STATE OF SOUTH DAKOTA)		IN CIRCUIT COURT
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COUNTY OF HUGHES)		SIXTH JUDICIAL DISTRICT

IN THE MATTER OF THE APPLICATION OF BLACK HILLS POWER, INC. FOR AUTHORITY TO INCREASE ITS ELECTRIC RATES	Civ. No. 15-146 **APPELLANT'S BRIEF**

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PRELIMINARY STATEMENT

For convenience and clarity, Appellant/Black Hills Industrial Intervenors, GCC Dacotah 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., will be referred to collectively as "*BHII*" and the South Dakota Public Utilities Commission and Black Hills Power, Inc. will be referred to as the "*Commission*" and "*BHP*," respectively.

JURISDICTIONAL STATEMENT

This is an appeal taken from the Commission's Final Decision and Order dated April 17, 2015 ("*Final Decision*"), which was affirmed on May 29, 2015 in an Order Denying Rehearing and Reconsideration. BHII filed a Notice of Appeal on June 26, 2015. This Court has jurisdiction over the appeal under SDCL Ch. 1-26, including SDCL 1-26-30, and -30.2.

STATEMENT OF ISSUES

The broad issues before this Court are:

A. WHETHER THE COMMISSION CAN PERMIT ADJUSTMENTS TO A UTILITY'S COST OF SERVICE ANALYSIS UNDER ARSD 20:10:13:44 WHEN THOSE ADJUSTMENTS WERE NOT SUPPORTED AND WERE NEITHER KNOWN WITH REASONABLE CERTAINTY NOR MEASUREABLE WITH REASONABLE ACCURACY AT THE TIME THE UTILITY FILED ITS APPLICATION TO INCREASE RATES.

The Commission held in the affirmative.

Relevant Cases:

In re Application of Nw. Pub. Serv. Co. for a Proposed Increase in Rates for Electric Service, 297 N.W.2d 462 (S.D. 1980).

Permann v. Dept. of Labor, 411 N.W.2d 113 (S.D. 1987).

In re Minn. Gas Co., F-3302, 32 P.U.R. 4th 1 (S.D.P.U.C. 1979).

Relevant Statutes and Rules:

SDCL 49-34A-8.4.

ARSD 20:10:13:44.

B. WHETHER ARSD 20:10:13:44 PERMITS CONTINUAL POST-FILING ADJUSTMENTS TO A UTILITY'S APPLICATION TO INCREASE RATES THAT WERE NEITHER KNOWN WITH REASONABLE CERTAINTY NOR MEASURABLE WITH REASONABLE ACCURACY AND, IF SO, WHETHER THE COMMISSION'S DECISION TO APPROVE THE CALCULATION OF A FIVE-YEAR AVERAGE PENSION EXPENSE—BASED UPON 2010–2014, RATHER THAN 2011–2015 DATA—WAS ARBITRARY AND CAPRICIOUS WHEN THE DATA FOR 2015 WAS KNOWN TO THE COMMISSION AND SUBMITTED INTO EVIDENCE IN REBUTTAL TESTIMONY.

The Commission held that such post-filing adjustments were allowed and that it could calculate BHP's average pension expense for the five year period from 2010 through 2014, without any consideration of 2015 expense data.

Relevant Cases:

In re Jarman, 2015 S.D. 8, 860 N.W.2d 1.

Tucek v. Dep't of Soc. Servs., 2007 S.D. 106, 740 N.W.2d 871.

Smith v. Canton Sch. Dist. No. 41-1, 1999 S.D. 111, 599 N.W.2d 637.

Relevant Statutes and Rules:

SDCL 1-26-36.

ARSD 20:10:13:44.

C. WHETHER A UTILITY MEETS ITS BURDENS—UNDER SDCL 49-34A-8.4, 49-34A-11 AND ARSD 20:10:13:44—OF PROVING THAT ITS INCENTIVE COMPENSATION PACKAGE IS PRUDENT, EFFICIENT, AND ECONOMICAL, IS REASONABLE AND NECESSARY TO PROVIDE SERVICE TO ITS CUSTOMERS IN SOUTH DAKOTA, AND IS FULLY SUPPORTED, BY PRESENTING CONCLUSORY AND SELF-INTERESTED STATEMENTS OF ONE OF THE UTILITY'S OWN EXECUTIVES, UNSUBSTANTIATED BY ANALYSIS, MEANS OF CALCULATION OR ANY DOCUMENTATION?

The Commission held in the affirmative.

Relevant Cases:

In re One-time Special Underground Assessment by Northern States Power Co. in Sioux Falls, 2001 S.D. 63, 628 N.W.2d 332.

In re Otter Tail Power Co. ex rel. Big Stone II, 2008 S.D. 5, 744 N.W.2d 594.

In re Petition for Declaratory Ruling of Black Hills Power, Inc., Regarding the Proposed Black Hills Power Wind Project, EL11-007, 2011 WL 11820302 (S.D.P.U.C. June 8, 2011).

Irvine v. City of Sioux Falls, 2006 S.D. 20, 711 N.W.2d 607.

Relevant Statutes and Rules:

SDCL 49-34A-6.

SDCL 49-34A-8.4.

SDCL 49-34A-11.

ARSD 20:10:13:44.

I. STATEMENT OF THE CASE AND FACTS

Over BHII's objections and upon reconsideration, the Commission approved the Amended Settlement Stipulation dated February 10, 2015 ("*Amended Settlement*") between BHP and Commission staff ("*Staff*") with respect to BHP's application for authority to increase electric rates ("*Application*"). In this appeal, BHII seeks to resolve the following disputed issues of law that are matters of first impression and bear directly on the calculation of a public utility's cost of service: (1) the proper interpretation of ARSD 20:10:13:44, and (2) the evidentiary standard a utility must meet to satisfy its burdens of proof under SDCL 49-34A-8.4, -11, and ARSD 20:10:13:44.

BHP submitted its Application to the Commission on March 31, 2014. *Final Decision* at 1, App. A-2. The Application proposed an increase in electric rates of approximately $14.6

million annually, or 9.7%. *Id*. As part of the Application, and pursuant to South Dakota law, BHP submitted a cost of service analysis.[1] *Appl.* § 4, Statems. A-R.

On June 6, 2014, BHII and Dakota Rural Action filed petitions to intervene in the proceeding, and on June 26, 2014, the Commission granted them. *Final Decision* at 2, App. A-3. During the Fall of 2014, the parties engaged in settlement discussions in an effort to avoid contested proceedings. *BHII's Post-Hrg. Br.* at 2 (Feb. 17, 2015) ("*Appellants' Brief*"), App. A-70–133. BHII was not privy to all settlement discussions between BHP and Staff. *See, e.g.*, *id.* at 2, n.4, App. A-74; *infra* at 17.

On December 9, 2014, following the breakdown of settlement discussions between the parties, BHP and Staff filed a Joint Motion for Approval of Settlement Stipulation ("*Original Settlement*"). *Final Decision* at 2, App. A-3. BHII had a number of concerns with the Original Settlement, and, pursuant to the Commission's December 12, 2014, Scheduling Order, BHII submitted expert testimony disputing the terms of the Original Settlement. *Kollen Direct Test. & Exs.* (Dec. 30, 2014) ("*Kollen Direct*"), App. A-134–303; *Baron Direct Test. & Exs.* (Dec. 30, 2014). On the same date, the Commission entered an Order for and Notice of Hearing ("*Notice of Hearing*") setting forth the issues for the evidentiary hearing. *Final Decision* at 2, App. A-3. The overarching issue described in the Notice of Hearing was the Commission's legal authority to approve the Original Settlement. *Notice of Hrg.* at 2, App. A-26.

