

**APPENDIX OF
APPELLEE BLACK HILLS POWER, INC.
("Co. App. A.")**

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Direct Testimony
Laura A. Patterson

Before the South Dakota Public Utilities Commission
of the State of South Dakota

In the Matter of the Application of
Black Hills Power, Inc., a South Dakota Corporation

For Authority to Increase Rates
In South Dakota

Docket No. EL14-___

March 31, 2014

Co. App. A-2

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Exhibits

None

1 **I. INTRODUCTION AND QUALIFICATIONS**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Laura A. Patterson and my business address is 625 9th Street (4th
4 Floor), Rapid City, South Dakota 57701.

5 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

6 A. I am employed by Black Hills Service Company, (“Service Company”), a wholly-
7 owned subsidiary of Black Hills Corporation (“BHC”), as the Director of
8 Compensation, Benefits and Human Resources Information Systems (“HRIS”). In
9 my position, I am responsible for partnering with business leaders to design and
10 execute compensation and benefits strategies and plans. I also provide input
11 related to strategic planning, implementation and administration of compensation
12 and benefits programs, executive plans, equity programs, non-qualified plans and
13 other initiatives. My responsibilities also cover employees working for Black Hills
14 Power, Inc. (“Black Hills Power” or the “Company”).

15 **Q. PLEASE BRIEFLY SUMMARIZE YOUR ACADEMIC AND**
16 **PROFESSIONAL BACKGROUND?**

17 A. I have more than 23 years of experience in compensation and benefits, with
18 responsibilities including the development, management, administration and
19 regulatory compliance of such plans. I began my current position as Director of
20 Compensation, Benefits and HRIS for BHC in April 2009. Prior to this position, I
21 spent 6 years as Director of Compensation, Benefits and HRIS and 2 years as
22 Employee Benefits Manager, for PNM Resources, Inc. (PNMR), where I was

1 responsible for managing and administrating all compensation and benefit
2 programs for PNMR, its subsidiaries and for its joint venture business with
3 Cascade Investments, Optim Energy. Prior to working for PNMR, I was employed
4 as a Tax Manager and Human Capital Consultant for four years at Arthur
5 Andersen, a global tax and consulting firm. In this position, I worked with
6 organizations to identify, analyze and apply regulatory rules that govern structure,
7 compliance, and administration of employee benefit plans. Prior to Arthur
8 Andersen, I was employed as a Trust Officer at Mercantile Trust Company from
9 1995 to 1999 with responsibilities for managing and administration of profit
10 sharing, 401(k), and pension purchase retirement plans sponsored by a wide range
11 of clients. I have a Bachelor of Business Administration degree from the
12 University of Iowa.

13 **Q. HAVE YOU PROVIDED TESTIMONY IN REGULATORY**
14 **PROCEEDINGS PRIOR TO THIS CASE?**

15 A. Yes. I have previously testified in New Mexico PRC Case No. 06-00210-UT, a
16 gas rate case, in New Mexico PRC Case No. 07-00077-UT, an electric rate case, in
17 Texas PUC Case Docket No. 36025, an electric rate case, in Nebraska PUC Case
18 Docket No. NG-0061, a gas rate case, and in Colorado PUC Case Docket No. 11-
19 AL-382E, an electric rate case. I have also submitted testimony in Black Hills
20 Power's last rate application with the South Dakota PUC, Docket No. EL 12-061.
21 Finally, I testified on behalf of Cheyenne Light before the Commission in
22 Cheyenne Light's 2009 and 2011 electric and natural gas rate proceedings.

1 **Q. DESCRIBE YOUR PROFESSIONAL ASSOCIATIONS.**

2 A. I served on the Corporate Board of Directors of the International Foundation of
3 Employee Benefit Plans and currently serve on the Employee Benefits Committee
4 for the U.S. Chamber of Commerce. I am also a Certified Retirement Services
5 Professional.

6 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING?**

7 A. Black Hills Power.

8 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

9 A. I describe and support the general compensation program for BHC employees,
10 and particularly the employees of Black Hills Power, including the variable
11 compensation program and the equity compensation program. I explain why
12 these programs and their associated costs are reasonable and necessary to attract,
13 motivate and retain well qualified and competent employees to support utility
14 operations. Black Hills Power employees, both non-union and union, participate
15 in the compensation and benefit plans sponsored by BHC.

16 I also describe and support the general benefits programs and policies for BHC
17 employees, particularly the employees of Black Hills Power, including the health,
18 welfare and retirement benefits, and explain why those programs and their
19 associated costs are reasonable and necessary.

20 My testimony specifically supports employee compensation related adjustments,
21 including base salary, variable compensation, equity compensation, retiree
22 healthcare, pension plan, pooled medical, and 401(k) plan, that are part of the

1 overall benefits adjustment. Finally, my testimony will explain the adjustments
2 related to personnel due to the suspension of operations at certain facilities.

