STOEL RIVES LLP
ATTORNEYS AT LAW

33 South Sixth Street, Suite 4200
Minneapolis, Minnesota 55402
main 612.373.8800
fax 612.373.8881
www.stoel.com

ANDREW P. MORATZKA
Direct (612) 373-8822
apmoratzka@stoel.com

December 30, 2014

VIA E-FILING

Ms. Patricia Van Gerpen
Executive Director
South Dakota Public Utilities Commission
500 E. Capitol Avenue
Pierre, SD 57501

Re: In the Matter of the Application of Black Hills Power, Inc. for Authority to Increase its Electric Rates
Docket No. EL 14-026

Dear Ms. Van Gerpen:

Enclosed for filing are the following documents:

1. Direct Testimony and Exhibits of Lane Kollen on behalf of Black Hills Industrial Intervenors (Public and Confidential versions); and

2. Direct Testimony and Exhibits of Stephen J. Baron on behalf of Black Hills Industrial Intervenors (Public and Confidential versions).

Very truly yours,

Stoel Rives LLP

/s/ Andrew P. Moratzka

Andrew P. Moratzka

APM:kap
Attachments

cc: Service List

BEFORE THE SOUTH DAKOTA
PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF	)	
BLACK HILLS POWER, INC., A SOUTH DAKOTA	)	DOCKET NO. EL14-026
CORPORATION, FOR AUTHORITY TO INCREASE	)	
RATES IN SOUTH DAKOTA	)	

DIRECT TESTIMONY AND EXHIBITS

OF

LANE KOLLEN

ON BEHALF OF

BLACK HILLS INDUSTRIAL INTERVENORS

PUBLIC DOCUMENT

J. KENNEDY AND ASSOCIATES, INC.
ROSWELL, GEORGIA

DECEMBER 2014

TABLE OF CONTENTS

DIRECT TESTIMONY OF LANE KOLLEN

I. QUALIFICATIONS AND SUMMARY

Q. Please state your name and business address.

A. My name is Lane Kollen. My business address is J. Kennedy and Associates, Inc. ("Kennedy and Associates"), 570 Colonial Park Drive, Suite 305, Roswell, Georgia 30075.

Q. What is your occupation and by whom are you employed?

A. I am a utility rate and planning consultant holding the position of Vice President and Principal with Kennedy and Associates.

Q. Please describe your education and professional experience.

A. I earned a Bachelor of Business Administration in Accounting degree and a Master of Business Administration degree, both from the University of Toledo. I also earned a Master of Arts degree from Luther Rice University. I am a Certified Public Accountant, with a practice license, a Certified Management Accountant, and a Chartered Global Management Accountant. I am a member of numerous professional organizations.

I have been an active participant in the utility industry for more than thirty years, both as a consultant and as an employee. Since 1986, I have been a consultant with Kennedy and Associates, providing assistance to consumers of utility services and state and local government agencies in the areas of utility planning, ratemaking, accounting, taxes, financial reporting, financing and management decision-making. From 1983 to 1986, I was a consultant with Energy Management Associates, providing services to investor and consumer owned utility companies in the areas of planning, financial accounting and reporting, financing, ratemaking and management decision-making. From 1976 to 1983, I was employed by The Toledo Edison Company in a series of positions, providing services in the areas of planning, accounting, financial and statistical reporting, and taxes.

I have appeared as an expert witness on utility planning, ratemaking, accounting, reporting, financing, and tax issues before state and federal regulatory commissions and courts on more than two hundred occasions. In addition to consumers of electricity and natural gas utility services, I have represented state and local ratemaking agencies or their Staffs, including the Louisiana Public Service Commission, Georgia Public Service Commission and various Cities with original rate jurisdiction in Texas. I have developed and presented papers at various industry conferences on ratemaking, accounting, and tax issues. My qualifications and regulatory appearances are further detailed in Kollen Exhibit___(LK-1).

Q. On whose behalf are you testifying in this proceeding?

A. I am testifying on behalf of GCC Dakotah, Inc., Pete Lien & Sons, Inc., Rushmore Forest Products, Inc., Spearfish Forest Products, Inc., Rapid City Regional Hospital, Inc. and Wharf Resources (U.S.A.), Inc. (collectively, the

"Black Hills Industrial Intervenors" or "BHII").

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to address (1) the claimed base revenue deficiency and requested rate increase of $14.634 million set forth in the Company's application (the "Application") and (2) the revised revenue deficiency and requested rate increase of $6.891 million set forth in the proposed Settlement Stipulation (the "Proposed Settlement") between the Company and the Commission Staff ("Staff") filed in this docket on December 8, 2014. I recommend numerous adjustments to the base revenue deficiency in each of the Application and the Proposed Settlement necessary to ensure that the Company's rates are just and reasonable.

Q. What support has the Company and Staff provided for the Proposed Settlement?

A. The Proposed Settlement states how the Company and Staff have resolved certain issues and incorporates various schedules. To support the Proposed Settlement, the Staff developed and provided to BHII an Excel spreadsheet that provides some details regarding the calculation of the rate increase in the Proposed Settlement. Although the spreadsheet incorporates the adjustments reflected in the Proposed Settlement, it does not include all calculations or source all adjustment amounts. Nor does the spreadsheet provide any descriptions or testimony in support of the adjustments that were included or the reasons why certain adjustments proposed by BHII and shared during Proposed Settlement discussions with the parties were not accepted.

Q. Please summarize your testimony.

A. While I agree (in whole or in part) with the resolution of certain issues reflected in the Proposed Settlement, I recommend that the Commission reject both the base rate increase requested by the Company in its Application and the base rate increase set forth in the Proposed Settlement. Because evidence in the Application and responses to BHII information requests demonstrate that the Company's rates have grown increasingly uncompetitive,[1] BHII refused to sign on to the Proposed Settlement. As demonstrated below, the Proposed Settlement between the Company and the Staff is woefully inadequate. It fails to address or properly resolve certain issues that, if addressed and resolved properly, would substantially reduce the revenue requirement necessary to set rates at just and reasonable levels.

Taken together, the recommendations set forth in my testimony support a *reduction* in the Company's current base rates of at least $5.258 million (as opposed to the *significant and unnecessary increase* in base rates proposed by the Company in its Application and by the Company and Staff in the Proposed Settlement). Thus, I recommend that the Commission (1) reduce the $14.634 million increase requested by the Company in its Application by $19.893 million

[1] As of 2012, and compared to other investor owned utilities in South Dakota, Black Hills Power had the highest average residential rate, the highest average commercial rate, and the third highest industrial rate. Source: U.S. Energy Information Administration; http://www.eia.gov/electricity/data.cfm#sales

and (2) reduce the $6.891 million increase agreed to by the Company and Staff in the Proposed Settlement by $12.149 million. The reductions that I recommend reflect the return on equity of [redacted] set forth in the Proposed Settlement.

I recommend that the Commission adopt numerous adjustments to both the Company's requested increase and the Proposed Settlement increase. I summarize the revenue requirement effects of these adjustments on the following table.

The first column in the table starts with the Company's claimed revenue deficiency set forth in its Application and then shows the revenue requirement effect of each adjustment to the Company's request that I recommend. If the Commission starts with the Company's request, then it should adopt the adjustments that I recommend in this column.