[1] Generally speaking, a utility's "cost of service" or "revenue requirement" is the amount of money asserted by the utility as necessary to operate and maintain facilities, cover capital expenses, and provide a rate of return to its investors. The terms are used interchangeably. The cost of service is the foundation for any increase in a utility's electric rates and state law dictates how it must be determined.

Pursuant to the Notice of Hearing and SDCL Ch. 1-26, the Commission conducted a contested case proceeding on January 27 and 28, 2015. *Final Decision* at 2, App. A-3. At the hearing, BHP and Staff admitted that the Original Settlement contained a $0.286 million error in the allocation from BHP's affiliate, Black Hills Utility Holdings ("*BHUH*"). *Evid. Hrg. Tr.* at 279:24-280:5, App. A-443–44; *see Thurber Rebuttal Test. & Ex.* at 16 (Jan. 15, 2015), App. A-366–92. ("*Thurber Rebuttal*"); *Peterson Test.* at 19 (Jan. 15, 2015), App. A-324. After the hearing, and upon BHII's motion, the parties were afforded the opportunity to submit post-hearing briefs. *Post-Hrg. Procedural Order* at 2 (Jan. 29, 2015).

One week prior to the due date for post-hearing briefs, on February 10, 2015, BHP and Staff filed the Amended Settlement, *Final Decision* at 2, App. A-3, which reflected two changes to the Original Settlement. Specifically, the Amended Settlement (1) removed the erroneous $0.286 million affiliate allocation from BHUH and (2) added a new $0.413 million affiliate allocation from BHUH for operations and maintenance ("*O&M*") expenses related to BHP's Wyodak power plant—an amount that was first submitted into evidence in BHP witness Thurber's rebuttal testimony on January 15, 2015. *Staff Mem. Supp. Am. Settlem. Stip.*at 2 (Feb. 10, 2015), App. A-68 ("*Am. Staff Mem.*"); *Thurber Rebuttal* at 17-19, App. A-384–86, *id.* Ex. JTR-1, App. A-392. Despite these changes, the overall revenue deficiency agreed upon between BHP and Commission Staff in the Amended Settlement remained the same at $6,890,746. *Am. Staff Mem.* at 3, App. A-69.

On February 17, 2015, Appellants and BHP submitted their respective briefs, *Final Decision* at 3, App. A-4, and on February 23, 2015, Staff and BHP submitted a Joint Motion for Approval of Amended Settlement Stipulation, *id.* Less than 10 days later, at a hearing on March 2, 2015, the Commission voted to grant that Motion. *Id.*

BHII seeks reversal of the Final Decision based on: (1) the Commission's interpretation of ARSD 20:10:13:44, and (2) the Commission's application of the legal standard a utility is obligated to meet when satisfying its burdens of proof under SDCL 49-34A-8.4 and 49-34A-11. BHII asserts that the Commission misinterpreted and misapplied the law, resulting in certain adjustments to BHP's filed cost of service analysis that should have been rejected. The issues on appeal are questions of law, not fact. Applying the Commission's interpretation of the law to certain facts in the record tellingly illustrates the financial impact on ratepayers. While not issues on appeal themselves, those facts are relevant to the grounds upon which BHII seeks reversal of the Final Decision and are discussed in detail below.

Critical to the Court's analysis, the issues on appeal *do not* challenge the Commission's authority to approve settlement agreements based on facts properly before it. Nor do the appeal issues address the give-and-take that occurs between parties in settlement negotiations based on such facts. Instead, the issues are legal ones that strike at the heart of what facts may be on the table for negotiation by the parties in the first place.

BHII appeals from the Commission's approval of the Amended Settlement because the overall cost of service in the settlement incorporates costs and adjustments that the Commission had no discretion to accept or approve. Stated differently, the Amended Settlement includes both (1) adjustments to test-year book costs originally proposed by BHP in its Application ("*Pre-Filing Adjustments*") and (2) adjustments to test-year book costs and Pre-Filing Adjustments originally proposed by BHP after filing the Application ("*Post-Filing Adjustments*"), that the Commission was legally obligated to reject. The result of the Commission's errors is that the overall revenue requirement in the Amended Settlement would permit BHP to recover more from ratepayers than the law allows.

II. ARGUMENT

In general terms, a utility rate case has two sets of issues that are addressed in a contested case: (1) the revenue requirement—*i.e.* "how much" rates should increase, analyzing the utility's filed cost of service analysis; and (2) the revenue allocation—*i.e.*, "who pays" for the rate increase ultimately resolved under (1). This appeal involves only the revenue requirement.

A public utility's application to increase rates is governed by SDCL Ch. 49-34A and ARSD Ch. 20:10:13. The utility requesting a rate increase bears the burden of proving both that the proposed costs supporting its request are justified and that the proposed rates are just and reasonable. SDCL 49-34A-8.4, -11. To assist the Commission in its review of the revenue issues, the utility's application must include an analysis of its cost of service. ARSD 20:10:13:44. The cost of service analysis must include the statements and schedules identified in ARSD 20:10:13:51 through 20:10:13:102, and each is subject to the burdens of proof referenced above. ARSD 20:10:13:104.

The cost of service analysis must analyze the utility's book costs for a test period consisting of 12 months of actual data. ARSD 20:10:13:44. Although this rule permits adjustments to those book costs, the utility must meet its burden of demonstrating that any such adjustments are "fully supported." *Id.* Controlling law further provides that the Commission cannot permit adjustments to a public utility's filed cost of service that are not "known with reasonable certainty and measurable with reasonable accuracy" at the time the utility files its application for a rate increase. *Id.*

In this case, the Amended Settlement contained adjustments to BHP's 12 months of actual experience that were neither "fully supported" nor "known with reasonable certainty and measurable with reasonable accuracy" at the time BHP submitted its Application. And the

Amended Settlement contained an unsupported, unjust, and unreasonable level of incentive compensation. BHII therefore respectfully requests that the Court reverse the Commission's decision to approve the Amended Settlement as a matter of law and remand the case for further proceedings.

A. THE COMMISSION VIOLATED THE PLAIN LANGUAGE OF ARSD 20:10:13:44 BY FAILING TO REJECT ADJUSTMENTS TO BHP'S COST OF SERVICE THAT WERE NOT SUPPORTED BY THE RECORD AND WERE NEITHER KNOWN WITH REASONABLE CERTAINTY NOR MEASURABLE WITH REASONABLE ACCURACY AT THE TIME BHP FILED ITS APPLICATION TO INCREASE RATES.