3 **II. COMPENSATION PHILOSOPHY AND PROGRAMS**

4 **Q. WHAT IS BHC'S GENERAL COMPENSATION PHILOSOPHY?**

5 A. BHC's long-term success depends on operational excellence, providing reliable
6 products and services to our customers, and investing wisely to ensure present
7 and future strength. BHC's strength allows us to invest in our utility infrastructure
8 and systems to improve the safe, reliable and affordable service our customers
9 and communities depend on. To consistently achieve these outcomes, BHC must
10 attract, motivate and retain employees to achieve appropriate business results. For
11 these reasons, BHC promotes a compensation program that supports the overall
12 operational excellence and customer service objectives, based on principles
13 designed to:

- 14 • attract, motivate, retain and encourage the development of highly qualified
15 employees;
- 16 • provide compensation that is competitive;
- 17 • promote the relationship between pay and performance;
- 18 • promote overall performance that is linked to our customers and
19 shareholders; and
- 20 • recognize and reward individual performance appropriately.

1 All compensation programs are designed to be strategically aligned, externally
2 competitive, internally equitable, personally motivating, cost effective and legally
3 compliant.

4 **Q. PLEASE DESCRIBE BHC'S COMPENSATION PROGRAMS.**

5 A. There are two primary components to the compensation program – Base Salary
6 and Variable Pay programs.

7 • Base Salary: Base salary represents the fixed portion of an employee's total
8 cash compensation opportunity. Base salary compensation is determined by
9 the market value of the job, the experience level of the employee, and
10 specific performance standards and competencies. Base salaries are
11 reviewed on an annual basis and merit salary increases are based on
12 individual performance and contributions. Base rates of pay for Black Hills
13 Power's union employees are established under the terms of the collective
14 bargaining agreement with the International Brotherhood of Electrical
15 Workers ("IBEW") Local 1250.

16 • Variable Pay: Variable Pay is pay that is "at risk" and is not fixed or
17 guaranteed. Variable Pay is only earned and awarded based on
18 achievements against specific performance-based goals. All BHC
19 employees (non-union and union) participate in the Annual Incentive Plan
20 (AIP) which is described in detail later in this testimony.

1 Q. PLEASE EXPLAIN BHC'S PHILOSOPHY ON BASE PAY
2 COMPENSATION.

3 A. Base pay is intended to reflect the median of the market for similar positions in
4 similar companies. Overall, our goal is to target direct compensation (base salary
5 and variable pay / annual incentives) at the median of the appropriate market when
6 our operating results approximate average in relation to our peers.

7 There are twenty-three (23) pay grades which are used for all non-executive, non-
8 union jobs. Each grade has a minimum, midpoint, and a maximum pay level. This
9 means that the pay ranges within the grades are competitive with what other
10 companies pay for similar positions. All jobs are compared to the market, where
11 data exists, and placed in the grade where the midpoint of the range is closest to
12 the average market rate for that job. In 2009, Towers Watson conducted an
13 independent market review of the BHC's positions and benchmarked each
14 position. Each position was placed in the appropriate salary grade, reflecting the
15 market median values. Subsequent to the Towers Watson study, the BHC Human
16 Resources Compensation Department periodically reviews each position in the
17 company and compares it to credible market survey data to ensure that current
18 compensation remains within the competitive range.

19 Market rates are determined by utilizing compensation survey data where
20 companies report actual compensation paid to employees by position. The survey
21 most widely used by BHC is from Towers Watson, as they are recognized
22 nationally as the leader in the energy services / utility market place.

1 **Q. IN ADDITION TO THE TOWERS SURVEY, ARE THERE ANY OTHER**
2 **SURVEYS THAT BHC UTILIZES TO ENSURE THAT ITS OVERALL**
3 **COMPENSATION IS COMPETITIVE IN COMPARISON WITH OTHER**
4 **COMPANIES?**

5 A. Yes. BHC also utilizes surveys conducted by Aon Hewitt, Mercer, the Edison
6 Electric Institute (EEI), ECI, the EAPDIS LLC, Ed Powell, and other surveys,
7 including several specific to wages by state. The surveys provide compensation
8 and other data for each position by company size, revenue, and number of
9 employees so that BHC can match each of its positions to positions in the market
10 that are most similar in duties and most similar for the company size/revenue.

11 **Q. HOW DO THE COMPANY'S COMPENSATION STRATEGIES**
12 **COMPARE TO THE CURRENT MARKET?**

13 A. The BHC Compensation Department reviews the pay structure annually to see
14 how the structure and pay practices reflect the market. As of October 21, 2013, the
15 average base pay for non-union employees of Black Hills Power was 95% of the
16 market median, indicating Black Hills Power employees' base pay rates were
17 lower than the market median. Compensation is considered to be competitive to
18 the market at a range of 95% to 105% of the market median, so compensation for
19 Black Hills Power is at the lower end of this range.