The second column starts with the Company's claimed revenue deficiency set forth in its Application and then shows the revenue requirement effect of each adjustment identified and reflected in the Proposed Settlement. I included this column in the event the Commission starts with the Proposed Settlement so that it can directly compare my recommendations for each issue with the comparable adjustments, if any, reflected in the Proposed Settlement.

The third column represents the incremental effect of the adjustments that I recommend, as shown in the first column, in the event the Commission starts with the Proposed Settlement and the Commission adopts my adjustments and quantifications.

Docket No. EL14-026
Black Hills Power, Inc.
South Dakota Retail Revenue Requirement
Summary of BHII Recommendations
Compared to Company's Filing and Proposed Settlement With Staff
($ Millions)

	BHII Recommend Compared to Company Filing	Proposed Settlement	BHII Recommend Compared to Proposed Settlement
Black Hill Power Company Requested Rate Increase	14.634	14.634	
Adjustments			
Rate Base			
Remove Company's Double Count of Spare Parts for CPGS	(0.132)		(0.132)
Remove NOL ADIT	(1.414)	(0.026)	(1.388)
Adjust Retired Steam Plants Regulatory Asset - NBV	0.043		0.043
Reduce or Remove Retired Steam Plants Regulatory Asset - Def Decom	(0.894)	0.388	(1.282)
Extend Storm Damage Amortization to Ten Years and Subtract ADIT	(0.102)	(0.179)	0.077
Remove Regulatory Asset - 69kV LIDAR Surveying Project	(0.057)	(0.046)	(0.011)
Adjust Accumulated Depr. and ADIT Related to Restatement of Net Negative Salvage	0.019		0.019
Adjust Accumulated Depr. and ADIT Related to CPGS Life Span Extension	0.006		0.006
Adjust Rate Case Regulatory Asset		(0.036)	0.036
Operating Income			
Remove FutureTrack Workforce	(0.676)	(0.344)	(0.332)
Remove Employee Additions/Eliminations Identified on Schedule H-1 Line 5	(1.266)	(0.096)	(1.169)
Remove Additional Pension Plan Expense Based on 5 Year Average	(1.247)	(0.289)	(0.958)
Remove Incentive Compensation Tied to BHC Fin'l Peformance	(1.554)	(0.666)	(0.888)
Remove Proforma Increased Affiliate Allocations from BHUH	(1.846)	0.527	(2.373)
Remove Settlement Adjustment to Increase Affiliate Allocations from BHSC		1.132	(1.132)
Extend Retired Steam Plants Amortization Expense	(0.582)		(0.582)
Reduce Amortization Expense on Atlas Storm Damage Regulatory Asset	(0.414)	(0.512)	0.098
Retired Steam Plants Decommissioning Amortization Expense	(1.956)	(0.487)	(1.469)
Remove 69kV LIDAR Surveying Project Amortization Expense	(0.130)	(0.066)	(0.064)
Extend CPGS Life Span (Depr Expense)	(0.338)	(0.314)	(0.024)
Correct Steam and Other Production Net Salvage (Depr Expense)	(1.132)		(1.132)
Remove Company's Double Count of Spare Parts for CPGS (Depr Expense)	(0.033)		(0.033)
Adjust Rate Case Regulatory Asset Amortization		(0.083)	0.083
Adjustment to Weather Normalization Revenue	(0.380)	(0.380)	-
Adjustment to Allocated Neil Simpson Rent Revenue and Expense	(0.219)	(0.219)	-
Adjustment to Neil Simpson Common Steam Allocation	(0.244)	(0.244)	-
All Other Proposed Settlement Changes Combined		(0.217)	0.217
Rate of Return			
Reduce Cost of Debt to Reflect Lower Interest Rate on New Debt Issue	(0.885)	(0.925)	0.040
Reflect Proposed Settlement Capital Structure	(0.216)	(0.226)	0.010
Reduce Return on Equity - Proposed Settlement	(4.245)	(4.435)	0.191
Total Adjustments to Company's Request	(19.893)	(7.744)	
Net Rate Increase/(Reduction) Recommendation	(5.258)	6.891	
Total Differences Between BHII Recommendation and Proposed Settlement			(12.149)

Q. In the Rate of Return section of the preceding table, the effects on the revenue requirement for each adjustment are less pursuant to your recommendations in the first column compared the Proposed Settlement in the second column. Please explain why this is the case.

A. The rate base that I recommend is less than the rate base reflected in the Proposed Settlement. I recommend additional adjustments or different quantifications for certain adjustments to rate base than the adjustments reflected in the Proposed Settlement. For example, I recommend that the Commission remove the NOL ADIT from rate base and show the reduction in the revenue requirement based on the Company's requested rate of return. However, the Proposed Settlement does not reflect a similar reduction in rate base for this issue. Thus, despite the fact that the adjustments to the rate of return are the same under my recommendations and pursuant to the Proposed Settlement, the effect is slightly greater pursuant to the Proposed Settlement.

Q. Are there general ratemaking principles that form the basis for many of your recommended adjustments?

A. Yes. First, I recommend that the Commission limit any post-test year adjustments to the twelve month period immediately following the historic test year ending September 30, 2013. Adjustments beyond this twelve month post-test year period are not known and measurable and, in some instances, represent costs that should not be incurred or, if incurred, that should be included in a subsequent rate proceeding. Such adjustments to costs are uncertain. They are opportunistic and selective in that they do not represent a comprehensive or consistent set of adjustments for the period two years after the actual test year. More specifically, the Company did not include all potential corresponding increases in revenues or reductions in costs that would offset the adjustments for projected increases in costs beyond the twelve month post-test year period. By failing to include such revenue increases and cost reductions in its Application, the Company unjustly and unreasonably skewed the proposed base rate increase upward. As discussed below, my understanding of S.D. Admin. Rule 20:10:13:44, is that any proposed adjustments based on projected costs beyond the twelve month post-test year period must be accompanied by projected changes in revenue for the same period. The Company's selective adjustments beyond the twelve month post-test year period may violate South Dakota law.

Second, I recommend that the Commission reject proposed post-test year increases in various expenses that are not justified and that the Company did not demonstrate were necessary and appropriate. The Company bears a special burden to demonstrate that these increases in expenses compared to the historic test year are just and reasonable. Such increases tend to be self-fulfilling and permanent once recovery is assured in rates.

Third, I recommend that the Commission reject adjustments that are not consistent with Commission precedent or policy, that are not justified, and that the Company did not demonstrate were necessary and appropriate.

Q. How is the remainder of your testimony organized?

A. The remainder of my testimony is organized so that it follows the sequence of the issues in the preceding table. On each issue, I will first address the issue as it is reflected in the Company's Application. I then will address the issue as it is reflected in the Proposed Settlement.

II. RATE BASE ISSUES

A. <u>The Commission Should Correct the Double Counting Error in CPGS Spare Parts Inventory</u>

Q. Please describe the error in the CPGS spare parts inventory included in rate base.

A. The Company erroneously included $2.200 million (total plant and total Company) CPGS spare parts inventory in both the CPGS plant in service amounts shown on Schedule D page 2, Schedule D-11, and in the materials and supplies amount shown on Schedule F-4. The CPGS spare parts inventory should be removed from the plant in service amounts.

Q. What are the effects on rate base and the revenue requirement of correcting this error?

A. The correction results in a reduction in the jurisdictional rate base of $1.152 million (BHP owns 58% of the plant), consisting of a reduction in plant in service of $1.157 million, a reduction in accumulated depreciation of $0.017 million and an increase in accumulated deferred income taxes ("ADIT") of $0.012 million.

