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February 1, 2018



Ms. Patricia Van Gerpen, Executive Director
South Dakota Public Utilities Commission
State Capitol Building
500 East Capitol Avenue
Pierre, SD 57501-5070

**RE: In the Matter of Staff's Request to Investigate the Tax Cuts and Jobs Act on South
Dakota Utilities
Docket No. GE17-003
Initial Comments**

Dear Ms. Van Gerpen:

Otter Tail Power Company (Otter Tail) submits these Initial Comments in response to the South Dakota Public Utilities Commission's December 29, 2017 Order in Docket No. GE17-003.

Pursuant to Administrative Rules of South Dakota (ARSD) Part 20:10:01:02:05, this filing has been electronically submitted to the Commission.

If you have any questions, please contact me at (218) 739-8607 or pbeithon@otpc.com.

Sincerely,

/s/ PETE BEITHON
Pete Beithon
Manager, Regulatory Recovery

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Enclosures
By electronic service

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA**

In the Matter of Staff's Request
To Investigate the Tax Cuts and
Jobs Act on South Dakota Utilities

Initial Comments of
Otter Tail Power Company
Docket GE17-003

Otter Tail is filing these Initial Comments in compliance with the South Dakota Public Utilities Commission's (the Commission's) December 29, 2017 Order in the above-cited docket. In its Order, the Commission required Otter Tail Power Company (Otter Tail) and other utilities to file by February 1, 2018, initial comments regarding the general effects of the Tax Cuts and Jobs Act (TCJA or Act) on the utility's cost of service in South Dakota and possible mechanisms for adjusting rates.

In its Order, the Commission also required the utilities to work with Staff to determine a deadline for additional comment filings to address proposals and impacts, and including: 1) an estimate of the company's determination of the TCJA's effects on its South Dakota cost of service, inclusive of all elements; 2) an explanation of these effects, and 3) proposals for procedures for changing rates to reflect these impacts. The Commission also required the utilities to provide information on any FERC proceedings addressing how federal income taxes will be adjusted for FERC transmission tariff rates.

Tax Cuts and Jobs Act Impacts on Otter Tail Power Company

On Dec. 22, 2017, the TCJA was signed by the President, which enacted significant changes to the Internal Revenue Code. The TCJA includes, among other things, a reduction in the maximum U.S. federal corporate income tax rate from 35 percent to 21 percent. In its final form, the TCJA recognizes the unique nature of public utilities and contains certain provisions specific to the industry, including the continuation of certain interest expense deductibility and relief from 100 percent expensing of capital investments

Summary of Expected Tax Reform Impacts on Otter Tail Power Company (Otter Tail)

Otter Tail is currently evaluating the impacts of the new legislation. A preliminary estimated impact of the TCJA on Otter Tail's cost of service is in the range of 2 percent on a stand-alone basis, before considering the impacts of any existing revenue deficiency or impacts of the Federal Energy Regulatory Commission's (FERC) treatment of the Midwest Independent System Operator's (MISO) tariffs and schedules.

Potential Regulatory Options

In very basic terms, an evaluation should be completed to assess whether the change to tax rates has resulted in surplus earnings for the utility, and if so, the surplus could be refunded to customers through a rider mechanism or a change to base rates. The assessment could be completed in a general rate case proceeding or in a separate proceeding where a review of the utility's cost of service could be completed. The last time a similar situation arose, Otter Tail filed a case in Docket F-3691 which assessed the effects of the Tax Reform Act of 1986 (TRA 86).

Impacts of TCJA

In the most general terms, when tax rates are lowered it reduces a utility's cost of providing service. By comparing a utility's cost of service to its current revenues, an assessment can be made to determine whether the utility has a deficiency or a surplus of revenues from which to meet its cost of service. In more specific terms, the change to tax rates reduces the tax expense of the utility and several other components of utility financials; for example:

- Importantly, the tax gross up factor goes down. For Otter Tail, the tax gross-up factor of 1.540541 times the short fall is reduced to 1.267534.
- With the elimination of bonus depreciation, the utility will have lower accumulated deferred tax liabilities (ADIT) going forward (not impacting past ADIT net of regulatory liabilities), which increases rate base growth for the same level of expected capital expenditures due to lower forecasted deferred tax liabilities. The TCJA requires the revaluation of federal deferred tax assets and liabilities using the new lower tax rate. The net revaluation of Otter Tail's ADIT is a small change. The ADIT due to excess tax over book depreciation is "protected" under the new tax law which means the amount is to be amortized over the remaining life of the property that created the ADIT. It is Otter Tail's understanding that any other treatment would constitute a normalization violation by the Federal Internal Revenue Service (IRS). In Otter Tail's case, only a small net amount of ADIT (less than one half of a percent) is not "protected" under the new tax law. The changes are expected to result in the recording of regulatory assets and liabilities for the non-protected portion of ADIT, with no estimated income statement impact.

Revaluation of Deferred Tax Assets & Liabilities

Otter Tail is required to revalue its deferred tax assets and liabilities, including U.S. federal income tax net operating losses, as of the enactment date of the TCJA. Most of Otter Tail Power Company's deferred tax assets and liabilities are predominantly subject to a normalization

method of accounting. As a result, the revaluation of most of the utility's net deferred taxes is expected to result in the establishment of regulatory liabilities which would be refundable to utility customers over the remaining life of the related assets.

Conclusion

Otter Tail looks forward to working with South Dakota Public Utilities Staff to determine the next steps for additional comments as required by the Order in Docket GE17-003.

OTTER TAIL POWER COMPANY

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