



Gary Hanson, Chairperson
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South Dakota

PUBLIC UTILITIES COMMISSION

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June 16, 2014

Darwin Jensen
[REDACTED]

Dear Mr. Jensen:

This letter is in response to your letter dated June 10, 2014, responding to my letter dated June 6, 2014, responding to your initial June 2, 2014, letter regarding Black Hills Power's rate increase request.

I understand that at times it can seem to be unfair for regulated utilities to have their rates set based on an authorized rate of return. Note that I said "authorized" not "guaranteed." The utility is not guaranteed to earn that rate of return, but the rates are set based on a rate of return that is in turn based on utility debt and equity market rates justified by current market conditions. In the past few years, the South Dakota Public Utilities Commission's approved rates of return have been the lowest in the nation for the electric sector.

The reason the Commission must allow rates based on a reasonable rate of return for the regulated utility sector is that it is required by both the statutes of this state passed by the Legislature and numerous decisions of the South Dakota Supreme Court and the United States Supreme Court. The Supreme Court has ruled that it is unconstitutional under the "takings clause" of the Constitution for the Commission to set rates based on debt and equity values that are not within the current range of market rates for utility debt and equity securities.

The reason for this is that the rates of regulated utilities are regulated. A utility is in a "captive" rate situation; that is, it is not permitted to charge whatever rates it wants like other businesses. Because it is a monopoly situation, there is no "market" to discipline prices in a regulated utility situation as there is in unregulated business sectors. One effect of this is that regulated utility rates of return are almost always significantly lower than for unregulated business corporations.

So that's the other side of the coin. A regulated utility may have a rate that is set based in part on current debt and equity return values, but that process also results in the utility not being able to earn the higher rates of return that unregulated businesses can and do charge.

Thank you again for writing and expressing your opinion. Your message will be filed in Docket EL14-026.

Sincerely,

Gary Hanson
Gary Hanson

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