The calculations and sources of these amounts are detailed on my Exhibit___(LK-2).

The correction reduces the Company's revenue requirement by $0.165 million, consisting of a reduction in the return on rate base of $0.132 million and a reduction in depreciation expense of $0.033 million.

Q. Does the Company agree that this was an error and should be corrected?

A. Yes. The Company agreed that this was an error in response to SDPUC Request No. 6-42, a copy of which I have attached as my Exhibit___(LK-3).

Q. Does the Proposed Settlement properly reflect the correction of this error?

A. Yes.

B. <u>The Commission Should Remove the Asset Net Operating Loss ("NOL") Accumulated Deferred Income Taxes ("ADIT") from Rate Base</u>

Q. Please describe the Company's proposal to include asset NOL ADIT amounts in rate base.

A. The NOL ADIT is the tax effect of the NOL carry-forward, which is stated in the form of taxable losses that can be carried forward to reduce taxable income in subsequent years. The Company included $12.373 million (jurisdictional) and $13.497 million (total Company) in asset NOL ADIT in rate base as shown on Schedule M-1 (lines 12 and 27) based on a thirteen month average in the historic test year, and on Schedule M-2 (line 21) to reflect certain plant additions through

September 30, 2014. The total Company amounts and the jurisdictional amounts are detailed on my Exhibit___(LK-4).

Q. Should the Commission include the asset NOL ADIT in rate base?

A. No. First, as a conceptual matter and as a matter of regulatory principle, the NOL ADIT violates the prohibition against retroactive ratemaking. The NOL ADIT is the result of actual taxable losses in prior years that could not be fully utilized or monetized through carrybacks. However, in prior rate cases, the Company's rates were set to recover the maximum income tax expense under the assumption that there would be no taxable losses. The fact that the Company subsequently actually incurred taxable losses rather than taxable income does not entitle it to include the tax effect of those losses in rate base and earn a return from customers. This would constitute an improper retroactive true-up of a portion of the Company's income tax expense incurred in prior years for ratemaking purposes.

Second, the NOL ADIT is only temporary. The NOL carryforward will be utilized as the Company generates taxable income. Nevertheless, the Company's Application assumes not only that the NOL ADIT will continue to exist, but that it will exist at the same level until rates are reset in the next base rate proceeding. The Company's assumption is incorrect and without valid foundation.

In fact, the Company's Schedule K page 2 indicates that the NOL carryforward that gave rise to the NOL ADIT will be fully utilized *prior to or* *during the first year that rates are effective*. The actual NOL ADIT at September 30, 2013 is equivalent to a $16.996 million NOL carryforward, assuming a 35% federal income tax rate. The Company's Schedule K page 2 indicates that the Company will generate $44.678 million in federal taxable income if its base rate increase is granted in full in this proceeding. Even with zero base rate increase, the Company's filing indicates that taxable income still will be more than sufficient to fully utilize the NOL carryforward either before rates are reset or within the twelve months after rates are reset.

Q. What is the effect on the revenue requirement of removing the asset NOL ADIT from rate base?

A. The effect is a reduction in the revenue requirement of $1.414 million.

Q. As a practical matter, if the Commission decides to include the asset NOL ADIT in rate base, then should the thirteen month average for the historic test year be adjusted to October 1, 2014 in the same manner that the Company adjusted other rate base components to reflect known and measurable adjustments through October 1, 2014?

A. Yes. As I noted previously, the NOL ADIT is a temporary amount that should decline to $0 when the NOL carryforwards are fully utilized. The Commission should not set rates to provide a return on an asset NOL ADIT that either no longer exists or has declined significantly since the historic test year. Adjusting the 13-month average for the historic test year to October 1, 2014, would be consistent with the Company's proposal to adjust certain of its regulatory assets and to increase its plant in service amounts for allegedly known and measurable changes to October 1, 2014.

The October 1, 2014 date is twelve months after the end of the historic test year and the assumed date when rates would be reset in this proceeding. If the Commission allows the Company to selectively adjust other rate base components to October 1, 2014, then it also should ensure that the NOL ADIT is adjusted to that same date, and should do so based on the information in the Application.

Q. Did the NOL ADIT on the Company's balance sheet decline since the beginning of the historic test year?

A. Yes. The NOL ADIT has steadily declined since October 1, 2012, the beginning of the historic test year, toward a $0 balance at October 1, 2014, twelve months after the end of the historic test year. Unlike the updated amounts for regulatory assets and plant in service additions, the Company used the thirteen month balance during the historic test year for the NOL ADIT. This overstates the NOL ADIT that remained at September 30, 2013, the end of the historic test year and at October 1, 2014, because it failed to capture the decline throughout the test year and the continued decline in the twelve month post-test year period. As of September 30, 2013, the NOL ADIT was $5.949 million (jurisdictional) and $6.489 million (total Company).[2]

The NOL ADIT continued to decline from that date through December 31, 2013, when it had declined to $4.363 million (jurisdictional) and $4.760 million (total Company).[3]

Q. How much of the Company's NOL carryforward did it utilize in 2013 and how much will it utilize going forward based on the calculation of taxable income reflected in the Application?

A. The Company had a federal NOL carryforward of $14 million at December 31, 2013.[4] During 2013, the Company utilized $16.708 million of the federal NOL carryforward at December 31, 2012. In other words, the Company had taxable income of $16.708 million, but was able to reduce that to $0 by utilizing the NOL carryforward. This pattern will repeat itself in 2014, although taxable income will be greater in 2014 compared to 2013 due to the unavailability of bonus tax depreciation in 2014. In other words, the Company will be able to utilize the full remaining amount of the NOL carryforward in 2014, all else being equal. I calculated the NOL carryforward that was utilized based on the reduction in the NOL ADIT during 2013. The Company reduced the NOL ADIT during 2013 by $5.207 million (jurisdictional)[5], and by $5.681 million (total Company)[6].

In short, based on the Company's filing, there should be no remaining asset NOL ADIT at October 1, 2014. Thus, even if the Commission decides to

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[2] Schedule M-1 page 2.
[3] Black Hills Power Company 2013 FERC Form 1 page 234, attached as my Exhibit___(LK-5).
[4] *Id.,* page 123.13, attached as my Exhibit___(LK-6).
[5] From $9.570 million (jurisdictional) at the beginning of the year to $4.363 million (jurisdictional) at the end of the year.
[66] From $10.441 million (total Company) at the beginning of the year to $4.760 million (total Company) at the end of the year.

allow an asset NOL ADIT in rate base, which would violate the prohibition on retroactive ratemaking, the amount at October 1, 2014 should be $0 as a practical matter.

Q. What amount of NOL ADIT was included in the rate base reflected in the Proposed Settlement?

A. The Proposed Settlement reflects a slight reduction of $0.226 million in the NOL ADIT compared to the Company's Application. This slight reduction in the NOL ADIT included in rate base had the effect of reducing the Company's revenue requirement by a mere $0.026 million.

Q. Is there any justification for including any NOL ADIT in rate base in the Proposed Settlement?

A. No, for the reasons that I previously discussed.

C. <u>The Commission Should Reduce Regulatory Asset - Deferred Decommissioning on Retired Plants</u>

Q. Please describe the Company's requested regulatory asset and amortization expense for decommissioning costs on its retired coal-fired power plants.

