STAFF MEMORANDUM SUPPORTING SETTLEMENT STIPULATION

TO: COMMISSIONERS AND ADVISORS

FROM: BRITTANY MEHLHAFF, PATRICK STEFFENSEN, 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: JULY 5, 2018

Commission Staff (Staff) submits this Memorandum in support of the June 25, 2018 Settlement Stipulation (Stipulation), between Staff and Northern States Power Company dba Xcel Energy (Xcel 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 all ratepayers. The TCJA contains provisions including, but not limited to, lowering the corporate tax rate from 35% to 21% effective 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 from the TCJA will 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 June 25, 2018, Staff and Xcel Energy (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 the 2018 impacts of the TCJA, consistent with the Commission's order requiring any adjustment to rates be effective January 1, 2018, while incorporating alternative performance-based regulation and providing ongoing benefits to customers over the next two years.

2018 TCJA Refund

The Parties agree that the effects of the TCJA should be refunded to customers effective January 1, 2018 as required in the Commission's December 29, 2017 order. The Parties further agree that the amount of the calendar year 2018 refund should be calculated by revising Staff's settlement cost of service model used in Xcel's most recent rate case, Docket No. EL14-058, to reflect the 21% corporate tax rate, which went into effect January 1, 2018. This will ensure that Xcel's base rates currently in effect will stay proportional and representative of what was allowed in Xcel's most recent rate case. Xcel's current base rates will not change as a result of this settlement; but Xcel will refund to customers, on a lump-sum basis, the annualized impact of the TCJA on its cost of service.

The agreed upon refund amount for 2018, $10,868,000, will be posted in a single payment to customers' accounts no later than August 2018. The refund will be allocated to customer classes based on each class' share of the revenue allocation approved in EL14-058. Customer refunds will be calculated based on each customer's most recent 12 months of sales available at the time of the refund. No carrying charge will be applied to the 2018 refund amount, as approximately half of the refund will be in the form of a prepayment.

Base Rate Moratorium and Earnings-Sharing Mechanism

Absent this settlement, Xcel was prepared to file for a rate increase in June 2018. In lieu of Xcel filing a rate case with rates becoming effective January 1, 2019, the Parties agree to a two-year rate moratorium coupled with an earnings-sharing mechanism, which requires Xcel to share excess earnings with customers from January 1, 2019 until the effective date of Xcel's next change in base rates.

With the two-year rate case moratorium, Xcel cannot file another general rate case prior to June 30, 2020, for rates to become effective January 1, 2021. Under the settlement, all currently effective riders will continue during the moratorium period, including the Infrastructure Rider in a limited capacity. The Parties agree that Xcel may not include any new projects or costs in the Infrastructure Rider except for new wind generation projects and the costs of terminating certain biomass power purchase agreements. The Stipulation provides no agreement regarding prudence of any Infrastructure Rider projects or costs. Staff will continue to examine the appropriateness of Infrastructure Rider costs during annual filings.

The Parties further agree that the proper way to ensure rates are just and reasonable and that the TCJA impacts are returned to ratepayers beyond 2018 is through the continued use of the earnings-sharing mechanism approved by the Commission in EL14-058. This mechanism will continue to be in effect until the conclusion of Xcel's next general rate case with the only change being 100% of any earnings that result in a return on equity over 10% will be refunded to Xcel's South Dakota customers.

Excess Accumulated Deferred Income Taxes

Due to the use of accelerated and bonus depreciation and tax normalization for rate purposes, the amount of taxes actually paid to the IRS by Xcel has been much less than the taxes recovered from ratepayers. Prior to January 1, 2018, Xcel's accumulated deferred income tax (ADIT) balance had been accumulating at the 35% tax rate. Because the tax rate has now been reduced to 21%, Xcel now has an excess in its deferred tax reserve that must be returned to ratepayers.

This settlement also establishes a method for returning these excess ADIT balances to ratepayers. The Parties agree that all excess protected plant-related ADIT and excess NOL ADIT will be amortized over the remaining book life of Xcel's plant using the Average Rate Assumption Method (ARAM). All unprotected non-plant-related excess ADIT will be amortized over a three-year period, commencing January 1, 2018. The three-year amortization of the non-plant related excess ADIT will be completed at the end of the moratorium period.

RECOMMENDATION

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