The standard of review for this issue is *de novo*. "When the issue is a question of law, the decisions of the administrative agency . . . are fully reviewable" by the courts. *Permann v. Dept. of Labor*, 411 N.W.2d 113, 116 (S.D. 1987) (quoting *Johnson v. Skelly Oil Co.*, 359 N.W.2d 130, 132 (S.D. 1984)). The proper interpretation of ARSD 20:10:13:44 is a matter of first impression in South Dakota. The Commission set out its interpretation of ARSD 20:10:13:44 for the first time in the Final Decision, in Conclusions of Law 2 and 9. *Final Decision* at 16-17, ¶ 2 & 18, ¶ 9, App. A-17–19. BHII disputes the Commission's interpretation and prays the Court reverse the Final Decision and remand this case to the Commission for further proceedings consistent with the plain language of ARSD 20:10:13:44 and the analysis discussed below.

BHII's argument on this issue is separated into five parts to clearly address the elements of the rule, starting with a diagram of the rule itself. The argument is designed to support two primary conceits: (1) the Commission should have rejected the Amended Settlement because certain Pre-Filing Adjustments included in BHP's Application were not "fully supported" and (2) the Commission should have rejected the Amended Settlement because certain Post-Filing Adjustments were not "known with reasonable certainty and measurable with reasonable accuracy" at the time BHP filed the Application.

1. BHP's Proposed Cost of Service Must Meet the Requirements Set Forth in SDCL 49-34A-8.4 and ARSD 20:10:13:44.

SDCL 49-34A-8.4 states that "[t]he burden is on the public utility to establish that the underlying costs of any rates, charges, or automatic adjustment charges filed under this chapter are prudent, efficient, and economical, and are reasonable and necessary to provide service." Thus, it is not incumbent upon Staff or any intervenor to establish that the BHP's proposed cost of service is imprudent, inefficient, uneconomical, or not reasonably necessary to provide service. The burden of proof lies squarely on BHP.

Importantly, neither SDCL 49-34A-8.4 nor any other South Dakota statute establishes the criteria the Commission must use to determine whether a utility's filed costs are "prudent, efficient, and economical and are reasonable and necessary to provide service." The Commission is required, however, to analyze the completeness and accuracy of a utility's filed cost of service under ARSD 20:10:13:44. The language of the rule, stated below, has been diagrammed for purposes of the discussion that follows:

> **20:10:13:44. Analysis of system costs for a 12-month historical test year.** The statement of the cost of service shall contain an analysis of system costs as reflected on the filing utility's books for a test period consisting of 12 months of actual experience ending no earlier than 6 months before the date of filing of the data required by §§ 20:10:13:40 and 20:10:13:43 unless good cause for an extension is shown.
>
> The analysis shall include the return, taxes, depreciation, and operating expenses and an allocation of such costs to the services rendered.
>
> The information submitted with the statement shall show the data itemized in this section for the test period, as reflected on the books of the filing public utility.
>
> Proposed adjustments to book costs shall be shown separately and *shall be fully supported*, including schedules showing their derivation where appropriate.
>
> However, *no adjustments shall be permitted*
>
> *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*
>
> *and* which will become effective within 24 months of the last month of the test period used for this section
>
> and unless expected changes in revenue are also shown for the same period.

ARSD 20:10:13:44 (*emphasis added*).

As the rule clearly states, not only must proposed adjustments to the utility's cost of service be shown separately and "fully supported" in the record, but also the phrase "no adjustments shall be permitted unless . . ." obligates the Commission to evaluate each and every adjustment and reject any that is not "known with reasonable certainty and measurable with reasonable accuracy at the time of filing" or will not "become effective within 24 months of the last month of the test period." No other body has jurisdiction to evaluate adjustments to a utility's cost of service and failure to analyze each is an abdication of one of the Commission's core responsibilities in rate cases. The Commission can only find that a utility has met its burden

of proof under SDCL 49-34A-8.4 if the utility's cost of service satisfies the provisions of ARSD 20:10:13:44.

2. ARSD 20:10:13:44 Requires BHP to Base its Cost of Service on a 12-Month Historical Test Year.

The first sentence of ARSD 20:10:13:44 plainly establishes a static, 12-month historical test period: "The statement of the cost of service shall contain an analysis of system costs as reflected on the filing utility's books *for a test period consisting of 12 months of actual experience*" (emphasis added). Significantly, the utility is in complete control of both (1) the 12-month period it chooses for its test year and (2) the date on which it applies for a rate increase.[2] Thus, a utility can pick the test period and the filing date to meet its business goals, but the utility is then required to base its cost of service on the 12-month period it chooses.

Granted, a 12-month historical test year is not a perfect predictor of future costs. Indeed, the South Dakota Supreme Court has stated that "[t]he purpose of using a test year is to establish *with a reasonable degree of accuracy* the revenue and expenses that a utility will experience during the period when the new rates will be in effect." *In the Matter of the Application of Northwestern Pub. Serv. Co. for a Proposed Increase in Rates for Electric Service*, 297 N.W.2d 462, 469 (S.D. 1980) (quoting *Northwestern Pub. Serv. v. Cities of Chamberlain, Huron, Mitchell et al.*, 265 N.W.2d 867, 879 (S.D. 1978)) (emphasis added). But ARSD 20:10:13:44 takes into account the imperfect nature of the historical test year by incorporating two mechanisms that ensure test-year data is representative of the utility's cost of service on the date it files for a rate increase. First, the rule requires the utility to file its application within six

[2] Provided the utility's application is filed within six months after the end of the test year. ARSD 20:10:13:44.

months after the end of the test year.[3] By mandating that a utility file within six months, the rule helps to protect the contemporaneousness of the historical test-year data. Second, the rule allows the utility to propose adjustments to test-year book costs that become known and measurable in the time between the end of the historical test year and the date the utility chooses to file its case. In particular, the rule allows the utility to propose an adjustment for any cost that "will become effective" (*i.e.*, that the utility will incur) within 24 months after the end of the test year so long as it is (1) "fully supported" by the evidence and (2) "known with reasonable certainty and measurable with reasonably accuracy" at the time the its application is filed. Only adjustments that fall outside those parameters are expressly prohibited, and by permitting such adjustments the rule helps ensure that the utility's cost of service is as accurate as possible as of the date it files its application. The adjustments for Light Detection and Ranging ("*LIDAR*"), affiliate allocations, and employee additions clearly fall outside those parameters.

3. ARSD 20:10:13:44 Requires Proposed Adjustments to be "Fully Supported."

Any adjustment to test-year book costs proposed by the utility must be "fully supported, including schedules showing their derivation where appropriate." The Commission has previously determined that a pre-filing adjustment cannot be "fully supported" if it merely represents a budget estimate. In *In re Minnesota Gas Co.*, the Commission held that a "budget is an unreliable basis for establishing rates," and to allow such estimates to influence ratemaking would be tantamount to adopting a projected test year "in total contravention of the rational and

[3] BHII is only aware of one instance where a utility filed for and received an extension of the six month period for filing after the end of the 12-month test year. *In re Petition of MidAmerican Energy Co. for Extension of Test Period*, EL14-030, Order Approving Extension of Filing Deadline Following Test Period (S.D.P.U.C. May 1, 2014) (approving August 2014 filing for a test year ending December 2013).

sound rate-making principle of utilizing a test year adjusted for known and measurable changes." F-3302, 32 P.U.R. 4th 1 (S.D.P.U.C. 1979) (holding that Minnegasco's construction budget was an unreliable basis for establishing rates). The facts, supported in the record, demonstrate that the Amended Settlement contains allowances for three Pre-Filing Adjustments that were based on budgets.