A. The Company included $7.824 million in rate base for its estimated costs to decommission the retired Osage, Neil Simpson I and Ben French power plants, net of accumulated depreciation and an incorrectly calculated adjustment to reduce ADIT. The Company also included $1.956 million in amortization expense based on a proposed five year amortization period. I provide the details of the Company's request, including the source of the amounts that I cited, on my Exhibit___(LK-7).

Q. When does the Company plan to spend the estimated amounts?

A. The Company plans to begin decommissioning activities at the Ben French plant in January 2015 and complete the activities in September 2015. It planned to begin activities at the Neil Simpson 1 plant in November 2014 and complete the activities in June 2015. It planned to begin activities at the Osage plant in August 2014 and complete the activities in April 2015.[7]

Q. Did the Company seek or obtain an order to defer decommissioning costs that have been incurred to date?

A. No.

Q. Should the Commission include the estimated decommissioning costs as a regulatory asset in rate base and allow amortization expense in this proceeding?

A. No. The Company's request is premature and overreaching. The Company had not yet incurred most of the decommissioning costs that it seeks to include in rate base as of October 1, 2014, twelve months after the end of the historic test year. In addition, the Company's request includes estimated costs through September

[7] Direct Testimony of Mr. Mark Lux at 18-19.

2015, some twenty-four months after the end of the historic test year. Thus, these amounts should not be included in rate base in this proceeding.

Instead, the Commission should authorize the Company to defer these decommissioning costs as regulatory assets and address the recovery of the costs in the Company's next base rate proceeding.

Q. Is there support in South Dakota law for excluding estimated costs that would be incurred after the end of the 12-month historical test year?

A. Yes. My understanding of S.D. Admin. Rule 20:10:13:44, is that the Commission is not permitted to allow adjustments that would become effective unless they are based on changes in facilities, operations, or costs which are known with reasonable certainty and measurable with reasonable accuracy at the time of filing. Moreover, it is my understanding that any such adjustment to costs must be accompanied by expected changes in revenue for the same period. The Company has not provided evidence that any estimated costs that would be incurred after the end of the 12-month historical test year were known with reasonable certainty or measurable with reasonable accuracy at the time that the Company filed its Application, and the Company has not provided any adjustments to revenue for the same period.

Q. If the Commission allows the estimated decommissioning costs in rate base and authorizes recovery of amortization expense, should it correct the ADIT error?

A. Yes. The Commission should correct the ADIT error. The Company incorrectly calculated the ADIT offset for the regulatory assets shown on Schedule M-2 as an asset ADIT of $0.762 million (total Company). Specifically, the Company failed to include the deduction for the entire decommissioning cost under the column titled "tax depreciation" on line 35 of Schedule M-2. If this deduction is properly reflected, the ADIT related to the regulatory asset for decommissioning should be $3.423 million (jurisdictional, using an 89.83% production plant allocation factor) or $3.811 million (total Company).

The Company will be able to deduct the entirety of the estimated $10.887 million (total Company) decommissioning costs for income tax purposes when the costs are incurred. This deduction will create a book/tax temporary difference. The ADIT is equal to 35% of the book/tax temporary difference. The Company estimates that it will incur all decommissioning costs related to these retired plants by September 2015.

If the Commission includes the entirety of the costs that the Company estimates it will incur by September 2015 in rate base, then the Commission should also reflect the offsetting ADIT in 2015 as a subtraction from rate base.

Q. What is the effect on the revenue requirement if the Company's ADIT error is corrected?

A. The effect is a reduction of $0.391 million in the Company's claimed revenue requirement, using the Company's requested grossed-up rate of return ($3.423 million times 11.43%).

Q. Does the Proposed Settlement correct the error in the ADIT?

A. No. If the Commission adopts the Proposed Settlement, then it should modify it to correct the error in the ADIT.

Q. If the Commission allows the estimated decommissioning costs in rate base and authorizes recovery of amortization expense, should it make any adjustments in addition to correcting the ADIT error?

A. Yes; the Commission should make two other adjustments. First, the Commission should remove the contingencies from the decommissioning cost estimate. By definition, contingencies are not known and measurable. If the Commission allows the estimated decommissioning costs in rate base and the amortization in expense, then it should use the Company's best estimate for the decommissioning cost, not an inflated estimate that includes contingencies. The contingencies included in the Company's estimated decommissioning costs are $0.956 million, according to the Company's response to Staff DR 3-23.

Second, the Commission should exercise its discretion to use a longer amortization period to minimize the effect on customers. In this case, a ten-year amortization period will achieve this objective. The Company's proposed five-year amortization period is unnecessarily short. If the Commission includes the estimated decommissioning costs in rate base, then the Company will earn a return on the unamortized regulatory asset regardless of the amortization period.

Q. What is the effect on the revenue requirement of eliminating the contingencies and using a ten year amortization period?

A. A 10-year amortization period will reduce the Company's revenue requirement by $1.162 million. The calculations are detailed on my Exhibit____(LK-8).

Q. Does the Proposed Settlement reflect your recommendation to remove contingencies and use a ten year amortization period?

A. Yes.

D. <u>The Commission Should Correct Accumulated Deferred Income Taxes Due to Regulatory Asset for Storm Costs</u>

Q. Did the Company reflect the correct ADIT due to the regulatory asset for storm costs as a reduction to rate base?

A. No. The Company failed to reflect the ADIT on storm costs in excess of the casualty loss deduction on Schedule M-1 or Schedule M-2.

Q. Does the Company agree that this was an error and should be corrected?

A. Yes. The Company acknowledged this error in response to BHII Request No. 26, although its quantification of the error was not correct. I have attached a copy of the Company's response to BHII Request No. 26 as my Exhibit___(LK-9).

Q. Why is the Company's quantification of the ADIT error incorrect?

A. The Company should have treated the entirety of the regulatory asset as a temporary difference. However, in its response to BHII Request No. 26, the Company reduced the temporary difference by the amount of the estimated casualty loss, as well as an additional amount, apparently to reflect changes in its estimated costs compared to its Application. Those amounts should be included in the temporary difference.

Q. What is the effect on the revenue requirement of correcting this error, using the regulatory asset quantified by the Company in its Application?

A. Using the Company's proposed five-year amortization period, the Company's claimed revenue deficiency should be reduced by $0.132 million. The Company should have reflected $1.159 million in ADIT as a reduction in rate base in its filing, using the five-year amortization period proposed in its Application.

If, however, the Commission adopts a ten-year amortization period, as I propose, then the Company's claimed revenue requirement should be reduced by $0.516 million, consisting of a reduction of $0.102 million due to the net change in rate base (increase in ADIT and reduction in accumulated amortization) and a reduction of $0.414 million in amortization expense to reflect the longer amortization period. The calculation of these amounts is detailed on my Exhibit___(LK-10).

Q. Was this error corrected in the Proposed Settlement?

A. Yes. However, the Proposed Settlement includes the effect of reducing the regulatory asset amount for various costs before computing the effects of including the ADIT as a reduction to rate base. The Proposed Settlement reflects a reduction in the revenue requirement of $0.179 million based upon the net reduction in rate base, including the reduction in the regulatory asset and the subtraction of the ADIT based on the adjusted regulatory asset.

E. The Commission Should Remove Regulatory Asset for Estimated 69 kV LIDAR Surveying Project Costs

Q. Please describe the Company's requested regulatory asset and amortization expense for estimated LIDAR surveying costs.