20 **Q. DOES BHC HAVE A VARIABLE COMPENSATION COMPONENT OF**
21 **ITS TOTAL COMPENSATION PHILOSOPHY?**

22 A. Yes. The Black Hills Corporation Annual Incentive Plan (the "AIP" or the "Plan")

1 is designed to motivate and reward employees for achieving and exceeding goals
2 that benefit our customers and our shareholders. The AIP is designed to reward
3 eligible employees, including both non-union and union employees of Black Hills
4 Power, who contribute to the success of the BHC and/or their assigned Business
5 Unit; reward employees who contribute to the quality of service provided to
6 customers including, but not limited to, the provision of safe, reliable and
7 affordable service; motivate work performance and behavior that supports the
8 Corporation's financial and non-financial goals and increase the employee's
9 understanding of the Corporation's business objectives and performance.

10 **III. COMPANY ANNUAL INCENTIVE PLAN**

11 **Q. PLEASE DESCRIBE BHC'S ANNUAL INCENTIVE PLAN.**

12 A. The purpose of BHC's AIP is to promote BHC's pay for performance philosophy,
13 to provide competitive incentive opportunities that are consistent with other
14 companies in the industry, and to focus employees on important performance
15 objectives. The AIP is an important component of the total pay package necessary
16 to ensure BHC is competitive with market practices for employees. In addition,
17 the AIP directly links pay with performance, and therefore total compensation
18 expense varies with BHC's performance on measures important to the customers,
19 and provides a tool to align employees' interests with customer and community
20 interests.

1 **Q. WHO IS ELIGIBLE TO PARTICIPATE IN THE AIP?**

2 A. All regular full-time and part-time employees, both union and non-union, who are
3 hired and working by October 1 of the plan year are eligible to participate in the
4 Plan for that plan year. Part-time employees who work a minimum of 20 hours
5 per week are eligible for a pro-rata award based on their actual wages for hours
6 worked. Pro-rata awards for the number of months actively employed at each
7 eligibility level during the plan year will also be paid to Participants who are hired,
8 promoted, retire or have other job changes during the year.

9 **Q. WHAT PERFORMANCE GOALS ARE MEASURED UNDER THE AIP?**

10 A. An eligible employee can earn an incentive award based on that employee's
11 performance toward goals designed to achieve business unit operational
12 performance targets. The components of the incentive award for the test year were
13 as follows:

- 14 • An employee could qualify for up to 50% of the maximum possible award
15 for goals tied to customer satisfaction, cost control, safety, reliability,
16 operations efficiency, expense reductions and other operational measures;
- 17 • An employee could qualify for up to 25% of the maximum possible award
18 for the achievement of direct business unit operating income goals,
19 including initiatives on cost control, continuous improvement and
20 improvements in operations efficiencies; and
- 21 • An employee could qualify for up to 25% of the maximum possible award
22 if BHC realizes established earnings per share ("EPS") targets.

1 Each goal is measured independently. Goal performance that meets or exceeds the
2 threshold level will be used to calculate the incentive award. Achievement of
3 financial results is not a condition to award incentive for achievement of other
4 goals. An employee can earn from 0 to 1.50 times the target percentage incentive
5 based on achievement against each of the AIP goals. Performance below
6 threshold results in a zero payout for the associated goal. Achievement of a goal's
7 "target" performance results in a payout of 100% of the payment relative to that
8 goal. There is also a Maximum payout, which means that if performance exceeds
9 target, no more than 1.50 times the target payment will be made relative to that
10 goal.

11 **Q. HOW DOES THE AIP PROVIDE VALUE TO CUSTOMERS?**

12 A. The AIP provides direct and indirect value to customers in a number of different
13 ways. For example, AIP goals are aligned with BHC's high-level objectives and
14 strategic framework. Business unit goals are primarily designed to improve the
15 performance of utility operations by focusing on improvements to operational
16 excellence, safety, reliability, and customer satisfaction. Examples of Black Hills
17 Power's business unit goals include:

- 18 • Continuous improvement in results from customer satisfaction surveys.
19 These results are measured each quarter.
- 20 • Service reliability metrics.
- 21 • Increase in number of completed service orders per day.
- 22 • Reduction in labor cost per service order.

- 1 • Reductions in O&M expense resulting from Continuous (Process)
- 2 Improvement projects.
- 3 • Reduction in number of lost time accidents, preventable vehicle accidents,
- 4 and OSHA recordable accidents.

5 BHC must maintain a skilled and motivated workforce in order to provide safe,
6 reliable and affordable service and products. To do so, it is important to pay our
7 employees at rates competitive to rates paid by similar utilities and other
8 companies with which we compete for employees. Because the actual base
9 salaries for Black Hills Power's employees fall somewhat below the market
10 median levels, total compensation would be significantly less competitive without
11 the incentive plan component. An employee's total cash earnings potential (base
12 salary *plus* AIP incentive award) depends on both competitive base salary and on a
13 competitive AIP incentive compensation opportunity awarded for the achievement
14 of key operating and strategic goals.

