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February 15, 2018

Darrell Nitschke  
Director of Administration/Executive Secretary  
North Dakota Public Service Commission  
600 East Boulevard, Dept. 408  
Bismarck, ND 58505-0480

**RE: In the Matter of Advocacy Staff's Request to Investigate the Effects of Tax Reform and  
for Accounting Treatment  
Case No. PU-17-490  
Comments**

Dear Mr. Nitschke:

Otter Tail Power Company (Otter Tail) respectfully submits comments in response to the North Dakota Public Service Commission's January 10, 2018 Order requiring each regulated utility to file information and comments regarding the impact of the Tax Reform Act.

An original and seven copies of the Company's Comments are being sent via mail. Please contact me at (218) 739-8607, or [pbeithon@otpc.com](mailto:pbeithon@otpc.com) should you have any questions with respect to this filing.

Very truly yours,

A handwritten signature in black ink, appearing to read "Pete Beithon", with a long horizontal flourish extending to the right.

Pete Beithon  
Manager, Regulatory Recovery

kaw  
Enclosures  
By electronic filing  
c: Service List

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF NORTH DAKOTA**

In the Matter of Public Service Commission  
Rate Impact and Accounting Treatment Investigation

Comments of  
Otter Tail Power Company  
Case No. PU-17-490

## **I. Background**

On December 22, 2017, the Tax Cuts and Jobs Act (TCJA) was signed by the President, which enacted significant changes to the Internal Revenue Code.

On January 10, 2018 the North Dakota Public Service Commission (Commission) initiated an investigation of the impacts of the TCJA on rate regulated utilities. Among other things, the Commission directed rate-regulated utilities to file by February 15, 2018 “information in this investigation regarding the impact of the [TCJA] with supporting calculations.” The Commission also directed utilities to file comments regarding the appropriate regulatory treatment of TCJA impacts.<sup>1</sup>

Otter Tail Power Company (Otter Tail or Company) respectfully submits the following comments in response to Commission’s January 10, 2018 Order. Simultaneous with this submission, Otter Tail is filing a request to reduce interim rates in Otter Tail pending general rate case (Case No. PU-17-398) from 10.44% to 6.79%. If Otter Tail’s request is approved, the revenue requirement for interim rates will be reduced from \$12.8 million to \$8.3 million, a total reduction in interim revenue of \$4.5 million. This decrease is the result of Company’s preliminary assessment of the tax rate reduction components of TCJA. Otter Tail is also proposing to reduce rates in its Transmission, Renewable, and Environmental riders to further capture the impacts of the TCJA in those cost recovery mechanism. Collectively, adjusting those riders reduces their revenue requirements by approximately \$1.7 million.

## **II. Tax Cuts and Jobs Act Key Features**

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

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<sup>1</sup> Order Initiating Investigation, ordering point 3, December 29, 2017, Public Service Commission Rate Impact & Accounting Treatment Investigation, Case No. PU-17-490.

continuation of certain interest expense deductibility and relief from 100 percent expensing of capital investments.

### **III. Summary of Expected Tax Reform Impacts on Otter Tail**

Although Otter Tail is still evaluating the impacts of the new legislation, the Company believes the major impacts of the TCJA are sufficiently known to reduce interim rates 3.65 percent, a total reduction of \$4.5 million for our North Dakota customers. Similar adjustments to the Transmission, Renewable, and Environmental cost recovery riders results in an annualized \$1.7 million savings to Customers. Any additional impacts of the TCJA, will be evaluated and addressed through the process for setting final rates and subsequent rider true-ups.

### **IV. Mechanism for Identifying TCJA Impacts**

Otter Tail believes its pending rate case, which uses a 2018 forecast test year, is the most efficient mechanism for identifying and passing on the beneficial impacts of the TCJA to our customers. In contrast, Otter Tail's rates in Minnesota and South Dakota were set based on our cost of providing service in 2016 and 2009, respectively. This will require that we approach each state differently to assess the impact of the TCJA based on our current cost of providing service. Otter Tail is assessing our current cost of providing service in each of those states.

The pending North Dakota rate case provides a platform to determine impacts of the TCJA on the Company's cost of service and resulting rates. Because of the pending rate case, Otter Tail requests that it be allowed to determine the impact of the TCJA through that proceeding, and incorporate those calculations in this docket at appropriate times. Please note that Otter Tail will continue to make appropriate filings in above-referenced docket as required by the Commission. Those filings, however, would be derived from calculations made and filed in Otter Tail's general rate case (Case No. PU-17-398). Otter Tail anticipates filing supplemental direct testimony in the pending rate case that will among other things address the impact of the TCJA on the Company's Application to increase electric rates in North Dakota.

### **V. Summary of Calculations**

As noted above, Otter Tail is seeking a reduction in interim rates to account for the major impacts of the TCJA. Otter Tail's Petition to Reduce Interim Rates in Case No. PU-17-398 sets forth the calculations supporting the reduction. Summarized, the Company requests a reduction of interim rates from 10.44 percent to 6.79 percent. The request decreases interim rates from \$12.8 million to \$8.3 million on an annualized basis, in base rate revenue currently being recovered from each customer class; a reduction of \$4.5 million. The request reduces the Environmental, Renewable, and Transmission Cost Recovery Rider annualized revenue

requirements that current rates are based on from \$26.5 million to \$24.8 million resulting in lower rates provided in the Mandatory Rider tariff sheets included in that filing. Impacts passed through in the Transmission Cost Recovery Rider may be affected by any action yet to be taken at the Midwest Independent System Operator (MISO) and the Federal Energy Regulatory Commission (FERC), and Otter Tail will provide additional assessment of the cost of service impacts of the TCJA in the rate case and rider proceedings as it becomes available.

## **VI. Impacts of TCJA and Appropriate Regulatory Accounting Treatment**

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 1.607756 times the short fall is reduced to 1.322837.
- 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.

## **VII. 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 creditable to the cost of service over the remaining lives of the related assets.

## **VIII. Conclusion**

Otter Tail looks forward to working with the Commission and Staff to assessing the cost of service impacts of the TCJA, which will be facilitated effectively in the ongoing rate case proceeding as described herein.

OTTER TAIL POWER COMPANY



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