A. The Company included $0.502 million in rate base for its estimated costs to perform a LIDAR survey of its 69kV distribution system, net of accumulated depreciation. The Company did not include any ADIT offset to the requested regulatory asset even though it represents a book/tax temporary difference. The Company also included $0.137 million in amortization expense based on a proposed five-year amortization period. I have provided the details of the Company's request, including the source of the amounts that I cited, on my Exhibit___(LK-11).

Q. When does the Company plan to spend the estimated amounts?

A. The Company planned to begin the activities and incur costs by "by the end of 3Q 2014," according to its response to BHII Request No. 20 dated July 7, 2014. The response has not been updated. I have attached a copy of the Company's response to BHII Request No. 20 as my Exhibit___(LK-12).

Q. Has the Company sought or obtained an order to defer any costs that have been incurred to date?

A. No. According to its response to BHII Request No. 20, if the Commission does not issue its decision in this proceeding before the end of 2014, the Company plans to make a separate request to the Commission to defer the LIDAR costs as a regulatory asset.

Q. Should the Commission include the estimated LIDAR survey costs as a regulatory asset in rate base and allow amortization expense in this proceeding?

A. No. The Company's request is premature and overreaching. The Company has provided no evidence that it incurred these costs prior to October 1, 2014, or within the 12 months after the end of the historic test year. They are not known and measurable.

Instead of including these costs in this proceeding, the Commission should authorize the Company to defer the survey costs as a regulatory asset and address the recovery of the costs in the Company's next base rate proceeding.

Q. If the Commission allows the estimated LIDAR survey costs in rate base and authorizes recovery of amortization expense, do you have an alternative recommendation?

A. Yes. First, the Commission should correct the ADIT error in the Company's filing. The Company failed to include the related ADIT on Schedule M-1, which it acknowledged in response to BHII Request No. 20. The ADIT should be $0.176 million ($0.502 million times 35%), which will reduce the Company's claimed revenue deficiency by $0.020 million ($0.176 million times 11.43%) if the Commission adopts the Company's proposed five-year amortization period.

Second, the Commission should exercise its discretion to use a longer amortization period to minimize the effect on customers. In this case, a ten-year amortization period will achieve this objective. The Company's five-year amortization period is unnecessarily short. If the Commission includes the estimated survey costs in rate base, then the Company will earn a return on the unamortized regulatory asset regardless of the amortization period.

Q. What is the effect of your alternative recommendation to use a ten-year amortization period?

A. If the Commission adopts a ten-year amortization period, it will reduce the Company's revenue requirement by $0.080 million. This includes the effects on amortization expense and the effects of extending the amortization period on the correction of the ADIT error. The calculations are detailed on my Exhibit____(LK-13).

Q. Does the Proposed Settlement correct the error in the ADIT?

A. No. If the Commission adopts the Proposed Settlement, then it should correct the error in the ADIT regardless of whether it adopts a five-year or ten-year amortization period.

Q. Does the Proposed Settlement reflect your alternative recommendation to use a ten-year amortization period?

A. No. The Proposed Settlement reflects the Company's proposed five-year amortization period. If the Commission adopts the Proposed Settlement, then it should modify the Proposed Settlement to reflect a ten-year amortization period for the reasons that I described.

III. OPERATING INCOME ISSUES

A. <u>The Commission Should Remove Estimated Costs for FutureTrack Workforce Program</u>

Q. Please describe the Company's request to increase payroll and related expenses for its FutureTrack Workforce program.

A. The Company proposes an increase in payroll and related expenses of $0.676 million for its FutureTrack Workforce program. The Company proposes a deferral mechanism so that any costs that it incurs in excess of the annual amount authorized will be deferred as a regulatory asset. Ostensibly, this is a program whereby the Company plans to add staffing in anticipation of future employee retirements, even though the Company has experienced retirements throughout its history and has historically trained and promoted employees or retained new employees to replace retired employees on a recurring basis.

Q. Doesn't the Company and don't other utilities already continually assess their workforce requirements, hire younger and less skilled employees, train them, and then promote them as openings become available regardless of the reasons for the openings?

A. Yes. There is nothing new here that justifies or supports the Company's request. This has been and will continue to be the Company's practice and the nature of the workforce planning and implementation process throughout the industry.

Q. If there are positions that require specialized education and/or skills, what is the current standard industry practice?

A. Current standard industry practice is to hire employees with the appropriate education and/or skills to meet a company's needs when they are needed. This may require hiring employees who have obtained technical training at community colleges with specialized programs and may require hiring employees that have other specialized college and university training and expertise in professional areas.

Typically, new employees enter a company with less experience, but in a junior level position. They are promoted as they gain experience and as positions open up due to other promotions, transfers, resignations/terminations, and retirements.

Q. One aspect of the Company's proposal is to recruit high school students and "more mature workers" and provide them with scholarships to South Dakota vocational schools. Please comment.

A. There is no reason why the Company needs to actively recruit high school students or offer scholarships. Potential employees already have access to technical and vocational programs. Presumably, these programs are offered because there is student demand for those programs, even without such scholarships. In any event, the Company has provided no evidence that the practice is necessary or the only way that it can recruit or fill entry-level positions at the Company. As I noted previously, the Company has been able to recruit and fill entry-level positions since its inception without such a program and without incurring the expense that it proposes in this proceeding.

Q. Should the Commission allow the Company to recover its proposed FutureTrack Workforce program costs?

A. No. The Company has provided no evidence that its program and the associated expenses are necessary for its public utility operations or that it cannot or will not be able to hire qualified employees when they need them. There is nothing new here that the Company does not already do in the normal course of business, including hiring younger and less experienced employees, who then grow into higher level positions when those positions are vacated for any reason, not just retirements.

The Company has access to employees with the appropriate training and experience to meet its staffing requirements. Training programs are already available to students at vocational and community colleges. For example, Mitchell Technical Institute ("MTI"), located in Mitchell, SD, has vocational programs for electrical construction and maintenance, electric utilities and substation technology, power line construction and maintenance, utilities technology – power line. The link to the latter MTI program is https://www.mitchelltech.edu/programs/on-campus/energy-production-transmission/utilities-technology-power-line. MTI also offers scholarships and career services.

As yet another example, Lake Area Technical Institute ("LATI"), located in Watertown, SD, offers a vocational program for energy operations to train operations technicians.

In addition, on-the-job training programs are embedded into the Company's daily operations. There is no compelling evidence that these training programs are insufficient or need to be expanded in the manner proposed by the Company.

The Commission should not impose costs on the Company's customers to resolve problems that do not actually exist.

Q. If the Commission allows the Company to recover any amount for the FutureTrack Workforce program, should the Commission nevertheless deny the Company's request to defer costs in excess of the expense allowed current recovery?

A. Yes. The Commission should limit the recovery of these costs for at least three reasons. First, the Company's request is inappropriately open-ended. In other words, it wouldn't matter what amount was allowed in rates in this proceeding because the Company could defer any amount that it incurred in excess of the amount allowed and then recover it in subsequent proceedings.

Second, the Company has not proposed a measurement baseline that defines how the payroll and related expenses associated with this program can be and will be differentiated from any other payroll and related expenses. The Company's proposal to "track" the costs in a regulatory asset account does not address or cure this fundamental problem because the costs that will be identified and tracked in this manner still will not be subject to any defined or objective measurement baseline.