15 **Q. HOW WOULD AVERAGE BASE SALARIES BE AFFECTED IF AIP**
16 **INCENTIVES WERE ELIMINATED?**

17 A. If BHC did not offer employees the opportunity to earn AIP incentive
18 compensation, BHC would need to make-up the difference by increasing base
19 salaries in at least an equivalent amount, which would result in higher fixed costs
20 for salaries and benefits. An alternative to variable compensation would be for
21 BHC to raise all employees base pay to reflect the median variable compensation
22 earnings provided by other utilities. While this would provide a competitive total

1 compensation rate that is “fixed and measurable”, it would de-link those costs with
2 customer performance measures and increase overall costs as many of our benefits
3 are also tied to base pay rates.

4 **Q. DO YOU BELIEVE THAT THE AIP IS AN IMPORTANT ELEMENT OF**
5 **EMPLOYEE RETENTION?**

6 A. Yes. If BHC were to eliminate its variable pay program and did not replace that
7 compensation with base pay, employees would be much less likely to stay with
8 BHC because their total compensation would significantly lag what other utilities
9 were paying for the same positions. Coupling this risk with the loss of experience
10 that Black Hills Power will realize over the next eight years due to retirements,
11 results in a significant and immediate business risk.

12 **Q. ONE OF THE INCENTIVE GOALS UNDER THE AIP RELATES TO THE**
13 **COMPANY’S OPERATING INCOME OR EARNINGS PER SHARE**
14 **(“EPS”) PERFORMANCE. DO CUSTOMERS BENEFIT FROM**
15 **COMPANY EPS PERFORMANCE IN LINE WITH INCENTIVE PLAN**
16 **TARGETS?**

17 A. Yes. Earnings Per Share is an easily recognized benchmark for successful and
18 productive companies that are meeting their customers’ needs. They provide
19 company-wide objective measures of performance that cannot reasonably be
20 separated from customer interest. Both shareholders and customers benefit from
21 strong EPS performance - - they are not mutually exclusive. Two primary drivers
22 of EPS are expense management and debt costs. Customers benefit from receiving

1 service from a company that is able to effectively manage its costs. When the
2 Company is managing its costs, rate cases are less frequent. When a rate case is
3 required, the requested increase is less than would otherwise be required.

4 **Q. DO INDIVIDUAL EMPLOYEES CONTRIBUTE TO THE COMPANY'S**
5 **EPS PERFORMANCE?**

6 A. Yes. Each employee primarily contributes to the financial success of the Company
7 through the prudent actions he or she takes to control costs, work efficiently, and
8 drive operational excellence. By setting an EPS target, and monitoring company
9 performance against the target throughout the year, employees receive immediate
10 feedback regarding performance. Providing incentive compensation related to
11 meeting financial performance drives employees to cost-conscious behavior that is
12 beneficial to customers.

13 **Q. HOW ELSE DO CUSTOMERS BENEFIT FROM A STRONG EPS**
14 **RECORD?**

15 A. As described in the Direct Testimony of Brian G. Iverson, Black Hills Power must
16 maintain financial integrity to access capital at reasonable costs. A strong
17 financial position provides the financial flexibility necessary to meet the ongoing
18 demand for utility services. Credit ratings agencies compare quantitative
19 measures of a company's financial performance, including EPS, to determine a
20 company's credit ratings. These ratings have a direct impact on the cost of
21 Company's debt, both for acquiring debt and refinancing higher cost debt, which
22 directly impact customer rates. Through strong EPS performance, the Company is

1 able to maintain or even improve its credit ratings, resulting in a lower cost of debt
2 for customers. Because Company earnings are such an important consideration in
3 rating agency evaluations of the Company, it is critical that employees receive
4 incentives to maintain strong financial performance, which ultimately results in
5 lower costs for customers.

6 **IV. COMPANY LONG-TERM INCENTIVE PROGRAM**

7 **Q. PLEASE DESCRIBE BHC'S LONG-TERM INCENTIVE PROGRAM.**

8 A. The Company provides a long-term incentive program on a limited basis to key
9 employees who are responsible for various aspects of management and business
10 results. These long-term incentives include restricted stock and performance share
11 awards. Restricted stock is granted to key employees and vests ratably over a 3-
12 year period. The purpose of the 3-year vesting period for both the restricted stock
13 and the performance shares is to get retention of key employees.

14 Performance shares, if any, are based on achievement against established criteria
15 measured over a 3-year period and are made at the conclusion of that 3-year
16 period. The performance share component measures relative performance of
17 BHC against other utilities - - it is about operational performance and metrics.
18 BHC focuses on top quartile performance in all areas and performs at this level on
19 a sustained basis. This operational excellence is recognized by the market and
20 using performance measures to compare BHC to its peers provides focus for key
21 employees in these areas. This operational excellence also results in lower costs to
22 customers in very direct ways. For example, BHC's continued high performance

1 for power plant availability is recognized by the market with higher stock
2 performance, but impacts the customers directly through lower cost of service,
3 high reliability, and high customer satisfaction.

4 Both forms of equity grants under the long-term incentive program are intended to
5 provide participants with incentives for excellent performance, to promote
6 teamwork and to motivate, retain and attract the services of participants who make
7 significant contributions to the success of the company and its operational goals.

