year weighted average
18 used to calculate property tax liability as discussed below) is forecasted to increase
19 by 2021 by [REDACTED] or [REDACTED].

20 **Q. PLEASE DISCUSS THE UPCOMING CHANGES IN TOTAL COMPANY NET**
21 **PLANT LEVELS.**

22 A. The Company's forecast considers that additions to total Company plant during
23 2018, 2019, and 2020 will be \$3.84 billion and will impact the 2021 property tax.

1 However, it is important to note that the Company's wind projects, for which the
2 impact to property tax expense is removed through the Colorado deductions to
3 market value, represent a significant portion of the \$3.84 billion additions between
4 2018 and 2020.

5 Specifically, these wind projects add \$1.75 billion to Company plant-in-
6 service by 2021. Colorado law provides that wind energy facilities and other
7 renewable energy projects are treated differently for property tax purposes than
8 other components of the Company property. The impact of the special valuation
9 procedure for these renewable energy projects is built into the Company's property
10 tax forecast. Accordingly, included in the \$237.02 million of forecasted 2021
11 property tax expense is the property tax associated with the wind projects of only
12 \$4.44 million. Without this special treatment for renewable energy projects, the
13 Company's property tax expense would have been \$259.38 million in 2021, and
14 the additional \$22.36 million of property tax would have continued annually into the
15 future.

16 In the next section of my Direct Testimony, I discuss in more detail how
17 these property tax expense levels, including Colorado deductions, were
18 calculated.

19 **B. Property Valuation**

20 **Q. WHAT IS THE PURPOSE OF THIS SECTION OF YOUR DIRECT TESTIMONY?**

21 A. In this section of my Direct Testimony, I present how the Division of Property
22 Taxation ("DPT") values the Company's property and how property tax is
23 calculated by the various taxing jurisdictions throughout Colorado.

1 **Q. WHAT ARE THE METHODS USED BY THE DPT IN DETERMINING THE**
2 **ASSESSED VALUE TO BE USED TO CALCULATE COMPANY PROPERTY**
3 **TAX?**

4 A. In Colorado, the DPT is generally responsible for determining the assessed value
5 of the operating property of utility companies for property tax purposes. However,
6 a few of the Company's real estate parcels and some non-operating personal
7 property are valued by county assessors. The operating property is considered to
8 include all real⁵ and personal⁶ property used in the Company's utility business.
9 The two approaches the DPT uses to assess utility property are referred to as the
10 "cost approach" and the "income approach," which I describe below.

11 **Q. CAN YOU SUMMARIZE THE DPT'S FORMULA FOR VALUING THE**
12 **PROPERTY OF THE TOTAL COMPANY?**

13 A. Yes. The following equation summarizes the DPT's formula to value the property
14 of the total Company:

⁵ Real property includes real estate, land, and buildings.

⁶ Personal property excludes real property, and generally includes machinery and equipment.

Figure NK-D-1
Property Tax Formula

(DPT Determined Cost Indicator x 40% + DPT Determined Income Indicator x 60%)
= System Unit Value
- Deductions to Market Value
= Colorado Current Value
x Equalization Factor
= Colorado Actual Value
x Statutory Assessment Ratio
= Colorado Assessed Value
x Statewide Effective Tax Rate
= State-Assessed Property Tax
+ Tax on Locally & Separately Assessed Property
= Total Company Property Tax

Once the assessed valuation is determined by the DPT, it is then allocated to the taxing jurisdictions in Colorado and each jurisdiction's tax rate is applied to determine the property tax that is due.

Q. WHAT IS THE DPT'S STARTING POINT FOR AN APPRAISAL OF COMPANY PROPERTY?

A. The DPT staff bases its calculation on the Company's financial data found in the Company's FERC Form 1 filing from the end of the prior year. In other words, the Company's 2021 property tax will be based on the Company's financial data from year-end 2020.

