STAFF MEMORANDUM SUPPORTING SETTLEMENT STIPULATION

TO: COMMISSIONERS AND ADVISORS

FROM: BRITTANY MEHLHAFF, KRISTEN EDWARDS, AND AMANDA REISS

RE: DOCKET GE17-003 – IN THE MATTER OF STAFF'S REQUEST TO INVESTIGATE THE EFFECTS OF THE TAX CUTS AND JOBS ACT ON SOUTH DAKOTA UTILITIES

DATE: May 3, 2019

Commission Staff (Staff) submits this Memorandum in support of the May 2, 2019 Settlement Stipulation (Stipulation), between Staff and MidAmerican Energy Company (MidAmerican or the Company) in the above-captioned matter.

BACKGROUND

On December 20, 2017, the United States Congress passed the Tax Cuts and Jobs Act (TCJA), which was ultimately signed into law by the President on December 22, 2017. The TCJA impacts each tax paying utility's cost of service and, therefore, all ratepayers as well. The TCJA, among other provisions, reduced the corporate tax rate from 35% to 21% for tax years beginning on and after January 1, 2018. The significant decrease in the tax rate and its resulting impact on utility costs and rates requires an investigation to ensure rates remain just and reasonable going forward after the enactment of the TCJA.

On December 21, 2017, Staff filed a "Motion Requesting Order Requiring Comments and Securing Tax Effects for Customers as of January 1, 2018" (Motion). In the Motion, Staff requested the Commission investigate the effect the TCJA has on South Dakota utilities and requested the Commission issue an order requiring utilities to submit comments on the effect the TCJA has on each utility. Additionally, Staff requested the Commission issue an order requiring that any adjustment to rates resulting from the TCJA be made effective January 1, 2018.

On December 29, 2017, the Commission issued its "Order Requiring Comments; Order Requiring Rates in Effect January 1, 2018, are Subject to Refund; Order Granting Intervention." On January 29, 2018, NorthWestern Energy submitted initial comments and on February 1, 2018, Black Hills Energy, Montana-Dakota Utilities Co., MidAmerican Energy, Xcel Energy, and Otter Tail Power Co. filed initial comments pursuant to the Commission's instructions. On May 2, 2019, Staff and MidAmerican (Parties) filed a "Joint Motion for Approval of Settlement Stipulation" and a "Settlement Stipulation" (Stipulation). A review of the terms of the Stipulation is provided below.

REVIEW OF THE STIPULATION

Staff worked with the Company to design a settlement that refunds to MidAmerican's South Dakota electric and gas customers the cost-reducing impacts resulting from the TCJA that have been accumulating since January 1, 2018, consistent with the Commission's order requiring any adjustment to rates be effective January 1, 2018. The settlement also provides for a permanent reduction in MidAmerican's electric and gas[1] base rates effective June 1, 2019.

Prospective Base Rate Reduction

The Parties agree that the on-going cost-reducing effects of the TCJA as of June 1, 2019 and beyond should be recognized in the form of a permanent base rate reductions. The amounts of the base rate reductions determined by the Parties are based on the impact of the change in tax rate on the Company's revenue requirements as established in its most recent rate cases. The base rate reductions that were determined in this manner are $359,811 for MidAmerican's South Dakota electric system and $1,205,376 for MidAmerican's South Dakota natural gas system. The revenue reductions were allocated to customer classes based on each class' share of the revenue allocations determined in the Company's most recent base rate cases. The Proof of Revenue for gas and electric found in Exhibits A and B to the Stipulation detail these base rate reductions and corresponding rate derivations. Revised tariff sheets reflecting new base rates going forward are provided in Exhibits E through H to the Stipulation.

Energy Cost Adjustment

MidAmerican's Energy Cost Adjustment (ECA) includes the benefit of production tax credits (PTCs) associated with wind projects that are included in rate base. To reflect the appropriate pre-tax benefit in the ECA, PTCs are "grossed- up" using the federal income tax rate. Since the federal income tax rate was reduced from 35% to 21%, it is appropriate that the PTC gross up factor listed in the ECA tariff be reduced accordingly from 1.538 to 1.266. This change in the gross-up factor results in a prospective reduction in the PTC benefit reflected in the ECA. The proposed changes to the ECA tariff are located in Exhibits E and F, tariff sheet Section No. 3, 2nd Revised Sheet No. 78 Canceling 1st Revised Sheet No. 78. The ECA tariff change will be effective July 1, 2019.