Third, the Company is not adequately incentivized to operate efficiently if there is no defined measurement baseline and it can defer (and later recover) any amount in excess of the allowed amount. The Company will no longer be at risk for increased expenses for payroll between rate cases. Such a scenario is not in the public interest. The better policy is to determine and provide recovery of the just and reasonable payroll and related expenses for the test year and to allow the Company to manage its payroll and related expenses between rate cases with the proper incentives to ensure that the costs are minimized. Under the present approach, the Company is incentivized to operate efficiently. While it cannot immediately recover or defer increases in payroll and related expenses, it can retain the savings from productivity gains that it achieves between rate cases.

Such a balancing is in the public interest.

Q. Does the Proposed Settlement adopt the Company's proposal?

A. Yes, in part. The Proposed Settlement allows the Company to recover $0.344 million in FutureTrack Workforce program expense. However, the Proposed Settlement does not address the Company's proposal to maintain a regulatory asset account or authorize the Company to defer amounts in excess of the $0.344 million that the Proposed Settlement proposes be allowed in the base revenue requirement.

Q. Even if the Commission adopts the adjustment to increase expense reflected in the Proposed Settlement, should the Commission specifically reject the Company's proposal to maintain a regulatory asset account and defer amounts in excess of the amount allowed in the base revenue requirement?

A. Yes, for the reasons that I previously discussed. The Commission should specifically and clearly reject the Company's deferral proposal to ensure that there is no ambiguity in future proceedings when the Company might seek to recover such deferrals.

B. <u>The Commission Should Remove the Company's Adjustment for Employee Position Additions/Eliminations</u>

Q. Please describe the Company's request to increase payroll and related expenses for additional projected employee positions.

A. The Company seeks recovery of $1.266 million in payroll and related expenses for additional employee positions as shown on Schedule H-1. The $1.266 million is based on the labor and related expenses for 17 open positions.[8]

This request is in addition to the request for increases in payroll and related expenses related to the FutureTrack Workforce program.[9] This amount does not include the Company's proposed adjustments for wage increases or the Neil Simpson I labor costs also shown on Schedule H-1, which I do not address in my testimony.

In the only testimony on this issue, Company witness Mr. Jon Thurber describes the calculation of the adjustment (including the wage adjustments, Neil Simpson I labor costs, and open positions): "These amounts are calculated using an average of union negotiated wage increases and expected non-union wage increases, together with the costs associated with open vacancies and additional employees needed for operations."[10]

Q. How does the Company's request to increase labor and related expenses for open positions compare to its actual history of open positions?

A. The Company's actual history for the last several years indicates that it is not likely to fill all the open positions or actually incur the requested expense. In all

[8] Company response to BHII Request No. 18 (Attachment 18 "Positions by Dept" tab), a copy of which is attached as my Exhibit___(LK-14).

[9] The Company's response to BHII Request No. 18 states "The additional costs on Schedule H-1 are for current open positions to be filled as soon as possible. They do not include any positions related to FutureTrack."

[10] Direct Testimony of Jon Thurber at 17.

months, at least since January 2011, the Company has had open positions.[11] The number of open positions ranged from 5 to 42 in any one month and averaged 19 each month since January 2011. The open positions ranged from 18 to 42 and averaged 26 each month during the test year.[12]

Q. What should the Commission conclude?

A. The Commission should conclude that the request to increase payroll and related expenses is not justified. It is not consistent with the Company's actual experience. The Company has consistently maintained an average of 19 open positions, which is more than the 17 reflected in its adjustment to increase labor and related expenses.

Q. Is there another factor that the Commission should consider?

A. Yes. The Company's request represents an 11% increase in labor and related expense compared to the labor expense without the proposed adjustment. Thus, the Company is requesting an 11% increase simply assuming away its history of maintaining a significant number of open positions.

Q. What is your recommendation?

A. I recommend that the Commission reject this adjustment. It is not justified and it is contrary to the Company's history of 19 to 26 open positions on average. The Commission should not assume that the Company will change its historic practice

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[11] Company's response to SDPUC Request No. 5-14.
[12] *Id.*

going forward.

C. The Commission Should Remove the Company's Adjustment to Increase Pension Expense Based on Five-Year Average

Q. Please describe the Company's request to increase pension expense based on a new methodology compared to the 2014 known and measurable expense.

A. The Company proposes a new, five-year average methodology to calculate pension expense instead of using the 2014 pension expense, which is known and measurable and consistent with the Commission's historic approach to reflect such changes within the twelve month post-test year period.

The pension expense in the test year was $2.608 million ($2.845 million total Company). The Company's new methodology results in adjusted pension expense of $2.142 million. In contrast, the actual known and measurable 2014 pension expense is $0.895 million. The Company's request exceeds the actual known and measurable 2014 pension expense by $1.247 million without justification.

Q. Should the Commission adopt a new methodology for pension expense in this proceeding?

A. No. First, the Company's proposed adjustment is nothing more than an opportunistic response to the reduction in the expense in 2014. The Company has offered no evidence that the pension expense will swing upward to the five year average in future years. Thus, the proposed adjustment reflects nothing more than speculation. It certainly does not reflect a known and measurable change. The actual 2014 expense is the best evidence of the post-test year known and measurable change in the expense compared to the historic test year.

Second, the Commission should be careful not to adopt an adjustment in this proceeding to accommodate the Company that could be considered precedent for other utilities.

Third, the Company has already received the benefit of the lower pension expense this year and will unjustly continue to receive the benefits of lower pension expense if it is allowed excessive recovery based on its new methodology. The Company has not offered to defer the difference between the pension expense reflected in its rates and the actual pension expense this year or to share it with customers. The Company has proposed a new methodology solely to recover more in revenues than its most recent actual pension expense.

Q. Does the Proposed Settlement reflect the Company's proposed new methodology?

A. Yes. If the Commission adopts the Proposed Settlement, then the Commission should revise the pension expense to the actual 2014 expense for the reasons previously described.

D. <u>The Commission Should Remove All Incentive Compensation Tied to Financial Performance From Base Rates</u>

Q. Please describe the Company's incentive compensation expense tied to BHC financial performance.

A. The Company seeks recovery of $1.554 million in incentive compensation expense tied to operating and financial performance. In response to discovery, the Company provided the South Dakota incentive compensation expense and the portion of the expense that was "tied to operating and financial criteria for the test year."[13] In its response, the Company listed the total expense for BHP, Black Hills Service Company, LLC ("BHSC"), allocated to BHP, and Black Hills Utility Holdings, Inc. ("BHUH"), allocated to BHP for each incentive compensation plan and listed the portion of the expense that it determined was "tied to operating and financial criteria for the test year." The expenses identified by the Company as meeting the operating and financial criteria summed to $0.666 million and included a portion of the performance plan expense. However, the Company excluded 0.149 million in performance plan expenses and the entirety of the $0.739 million in incentive restricted stock expense.

Q. Is it Commission precedent to deny recovery of incentive compensation expense tied to operating and financial performance?

A. Yes. This is appropriate for several reasons. First, the Company's financial performance is a direct function of the revenues recovered from customers,

[13] SDPUC Request No. 2-11 (Confidential Attachment G).

including the rate increases that are authorized by the Commission. There is an inherent conflict between lower rates and greater financial performance. Incentive compensation tied to operating and financial performance. The Commission should not incentivize the Company to seek greater rate increases and act against their customers' interests. This expense should be a shareholder cost.

Second, the revenue requirement should not embed recovery of an expense that is based on performance, regardless of whether it is based on operating or financial performance. If the Company is ensured recovery of the expense from customers, then there is no performance that is at risk or that must be achieved in order to recover that expense.

