BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA

IN THE STAFF'S REQUEST TO INVESTIGATE THE TAX CUTS AND JOBS ACT ON SOUTH DAKOTA UTILITIES	NORTHWESTERN ENERGY'S ADDITIONAL COMMENTS AND SPECIFIC PROPOSALS GE17-003

NorthWestern submits these Additional Comments and Specific Proposals to the Commission in response to the Commission's December 29, 2017 Order.[1] NorthWestern projects that in 2018 the total benefits from the TCJA[2] for its South Dakota utility will be $854,000. Exhibit 1, p. 1. NorthWestern proposes to either refund this amount, subject to true up, or to hold it in a regulatory liability to provide rate moderation in its next electric and natural gas rate cases, at the Commission's option.

I. **Background**

Congress considered and passed the TCJA during a short period in late 2017. On November 2, H.R. 1[3] was introduced and referred to the Committee on Ways and Means. Eleven days later, the Ways and Means Committee reported H.R. 1, as amended, out to the House. On November 16, the House passed H.R. 1. The Senate began consideration of H.R. 1 on November 29 and passed it, with amendments on December 2, 2017. The House disagreed with the

[1] "NorthWestern" refers to NorthWestern Corporation d/b/a NorthWestern Energy. "Commission" refers to the South Dakota Public Utilities Commission. "Order" refers to Order Requiring Comments' Order Requiring Rates in Effect January 1, 2018, Are Subject to Refund; Order Granting Intervention.
[2] "TCJA" refers to the Tax Cuts and Jobs Act, Public Law 115-97, December 22, 2017.
[3] "H.R. 1" refers to House Resolution 1 of the 115th Congress.

Senate's amendment, the Senate insisted on its amendment, and each body appointed members of a conference committee. The conference committee reported the bill out on December 15. On December 20, 2017, after further amendment by the Senate, the Congress passed House Resolution 1. The next day the Commission's Staff requested that the Commission open this docket, and on the following day, the President signed the TCJA. On December 29, the Commission issued the Order.

In the Order, the Commission directed NorthWestern to:

> file additional comments including more specific proposals and impacts and shall work with Staff to determine a deadline for the additional comments. The comments shall, at a minimum, address: 1) an estimate of the company's determination of the Act's effects on its South Dakota cost of service, inclusive of all elements; 2) include an explanation of these effects, and 3) propose a procedure for changing the company's rates to reflect these impacts[;]

and to "inform the Commission of any FERC proceedings addressing how federal income taxes will be adjusted."

II. NorthWestern estimates that the TCJA will provide $476,000 to its South Dakota Electric Utility in 2018.

Congress passed the TCJA to reduce the tax burden and to stimulate the economy through the creation of new jobs and spending. NorthWestern is in a special position as a public utility. While NorthWestern agrees that it should not receive a windfall from the TCJA, it also should not be harmed by the TCJA's passage. In other words, NorthWestern should earn the same after-tax income in 2018 under the TCJA as it would have earned under the old law.

NorthWestern believes that the impact of the TCJA cannot be correctly calculated by changing inputs to historical revenue requirement calculations. NorthWestern last changed its base rates for service effective December 29, 2015 in compliance with the Commission's final order in Docket No. EL14-106. Since then, NorthWestern has increased its electric rate base, has incurred increased costs, and faced changed billing determinants. Substituting the new income tax rate into the historical calculations does not provide an accurate estimate of the TCJA's benefits.

A. NorthWestern estimated its benefits from the TCJA by comparing its after tax net income under the old law and the new law.

Prior to passage of the TCJA, NorthWestern projected that from its South Dakota electric utility, it would earn after-tax net income of $29,556,000, including $20,594,000 before-tax net income and negative book tax expense of $8,962,000. Exhibit 1, p. 2, column "Old Law 2018". The negative book tax expense included negative income tax before credits of $1,400,000 due to negative book taxable income plus $7,562,000 of flow-through tax credit items. *Id.*, column "Old Law Fed".

NorthWestern made three adjustments to recognize the impact of the TCJA. First, changing the tax rate from 35% to 21% reduced the tax-value of negative book taxable income to negative income tax before credits of $840,000. *Id.*, column "New Law Fed". Second, NorthWestern included a credit of $936,000 for Excess Deferred Tax ARAM Amortization.[4] *Id.* This changed the total book tax expense to negative $9,338,000 and increased after-tax net income to $29,932,000. *Id.*, column "New Law 2018". Last, NorthWestern grossed up the $376,000 increase to after-tax net income by 1.267724 to calculate the amount that revenue could be decreased to leave NorthWestern's after-tax net income at the same $29,556,000 as before the TCJA. Applying the gross-up factor, NorthWestern estimates that for its South Dakota Electric Utility, the TCJA supports a revenue reduction of $476,000. *Id.*

[4] NorthWestern estimated the effect of the amortization of the Excess Deferred Tax using its understanding of ARAM. The Internal Revenue Service may issue guidance that conflicts with the calculation. If so, NorthWestern will recalculate the amortization.

B. NorthWestern requests that the estimated TCJA benefit be trued up to the actual benefit based on the entire calendar year.

