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VIA E-filing

Ms. Patricia Van Gerpen
Executive Director
South Dakota Public Utilities Commission
500 East Capitol Ave.
Pierre, SD 57501

Re: MidAmerican's Energy Cost Adjustment Factor As Applied to Repowered Wind Facilities

Dear Ms. Van Gerpen:

MidAmerican Energy Company ("MidAmerican") is currently in the process of repowering up to 510 existing Siemens wind turbines located in Iowa, which will qualify the turbines for new production tax credits ("PTCs") under guidance from the Internal Revenue Service ("IRS"). Since MidAmerican will not be including the costs of repowering in rates, MidAmerican believes that the PTCs associated with repowering should be excluded from MidAmerican's Energy Cost Adjustment ("ECA") tariff (South Dakota Electric Tariff Schedule No. 2, Sheet No. 78), and requests an interpretation from the South Dakota Public Utilities Commission ("Commission") confirming this conclusion. Recall that on December 21, 2017, the Commission issued an order in Docket No. EL17-040 determining that repowering up to 706 existing General Electric wind turbines are not subject to the provisions of MidAmerican's ECA tariff. By way of this letter, MidAmerican requests that the Commission open a docket and issue the same determination for the 510 Siemens wind turbines to be repowered.

MidAmerican's ECA states (in relevant part):

"The cost of energy will be adjusted by the pre-tax amount of any federal production tax credits associated with renewable power projects whose costs have been approved for inclusion in rate base in a rate proceeding, grossed up at the rate of 1.266 as entered into account 409.1, reduced for any negative energy settlements from those renewable power projects that result during the period the projects are eligible for the production tax credit, as recorded in account 447.043."

MidAmerican's reasoning for excluding PTCs from the ECA follows. The ECA is clear that PTCs are included for renewable power projects that are included in rate base. South Dakota is allocated approximately 1% of MidAmerican's wind projects, and all of the turbines that are subject to this repowering effort are currently included in South Dakota rate base. However, the incremental costs of repowering – i.e. the new equipment that makes the projects eligible for the PTC – will *not* be included in base rates¹ and MidAmerican will be taking on the risk of those costs consistent with traditional ratemaking practices. MidAmerican will not include the costs of repowering in base rates until a future rate case, which is not anticipated for many years. Therefore, MidAmerican believes the tariff should be interpreted to result in the PTCs associated

¹ The repowering costs will be added to the current book value of the existing blades, however.

with repowering *not* being included in the ECA. In the event of a rate case, the Commission will maintain oversight over the repowering costs since this interpretation of the tariff will not prejudice any party's ability to argue about the costs and benefits of the repowering efforts in a future rate case.

The renewal of the PTC is based on provisions of the Protecting Americans from Tax Hikes ("PATH") Act of 2015², along with IRS rules.³ Coupled together, these laws and guidance allow existing wind facilities to requalify for the PTC for an additional ten-year period provided the fair market value of the used property that remains part of the repowered (or retrofitted) wind turbine is not more than 20% of the total value of such repowered wind turbine (the cost of the new property plus the fair market value of the used property).⁴ This is known as the 80/20 Rule. In connection with the planned repowering project, MidAmerican will replace significant portions of existing wind turbines with new, more efficient parts and continue to operate the turbines at existing sites. Certain equipment will be retained, including the majority of the tower structure and the foundations;⁵ however, the entire nacelle will be replaced (or much of the machinery and equipment inside the nacelle). All repowered turbines will include new blades that are longer than the original installation configuration, resulting in an increase in the capacity factor for these wind farms.

The turbines that are subject to MidAmerican's repowering efforts will have been in service for over ten years at the time of repowering. Without repowering, the benefit of PTCs would end. By repowering, MidAmerican can begin collecting a new PTC. In addition to creating a new PTC, the longer blades and new equipment allow for an increase in the production capability and unit availability, increasing the capacity factor of the turbines. The increased generation production benefits customers through increased wholesale revenues and lower fuel costs. These benefits will flow through to customers through the ECA immediately. MidAmerican estimates that the overall ECA benefits for South Dakota customers will be \$1.5 million through 2029. South Dakota customers will realize these savings immediately through the ECA, with no increase in base rates. As previously stated, the investment in repowering is subject to review at a future rate case.

In support of this request, MidAmerican is including with this filing the following financial analyses as separate tabs in the attached Excel workbook Exhibit A:

1. A five-year estimate of the additional revenue requirement attributable to repowering. This is provided for illustrate purposes only, as MidAmerican does not plan to include any of the additional revenue requirement in base rates in the next five years. MidAmerican has a publicly stated goal to maintain low and stable rates for customers, and MidAmerican currently does not see the need for a South Dakota electric rate case in the next five years. Should this outlook change, no party nor the Commission would be prejudiced in the ability to argue about the prudence of MidAmerican's repowering efforts in the event of a rate case.
2. The incremental production tax credits earned from the repowered projects and, (a) their impact to the ECA, (b) their impact on return on equity if excluded from the ECA,

² Public Law 114-113 (December 18, 2015). The PATH Act of 2015 was a portion of the Consolidated Appropriations Act.