Third, this form of incentive compensation is primarily directed toward achieving shareholder goals, not customer goals. Thus, the cost should be borne by shareholders, not customers.

Q. Are the restricted stock expense and the performance plan expense tied to the Company's financial performance?

A. Yes. The restricted stock expense and performance plan expense represent awards of stock, units, or cash based on the performance measures listed in the Company's Confidential 2005 Omnibus Incentive Compensation Plan in Section 12.1, which consist primarily of financial performance measures.[14]

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[14] Id., Confidential Attachment 2-11A.

Q. Should the Commission deny recovery of the incentive compensation expense tied to the Company's "operating and financial criteria," including the restricted stock expense and the entirety of the performance plan expense?

A. Yes, for the reasons that I previously cited.

Q. Does the Proposed Settlement reflect any adjustment to remove incentive compensation expense?

A. Yes. However, the Proposed Settlement removes only the $0.666 million in incentive compensation expense "tied to operating and financial criteria" identified by the Company in response to SDPUC 2-11. Inexplicably, the Proposed Settlement allows the Company to include $0.739 million in incentive restricted stock expense and $0.149 million in performance plan expenses in its revenue requirement, despite the fact that these are incentive compensation expenses that are similar in nature to the expenses that were removed. The Commission should be consistent and remove all similar incentive compensation expense tied to the financial performance of the Company, BHC, and BHUH.

E. <u>The Commission Should Remove Company Adjustment to Increase Affiliate Allocations from BHUH</u>

Q. Please describe the Company's request to increase the test year affiliate allocations from BHUH.

A. The Company proposes to increase the affiliate allocations from BHUH by

$1.846 million compared to the historic test year. The Company provided adjustments by FERC account on Schedule H-5, although it did not provide any other support for these adjustments in its filing. The Company provided a further breakdown of the adjustments between direct and allocated expenses in response to BHII Request No. 6. The Company appears to have started with projected expenses for the twelve months ending September 2015 and then adjusted those expenses. The Company provided no additional workpapers in support of its proposed adjustments in this response.

Q. What is the magnitude of the proposed increase in affiliate allocations from BHUH?

A. The Company proposes a 19% increase over the historic test year expense, based on Schedule H-5. The largest dollar increases are in account 920 "administrative salaries" (21%) and account 923 "outside services" (56%). Based on these numbers, the adjustments apparently reflect additional staffing and/or salary increases and increased use of outside services.

Q. Should the Commission adopt this adjustment?

A. No. There is no justification for the proposed increase and the magnitude of the increase is unreasonable on its face. The best evidence of the reasonable expense is the test year itself unless there are identifiable known and measurable changes that should be reflected. However, the Company did not provide any evidence of any identifiable known and measurable changes in its filing or in response to

BHII discovery.

Q. Does the Proposed Settlement reflect any reduction in the Company's proposed increase to the affiliate allocations from BHUH?

A. No. To the contrary, the Proposed Settlement inexplicably *increases* the Company's proposed adjustment by $0.527 million to $2.373 million. The Proposed Settlement spreadsheet refers to emails from Jon Thurber to the Staff in support of the adjustments reflected in the Proposed Settlement, but these have not been provided to BHII, or otherwise included in the record. In addition, the Proposed Settlement spreadsheet appears to incorrectly include an allocation to SD of transmission load dispatch costs in account 561 that was not allocated to SD in the Company's Application.[15] The SD allocation for account 561 is shown as $0 on Schedule N-1 page 13 line 64 of the Company's Application. The incorrect allocation in account 561 adds $0.286 million to the Proposed Settlement revenue requirement.

Q. Should the Commission adopt the Proposed Settlement adjustment?

A. No. There is no justification for the proposed increase and the magnitude of the increase is unreasonable on its face. The best evidence of the reasonable expense is the test year itself unless there are identifiable known and measurable changes that should be reflected. However, the Company did not provide any evidence of any identifiable known and measurable changes in its filing or in conjunction

[15] Refer to Exhibit___(DEP-1) Schedule 2 line 4 of the Proposed Settlement spreadsheet.

with its supplemental response to Staff discovery. However, if the Commission adopts the Proposed Settlement adjustment, then it should at least correct the apparent allocation error in account 561 that I described previously.

F. The Commission Should Remove Proposed Settlement Adjustment to Increase Affiliate Allocations from BHSC

Q. Did the Company propose an adjustment for increases in affiliate allocations from BHSC in its filing?

A. No.

Q. Does the Proposed Settlement include increases in affiliate allocations from BHSC?

A. Yes. But to my knowledge the Company never notified the parties that it would seek to further increase its base rates to include increases in affiliate allocations from BHSC. The Company informed the parties in a supplemental response to SDPUC Request No. 3-96 that it planned to propose a new adjustment in its rebuttal testimony and attached a revised Schedule H-4 that detailed the proposed new adjustment by FERC account in the same manner that it filed Schedule H-5. However, the Company provided no additional detail in that response. Based on the Proposed Settlement, it appears that the Company provided the Staff with additional information and changes to the revised Schedule H-4 in a series of emails. None of those emails were shared with BHII during settlement negotiations, they have not been provided to BHII since, and they are not included in the record.

Q. What is the magnitude of the proposed increase in affiliate allocations from BHSC reflected in the Proposed Settlement?

A. The Proposed Settlement incorporates a 6.0% increase over the historic test year expense, based on Schedule H-4. The largest increases are (1) a 7.5% increase in account 920 "administrative salaries" and (2) an 11.7% increase in account 921 "office supplies and expenses." These adjustments apparently reflect additional staffing and/or salary increases and increased "office expenses."

Q. Should the Commission adopt this adjustment?

A. No. There is no justification for the proposed increase and the magnitude of the increase is unreasonable on its face. The best evidence of the reasonable expense is the test year itself unless there are identifiable known and measurable changes that should be reflected. However, the Company has not provided any evidence of any identifiable known and measurable changes in its filing or in response to BHII discovery.

G. <u>The Commission Should Extend the Retired Steam Plants Amortization Expense</u>

Q. Please describe the Company's proposal for the amortization of the regulatory asset for the remaining net book value of the retired steam plants and the obsolete inventory for those plants.

A. The Company proposes $1.163 million ($1.295 million total Company) in amortization expense to amortize the regulatory asset for the retired steam plants over five years.

Q. Should the Commission use a five-year amortization period?

A. No. The Commission should use a ten-year amortization period. The Company's proposed five-year amortization period is unnecessarily short. If the Commission includes the regulatory asset in rate base, then the Company will earn a return on the unamortized regulatory asset regardless of the amortization period. When it has discretion, as it does in this case, the Commission should use a longer amortization period to minimize the effect on customers. In this case, a ten-year amortization period will achieve this objective.

Q. What is the effect of your recommendation to use a ten-year amortization period?

A. Using a ten-year amortization period on the regulatory asset for the retired steam plants and obsolete inventory will reduce the Company's revenue requirement by $0.539 million, consisting of a reduction of $0.582 million in amortization expense, net of an increase in the return on rate base (net reduction in accumulated amortization and increase in ADIT) of $0.043 million. The calculations are detailed on my Exhibit____(LK-15).

Q. Does the Proposed Settlement reflect a ten-year amortization period?

A. No. The Proposed Settlement reflects the five-year amortization period proposed by the Company. If the Commission adopts the Proposed Settlement, then it should modify it to use a ten-year amortization period.