Q. PLEASE DISCUSS HOW THE VALUE OF THE COMPANY'S ASSETS ARE ASSESSED USING THE DPT'S COST APPROACH.

A. Public and Confidential Attachment NK-1 show how total Company property tax is calculated. To arrive at the cost indicator of value at line 4, the Company follows the DPT's methodology of using the depreciated value of the Company's operating property which includes all of the property that is needed to conduct the Company's business (i.e., property, plant, equipment, and materials and supplies) and

1 excludes non-utility property. As shown on line 4 of Public Attachment NK-1, the
2 cost indicator of value based on the depreciated value used by the DPT, was
3 \$8.52 billion for 2018. The cost indicator of value is forecasted to be \$11.40 billion
4 for 2021.

5 **Q. USING THE DPT'S METHODOLOGY, PLEASE DISCUSS HOW THE VALUE IS**
6 **CALCULATED USING THE INCOME APPROACH.**

7 A. In the income approach, the DPT typically uses a weighted average of the previous
8 three years' NOI from the Company's FERC Form 1, and includes operating
9 revenue less operating and maintenance expense, depreciation, and income tax,
10 and does not include interest expense or non-utility income. On occasion, the DPT
11 will use a different average from the NOI history of the past five years when the
12 Company suggests the three-year weighted average overstates the value of the
13 assets during a protest hearing. Next, the DPT applies a capitalization rate to the
14 weighted average NOI.

15 The capitalization rate is a weighted average cost of capital derived from
16 market data that incorporates all levels of corporate equity and debt for the utility
17 industry, as well as the market as a whole. For the DPT's methodology, the
18 capitalization rate is a discount factor that the DPT uses to convert the weighted
19 average NOI into an indicator of the total Company's market value.

20 The income approach calculation divides the weighted average NOI by the
21 capitalization rate to determine the income indicator of value. For 2018, the NOI
22 to capitalize was \$633.12 million and the capitalization rate was 7.70 percent. The
23 income indicator of value was \$8.22 billion. For 2021, the NOI to capitalize is

1 forecasted to be [REDACTED] and the capitalization rate for 2021 is forecasted
2 to be 7.57 percent. The resulting income indicator of value is [REDACTED].

3 **Q. HOW IS TOTAL SYSTEM UNIT VALUE ARRIVED AT FOR PUBLIC**
4 **ATTACHMENT NK-1?**

5 A. The DPT determines the Company's Total System Unit Value based on a weighted
6 average of the income indicator (typically 60 percent) and cost indicator (typically
7 40 percent). The 60 percent / 40 percent weighting applied to the two approaches
8 shown on lines 15 and 16 of Public Attachment NK-1 is the weighting that has been
9 consistently used by the DPT for many years. The application of the above
10 weightings produces a Total System Unit Value of \$8.34 billion for 2018 and
11 [REDACTED] for 2021.

12 **Q. HOW IS THE COLORADO CURRENT VALUE DETERMINED?**

13 A. It is arrived at by deducting certain property from the Total System Unit Value.
14 Deductions include assets on the Company's balance sheet where the property
15 tax is fully paid by another party (such as in a joint venture) and property that is
16 assessed by county assessors and billed to the Company separately (such as
17 undeveloped vacant land used as a buffer adjacent to power plants). The
18 Colorado deductions ensure that all exempted items are removed and no assets
19 will be taxed twice. As demonstrated in Confidential Attachment NK-1, the
20 deductions reflected on line 19 increase between 2018 and 2021 by [REDACTED].
21 Deductions are approximately \$373.81 million for 2018 and [REDACTED] in 2021.
22 Subtracting the 2021 deductions to value from the system unit value results in a
23 Colorado Current Value of \$9.38 billion.