TCJA Refund for the Period January 1, 2018 through June 30, 2019

The Parties agree that the cost-reducing effects of the TCJA should be refunded to customers retroactive to January 1, 2018, as required in the Commission's December 29, 2017 order. The Parties further agree

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[1] Customers taking service under rate NF (farm tap customers) will not receive a refund or base rate reduction due to the TCJA. MidAmerican's cost to serve these new farm tap customers are primarily operating expenses given the customers connect directly to Northern Natural Gas and own their own pipelines. Any impact to rate base is immaterial and given expenses are tax deductible, an adjustment due to the TCJA is not appropriate. Furthermore, as rates were designed to phase-in to cost-of-service based rates over 10 years, these customers are currently not paying their true cost of service. Reducing rates would aggravate this disparity.

that MidAmerican should refund to its South Dakota natural gas customers $3,308,988 and refund to its South Dakota electric customers $921,476, both refund amounts including interest, representing the cost-reducing impact of the TCJA during the period January 1, 2018 through May 31, 2019. These refunds reflect the Company's obligation to South Dakota customers as a direct result of the TCJA and include the impact of the difference between the 35% corporate tax rate and the 21% corporate tax rate, and the resulting excess in the deferred tax reserve balances also created by the TCJA. Exhibits C and D to the Stipulation detail the calculations of the refunds.

The refund calculations involve two components: First, is quantifying the impact of the reduction of the corporate tax rate from 35% to 21%. The Parties agreed to base this calculation on the settlement cost of service models from Docket Nos. EL14-072 (electric) and NG14-005 (gas), adjusted for a 21% federal income tax rate. The original cost of service models in these two dockets used a 35% federal income tax rate. Next, the change in the PTC gross up factor, as discussed above, for the period January through June 2019 is included as an offset to the electric refund. Exhibit I to the Stipulation provides the ECA workpapers which demonstrate the PTC gross-up factor change is included in the refund for the period January through June 2019, avoiding any double counting of the offset.

Prior to January 1, 2018, MidAmerican's accumulated deferred income tax (ADIT) balance was accumulating at the 35% tax rate. Since the tax rate was reduced to 21%, MidAmerican now has an excess in its deferred tax reserve. The Parties agree that all excess protected plant-related ADIT[2] will be amortized over the remaining book life of MidAmerican's plant using the Average Rate Assumption Method (ARAM), as required by the IRS. MidAmerican also has non-protected[3] excess ADIT. The Parties agreed that MidAmerican will refund its entire unprotected property excess ADIT balance to customers with the refund. For MidAmerican's unprotected non-property related ADIT balances, however, as those balances were not reflected in the impact to base rates in the Company's most recent rates cases, the Parties agreed that no refund or surcharge was appropriate associated with these balances.

The refunds will be returned to MidAmerican's South Dakota electric and gas customers by applying a per unit credit to customers' billed monthly usage beginning with July 2019 bills and continuing through December 2019 bills. Upon completion of the refund, if the actual refund varies from the expected refund by more than $5,000 for electric customers or $5,000 for natural gas customers, MidAmerican will extend the refund period until the balance is below the $5,000 threshold. The reconciled difference will be applied only to those customer classes that are outside an acceptable level in a manner mutually agreed to by MidAmerican and Staff. The tariff sheets associated with the refunds are provided in Exhibits E through H.

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[2] Excess ADIT associated with protected plant refers to excess ADIT that the TCJA requires be normalized using the Average Rate Assumption Method (ARAM). Under ARAM, the utility cannot return to customers the excess in the deferred tax reserve that is protected until the year in which the book depreciation expense is more than the tax depreciation on the underlying assets. Utilities must follow ARAM for these protected assets in order to avoid a normalization violation. Therefore, ARAM must be used for ratemaking purposes.

[3] Generally, the Commission has discretion on the amortization of non-protected excess ADIT for rate making purposes. This can include both plant related and non-plant related non-protected excess ADIT.

The refund mechanism agreed to as a result of this stipulation differs from the one-time refunds based on historical usage stipulated to with other companies. While Staff pursued a similar refund mechanism for MidAmerican, given the length of time already expended to bring this docket to a resolution with MidAmerican and in the interest of achieving a global settlement, Staff agreed to the alternative refund mechanism advanced by MidAmerican given complexity, cost, and time constraints of other alternatives. Further, Staff believes a reasonably equitable result can be achieved using this method.

RECOMMENDATION

Staff recommends the Commission grant the Joint Motion for Approval of Settlement Stipulation and adopt the Settlement Stipulation without modification.