³ See e.g., IRS Notice 2016-31 at 11 (identifying the application of the safe harbor requirements to retrofitted facilities)

⁴ *Id.* (citing Rev. Rul. 94-31, 1994-1 C.B. 16; Notice 2008-60, 2008-2 C.B. 178).

⁵ The retained equipment will continue to be depreciated pursuant to the schedules approved in MidAmerican's last electric rate case.

and (c) their impact on return on equity if included in the ECA. In performing this analysis, MidAmerican used forecast operating income and rate base information, capital structure and cost of debt, from our 2018 financial plan to show projected returns on equity. Like any forecast, these figures are estimated and the closer in time the numbers are, the more probable they are.

The spreadsheet shows that under both scenarios, MidAmerican is expected to under-earn in the near term. However, under the first scenario where MidAmerican retains PTCs from repowering, the deficiency is remedied by 2023. Under the second scenario where customers get the PTC benefits (without the costs in rates), it is highly likely to drive a rate case along with the accompanying rate case costs.

3. The original book value, current book value and market value of the existing 510 wind turbines subject to repowering.
4. A top-sheet financial analysis for 510 wind turbines subject to repowering. In this analysis, rows 21-25 provide the cost/benefit on a per kilowatt hour. This shows, on a levelized basis, the benefits of the production tax credits and off system sales of additional generation more than offset the investment cost of the repowering. The project results in no net cost, but rather provides a net benefit of \$0.0273/kilowatt hour on a levelized basis.
5. The additional South Dakota electric gross revenue requirement attributable to the repowering process for 2018 through 2022, without netting the PTC or energy benefits.
6. A comparison of the rate base included in the settlement in docket EL14-072 with MidAmerican's current South Dakota electric rate base. These unadjusted numbers show MidAmerican's additions in plant since the last South Dakota rate case. The chart provides a snapshot of one point in time, and does not include pro forma adjustments that would be necessary to normalize the results, as would be done in a rate case filing. The plant additions have primarily been wind generation, which enables MidAmerican's delivery of low cost energy to customers and to secure production tax credits before the credits are phased-out.

The benefits of MidAmerican's repowering project accrue to customers immediately through lower production costs despite the fact that the repowering costs will not be included in base rates. The benefit of the production tax credits to MidAmerican has the effect of delaying any future rate case, which in turn lowers any revenue requirement associated with repowered facilities since they will have accrued more depreciation over time.

7. An itemization of all significant increases in South Dakota electric operating expense since rates were increased in docket EL14-072. The line item for "other power generation maintenance" costs reflects an increase related to new wind additions. The line item for "income taxes" reflects a reduction due to additional production tax credits that result from the new wind additions, lower pretax income, and a lower federal tax rate. The line item for "Transmission Ops" reflects an increase in regional transmission investment (MISO Schedule 26A). The line item for "Depreciation" reflects and increase due to a net increase in investment.
8. MidAmerican's earned return in 2018 for its South Dakota electric jurisdiction based upon updated costs for changes to material rate case elements since docket EL14-072.

This chart provides a snapshot of one point in time, and does not include pro forma adjustments that would be necessary to normalize the results, as would be done in a rate case filing. Due to the many factors like weather and sales volume changes, the calculation could produce different results in subsequent years. The current South Dakota electric rate base is approximately \$15.1m greater than the amount shown for 2018 due to additional wind investment going in-service.

Forecast information is contained in these financial analyses, and is proprietary and confidential under ARSD 20:10:01:39. MidAmerican respectfully requests that this confidential information be accorded confidential treatment in perpetuity pursuant to the ARSD 20:10:01:39, et seq. MidAmerican provides a confidential version of the spreadsheet (with the proprietary information highlighted) and a public version (with the proprietary information redacted).

MidAmerican believes the exclusion of PTCs from the ECA is the fairest outcome. Repowering makes economic sense for customers because of the increase in low-cost renewable energy provides customer benefits with no base rate increase, and for MidAmerican because of the retention of the PTC. MidAmerican respectfully requests a Commission interpretation of its tariff to clarify that it can retain 100% of the PTCs associated with repowering projects. MidAmerican is prepared to answer any questions that the Commission or staff may have on this request for an interpretation. If you have any questions, or need more information, please do not hesitate to contact me.

Sincerely,

/s/ Katelyn M. Lynch-Butcher

Katelyn M. Lynch-Butcher
Attorney