1 **Q. WHAT IS THE CAUSE OF THE LARGE INCREASE TO DEDUCTIONS**
2 **BETWEEN 2018 AND 2021?**

3 A. The increase between 2018 and 2021 is largely due to the Company's wind
4 projects. As discussed above, in Colorado, wind energy is subject to a particular
5 property tax statute regarding new renewable energy property. Therefore, the
6 property tax for this project is calculated using the DPT's renewable energy
7 template. On line 28 of Confidential and Public Attachment NK-1, the property tax
8 forecast of \$4.44 million for 2021 is shown. The impact of this project to the
9 assessed value for the Company is removed by inclusion in the Colorado
10 deductions.

11 **Q. PLEASE EXPLAIN THE EQUALIZATION FACTOR THAT IS APPLIED TO THE**
12 **COLORADO CURRENT VALUE.**

13 A. An equalization factor is an inflation factor used to equate utility property to non-
14 utility real property in order to bring the DPT's values for utilities to the same "level
15 of value" as the county assessors use for real property. Real property in Colorado
16 is valued only in odd numbered years, and by law the assessors must use
17 comparable sales data between two years prior (even numbered years) and six
18 months prior (odd numbered years) to the lien date. Public Attachment NK-1
19 shows a 99 percent equalization factor for 2021. Over the past 18 years, the
20 equalization factor has fluctuated between 96 percent and 100 percent, with the
21 average being 99 percent. The Colorado Current Value, when multiplied by the
22 equalization factor, determines the Colorado Actual Value which is expected to
23 increase from \$7.81 billion in 2018 to \$9.29 billion in 2021.

1 **Q. PLEASE EXPLAIN THE REMAINING STEPS TAKEN TO ARRIVE AT THE**
2 **ESTIMATED PROPERTY TAX FOR THE COMPANY.**

3 A. The assessment ratio of 29 percent, shown on line 23 of Public Attachment NK 1,
4 is the Colorado statutory assessment ratio for all property other than residential
5 property. The assessment ratio is applied to the Colorado Actual Value to arrive
6 at the assessed value, and the tax rate is applied to that assessed value. The
7 effective tax rate is applied to the assessed value to arrive at property tax for the
8 Company's utility property. The total property tax for property valued by local
9 county assessors is shown on line 27 of Public Attachment NK-1. The \$900,000
10 estimated for 2021 is based on the \$911,887 paid in 2018 for locally-assessed
11 property. With the addition of tax on locally-assessed property, we arrived at the
12 Company's total calculated property tax expense. In 2021, the Company also
13 added the forecasted property tax due from the wind projects as the value was
14 removed from the larger appraisal process pursuant to a statute that mandates a
15 specific valuation method for renewable energy. As shown on line 29 of Public
16 Attachment NK-1, the resulting property tax expense for the Company is \$195.43
17 million for 2018 and is expected to increase to \$237.02 million for 2021.

18 **Q. WHAT DOES THE EFFECTIVE TAX RATE REPRESENT?**

19 A. The effective tax rate as shown on line 25 of Public Attachment NK-1 represents
20 the total property tax to be paid each year to all jurisdictions that levy property tax
21 to the Company divided by each year's total assessed value for Colorado that
22 generated that total property tax.

1 **Q. WHAT TAX RATE IS THE COMPANY USING FOR ITS ESTIMATED PROPERTY**
2 **TAX FOR 2019?**

3 A. The Company is using the 2018 effective tax rate of 8.60 percent for 2021. The
4 2018 rate is the latest information the Company has to date and it is continued
5 through 2021 because the Company will not be able to calculate the 2021 effective
6 tax rate until April 2022. The Company typically sees gradual increases from year-
7 to-year in the effective tax rate for the Company. As such, using an effective tax
8 rate from prior years when it is likely that the effective tax rate will go up means
9 that the Company's actual tax liability may be underestimated for any future year.