As stated, NorthWestern estimates that the 2018 benefits from the TCJA to be $476,000 for its South Dakota Electric Utility. However, since the current year's net income is not known with certainty at the beginning of the year (and thus the precise value of the resulting tax benefits is not known either), NorthWestern proposes an annual adjustment to true up the net income and the tax benefits to customers to actual amounts, with a final true-up upon adjustment of rates in its next general rate case.

A true-up mechanism treats both customers and NorthWestern fairly. Absence of a true-up mechanism could lead to unfair results. For instance, if NorthWestern's pre-tax income is $5 million higher than its current projection, customers would miss out on the incremental benefits that they should have received. Conversely, if its pre-tax income is $5 million lower than its projection, NorthWestern would have given more benefit to customers than it received. A true-up mechanism is the only way ensure that customers receive and NorthWestern provide the exact benefit that it earns. NorthWestern proposes to use that mechanism until it receives an order in a general rate case.

A true-up mechanism is consistent with this single issue ratemaking docket. Generally, rates are not adjusted outside of rate cases. As Xcel Energy said in its Initial Comments, "it has been an accepted tenet of ratemaking that expenses rise and fall between rate cases and corrective action is not taken on a one-off basis in response to those fluctuations."[5] In this docket, the Commission and NorthWestern are responding to a material, unexpected change to a significant factor in determining a revenue requirement. However, neither the Commission, nor NorthWestern,

[5] Northern States Power doing business as Xcel Energy, Initial Comments, p. 1 (filed February 1, 2018).

is proposing to look at all changes since the last general rate case that affect a revenue requirement. To its own detriment, NorthWestern is not proposing to account for all of the changes flowing from the TCJA. Specifically, as NorthWestern amortizes excess ADIT, it increases its rate base. NorthWestern is not proposing to factor the increased rate base into the calculation of the benefits from the TCJA. A general rate case will deal with effects other than those described above. Therefore, it is important that the Commission treat both customers and NorthWestern fairly. A true-up mechanism ensures fair treatment.

C. NorthWestern presents the following alternatives to the Commission.

NorthWestern is willing to refund the estimated benefits from the TCJA to customers in 2018 and in each year until an order is issued in its next general rate case. NorthWestern's South Dakota retail sales in 2017 totaled $154,763,000.[6] If NorthWestern refunds the benefits from the TCJA on a uniform basis, the refund would be approximately 0.31%, which is less than $0.30/month for the average residential bill under Rate 10. Credit ratings agencies have recognized that the TCJA is negative for cash flow for utilities. NorthWestern believes that refunding $476,000 would not have a material impact.

In its initial comments, NorthWestern informed the Commission that it is likely that NorthWestern will file an electric general rate case by 2020. NorthWestern is willing to accumulate the benefits from the TCJA in a regulatory liability until its next general rate case. In that case, the Commission could determine the final disposition of the regulatory liability—either to reduce rate base or to amortize to reduce cost of service. Due to the uncertainties, such as final disposition, rate case timing, and rate case result, NorthWestern cannot estimate the effect that the regulatory liability would have. However, given that NorthWestern anticipates having

[6] NorthWestern's FERC Form 1, p. 304, lines 4-8 and 20- 34 & p. 304.1, lines 15, and 25.

substantially greater rate base value than it had in its previous rate case, rate moderation may provide a more discernable benefit to customers.

D. NorthWestern believes that the Commission may want to consider other factors.

NorthWestern believes that the Commission may want to consider other factors in evaluating NorthWestern's alternative proposals. One of the major impacts on NorthWestern of the TCJA is the elimination of bonus depreciation. NorthWestern eliminated bonus depreciation when it projected its book taxable income, and therefore, has not shown any impact explicitly in this filing

In Docket No. El14-106, the parties agreed to and the Commission approved the following provision:

> On or before October 1, 2018, NorthWestern will, at its option, file an electric general rate case or adjust the amount in base rates for Beethoven to the cost of service calculated based on actual year 3 revenue requirements adjusted for known and measurable changes, using Staff's settlement cost of service model utilized in this rate case. At the same time, NorthWestern will adjust the authorized revenue requirement for Beethoven for any differences between operations and maintenance expenses incurred in the operation of Beethoven and the estimated amounts used in establishing the amount in base rates. The net amount over collected or under collected from customers between October 1, 2015, and September 30, 2018, will be held in a regulatory asset until such time it is refunded or billed to customers (without interest) as a one-time separate line item amount on customer bills.[7]

NorthWestern has not determined whether it will file an electric general rate case or adjust the amount in base rates for Beethoven. However, if a change is made in 2018, a change to base rates will affect the actual benefits from the TCJA. NorthWestern cannot predict the effect of any such change at this time.