First, the cost of service analysis in BHP's Application contained no actual historical data to support including approximately $0.502 million of LIDAR surveying costs and $0.137 million in amortization expense. *Appl.* § 4, *Statem. H, Schedule H-20,* App. A-407; *see BHII's Post-Hrg. Br.* at 48-50, App. A-120–22. The Pre-Filing Adjustment for LIDAR costs was nothing more than a budget and not tied to actual costs. *Id*.

Second, the Application included a Pre-Filing Adjustment of approximately $1.846 million for affiliate allocations from BHUH. *Appl.* § 4, *Statem. H, Schedule H-5,* App. A-403.[4] This adjustment represented a 19% increase over the historic test year expense, for which BHP failed to provide any evidentiary support. *Kollen Direct* at 38, App. A-173. Indeed, Commission Staff conceded in its memorandum supporting the Original Settlement that "Staff objected to this adjustment because it did not reflect a known and measurable change in BHP's costs; rather, *it was merely BHP's estimate of future costs*." *Staff Mem. Supp. Settlem. Stip.* at 7 (Jan. 15, 2015) (emphasis added) ("*Original Staff Memorandum*"), App. A-44.

Third, the Application included a Pre-Filing Adjustment of $1.266 million for payroll and expenses related to 17 open positions. *Appl.* § 4, *Statem. H, Schedule H-1,* App. A-399; *Kollen*

[4] The Application no increased affiliate allocation costs to BHP from its affiliate, Black Hills Service Company ("*BHSC*")—*i.e.*, no Pre-Filing Adjustment was proposed. However, the Commission subsequently accepted a Post-Filing Adjustment for BHSC allocations, which is addressed later in this brief. *See e.g., infra* at 18-19.

Direct at 31, App. A-166. This amount was allegedly calculated using an average of union and non-union wages, along with the costs incurred in filling the positions. *Thurber Direct* at 17 (Mar. 31, 2014), App. A-364. Notably absent from this data was any analysis supporting the notion that the open positions would, in fact, be filled. Furthermore, it is undisputed that the 12-month historical test year indicated that BHP was unlikely to fill all of the open positions or incur the requested expense. *Kollen Direct* at 31, App. A-166. In fact, BHP admitted during discovery that the number of open positions during the test year ranged from 18 to 42 and averaged 26. *Id.* at 32, App. A-167.

Together, these Pre-Filing Adjustments reveal approximately $3.751 million in costs that were added to the total 12-month historical test year expense based on estimates that were unsupported by evidence in the record. The fact that these Pre-Filing Adjustments were later adjusted (in some instances upward and in some instances downward) based on information obtained after the date BHP filed its Application is irrelevant. Based on the insufficient information in the Application alone, the Commission should have rejected the Pre-Filing Adjustments. Instead, the Commission painted over BHP's failures by approving the Amended Settlement, boot-strapping the Post-Filing Adjustments to the Pre-Filing Adjustments, and relying on a theory that the Post-Filing Adjustments prohibited by the rule were nevertheless permissible because they related back to budgets included in the Application. If a budgeted cost runs afoul of rational and sound ratemaking principles (as the Commission determined it would in *In re Minnesota Gas Co.*), it is inconceivable how Pre-Filing Adjustments to a 12-month historical test year that are entirely unsupported, can be resurrected by Post-Filing Adjustments submitted months after BHP submitted its Application.

As a threshold matter, the Court should reverse and remand because the Pre-Filing Adjustments for LIDAR, BHUH affiliate allocations, and employee additions were not "fully supported" with schedules showing their derivation. But even if the Court determines that the Pre-Filing Adjustments *were* fully supported by the evidence, the Court should reverse and remand because the Post-Filing Adjustments were not known with reasonable certainty and measurable with reasonable accuracy at the time BHP filed its Application.

4. ARSD 20:10:13:44 Requires Proposed Adjustments to be Known with Reasonable Certainty and Measurable with Reasonable Accuracy "At the Time of Filing."

In addition to being "fully supported," each proposed adjustment to test-year book costs must be "known with reasonable certainty and measurable with reasonable accuracy *at the time of filing*." ARSD 20:10:13:44 (emphasis added). The proper interpretation of the phrase "at the time of filing" in ARSD 20:10:13:44 is critical to determining what adjustments to book costs BHP should be permitted to make. BHII interprets that phrase to mean "at the time the utility files its application." *See Evid. Hrg. Tr.* at 173:18-20, App. A-439 ("The utility must first demonstrate that [the proposed adjustments] are known and measurable at the time of the filing, which would be March 31, 2014"). The Commission, on the other hand, believes that the phrase means "at the time the utility submits the adjustment." *See Final Decision* at 8, ¶ 26, App. A-9 ("the adjustments have to be sufficiently known and measurable at the time of [Staff's] review of the hundreds of responses to discovery requests and filings in this case"). BHII submits that no adjustments are permitted 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 BHP filed its Application*. The Commission, however, interprets the rule to state that no adjustments are permitted 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 BHP submits the adjustment during the pendency of the case*.

a. "At the time of filing" means "at the time the utility files its application."

"At the time of filing" can only mean "at the time the utility files its application" because that reading is supported by the plain language of the rule, as well as the principles of equity and due process in rate case proceedings. The rule's chosen language—indeed, the title of the rule itself—calls for a 12-month historical test year and not a forecast test year.[5] The beginning of that 12-month historical test year provides the starting point for determining a utility's cost of service and the date the utility files its application represents the endpoint. The Commission may only permit adjustments to test-year book costs that become known and measurable before the utility files its case (*i.e.* in the time between the end of the test year and the date of filing) and that will become effective within 24 months after the end of the test year.[6] Absent those limited circumstances, which the utility must demonstrate exist, the utility must adhere to the cost of

[5] BHII acknowledges that ARSD 20:10:13:104 makes the following exception to the 12-month historical test year: "Although §§ 20:10:13:51 to 20:10:13:102, inclusive provide for a historical test period, the utility, in addition, may submit cost of service information for a nonhistorical test period beginning no later than the proposed effective date of the new rates. Statements A through R and the accompanying testimony shall include an explanation of these exhibits." BHII notes, however, that the Statements A through R BHP filed did not include nonhistorical test-year data beginning on or before October 1, 2014 (the proposed effective date of the Company's new rates), and that BHP did not provide any testimony explaining any changes to Statements A through R that included such information. As a result, the exclusive 12-month historical test year, with permitted adjustments, controls BHP's Application in this case.

[6] BHII admits there may be a very unlikely circumstance in which the utility discovers, after filing its application, that certain adjustments that were known and measurable at the time of the filing were erroneously excluded from the utility's application. ARSD 20:10:13:44 provides the utility with an opportunity for correcting such an error. What the utility knew and when it knew it would likely be contested issues in a general rate case.

service as it is understood at the time the utility files its case. The purpose of a 12-month historical test year is to prevent utilities from making post-filing adjustments that do not comply with the rule (*e.g.* true-ups for actual costs incurred after filing). The application submitted provides the snapshot of costs for which the utility is seeking recovery, and upon which the utility is seeking a rate of return, in the case. Nowhere does the rule contemplate post-filing adjustments that become known and measurable after the utility files its application.