10 **C. Property Tax Expenses and the Drivers Affecting Increased Property**
11 **Tax Expense**

12 **Q. PLEASE QUANTIFY THE TOTAL IMPACT OF PROPERTY TAX INCREASES**
13 **BETWEEN THE LEVEL OF TAXES APPROVED IN THE 2017 GAS PHASE I**
14 **AND THE AMOUNT OF PROPERTY TAXES REFLECTED IN THE COMPANY'S**
15 **COST OF SERVICE IN THIS RATE CASE.**

16 A. As noted above, the Company has calculated a total of \$237.02 million for 2021 in
17 property tax expense. As compared to the \$165.9 million in total Company
18 property tax expense that was the basis for the \$34.7 million used in gas base
19 rates in the 2017 Gas Phase I, the \$237.02 million property tax expense for this
20 proceeding is an increase of approximately \$71.12 million, or 42.87 percent.
21 However, this is the total of an incremental increase in property taxes in each of
22 the last several years.

1 **Q. HOW DOES THIS COMPARE TO THE PROPERTY TAX EXPENSE**
2 **FORECASTED FOR THE FUTURE TEST YEARS FILED IN THE 2017 GAS**
3 **PHASE I?**

4 A. The Company did not forecast its 2021 Total Company property tax expense in its
5 2017 Gas Phase I filing, however, it did forecast \$193.5 million for 2018, \$196.0
6 million for 2019, and \$211.4 million for 2020. These are comparable to the 2018
7 actual property tax expense of \$195.43 million, and the 2019 and 2020 forecasted
8 property tax expenses of \$201.57 million and \$224.17 million, respectively, that
9 were referenced earlier.

10 **Q. WHY HAVE THE COMPANY'S PROPERTY TAXES INCREASED OVER THE**
11 **LAST FEW YEARS?**

12 A. Changes to the investment in plant and operating income caused the majority of
13 the change in property tax expense since the end of the test year utilized in Public
14 Service's 2017 Gas Phase I.

15 **Q. BRIEFLY EXPLAIN THE INVESTMENTS IN PLANT SINCE THE 2017 GAS**
16 **PHASE I THAT ARE HAVING A LARGE IMPACT ON PROPERTY TAX**
17 **EXPENSE.**

18 A. As discussed above, the DPT always values the entire Company. Therefore,
19 investments in all Company departments impact total Company property tax
20 expense. The Gas Department property tax is estimated through a ratio of gas
21 plant to total plant. Under this approach, the Gas Department investments remain
22 in the gas property tax estimate, while the non-gas investments, such as new
23 electric transmission lines, are removed. As a result of significant investments, the

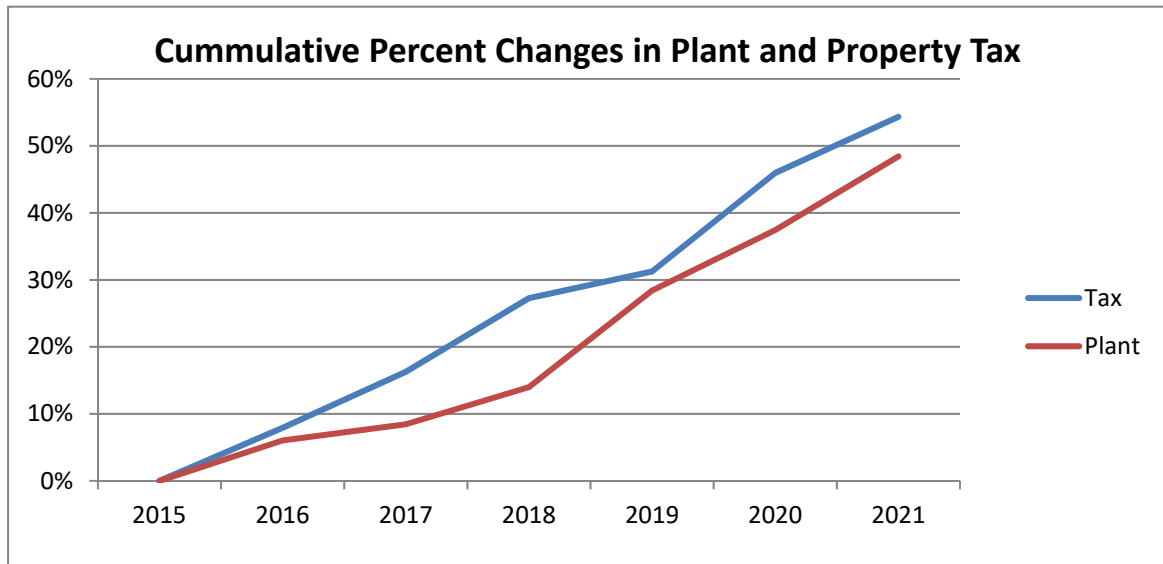
1 overall net plant-in-service for the Company has been steadily increasing. Net
2 plant-in-service for the entire Company as calculated for property tax valuation and
3 used in this rate case for purposes of setting the level of property tax expense in
4 the cost of service will increase by \$4.73 billion or 40 percent as compared to 2016,
5 which was the test year used for purposes of setting the level of property tax
6 expense in the 2017 Gas Phase I.

