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July 16, 2018

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

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

Dear Ms. Van Gerpen:

Otter Tail Power Company submits these Additional Comments in Docket No. GE17-003. A copy of these Additional Comments will be filed in Docket No. EL18-021.

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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**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

Additional Comments of
Otter Tail Power Company
Docket No. GE17-003

INTRODUCTION

Otter Tail Power Company (Otter Tail) files these Additional Comments in response to the South Dakota Public Utilities Commission's (the Commission's) December 29, 2017 Order in this docket.

On February 1, 2018, Otter Tail filed initial Comments in this matter. These Additional Comments provide specific financial information on Otter Tail's current revenue deficiencies, and they explain the practical effects of the Commission's denial of Otter Tail's request for interim rates in its pending general rate case, Docket No. EL18-021. These Additional Comments also describe how Otter Tail's current rates do not include any recovery of income taxes (and how they, in fact, include a credit for income taxes).

Based upon this information, Otter Tail asks that the Commission enter an Order in this matter that recognizes that Otter Tail has demonstrated revenue deficiencies from current rates that exceed any change to tax expense caused by the TCJA, and therefore, no further rate changes or refunds of current rates is appropriate, as any such change or refund would result in rates that are not just and reasonable. Also, Otter Tail's current rates do not include income taxes (in fact, they include a credit) and therefore adjusting Otter Tail's current rates for the TCJA changes would not result in a reduction of those rates.

I. Otter Tail's current rates leave Otter Tail with a significant revenue deficiency that is much larger than the TCJA-related reduction to taxes.

Otter Tail's current rates were set in 2010 based on a 2009 historic test year (Docket No. EL10-011). Due to costs that have risen since that time, these current rates leave Otter Tail with a significant revenue deficiency. That deficiency is demonstrated through Otter Tail's cost of service study, filed in Docket No. EL 18-021, which is based on a 2017 test year with known and measurable changes, including TCJA-related reductions to tax expense.

In its pending rate case, Otter Tail requested interim rates. The requested interim increase was net of the impacts of the TCJA. The Commission denied Otter Tail's request for interim rates, and suspended Otter Tail's requested rate increase for 180 days, the statutory maximum duration for a rate suspension. As noted in Staff's May 9, 2018 memorandum in the rate case, if Otter Tail had not included the impacts of the TCJA on Otter Tail's test year, the

interim request would have been increased by approximately \$1,205,765, to a interim deficiency total of \$3,592,303. In other words, Otter Tail's interim test year revenue deficiency is \$2,386,538 more than the TCJA has reduced taxes in the same interim test year. While the TCJA has resulted in a significant beneficial reduction to Otter Tail's requested rate increase, Otter Tail's current rates result in a revenue deficiency that exceeds the TCJA reduction by \$3,358,547 on the test year (non-interim) basis.

Also, Otter Tail's reported deficiency for the 2017 actual year (not the test year) was \$2,379,592 (\$2.4 million), filed on June 1, 2018, in Docket No. EL17-048. This reported 2017 actual-year deficiency further demonstrates that Otter Tail's current rates resulted in a revenue deficiency in 2017 that exceeded the TCJA reduction that occurs in the test year.

This information demonstrates that Otter Tail's significant revenue deficiency existed on and will exist following January 1, 2018 (the date the TCJA went into effect), and that any reduction to current rates or refunding of current rates would result in rates that are not just and reasonable.

II. A recalculation of Current Rates based on TCJA changes would result in higher rates for Otter Tail's customers due to Otter Tail's very favorable tax treatments at the time of its last rate case.

As earlier indicated, Otter Tail's current rates were set in 2010 based on a 2009 historic test year. And while it may be unexpected, those current rates actually include a *credit* for income taxes, not a tax expense. This tax-credit condition occurred because Otter Tail's 2009 historic test year had *negative* amounts for taxes resulting from significant bonus depreciation, accelerated depreciation, deductions and credits, mostly due to Otter Tail's then-recent capital investments (Docket No. EL10-011), and the then-current tax code included favorable provisions intended to incentivize investment.

To quantify the rate impact of the favorable tax code provisions that are reflected in Otter Tail's current rates, Otter Tail calculated its 2009 test year under the assumption that the TCJA had been in effect at that time. In a result that may be counter-intuitive, the impact of the TCJA changes on the 2009 Test Year used to set current rates is an increase of over \$1.44 million to the 2009 test year total revenue deficiency. The calculations of this impact have been supplied in response to data request SD-PUC-02.04 in Otter Tail's current rate case, Docket No. EL18-021. The summary page of Attachment 2 to that data request response is attached to these comments as Attachment 1. It compares the calculated deficiency from Docket No. EL10-011 to the deficiency using the impacts of the TCJA. The change in tax rates effectively turns the credit for tax built into the last approved revenue requirement into an expense for tax. In Otter Tail's last test year, net income tax expense was a *negative* \$0.8 million which when the TCJA is applied becomes a *positive* \$0.5 million due to the change in the tax rate from 35 percent to 21 percent, the change in bonus depreciation's impact on deferred tax expense (the Luverne wind farm went

into service during the 2009 test year) and the reduction in the gross revenue conversion factor along with the amortization of excess deferred income taxes (EBIT).