BHII is aware of only one instance where a utility was permitted to adjust the estimate of a cost to account for actual post-test year expenses. That case, though, involved a new cost (the Big Stone Power Plant) for which there was no historical data available at the time the utility filed its application. And the data the Commission relied upon were later found to be "speculative" and "nothing more than a prediction." *In re Application of Nw. Pub. Serv. Co. for a Proposed Increase in Rates for Electric Service*, 297 N.W.2d 462, 469 (S.D. 1980).[7]

In *Northwestern Public Service. Co.*, the South Dakota Supreme Court grappled with how to account for the Big Stone Power Plant, which came online near the end of the utility's test year.[8] Although no one disagreed with the notion that the plant be included in rate base, the parties were at odds on the magnitude of the impact the plant would have on power supply costs in the post-test year period. A number of intervenors cited a letter, dated during the test year, that contained a prediction of the plant's operating and maintenance costs assuming the plant

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[7] The case was further complicated by the fact that Northwestern Public Service Company transitioned from being a purchasing utility to a generating utility when the Big Stone plant came online.

[8] The utility's test year was May 1, 1974 through April 30, 1975. The utility filed its notice and application for a rate increase on July 17, 1975, before the first version of ARSD 20:10:13:44 took effect, which was on July 7, 1976.

operated "for the full year in 1975 and at an unrestricted load." *Id.* at 465. By the time of the hearing before the Commission, the plant had been operating for almost a full year, and the utility provided actual data of plant operation, which resulted in a significant variance from the initial prediction of costs. *Id.* at 469. The Commission rejected the utility's actual performance and sales data and adopted the estimate in the letter the intervenors thought was instructive, "ignoring [the] company's actual experience with the plant for nearly a year which had elapsed between the test year and the hearings." The South Dakota Supreme Court subsequently reversed that decision, concluding "that the [Commission's] reliance . . . on the speculative data presented by cities and its refusal to consider company's evidence of actual results and the recommendation of its own staff was arbitrary and that the decision on this issue was not supported by the evidence." *Id.* at 469-70. The Supreme Court did not, however, cite or otherwise interpret ARSD 20:10:13:44. The Court's decision is therefore of limited precedential value and should not be read to support BHP's repeated adjustments to true-up unsupported budgets in the Company's Application with actual costs that did not become known until well after the Application was filed.

Other references within the rule provide additional support for BHII's interpretation. The first sentence of ARSD 20:10:13:44 states that the utility must include in its application the data required by ARSD 20:10:13:41 through 20:10:13:107. That data includes the information in Statements A through R and the associated schedules[9] and any other supporting data the utility has relied on in determining its cost of service. ARSD 20:10:13:46 ("If the public utility has relied on supporting data other than that in statements A through R, such other data,

[9] Statements A through R and the associated schedules are required under ARSD 20:10:13:51 through 20:10:13:102.

appropriately identified and separately stated, shall be submitted in addition to the data required by statements A through R. *Such data shall be limited to the test period prescribed in § 20:10:13:44*") (emphasis added). With respect to the latter, ARSD 20:10:13:46 clearly provides that the additional supporting data "shall be limited to the test period prescribed in § 20:10:13:44"–*i.e.*, the 12-month historic test year. That language reinforces the fundamental principle that the utility's cost of service must be based on the 12-month historical test year and should not be a moving target subject to continuous updates throughout the pendency of a rate case.

If the Commission's interpretation is allowed to stand, then a utility would be free to propose Post-Filing Adjustments up to the date the Commission issues its decision in the case. Stated differently, the Commission's interpretation would violate the rule by transforming the static 12-month historic test year with limited adjustments into a dynamic, forward-looking test period with an unlimited opportunity to make adjustments for up to 30 months.[10] To permit a utility to continually update its cost of service in this manner would undermine due process because ratepayers would never know exactly what revenue requirement the utility was proposing. The utility's application, and the Commission's analysis of that application, should be based on the 12-month test year, as adjusted for changes that become known and measurable between the end of the test year and the date the utility files its application. To conclude otherwise would be arbitrary and fundamentally unfair to ratepayers.

[10] The 12-month test year, followed by a 6-month window for filing, followed by a 12-month period in which the Commission generally issues an order on the utility's application pursuant to SDCL 49-34A-17.

b. The Commission should have rejected BHP's Post-Filing Adjustments for LIDAR, BHUH affiliate allocations, and employee expense.

Both the Original Settlement and the Amended Settlement contain Post-Filing Adjustments that were admittedly unknown until well after the date of BHP's Application. For at least three reasons, the Commission misinterpreted ARSD 20:10:13:44. First, the Original Settlement included a Post-Filing Adjustment to the budgeted cost for LIDAR based on an agreement between BHP and GeoDigital International Corporation dated September 26, 2014 (nearly six months after BHP filed its Application), that was produced in response to BHII's discovery request. *BHII's Post-Hrg. Br.* at 49, App. A-121. Second, BHP's Post-Filing Adjustments to affiliate allocations in the Application were based upon informal e-mail communications between BHP and Staff that were not provided to BHII or otherwise included in the record. *Kollen Direct* at 39-41. In particular, the Original Settlement included previously undisclosed adjustments increasing the affiliate allocation from BHUH by $0.527 million ($0.286 million of which was included in error). *Orig. Staff Mem. at Ex. __(DEP-1), Schedule 2*, App. A-55. Third, the Original Settlement reflected a number of Post-Filing Adjustments to wages and salaries totaling $130,000, which allegedly included employees hired as of the date of the Original Settlement. *Orig. Staff Mem.* at 7, App. A-44. It is axiomatic that the employees hired as of December 9, 2014 (the date of the Original Settlement) were neither known with reasonable certainty nor measureable with reasonable accuracy as of March 31, 2014 (the date of BHP's Application) and the associated costs should have been rejected by the Commission.

Each of the three Post-Filing Adjustments described above is based on information obtained well after the date of BHP's Application, and should have been rejected because it was not "known with reasonable certainty and measurable with reasonable accuracy" at the time the Application was filed. The plain language of ARSD 20:10:13:44 prohibits their inclusion in

BHP's cost of service. Therefore, BHII respectfully requests that the Court reverse the Commission's approval of the Amended Settlement and remand for further proceedings consistent with BHII's legal interpretation of ARSD 20:10:13:44.

c. The Commission should have rejected BHP's Post-Filing Adjustment for affiliate allocations from BHSC because ARSD 20:10:13:44 does not permit a utility to propose new costs as adjustments to its filed cost of service.

The Commission's interpretation of the phrase "at the time of filing," raises a separate question with respect to the character of the adjustments a utility is permitted to request. The rule allows "[p]roposed adjustments to book costs." It does not permit line-item increases to the utility's overall cost of service by adding entirely new proposed adjustments that were not included in the utility's filed cost of service.

