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South Dakota

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August 20, 2014

Darwin Jensen
[REDACTED]
[REDACTED]

Dear Mr. Jensen:

This letter is in response to your letter dated August 11, 2014, responding to my letter dated June 16, 2014, regarding Black Hills Power's rate increase request.

You mention that everybody watching the market and stockholders comments realize that BHP is the most profitable utilities to invest in and BHP must have very fine equity securities.

Those watching the market are seeing activity for Black Hills Corporation (BHC). It is important to note that the commission's regulatory oversight is not over BHC's shareholders and its earnings, but over BHP, a utility which is a subsidiary of BHC and one entity in BHC's portfolio. Some of the entities in that portfolio are also regulated and others have minimal government oversight. Therefore, while the authorized rates of return approved by the South Dakota Public Utilities Commission in the last few years have been the lowest in the nation for the electric sector, such authorized rates of return apply to BHP only. Other unregulated subsidiaries of BHC may have much higher rates of return, impacting the profits of BHC. Ratepayers are only responsible for the rate of return allowed for BHP, not for other regulated or unregulated subsidiaries of BHC.

You say you are very interested in seeing the commission's formula for determining rates.

I am unsure whether you are referring to the formula for determining rates of return or the formula for determining the rates customers are charged. Thus, both are discussed below.

Regarding the formula for determining rates of return, the commission recently determined such a formula as a result of a contested hearing regarding this issue for Xcel Energy, in Docket EL11-019.

Xcel Energy's rate of return witness's testimony is found here:

<http://www.puc.sd.gov/commission/dockets/electric/2011/EL11-019/Volume2/roe.pdf> and commission staff's witness's testimony is found here: <http://www.puc.sd.gov/commission/dockets/electric/2011/EL11-019/stafftestimony/copelandtestimony.pdf>

The Commission based its decision on the written and oral testimony presented by these expert witnesses as well as the laws defining the commission's regulation. The commission's decision in Docket EL11-019 is found here:

<http://www.puc.sd.gov/commission/orders/electric/2012/el11-019final.pdf>

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As stated in the order, the Commission adopted staff's model approach and its conclusion for purposes of its decision on return on equity. As previously stated, the authorized rates of return approved by the South Dakota PUC have been the lowest in the nation for the electric sector. The documents filed in Docket EL11-019 thoroughly explain the commission's findings and I encourage you to read these for more information.

While BHP's rate case is currently under review and no decisions have yet been made, BHP witnesses have filed testimony regarding BHP's proposed overall rate of return and return on equity. If interested, here are the links to those documents:

<http://www.puc.sd.gov/commission/dockets/electric/2014/EL14-026/iverson.pdf>

<http://www.puc.sd.gov/commission/dockets/electric/2014/EL14-026/avera.pdf>

Regarding the rates customers are charged for electricity service: The formula for determining rates is a complex process involving much analysis of utility investments, costs, and revenues. This process can take up to a year to complete, in which commission staff and any intervenors to the case each review the data submitted by the company and request additional information in order to fully analyze the costs. Once the commission staff and intervenors finish their respective analyses, each party determines what each believes is the appropriate revenue requirement, which is the amount of revenues a utility should be authorized to collect from its customers in a year going forward. After a revenue requirement is determined, this amount is allocated to customer classes and rates are determined for each rate schedule. Commission staff will file several exhibits and schedules supporting its determination of the revenue requirement (including rate of return) and rates, along with accompanying testimony and/or a staff memorandum supporting settlement stipulation to explain these calculations. My fellow commissioners and I will analyze all the information filed in the docket, including the company's application and additional information submitted by commission staff and intervenors, in order to make an informed decision on the rates the company will be allowed to charge its South Dakota customers.

Thank you again for writing. I assure you the commission is "watching out" for the people of South Dakota and determining rates based on facts and under the context of the law. I hope this letter addresses your questions and I encourage you to continue to follow the progress of this docket on our website at <http://www.puc.sd.gov>, Docket EL14-026. Your message and my response to you will be filed in the docket.

Sincerely,



Gary Hanson