H. The Commission Should Reduce the Company's Amortization Expense on the Regulatory Asset for Storm Damage

Q. Please describe the Company's request for amortization expense on the regulatory asset for storm damage.

A. The Company proposes $0.828 million for amortization expense based on a five-year amortization period. I provide the details of the Company's request, including the source of the amounts that I cited, on my Exhibit___(LK-10).

Q. Should the Commission use a five-year amortization period?

A. No. The Commission should use a ten-year amortization period. The Company's proposed five-year amortization period is unnecessarily short. If the Commission includes the regulatory asset in rate base, then the Company will earn a return on the unamortized regulatory asset regardless of the amortization period. When it has discretion, as it does in this case, the Commission should use a longer amortization period to minimize the effect on customers. In this case, a ten-year amortization period will achieve this objective.

Q. What is the effect of your recommendation to use a ten-year amortization period?

A. Using a ten-year amortization period will reduce the Company's revenue requirement by $0.414 million to reflect the reduction in amortization expense of an equivalent amount. The rate base effects from the adjustment, along with the reduction for ADIT, are discussed in the rate base section of my testimony. The calculations are detailed on my Exhibit____(LK-10).

Q. Does the Proposed Settlement reflect a ten-year amortization period?

A. Yes.

I. The Commission Should Remove the Retired Steam Plants Decommissioning Amortization Expense

Q. Did you previously address this issue in the Rate Base Issues section of your testimony?

A. Yes.

J. <u>The Commission Should Remove the 69kV LIDAR Surveying Project Amortization Expense</u>

Q. Did you previously address this issue in the Rate Base Issues section of your testimony?

A. Yes.

K. <u>The Commission Should Extend the CPGS Life Span for Depreciation Expenses</u>

Q. Please describe the Company's proposed life span for the CPGS depreciation rate and expense.

A. The Company proposes a life span for the CPGS of 35 years, a depreciation rate of 3.29%, and $2.726 million in depreciation expense ($3.035 million total Company).

Q. Is the proposed 35-year life span reasonable?

A. No. A 35-year life span is unnecessarily short. A longer life span of 40 to 45 years is within the range of reasonableness supported by the Company's depreciation expert's own analysis. The longer life span reflects the estimated and actual service lives of similar facilities owned by other utilities.[16] The Company's depreciation expert, Mr. John Spanos, in consultation with the Company during his depreciation analysis, determined that an appropriate life

[16] Company response to BHII Request No. 11 (Spanos workpapers and source documents).

span for the facility was 40 years, which the Company appears to have confirmed.[17] Mr. Spanos offered no explanation in his testimony as to why he changed the 40 years set forth in his analysis to the 35 years set forth in the depreciation study attached to his testimony.

Q. What is the effect on the revenue requirement of using a 40-year life span?

A. A 40-year life span for the CPGS depreciation rate and expense will reduce the Company's revenue requirement by $0.332 million, consisting of a reduction of $0.338 million in amortization expense, net of an increase in the return on rate base (net reduction in accumulated amortization and increase in ADIT) of $0.006 million. The calculations are detailed on my Exhibit____(LK-16).

Q. Does the Proposed Settlement reflect a 40-year life span?

A. Yes.

L. The Commission Should Correct the Steam and Other Production Plant Net Salvage for Depreciation Expenses

Q. Please describe the changes in steam and other production plant net salvage reflected in the Company's proposed depreciation rates.

A. The Company proposes significant increases in net negative salvage for its steam and other production plant accounts. Net negative salvage refers to the net of estimated salvage income and cost of removal. Net negative salvage means that

[17] *Id.*, Attachment 11U - BHP and CLFP Projected Plant retirements updated 9-24-13, a copy of which I have attached as my Exhibit___(LK-17).

the projected salvage income is less than the projected cost of removal.

Mr. Spanos applied the net salvage rates to the entire plant balance, which covers not only interim retirements, but also terminal retirements (for decommissioning). Increases in net negative salvage have the effect of increasing the depreciation rates.

The present depreciation rates reflect -5% net salvage rates.[18] The Company proposes to increase these rates to -13% to -22% depending on the plant. I have replicated a summary schedule from the Company's depreciation study showing the net salvage rates and depreciation rates for each plant and each plant account as my Exhibit___(LK-18).

Q. Is this significant increase in net negative salvage for the production plant accounts appropriate?

A. No. First, the basis for the calculation of the terminal net salvage is flawed and unreliable, resulting in an excessive net negative salvage cost and percentage.

Second, this may represent an undisclosed proposal to change the Commission's policy for decommissioning cost recovery from recovery *after* the retirement of the plants (as is the case in this proceeding for the three retired coal-fired plants) to recovery *before* the future retirement of the plants.

Third, the increase in net negative salvage is not necessary at this time. The Commission is not required to provide recovery of unknown future costs in

[18] Present depreciation rates were adopted in Case No. E09-018 based on a depreciation study performed for the Company by Black and Veatch (Exhibit LWL-1 in that proceeding). I have attached pages illustrating the -5% used in that study and reflected in present depreciation rates as my Exhibit___(LK-19).

present rates. The Commission's current policy appears to be determine the appropriate manner of decommissioning (and associated costs) *after* plants are retired. This policy is prudent for ratepayers and still ensures that the Company recovers its costs.

Q. How should the Commission proceed on this issue?

A. The Commission should use the same -5% net salvage rate for these production plant accounts that is reflected in the present depreciation rates. The Company has not justified the significant increases that it proposes or provided any valid rationale to change policy. The Commission should not provide premature recovery of unknown future costs; the Company can seek recovery of decommissioning costs in the future when the method of decommissioning can be assessed and the cost can be determined based on actual bids.

Q. Have you quantified the effect on the revenue requirement of your recommendation?

A. Yes. Using a -5% net salvage rate reduces depreciation rates and reduces depreciation expense and the revenue requirement by $1.132 million. I provide the calculation of the depreciation rates using the -5% net salvage rate and the effects on depreciation expense on my Exhibit___(LK-20).

M. <u>Other Proposed Settlement Issues</u>

Q. Are there other issues specifically identified in the Proposed Settlement with which you agree and that you recommend the Commission adopt?

A. Yes. The Proposed Settlement includes an adjustment of $0.380 million to increase revenues for the effects of weather normalization, an adjustment of $0.219 million to reduce the allocation of the Neil Simpson rent revenue and expense, and an adjustment of $0.244 million to reduce the allocation of the Neil Simpson common steam plant. I recommend that the Commission adopt those proposed adjustments.

IV. MISCELLANEOUS ISSUES

A. [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[19] BHP response to BHII 5, a copy of which is attached as my Exhibit___(LK-21).

[redacted]

[redacted]

[redacted]

[redacted]

Q. Does that complete your testimony?

A. Yes.

BEFORE THE SOUTH DAKOTA
PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF	**)**	
BLACK HILLS POWER, INC., A SOUTH DAKOTA	**)**	**DOCKET NO. EL14-026**
CORPORATION, FOR AUTHORITY TO INCREASE	**)**	
RATES IN SOUTH DAKOTA	**)**	

EXHIBITS

OF

LANE KOLLEN

ON BEHALF OF

BLACK HILLS INDUSTRIAL INTERVENORS

J. KENNEDY AND ASSOCIATES, INC.
ROSWELL, GEORGIA

DECEMBER 2014

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