BHII's interpretation of "at the time of filing" would foreclose a utility from proposing any adjustments to its filed cost of service analysis that are not known and measurable at the time the utility files its application. By extension, the rule does not permit a utility to use the mechanism for proposing adjustments as a tool to introduce new costs to its filed cost of service that were not known and measurable at the time the utility filed its application. Therefore, the Commission should have rejected any Post-Filing Adjustments that actually proposed new costs, such as BHP and Staff's inclusion of $1.132 million in affiliate allocations from BHSC in the Amended Settlement, when the Application only included book costs and did not include any proposed adjustment. *Compare Application, Sched. H-4,* App. A-402 *with Orig. Staff Mem. at Exhibit __(DEP-1), Schedule 3,* App. A-56; *see also Kollen Direct,* at 40-41, App. A-175–76. BHP failed to provide any evidence that the increased BHSC allocation was known and measurable at the time BHP filed its Application. This Post-Filing Adjustment is a line-item addition to BHP's filed cost of service analysis that undermines the historical 12-month test year

established in ARSD 20:10:13:44 and magnifies its transformation into a dynamic test period of up to 30 months. Because the Commission was legally precluded from permitting the adjustment for the BHSC allocation, BHII respectfully requests that the Court reverse the Commission's approval of the Amended Settlement and remand for further proceedings consistent with BHII's construction of ARSD 20:10:13:44.

B. THE COMMISSION'S DECISION TO IGNORE DATA INCLUDED IN THE RECORD ON BHP'S 2015 PENSION EXPENSE AND APPROVE THE CALCULATION OF A FIVE-YEAR AVERAGE PENSION EXPENSE BASED ON DATA FROM 2010-2014, WAS ARBITRARY AND CAPRICIOUS AND A CLEARLY UNWARRANTED EXERCISE OF DISCRETION.

If the Court does not accept BHII's reasoned analysis of ARSD 20:10:13:44 set forth in the preceding section (and subsections), and thereby allows continual Post-Filing Adjustments to test-year book costs that were not known and measurable at the time BHP filed its Application, then the Court must conclude that the Commission is bound by to its own interpretation of the rule and therefore obligated to calculate BHP's five-year average pension expense based on data from 2011-2015, rather than 2010-2014, because the data for 2015 was known to the Commission and submitted into evidence by BHP. In light of the Commission's acceptance of other adjustments to test year book costs that were not known and measurable either at the time BHP filed its Application or when BHP and Staff submitted the Original Settlement, the Commission's approval of a five-year average pension expense based on 2010-2014 data represents an arbitrary and capricious decision that prejudices all of BHP's ratepayers. Accordingly, if the Court rejects the analysis set forth in Section A, above, then BHII prays the court modify the Final Decision by reducing BHP's revenue requirement by an amount equal to the difference between the 2010-2014 and 2011-2015 average pension expense calculations, consistent with the Commission's own interpretation of ARSD 20:10:13:44.

1. The Commission is Obligated to Calculate BHP's Five-Year Average Pension Expense Based on 2011-2015 Data.

The standard of review for this issue is *de novo*. Fundamentally, whether or not the Commission correctly and equitably applied its interpretation of ARSD 20:10:13:44 is a question of law. The facts (*i.e.* BHP's actual pension expense for the six years 2010-2015) are not in dispute. As stated earlier, "[w]hen the issue is a question of law, the decisions of the administrative agency . . . are fully reviewable" by the courts. *Permann*, 411 N.W.2d at 116. And the standard of review does not change if the Court determines that the Commission's selection of data from 2010-2014, rather than 2011-2015, was a finding of fact because the Commission's determination was based on documentary evidence included in the record. In *Tucek v. Department of Social Services*, the Supreme Court held that the standard of review for agency decisions varies depending on the type of evidence presented: "When findings of fact are made based on live testimony, the clearly erroneous standard applies. Deference and great weight are given to the hearing examiner on fact questions. When factual determinations are made on the basis of documentary evidence, however, [courts] review the matter de novo, unhampered by the clearly erroneous rule." 2007 S.D. 106, ¶ 13, 740 N.W.2d 867, 871 (internal citations and quotation marks omitted); *see also Vollmer v. Wal-Mart Store, Inc.*, 2007 S.D. 25, ¶ 12, 729 N.W.2d 377 (court conducts de novo review of an agency's factual findings based on documentary evidence).

In its Application, BHP proposed, and for settlement purposes Staff accepted, a normalization adjustment to BHP's annual pension expense based on "*the most recent* 5 year average of actual costs." *Appl. § 4, Statem. H, Schedule H-6, Note 1*, App. A-406 (emphasis added); *see Am. Settlem.* at 8-9, App. A-64; *Final Decision* at 11, ¶ 41, App. A-12. The five-year average pension expense adopted by BHP and Staff in the Amended Settlement, and approved

by the Commission in its Final Decision, was $2,336,305, based on data from the years 2010-2014. *Peterson Test.* at 16, App. A-321; *Final Decision* at 11, ¶ 43, App. A-12. On January 15, 2015, BHP witness Thurber stated in his rebuttal testimony that "[BHP's] actual total company 2015 pension expense is $2,056,581. The actuarial calculation was provided as a Supplemental Response to SDPUC 2-13. This information was not available at the time BHP and Staff reached a Settlement Agreement." *Thurber Rebuttal* at 22-23, App. A-389–90. Thus, BHP submitted evidence of its actual 2015 pension expense into the record *before* filing the Amended Settlement, but the Commission chose to ignore it. If the Court overrules BHII's interpretation of ARSD 20:10:13:44, then it should conclude that the Commission unjustly and inequitably applied its own interpretation of the rule. Using the data in Mr. Peterson's direct testimony for the years 2011-2014, and the information in Mr. Thurber's rebuttal testimony for 2015, the five-year average pension expense should be $2,162,450, not $2,336,305, a difference of $173,855 that ratepayers should not have to pay.

2. The Commission's Approval of a Five-Year Average Pension Expense Based on 2010-2014 Data was Arbitrary and Capricious and a Clearly Unwarranted Exercise of Discretion.

Not only did the Commission's exclusion of BHP's actual 2015 pension expenses contradict the Commission's own interpretation of ARSD 20:10:13:44 (an error that, if rectified, would reduce BHP's revenue requirement), it was arbitrary and capricious and a clearly unwarranted exercise of discretion based on the Commission's inclusion of O&M expenses for BHP's Wyodak power plant—expenses that were also first set forth in Mr. Thurber's rebuttal testimony. *Thurber Rebuttal* at 17-19, 22-23, App. A-384–86, A-389–90, Ex. JTR-1, App. A-392.

SDCL 1-26-36 clearly states that "[t]he Court may reverse or modify the [Commission's] decision if substantial rights of the appellant have been prejudiced because the administrative

findings, inferences, conclusions or decisions are: . . . (6) [a]rbitrary or capricious or characterized by . . . clearly unwarranted exercise of discretion." A decision is arbitrary and capricious (1) when it is "not governed by any fixed rules or standard," *Smith v. Canton Sch. Dist. No. 41-1*, 1999 S.D. 111, ¶ 9, 599 N.W.2d 637, 639-640, or (2) when it is based on "personal, selfish, or fraudulent motives, or on false information, and is characterized by a lack of relevant and competent evidence to support the action taken," *In re Jarman*, 2015 S.D. 8, ¶ 19, 860 N.W.2d 1, 9. Once it adopts an interpretation of ARSD 20:10:13:44 that would permit adjustments to BHP's cost of service that were not known and measurable at the time BHP filed the Application, the Commission is allowed no discretion in applying that rule to the evidence in the record. Thus, this issue is not one of an "abuse of discretion." Rather, the Commission's action was characterized by a "clearly unwarranted exercise of discretion" as there is no rational explanation for the Commission's simultaneous exclusion of 2015 pension expenses and inclusion of Wyodak O&M expenses. Both decisions unjustly (and incongruently) favored BHP.