8 **V. INDUSTRY COMPENSATION COMPARISONS**

9 **Q. DO OTHER COMPANIES IN THE UTILITY INDUSTRY USE**
10 **COMPARABLE VARIABLE AND LONG-TERM COMPENSATION**
11 **MECHANISMS?**

12 A. Yes. Other utilities do provide incentive or variable compensation as part of their
13 compensation packages, as do companies in other industries. Other utilities also
14 provide key employees with long-term incentives designed to retain these key
15 employees and to motivate them to achieve operational and strategic goals.
16 Without similar annual and long-term plans, BHC's total compensation package
17 would not be competitive with other utilities and BHC would be at risk for
18 retention of its key employees.

19 **Q. ARE YOU AWARE OF ANY STUDIES THAT SUPPORT THIS**
20 **CONCLUSION?**

21 A. Yes. Aon Hewitt Associates, an international business consulting firm that
22 specializes in compensation issues, conducted a survey of broad-based variable

1 pay plans in 2013 titled “Variable Compensation Measurement (VCM) Report –
2 U.S. Edition,” which includes 125 companies, including 25 energy / utility
3 companies. Results from the survey indicate the following:

- 4 • 90% of participating companies offered at least one broad-based variable
5 compensation plan covering 99% of total U.S. employees, an increase from
6 89% in 2007 and from 80% in 2002 as companies continue to turn to
7 variable pay as a means to attract, retain and award performance. All
8 energy / utility companies offer at least one broad-based variable incentive
9 plan and all cover 100% of their employees.
- 10 • 74% of the participating companies in the survey have an annual incentive
11 program with a plan design similar to BHC’s AIP, where awards are based
12 on the combined achievement of Company financial and business unit
13 operating performance.
- 14 • 88% of the participating companies reported the benefits realized from their
15 variable pay plan and the improved business results outweighed the cost.
- 16 • Notable outcomes reported by companies with a variable pay plan similar
17 to the AIP include reduced costs, increased productivity, increased quality,
18 increased customer satisfaction, and increased employee morale.

19 Other surveys published in 2012-2013 include:

- 20 • Mercer: 93% of employers provide short-term incentive or variable pay
21 plans, an increase from 78% in 2004.

- 1 • World at Work: 84% of employers provide short-term incentive or variable
2 pay plans, an increase from 77% in 2004. Of those providing a short-term
3 incentive plan, 98% of hourly employees (average payout was 5%) and
4 100% of salaried employees (average payout was 12%) are eligible under
5 the plan.
- 6 • Buck Consulting: 87% of utilities in the survey provide a short-term
7 incentive plan to all employees.
- 8 • Kenexa: 88.5% of energy and utility companies in the survey provide a
9 short-term incentive plan to all employees.

10 **Q. HOW DOES BHC MAKE IMPROVEMENTS TO ITS AIP?**

11 A. Through its annual strategic and operational planning process, BHC routinely
12 evaluates the effectiveness of the plan in meeting its goals. These goals are
13 modified and continually refined to drive continued operational excellence and
14 performance improvements. BHC also continuously evaluates the AIP design to
15 ensure that it remains competitive and comparable to other utilities.

16 **VI. COMPANY RECOVERY OF EMPLOYEE**

17 **COMPENSATION EXPENSES**

18 **Q. SHOULD THE COMPENSATION MERIT INCREASE BE APPROVED?**

19 A. Yes. Recovering the actual amount of employee compensation expense is
20 necessary to attract and retain the high quality of employees that are needed to
21 serve the customers of Black Hills Power. Under existing economic conditions,
22 independent surveys reflected that more than 97% of US-based companies will

1 award merit pay increases during 2014, with an average budget of 3% to 4%.
2 Non-union employee pay changes are effective each March, with the most recent
3 increase effective March 4, 2013 and the next scheduled merit increase to be
4 effective March 3, 2014. The company has a non-union merit increase budget for
5 2014 of 3.50%. The union salary increases for the period April 1, 2013 through
6 March 30, 2014 range from 3.0% to 3.5% by position and the wage increase will
7 be 3.25% effective April 1, 2014. Increases in employee compensation are known
8 and measurable, and these increases in employee compensation are supported by
9 extensive reviews of competitive market data.

10 Without merit increases, BHC would further lag the median pay for these
11 positions, significantly increasing retention and performance risk, and the
12 company will incur higher costs for turnover and related issues. A summary of
13 independent surveys regarding merit pay follows:

- 14 • Mercer: The survey of 634 employers reflects that energy and utility
15 employers plan to provide merit increases to employees in 2014, with an
16 average budgeted increase ranging from 3.0% to 4.0%.
- 17 • Aon Hewitt: The 2013-2014 survey of 1,096 employers reflects planned
18 2014 merit increases, with an average budget of 3.1%. The energy and
19 utility employers in the survey reflect a merit budget average of 3.7%.
- 20 • Towers Watson: The 2013-2014 survey of 633 employers reflects planned
21 2014 merit increases, with an average budget of 3.1%. This survey does
22 not reflect utility specific information.