This information shows that Otter Tail's current rates already reflect a very favorable tax position, which is due to the investment incentives that were part of the tax code when those rates were set. While the TCJA will reduce future rates when they are set in Otter Tail's current case, Otter Tail's current rates already reflect optimal tax benefits from the tax code provisions that were in effect when it last set rates.

III. No further rate changes or refunds of current rates is appropriate, as any such change or refund would result in rates that are not just and reasonable.

As stated in Otter Tail's February 1, 2018 Comments in this docket, "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 above information demonstrates that Otter Tail's current rates do not include income tax expense, nor would they be lower after an application of the TCJA. The above also demonstrates that Otter Tail's revenue deficiencies under current rates exceed the TCJA impacts on the test year of its pending rate case. Therefore, for the period following the implementation of the TCJA on January 1, 2018, no further rate changes or refunds of current rates is appropriate for Otter Tail, as any such change or refund would result in rates that are not just and reasonable.

The last time a similar situation arose, Otter Tail filed a rate case in Docket No. F-3691 which assessed the effects of the Tax Reform Act of 1986 (TRA 86). In Docket No. F-3691, South Dakota Public Utility Commission witness Robert G. Towers stated in his direct testimony:

Q. Should the Company be excused from the Stipulation Requirement [requiring refunds relating to "TRA" changes to the tax code at that time]?

A. Yes, I recommend that the Company not be required to refund TRA savings accruing from the July 1, 1987 [the date the TRA tax code changes became effective] to the effective date of the rates that will be established in this proceeding.

First, I should mention that, although Paragraph 4 of the Stipulation is clear in stating the requirement, the Stipulation states that no party is prohibited from "making any contention in any proceeding or investigation". Thus, there is no bar to the Company's request.

Substantively, waiving the requirement to make refunds (or to amortize the locked-in period tax savings into prospective rates) is supported by Staff's analysis of Otter Tail's overall revenue requirements. That analysis shows that, after considering the ongoing TRA savings and cost of capital reductions experienced since the Company's rates were last adjusted, a rate increase is warranted. The conditions reflected in the Staff's analysis are conditions that existed on July 1, 1987 and should be representative of the conditions the Company will experience during the locked in period.

The Settlement that was ultimately approved by the Commission in that rate case included recognition that further proceedings were unnecessary in the tax change investigation docket (Docket No. F-3647-5), as were rate adjustments or refunds for the period after the tax change was put in effect and up until the new rates were implemented. October 30, 1987 Settlement Agreement, Docket No. F-3691

In the current case, Otter Tail is in the same circumstance as that described in the above-cited testimony from 1987. Otter Tail's filing in Docket No. EL18-021, and its recently reported actual earnings for 2017, reflect Otter Tail is in a deficiency position in 2018 and the TCJA changes have not resulted in surplus earnings for the utility. It is based on a test year that has been adjusted to fully reflect the impacts of the TCJA, and those rates will be reviewed in that proceeding. The rate case test year cost of service, therefore, identifies the conditions that existed on January 1, 2018, and they are representative of the conditions the Company will experience during the entire period up until rates are implemented from its pending rate request. For these reasons, Otter Tail should not be required to refund tax-related savings accruing from January 1, 2018 to the effective date for the rates that will be established in the pending rate proceeding.

CONCLUSION

Otter Tail requests that the Commission enter an Order in this matter that recognizes that Otter Tail has demonstrated revenue deficiencies from current rates that exceed any change to tax expense caused by the TCJA. Therefore, no further TCJA-related changes to current rates or refunds of current rates is appropriate, as any such change or refund would result in rates that are not just and reasonable. Also, the Commission's Order may include a finding that Otter Tail's current rates do not include income taxes (in fact, they include a credit) and therefore any attempt to adjust Otter Tail's current rates for the TCJA changes would not result in a reduction of those rates. Finally, Otter Tail notes that the rates requested in Docket No. EL18-021 include the impacts of the tax changes and they will be reviewed in that proceeding and therefore no further action is required in this proceeding to address those requested rates.

OTTER TAIL POWER COMPANY

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