7 The net plant-in-service include significant investments in gas plant. For
8 the 2016 to 2021 property tax years, based on plant balances as of December 31,
9 2015, and December 31, 2020, respectively, Public Service has invested
10 \$1.11 billion in the gas distribution system, increasing the gross plant balance from
11 \$2.16 billion to \$3.27 billion. At the same time, the Company has invested
12 \$439 million in its gas transmission system, increasing the gross plant balance
13 from \$791 million to \$1.23 billion.

14 **Q. TO WHAT EXTENT DO PROPERTY TAXES INCREASE AT THE SAME RATE**
15 **AS PLANT?**

16 A. As mentioned above, property taxes are primarily based on plant balances.
17 Between property tax year 2015 and 2021, the net plant balance increased 48
18 percent while the property tax increased 54 percent. Figure NK-D-2, below, shows
19 how closely property tax has trended with plant growth in that time period.

**Figure NK-D-2:
Cumulative Percent Changes in Plant and Property Tax**



1 **Q. ARE THERE OTHER THINGS THAT CAN CAUSE PROPERTY TAXES TO**
2 **CHANGE?**

3 A. Yes. In addition to increases in plant, the effective tax rate and the income
4 capitalization rate can both cause property taxes to change. Between 2015 and
5 2021, the effective tax rate increased from 7.93 percent to 8.60 percent, while the
6 income capitalization rate decreased from 8.02 percent to 7.57 percent. Both the
7 effective tax rate increase and the capitalization rate decrease caused the property
8 tax liability to increase.

9 **Q. HOW DO CHANGES IN THE CAPITALIZATION RATE IMPACT THE**
10 **COMPANY'S PROPERTY TAX CALCULATION?**

11 A. Capitalization rates have an inverse relationship with value. In order to derive an
12 estimated value for the property of an operating public utility, an NOI selected by

1 the DPT as representative of current Company business activity is divided by the
2 capitalization rate.

3 **Q. DOES THE COMPANY WORK TO ACTIVELY MANAGE ITS CAPITALIZATION**
4 **RATES, AND THEREFORE ITS PROPERTY TAX LEVELS?**

5 A. Yes. Initially, the DPT proposed a capitalization rate of 7.30 percent for 2019,
6 which is a blended rate that combines separate capitalization rates the DPT
7 derived for the electric utility and gas utility. Intervention by the Company caused
8 the DPT to increase the blended capitalization rate to 7.57 percent, which had the
9 impact of lowering the total Company property tax for 2021 by \$8.40 million.