- 1 • World at Work: The 2013-2014 survey of 1,834 employers reflects a 3.1%
2 merit increase budget average for 2014 across all industries. The average
3 merit increase budgets for energy and utility companies average up to
4 4.1%.

5 Simply put, the merit increases and the union wage increases will be incurred, and
6 the overall compensation to Black Hills Power employees is fair and competitive
7 as tested against prevailing market comparisons.

8 **Q. SHOULD THE COMPENSATION INCREASE BE APPROVED FOR**
9 **UNION EMPLOYEES?**

10 A. Recovering the actual amount of employee compensation expense is necessary –
11 as described above – to attract and retain the high quality of employees that are
12 needed to serve the customers of Black Hills Power.

13 The ratified contract between Black Hills Power and the IBEW Local 1250 Local
14 Bargaining Unit requires an increase in union employee compensation of 3.0% to
15 3.5% depending on job classification effective April 1, 2013; and an increase of
16 3.25% effective April 1, 2014. Black Hills Power’s union employees also
17 participate in the AIP under the terms of the contract. Accordingly, the April 1,
18 2014 rate increase of 3.25% and AIP compensation for union employees is
19 representative of the amount that Black Hills Power will be obligated to pay while
20 its rates will be in effect. Black Hills Power’s union employee compensation
21 adjustment qualifies as a known and measurable change over the four-year
22 contract.

1 **VII. COMPANY BENEFITS AND PERIODIC REVIEW**

2 **Q. PLEASE DESCRIBE THE BENEFIT PLANS THAT BHC PROVIDES TO**
3 **ITS BLACK HILLS POWER EMPLOYEES?**

4 A. BHC offers a combination of company-provided and voluntary benefits.
5 Employees are enrolled in certain company-provided benefits automatically and
6 BHC pays the costs (for example, short-term and long-term disability benefits).
7 Employees choose whether or not to participate in the voluntary benefits and they
8 pay a portion or all of the costs. These company-provided and voluntary benefit
9 programs consist of: (1) medical, dental and vision plans, (2) flexible spending
10 accounts, (3) life insurance and accidental death and dismemberment insurance,
11 (4) paid time off, (5) retirement, and (6) other benefits including educational
12 assistance, holidays and other time away from work, business travel accident
13 insurance, rewards & recognition and wellness programs.

14 **Q. WHAT BENCHMARKING HAS BEEN CONDUCTED TO EVALUATE**
15 **COST/PERFORMANCE LEVELS?**

16 A. BHC solicits a number of independent reviews from external organizations and
17 consulting firms such as Towers Watson, Aon Hewitt, Mercer, etc. These reviews
18 cover a wide range of compensation and benefit program designs and costs
19 including compensation and benefit programs, HR function administrative
20 expenses, and market data for positions. BHC compares its benefit programs and
21 costs with companies from the utility sector and from general industry to ensure
22 the company can attract and retain employees with the necessary skills. BHC

1 utilizes multiple nationally recognized third-party surveys and also conducts
2 customized surveys where appropriate and necessary. These benchmarking
3 surveys allow BHC to evaluate the competitiveness and efficiencies of its benefit
4 programs and costs compared to other companies in the market. If a program does
5 not meet performance, cost or efficiency expectations, it is reviewed to determine
6 the root cause and the options or alternatives available. BHC closely monitors
7 market practices and benchmark data for costs to maintain competitive and cost
8 effective programs.

9 **Q. WHAT TYPE OF OVERSIGHT IS IN PLACE TO ENSURE THAT BHC'S**
10 **COMPENSATION AND BENEFIT PROGRAMS ARE THOSE THAT ARE**
11 **MOST BENEFICIAL FOR THE SUPPORT OF THE OPERATING**
12 **COMPANIES' UTILITY SERVICE?**

13 A. The BHC Human Resources Department, in partnership with the business unit
14 leaders and company management, develop annual budgets and long-range plans
15 (5 years), including compensation, benefit and other programs supporting the
16 business' goals and objectives. HR and key operating personnel manage these
17 budgets and review all programs for effectiveness, cost and any proposed
18 modifications. All costs are modeled to determine impacts to cost and are
19 benchmarked against the market parameters to ensure competitiveness, cost
20 effectiveness, and reasonableness.

1 **Q. ARE YOU AWARE OF OTHER STATE COMMISSIONS THAT HAVE**
2 **APPROVED THE EMPLOYEE COMPENSATION AND BENEFIT**
3 **STRUCTURE PROPOSED IN THIS PROCEEDING?**

4 A. Yes. Through rate case settlements and contested proceedings, commissions in
5 Nebraska, Iowa, Wyoming and Colorado in both gas and electric rate cases have
6 approved this employee compensation and benefit structure. BHC places emphasis
7 on maintaining a common employee compensation structure and program. The
8 same is true for its proposal related to its employees living in or supporting our
9 Black Hills Power customers.