NorthWestern has read other utilities' initial comments and is aware that some of them identified additional provisions in the TCJA that may affect them. The items identified by other

[7] Docket No. EL14-106, *Revised Settlement Stipulation*, pp. 6-7, (filed October 16, 2015).

utilities include (1) repeal of the alternative minimum tax, (2) elimination of the lobbying expense deduction regarding legislation before local governmental bodies, (3) exclusion of public utility property from the expense deduction for certain property, (4) increased limitation on depreciation expense for listed property, (5) repeal of § 199, (6) limitation of any NOL deduction to 80% of adjusted taxable income, (7) limitation on property eligible for like-kind exchange treatment, (8) limitations on entertainment expense deductions, (9) treatment of gain or loss on self-created intellectual property, (10) required capitalization of research and development expenditures, and (10) disallowance of deduction for expenses related to allegations of sexual harassment or sexual abuse if payment are subject to a nondisclosure agreement. NorthWestern believes that these provisions will not have an impact on it.

In its initial comments, NorthWestern explained how its FERC-regulated formula rates will be adjusted in April, 2019. In addition, NorthWestern serves three customers at stated rates under its OATT. The facilities that NorthWestern uses to serve these customers are not eligible for inclusion in SPP. FERC has opened a docket in which it will address the impact of the TCJA on these rates. NorthWestern believes the impact of the TCJA on South Dakota FERC-regulated formula rates will be immaterial.

III. NorthWestern estimates that the TCJA will provide $378,000 to its South Dakota Natural Gas Utility in 2018.

NorthWestern calculated the benefits from the TCJA for its South Dakota natural gas utility in the same way that it calculated the benefits for its electric utility. NorthWestern last adjusted it natural gas base rates in Docket NG11-003, effective December 1, 2011.

A. NorthWestern estimated its benefits from the TCJA by comparing its after tax net income under the old law and the new law.

Prior to passage of the TCJA, NorthWestern projected that from its South Dakota natural gas utility, it would earn after-tax net income of $5,850,000, including $6,277,000 before-tax net income and book tax expense of $427,000. Exhibit 1, p. 3, column "Old Law 2018". The book tax expense included income tax before credits of $435,000 less $8,000 of flow-through tax credit items. *Id.*, column "Old Law Fed".

NorthWestern made three adjustments to recognize the impact of the TCJA. First, changing the tax rate from 35% to 21% reduced the income tax before credits to $261,000. *Id.*, column "New Law Fed". Second, NorthWestern included a credit of $124,000 for Excess Deferred Tax ARAM Amortization. *Id.* This changed the total book tax expense to $129,000 and increased after-tax net income to $6,148,000. *Id.*, column "New Law 2018". Last, NorthWestern grossed up the $298,000 increase to after-tax net income by 1.267724 to calculate the amount that revenue could be decreased to leave NorthWestern's after-tax net income at the same $5,850,000 as before the TCJA. Applying the gross-up factor, NorthWestern estimates that for its South Dakota Electric Utility, the TCJA supports a revenue reduction of $378,000. *Id.*

B. NorthWestern requests that the estimated TCJA benefit be trued up to the actual benefit based on the entire calendar year.

For the same reasons explained in II.B above, NorthWestern proposes an annual adjustment to true-up the net income and the tax benefits to customers to actual amounts, with a final true-up upon adjustment of rates in its next general rate case. A true-up mechanism ensures fair treatment.

C. NorthWestern presents the following alternatives to the Commission.

NorthWestern is willing to refund the estimated benefits from the TCJA to customers in 2018 and in each year until an order is issued in its next general rate case. NorthWestern's South Dakota retail sales in 2017 totaled $45,440,411. If NorthWestern refunds the benefits from the

TCJA on a uniform basis, the refund would be approximately 0.83%, which is less than $0.38/month for the average residential bill. Credit ratings agencies have recognized that the TCJA is negative for cash flow for utilities. NorthWestern believes that refunding $378,000 would not have a material impact.

In its initial comments, NorthWestern informed the Commission that it is likely that NorthWestern will file a natural gas general rate case by 2020. NorthWestern is willing to accumulate the benefits from the TCJA in a regulatory liability until its next general rate case. In that case, the Commission could determine the final disposition of the regulatory liability—either to reduce rate base or to amortize to reduce cost of service. Due to the uncertainties, such as final disposition, rate case timing, and rate case result, NorthWestern cannot estimate the effect that the regulatory liability would have. However, given that NorthWestern anticipates having a substantially higher revenue requirement than it had in its previous rate case, rate moderation may provide a more visible benefit to customers.

IV. Conclusion

Congress passed the TCJA to lessen tax burdens and stimulate the economy. As a regulated utility, NorthWestern intends to pass the actual benefits from the TCJA to its customers. NorthWestern has estimated the actual benefits, proposed to true up the estimate to actual, and asked to the Commission to direct whether the benefits should flow to customers through an immediate rate reduction or through a regulatory liability. NorthWestern requests that the Commission approve the calculations of TCJA benefits and direct their disposition.

Respectfully submitted this 3rd day of April, 2018.

NORTHWESTERN CORPORATION,
d/b/a **NORTHWESTERN ENERGY**

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CERTIFICATE OF SERVICE

I, the undersigned, hereby certify that on the 3rd day of April 2018, true and correct copies of the foregoing, NORTHWESTERN ENERGY'S ADDITIONAL COMMENTS AND SPECIFIC PROPOSAL in Docket No. GE17-003, were served on the following via electronic mail:

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