Despite the parties' agreement that BHP's adjustment for affiliate allocations from BHUH in the Amended Settlement included a $0.286 million error, *Thurber Rebuttal* at 16:7-12, App. A-383; *Peterson Direct* at 19:3-5, App. A-324; *Evid. Hrg. Tr.* at 279:24-280:5, App. A-443–44, the Commission refused to order BHP and Staff to subtract that amount from the underlying revenue requirement. Instead, the Commission attempted to clothe that naked error in credibility by approving the Amended Settlement, which (1) acknowledged the $0.286 million error and (2) referenced a *new* $0.413 million adjustment for Wyodak O&M expenses incurred between October 2013 and September 2014, in order to justify the overall revenue requirement settlement figure contained in the Original Settlement. *Final Decision* at 2, App. A-3.

Like BHP's actual 2015 pension expenses, the Wyodak O&M expenses were first introduced into evidence in Mr. Thurber's rebuttal testimony on January 15, 2015—more than nine months after BHP filed its Application and less than two weeks before the evidentiary hearing. And both the exclusion of 2015 pension expenses and the inclusion of Woydak O&M expenses unjustly enriched BHP and unjustly burdened its ratepayers. Accordingly, the Commission's decision to exclude BHP's 2015 actual pension expenses from the five-year average calculation was arbitrary and capricious and a clearly unwarranted exercise of discretion.

C. THE CONCLUSORY AND SELF-INTERESTED STATEMENTS OF A BHP EXECUTIVE DURING THE EVIDENTIARY HEARING, UNSUPPORTED BY ANY ANALYSIS, MEANS OF CALCULATION, OR DOCUMENTATION IN THE RECORD, IS INSUFFICIENT TO MEET THE BURDENS OF PROOF UNDER SDCL 49-34A-8.4 AND -11, AND ARSD 20:10:13:44.

Regardless of whether the Court agrees with BHII's arguments on the first two issues, the Commission misapplied the legal standard a utility is obligated to meet when satisfying its burdens of proof under SDCL 49-34A-8.4, 49-34A-11 and ARSD 20:10:13:44. In particular, the Commission made no determination that the evidence BHP provided on incentive compensation met those burdens of proof. BHII thus asks that the Court reverse the Commission's decision to approve the Amended Settlement and remand the case for further proceedings consistent with the analysis set forth below.

1. Conclusory Testimony Alone is Insufficient to Meet a Utility's Burden of Proof Under South Dakota Law

The South Dakota Legislature requires the Commission to regulate rates to protect the public. Specifically, the Legislature "authorized, empowered and directed" the Commission "to regulate all rates, fees and charges for the public utility service of all public utilities . . . *to the end that the public shall pay only just and reasonable rates for service rendered*." SDCL 49-34A-6 (emphasis added). Likewise, the Legislature enacted SDCL 49-34A-8.4 to "protect the

ratepayers of South Dakota." *Hrg. on S. Bill 182 Before the S. Taxation Comm.*, 2007 Reg. Sess. (S.D. Feb. 14, 2007) (statement of Sen. Jim Peterson, bill author);[11] *see Hrg. on S. Bill 182 Before the H. Commerce Comm.*, 2007 Reg. Sess. (S.D. Feb. 26, 2007) (testimony of Dusty Johnson (confirming that language of S. Bill 182 clarifies the Commission's ability to disallow costs that are not economical or not efficient)).[12]

The State Legislature placed the burden squarely on public utilities to prove that "the underlying costs of any rates, charges, or automatic adjustment charges" are (1) "prudent, efficient, and economical" and (2) "reasonable and necessary to provide service to the public utility's customers in this state." SDCL 49-34A-8.4. The Legislature reinforced that burden in SDCL 49-34A-11: "The burden of proof to show that any rate filed is just and reasonable shall be upon the public utility filing same." As a result, a utility must prove by a preponderance of the evidence that a cost is (1) prudent, (2) efficient, (3) economical and (4) "reasonable and necessary to provide service to the public" and, based on the evidence, the Commission must affirmatively determine whether the rates resulting from such costs are both just and reasonable. *Irvine v. City of Sioux Falls*, 2006 S.D. 20, ¶ 10, 711 N.W.2d 607, 610 (stating "the burden of proof for administrative hearings is preponderance of the evidence").

The Commission may not abrogate its direction to ensure that the public pay only just and reasonable rates. While it expressly gave utilities the authority to make a reasonableness

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[11] *Available at* http://legis.sd.gov/sessions/2007/Audio.aspx?MeetingDate=02/14/2007&CommitteeCode=STA&BillNumber=182.

[12] *Available at* http://legis.sd.gov/sessions/2007/Audio.aspx?MeetingDate=02/26/2007&CommitteeCode=HCO&BillNumber=182.

decision with respect to "renewable, recycled, and conserved energy," SDCL 49-34A-104,[13] the Legislature did not authorize utilities to make any such determination with respect to their cost of service under SDCL 49-34A-6, -8.4 or -11. The Commission itself has observed that it is not free to disregard legislative allocations of authority to make determinations about reasonableness. *In re Petition for Declaratory Ruling of Black Hills Power, Inc., Regarding the Proposed Black Hills Power Wind Project*, EL11-007, 2011 WL 11820302 (S.D.P.U.C. June 8, 2011) ("The statutes do not provide the Commission with the authority to make these determinations").

The Commission cannot rely on evidence that fails to show that a cost is prudent, efficient, economical and reasonable and necessary to provide service to the public in determining that a rate is just and reasonable. "An agency's decision cannot rest significantly on a judgment pulled solely out of the air, without an anchor in the record." *Trans World Airlines, Inc. v. C. A. B.*, 385 F.2d 648, 658 (D.C. Cir. 1967).

In re One-time Special Underground Assessment by Northern States Power Co. in Sioux Falls, 2001 S.D. 63, 628 N.W.2d 332 is instructive. There, Sioux Falls required Northern States Power ("*NSP*") to bury power lines whenever certain streets were resurfaced and allowed NSP by tariff to recover the costs of burying lines from "benefited customers." *Id.* ¶ 1, 628 N.W.2d at 332-33. In response to a resurfacing project, NSP buried two-and-one-half blocks of power lines

[13] Section 49-34A-104 states, in pertinent part:

> Before using new renewable, recycled, and conserved energy after July 1, 2008, to meet the objective, the retail provider or the provider's generation supplier shall make an evaluation to determine if the use of new renewable, recycled, and conserved energy is reasonable and cost effective considering other electricity alternatives.

underground on one street, and then attempted to impose a surcharge on all of its Sioux Falls customers. *Id.* ¶¶ 1, 3, 628 N.W.2d at 332-33. Before the Commission, NSP presented evidence through testimony of one of its managers. Specifically, NSP considered five groups "as those that 'might be available to pay for a project like this'" and determined that it would charge "all the customers in Sioux Falls" on the theory that all benefitted from the aesthetic improvement of moving the power lines underground. *Id.* ¶¶ 5, 6, 628 N.W.2d at 334. The Commission found that NSP should not have charged all of its Sioux Falls customers. *Id.* ¶ 7, 628 N.W.2d at 334. The circuit court, however, reversed, accepting NSP's argument that that the aesthetic value of the underground lines "benefited" all Sioux Falls customers of NSP:

> The circuit court determined that "the only evidence in the record is that all Sioux Falls customers were benefited." The circuit court apparently based this finding on the testimony offered by NSP. Wilcox, an NSP manager, testified that the only feasible group to cover the cost was the Sioux Falls customer base. In addition, Heather Forney, a PUC staff witness, testified that the placement of the lines underground did not improve the safety or reliability of the electrical services. However, she also testified that it increased access to the downtown area, increased safety and improved appearance.