10 **Q. DOES THIS INFORMATION SUGGEST THAT PLANT IS AN APPROPRIATE**
11 **BASIS TO ALLOCATE PROPERTY TAX TO THE GAS DEPARTMENT?**

12 A. Yes. Plant is the single largest component of rate base, which drives required
13 earnings in the revenue requirement calculation. While NOI can fluctuate some
14 from year-to-year, plant growth correlates well with property tax expense growth
15 and using plant balances to allocate property taxes to the gas utility provides an
16 allocation basis that is cost-causative and consistent with historical rate-making.

17 **Q. FOR 2021, HOW ARE ALL OF THESE DRIVERS IMPACTING PROPERTY TAX**
18 **EXPENSE?**

19 A. All of the drivers discussed above contribute to the overall calculation of property
20 tax expense presented in Confidential and Public Attachment NK-1 for 2018
21 through 2021. Both the cost indicator of value and the income indicator of value
22 increase from 2018 to 2021. The Total System Unit Value increases by [REDACTED]
23 [REDACTED] between 2018 and 2021. Moreover, both the cost indicator of value and the

1 income indicator of value feed into the \$1.48 billion increase in the Colorado Actual
2 Value between 2018 and 2021. The addition of the wind projects is included in the
3 Total System Unit Value but is removed in calculating Colorado Actual Value.

4 **D. Accuracy of the Company's Property Tax Expense Calculations**

5 **Q. PLEASE EXPLAIN WHY THE COMPANY'S CALCULATION APPROPRIATELY**
6 **ANTICIPATES PROPERTY TAX EXPENSE FOR 2021.**

7 A. The DPT's valuation methodology has been in place for many years, and there
8 have been very few changes to this methodology over the past 10 years. The
9 DPT's methodology is stable, and the Company has substantial knowledge of the
10 appraisal process and the detailed calculations of which it is comprised. Use of
11 this stable methodology has resulted in property tax estimates in prior rate case
12 proceedings that are near or below the actual property tax expense incurred by the
13 Company. As I describe above, the data presented to the Commission in the
14 Company's most recent gas and electric rate cases (Proceeding No. 17AL-0363G
15 and Proceeding No. 19AL-0268E, respectively), as well as the new data presented
16 in this Direct Testimony, demonstrate that the Company's property tax estimates
17 end up being very close to, and typically below, the actual amount of property tax
18 paid on an annual basis.

19 For this proceeding, the Company is estimating property taxes in the same
20 way it did in these prior electric and gas rate cases. Just like in those prior matters,
21 the Company has estimated Test Year Total System Unit Value based on the most
22 recent estimated plant and income information available. The Company has
23 calculated the effective tax rate for the 2018 property tax after processing all the

1 tax bills in April 2019. The effective tax for 2018 is 8.60 percent, which is used in
2 the 2021 total Company property tax forecast. By using the effective tax rate from
3 2018 to estimate taxes for 2021, the Company is likely forecasting a conservative
4 property tax estimate as effective tax rates tend to rise over time and the use of a
5 historical tax rate typically leads to an underestimated, not overestimated, tax
6 liability.

7 **Q. OVERALL, IS THE AMOUNT OF PROPERTY TAX EXPENSE REQUESTED**
8 **FOR RECOVERY IN THIS PROCEEDING REASONABLE?**

9 A. Yes. It is important to remember that while the Company works to manage the
10 level of total Company property tax expense requested for recovery to the extent
11 possible, the amount of property tax Public Service is required to pay is largely out
12 of the Company's control. Increases in property tax rates result from a multitude
13 of factors, like the passage of school district measures, for example, and eventually
14 flow through to the levy rates used, in part, to determine, the Company's property
15 tax liability. Public Service takes steps to mitigate the impact of increasing property
16 tax expense in Colorado, though these steps do not absolve the Company from its
17 obligation to pay property tax nor do these steps necessarily lessen the Company's
18 property tax responsibility. In fact, continuing to pay the requisite assigned
19 property tax is necessary to comply with governmental mandates supporting local
20 Colorado communities and residents.