10 **VIII. ADJUSTMENTS DUE TO SUSPENSION OF**
11 **CERTAIN OPERATIONS**

12 **Q. HAS BLACK HILLS POWER SUSPENDED OPERATIONS AT ANY OF**
13 **ITS FACILITIES?**

14 A. Yes, Black Hills Power placed its Osage and Ben French facilities into economic
15 shutdown. Black Hills Power has suspended operations at its Neil Simpson I
16 facility. As indicated in the testimony of both Vance Crocker and Mark Lux, these
17 three facilities will be decommissioned as a result of the EPA's National Emission
18 Standards for Hazardous Air Pollutants for Area Sources: Industrial, Commercial
19 and Institutional Boilers.

1 **Q. WHAT ADJUSTMENTS WERE MADE RELATED TO PERSONNEL DUE**
2 **TO THE SUSPENSION OF OPERATIONS AT THESE FACILITIES?**

3 A. Adjustments have not been made for the employees that were employed at Osage
4 and Ben French when those facilities were placed into economic shutdown. The
5 affected employees retired, took alternate positions with the Company, or left the
6 Company. Black Hills Power has had a labor reduction due to the suspension of
7 operations at Neil Simpson I. However, these employees were retained by Black
8 Hills Power as part of its strategic workforce planning.

9 More specifically the Neil Simpson I employees have been retained and are
10 assigning part of their time to the common Neil Simpson complex facilities.
11 These employees also direct charge other specific units, such as Cheyenne Light
12 and Black Hills Wyoming, and common facilities for work performed at those
13 facilities. Retention of these critical skills is necessary to ensure the continued
14 provision of safe, reliable and cost-effective service to customers.

15 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

16 A. Yes.

Rebuttal Testimony and Exhibits
Kyle D. White

Before the South Dakota Public Utilities Commission
of the State of South Dakota

In the Matter of the Application of
Black Hills Power, Inc., a South Dakota Corporation

For Authority to Increase Rates
In South Dakota

Docket No. EL14-026

January 15, 2015

Co. App. A-27

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EXHIBITS

- CONFIDENTIAL KDWR-1 Settlement Class Cost of Service Study
- CONFIDENTIAL KDWR-2 Large General Service Contract Bill Comparisons

1 **I. INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. Kyle D. White, 625 Ninth Street, P.O. Box 1400, Rapid City, South Dakota.

4 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

5 A. I am currently employed by Black Hills Service Company (“Service Company”), a
6 wholly-owned subsidiary of Black Hills Corporation (“BHC”), as Vice President
7 of Regulatory Affairs. My areas of responsibility include regulatory affairs for the
8 regulated utility subsidiaries of BHC.

9 **Q. FOR WHOM ARE YOU TESTIFYING ON BEHALF OF TODAY?**

10 A. I am testifying on behalf of Black Hills Power, Inc. (“Black Hills Power” or
11 “Company”).

12 **Q. DID YOU PROVIDE DIRECT TESTIMONY IN THIS DOCKET?**

13 A. Yes.

14 **II. PURPOSE OF REBUTTAL TESTIMONY**

15 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

16 A. The purpose of my rebuttal testimony is to support the Settlement Stipulation
17 (“Settlement Agreement”), reached between Black Hills Power and the South
18 Dakota Public Utilities Commission Staff (“Staff”). I specifically address: (1) the
19 status of settlement; (2) the FutureTrack Workforce Development program; (3)
20 incentive compensation; and (4) class cost of service. I also explain why the
21 positions taken by the opposing parties on these topics are unpersuasive. Lastly, I

1 address why the Company may not object if the Commission elects to modify
2 specifically articulated terms reflected in the Settlement Agreement.

3 **III. SETTLEMENT STATUS**

4 **Q. IS THERE A SETTLEMENT OF ALL RATE CASE ISSUES PENDING**
5 **BEFORE THE COMMISSION?**

6 A. Yes. On December 8, 2014, Black Hills Power entered into a Settlement
7 Agreement with Staff regarding all issues pertaining to the Company's application
8 for authority to revise electric rates. The Black Hills Industrial Intervenors
9 ("BHII") and Dakota Rural Action ("DRA") chose to not be parties to the
10 Settlement Agreement.

11 **Q. DOES BLACK HILLS POWER CONSIDER THE SETTLEMENT TO BE**
12 **COMPREHENSIVE?**

13 A. Yes. The Settlement Agreement represents the culmination of months of
14 substantial formal and informal discovery regarding the Company's operations. It
15 resulted from extensive negotiations between Commission Staff and the Company,
16 which at times also included all parties to this docket.

17 **Q. DOES THE SETTLEMENT AGREEMENT CONTAIN TERMS THAT**
18 **BENEFIT BHII?**

19 A. Yes, it does. Customers that comprise the BHII were primary beneficiaries of the
20 rate mitigation plan that is reflected in the Settlement Agreement. As a result, the
21 bill increases for BHII members are in a range of two to five percent.