Id. ¶ 10, 628 N.W.2d at 334-35.

On appeal, the South Dakota Supreme Court reversed the circuit court, finding that NSP relied upon "who could pay, not who received the benefit." *Id.* ¶ 14, 628 N.W.2d at 335. The Supreme Court held that NSP had the burden to show benefit, not ability to pay, and the company's conclusory evidence about the benefit to all customers in Sioux Falls was insufficient to meet this burden: "To recover under the tariff, NSP had the burden of demonstrating all of its Sioux Falls customers were benefited. As this record fails to support NSP's contention that all of its customers in the City of Sioux Falls are "benefited customers," we reverse the circuit court." *Id.* ¶ 15, 628 N.W.2d at 335.

When reviewing a decision of the Commission, the circuit court "give[s] due regard to an agency's well-reasoned and fully informed decision" but it "will not uphold clear errors of judgment or conclusions unsupported in fact." *In re Otter Tail Power Co. ex rel. Big Stone II*, , 2008 S.D. 5, ¶ 29, 744 N.W.2d 594, 603. In approving the Amended Settlement, the Commission accepted BHP's adjustments for incentive compensation, including $0.888 million in performance plan and incentive restricted stock expenses that were not "fully supported" by evidence in the record as required under ARSD 20:10:13:44. BHP provided no evidence that would satisfy its burden of proving that the expenses were "prudent, efficient, and economical" and "reasonable and necessary to provide service" to its customers as mandated by SDCL 49-34A-8.4. This being the case, the Commission's decision to approve BHP's incentive compensation plan—and by extension, the Amended Settlement—was a clear error of judgment, unsupported by the facts in evidence.

2. The Commission Should Have Rejected BHP's Adjustments for Incentive Compensation Tied to Performance Plans and Incentive Restricted Stock Expenses.

The cost of service analysis in BHP's Application included $3,789,297 for incentive compensation. *Orig. Staff Mem. at Exhibit __(DEP-1) Schedule 1,* App. A-54. Of that, $1.554 million was tied to operating and financial performance. *Kollen Direct* at 35, App. A-170. In response to discovery, BHP claimed that (1) it should bear only $0.666 million of the $1.554 million cost because only $0.666 million was related to financial goals and (2) the remaining $0.888 million (including $0.149 million in performance plan expenses and $0.739 million in incentive restricted stock expense) should be added to rates and borne by customers. *BHII Ex. No. 6,* App. A-448–449; *Kollen Direct* at 37, App. A-172. The Commission should have rejected BHP and Staff's proposal to include the remaining $0.888 million in the cost of service set forth in the Amended Settlement because, as a matter of law, those costs were not fully

supported by the evidence in the record and, as a matter of policy, BHP's customers should not be required to fund incentives that meet shareholder goals.

The performance plan and incentive restricted stock expenses represent awards of stock, units, or cash based on the performance measures listed in Section 12.1 of BHP's Confidential 2005 Incentive Compensation Plan. *Kollen Direct* at 36:18-21, App. A-171; *BHII Ex. No. 7*, App. A-461 (Confidential). In light of the lengthy discussion on this point at the hearing, *Evid. Hrg. Tr.* at 45:19-67:14, 76:12-80:4, 95:4-22, App. A-410–38, BHII presents the following definitions and provisions from the plan for ease of reference: **[BEGIN CONFIDENTIAL:**

[redacted]

END CONFIDENTIAL]

The record does not contain a copy of any Restricted Stock Agreement, *Evid. Hrg. Tr.* at 65:13-16, App. A-430; nor does it contain evidence indicating the reasons that the Committee makes awards of restricted stock. In fact, the sum-total of BHP's evidence with respect to incentive compensation is the table attached to *BHII Ex. 6* labeled 2-11G, which was presented with no underlying work papers or other references to other documents. *Evid. Hrg. Tr.* at 59:11-18, App. A-424. When questioned about the sufficiency of the 2-11G attachment and the lack of supporting documents, BHP witness Kyle White, a company executive, simply shrugged it off:

[BEGIN CONFIDENTIAL [redacted]

[redacted] **END CONFIDENTIAL]**

Id.

In Mr. White's view, BHP's testimony alone, without *any* supporting documentation, should be sufficient for the Commission to conclude that the Company has satisfied its burden and the adjustment is just and reasonable. It is not. The record is devoid of any documentary evidence to support BHP's assertion that awards of restricted stock are not performance-based compensation, *id.* at 79:8-10, App. A-436, and the Commission should have rejected BHP's proposed $0.888 million adjustment for performance plan and incentive restricted stock expenses because those costs are not "fully supported" in the record.

The Commission made no determination that the evidence BHP provided met the burdens of proof under SDCL 49-34A-8.4, 49-34A-11, and ARSD 20:10:13:44. Rather, the Commission inexplicably concluded that "the incentive compensation plan included in the [Amended Settlement] does not render the [that Settlement] unjust and unreasonable." *Final Decision* at 10, ¶ 40, App. A-11. Apparently, the Commission believed that it could approve an overall settlement amount even if $0.888 million of the costs built into it should have been thrown out due to insufficient evidence. It cannot. Inclusion of the $0.149 million in performance plan expenses and $0.739 in incentive restricted stock expense makes the overall cost of service included in the Amended Settlement unjust and unreasonable. The burden of proof was on BHP to establish an appropriate value for incentive compensation and to demonstrate that it was a reasonable and necessary cost to incur in providing service. The opinion of a BHP executive coupled with a table that is unsupported by *any* analysis is not sufficient evidence to support a legal conclusion that the adjustment is just and reasonable.

III. CONCLUSION

BHII requests that the Court reverse and remand the Commission's Final Decision on two independent grounds. First, BHII asks the Court to determine, as a matter of law, that the Commission misinterpreted the plain language of ARSD 20:10:13:44, and remand the case for further proceedings consistent with BHII's analysis of the rule discussed herein. Second, BHII prays the Court conclude, again as a matter of law, that the Commission misapplied the legal standard a utility is obligated to meet when satisfying its burdens of proof under SDCL 49-34A-8.4, 49-34A-11, and ARSD 20:10:13:44, and remand the case for further proceedings consistent with BHII's construction of those provisions. If the Court disagrees with BHII's interpretation of ARSD 20:10:13:44, BHII requests, at a minimum, that the Court modify the Commission's Final Decision by reducing the revenue requirement set forth therein by an amount equal to the difference between the 2010-2014 and 2011-2015 average pension expense calculations, consistent with the Commission's own interpretation of ARSD 20:10:13:44 and for the reasons already explained.

IV. REQUEST FOR ORAL ARGUMENT

BHII hereby requests oral argument on all issues and matters raised in this appeal pursuant to SDCL 1-26-35.

Dated: August 19, 2015

Respectfully submitted,

/s/ Mark A. Moreno

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