1 **Q. IN SUMMARY WHAT IS THE COMPANY RECOMMENDING REGARDING**
2 **PROPERTY TAX?**

3 A. The property tax expense discussed above is a necessary expense in order for
4 Public Service to provide gas service to customers. Therefore, I recommend that
5 the Commission allow Public Service to recover the property tax expense included
6 in its Test Year cost of service. Although the 2021 property tax forecast is based
7 on the valuation received, changes are expected to occur in the effective tax rate,
8 and there is still some uncertainty in the forecasted property tax expense. As a
9 result, I also recommend the Commission approve the continuation of the property
10 tax deferral as discussed by Mr. Berman.

VII. CONCLUSION

Q. PLEASE SUMMARIZE THE RECOMMENDATIONS FROM YOUR TESTIMONY.

A. I have four primary recommendations. I recommend that the Commission calculate Public Service's income tax expense as though Public Service had depreciated its assets on a straight-line book basis. I also recommend that the Commission allow the two TCJA updates discussed in my Direct Testimony to be made in this proceeding. Additionally, I recommend that the Commission allow Public Service to update its cost of service for a Colorado law change that will be effective in January 2020. My final recommendation is that the Commission allow Public Service to recover \$237 million of property tax expense, as allocated by the Ms. Blair and included in the Test Year and allow the continuation of the property tax deferral as discussed in Mr. Berman's Direct Testimony.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

Statement of Qualifications

Naomi Koch

I am employed by XES, as Director, Tax Reporting. I earned a Bachelor of Science degree from the University of Minnesota and a Master of Business Taxation degree from the University of Minnesota. I joined what is now Xcel Energy in 1999 in Tax Services, and have more than 20 years of corporate tax experience. Through this experience, I have become familiar with various provisions of the IRC and IRS regulations that affect public utilities. I also have become familiar with various state laws, utility commission rules, and court cases that relate to the treatment and calculation of tax expenses, including income tax, for ratemaking and utility regulatory purposes. In 2019, I also became responsible for the sales/use and property tax compliance and accounting for all Xcel Energy group companies, including Public Service. I have taken several courses related to accounting and taxation of public utilities offered by the Edison Electric Institute, the American Gas Association, Deloitte & Touche, PricewaterhouseCoopers, and Arthur Andersen. I am also a member of the Tax Executives Institute, an association of in-house business tax professionals worldwide.

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

* * * *

IN THE MATTER OF ADVICE NO. 961-GAS OF)
PUBLIC SERVICE COMPANY OF COLORADO)
TO REVISE ITS COLORADO PUC NO. 6-GAS)
TARIFF TO INCREASE JURISDICTIONAL BASE) PROCEEDING NO. 20AL-____G
RATE REVENUES, IMPLEMENT NEW BASE)
RATES FOR ALL GAS RATE SCHEDULES, AND)
MAKE OTHER PROPOSED TARIFF CHANGES)
EFFECTIVE MARCH 7, 2020.)

AFFIDAVIT OF NAOMI KOCH
ON BEHALF OF
PUBLIC SERVICE COMPANY OF COLORADO

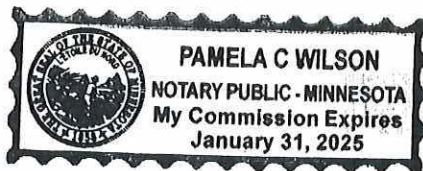
I, Naomi Koch, being duly sworn, state that the Direct Testimony and attachments were prepared by me or under my supervision, control, and direction; that the Direct Testimony and attachments are true and correct to the best of my information, knowledge and belief; and that I would give the same testimony orally and would present the same attachments if asked under oath.

Dated at Minneapolis, Minnesota, this 27th day of January, 2020.

Naomi Koch

Naomi Koch
Director, Tax Reporting

Subscribed and sworn to before me this 27th day of January, 2020.



Pamela C. Wilson
Notary Public

My Commission expires 1-31-2025