1 Additionally, under the terms of the Settlement there will be no additional change
2 in base rates for at least two years.

3 **Q. DID BHII AND DRA FILE ANSWER TESTIMONY IN OPPOSITION TO**
4 **THE SETTLEMENT AGREEMENT?**

5 A. Yes and no. BHII filed testimony from two consultants, Mr. Steven J. Baron and
6 Mr. Lane Kollen. DRA did not file testimony in opposition to the Settlement
7 Agreement.

8 **Q. THROUGH ITS ANSWER TESTIMONY, DO YOU BELIEVE THAT BHII**
9 **HAS RAISED ISSUES THAT SUPPORT REJECTION OF THE**
10 **SETTLEMENT AGREEMENT?**

11 No, I do not. Although introducing new areas for the Commission to consider, the
12 answer testimony largely supports the numerous compromises reflected in the
13 Settlement Agreement. As an example, after 32 pages of testimony regarding the
14 class cost of service, Mr. Baron recommends that the Commission adopt the
15 apportionment of the overall revenue increase to the rate classes as reflected in the
16 Settlement Agreement. As illustrated in my rebuttal testimony, and the rebuttal
17 testimony of Black Hills Power's other rebuttal witnesses, in the areas in which
18 BHII's consultants' disagree with the terms of the Settlement Agreement the BHII
19 consultants' analysis is flawed. As a consequence, the BHII answer testimony
20 provides no evidence that would warrant the Commission rejecting the Staff and
21 its consultants' comprehensive assessment and complete settlement of all issues.

1 Q. DOES THE COMPANY FULLY SUPPORT THE SETTLEMENT
2 AGREEMENT?

3 A. Yes. The revenue requirement reflected in the Settlement Agreement is consistent
4 with the utility's cost to meet its obligation to serve its South Dakota customers. If
5 approved, the Settlement Agreement will result in just and reasonable rates. As a
6 result, the Company fully supports the Settlement Agreement that is presently
7 before the Commission.

8 However, as indicated later in my testimony and the testimony of Jon Thurber,
9 there are opportunities before the Commission to modify specific terms of the
10 Settlement Agreement that would not likely be opposed by the Company. Those
11 areas include possible changes to the rate treatment of certain customers and an
12 adjustment for O&M costs associated with the Wyodak facility.

13 Q. IF THE COMMISSION APPROVED THE SETTLEMENT AGREEMENT,
14 WOULD THE APPROVAL SET PRECEDENT FOR FUTURE RATE
15 CASE DOCKETS?

16 A. No, it would not.

17 IV. FUTURETRACK WORKFORCE PROGRAM

18 Q. DOES THE SETTLEMENT WITH STAFF REQUEST APPROVAL OF
19 THE FUTURE TRACK PROGRAM THAT WAS INCLUDED IN THE
20 COMPANY'S FILED POSITION?

21 A. No. Settlements generally do not address questions of policy, like the innovative
22 eight-year Future Track workforce development proposal, unless there has been

1 prior Commission guidance or direction provided in previous decisions and orders.
2 The Settlement only provides for rate recovery of employees hired in 2014. It does
3 not include future expenses, the tracking of expenses, or reporting requirements as
4 contemplated by the proposed program.

5 **Q. NOTWITHSTANDING THE FACT THAT THE PROGRAM IS NOT**
6 **INCLUDED IN THE SETTLEMENT AGREEMENT, DOES MR. KOLLEN**
7 **PROPERLY EXPLAIN IN HIS TESTIMONY THE FUTURE TRACK**
8 **WORKFORCE PROGRAM THAT THE COMPANY INCLUDED IN ITS**
9 **FILED POSITION?**

10 **A.** No. The Commission should review the testimony of Black Hills Power witness
11 Jennifer Landis if it wants to fully understand the proposed workforce
12 development program, the circumstances that have created the need to modify
13 traditional approaches to attracting and developing new employees into key
14 operational roles, and the need to mitigate the operational and safety risks
15 associated with replacing an unprecedented number of employees from the
16 Company's experienced workforce.

17 **Q. MR. KOLLEN STATES ON PAGE 27 OF HIS TESTIMONY, "IN ANY**
18 **EVENT, THE COMPANY HAS PROVIDED NO EVIDENCE THAT THE**
19 **PRACTICE IS NECESSARY OR THE ONLY WAY THAT IT CAN**
20 **RECRUIT OR FILL ENTRY-LEVEL POSITIONS AT THE COMPANY."**
21 **DO YOU AGREE?**

1 A. No. Ms. Landis’ testimony provides extensive evidence that supports the need to
2 be more thoughtful and aggressive in ensuring Black Hills Power’s customers
3 have the benefit of a qualified and cost-effective workforce in the future.
4 Curiously, Mr. Kollen directs the Commission to learn about the programs
5 available to students at Mitchell Technical Institute as evidence that new
6 employees will be available for hire by Black Hills Power. What he fails to
7 recognize is the information contained in Ms. Landis’ testimony that indicates,
8 “...approximately 25 companies are working with Mitchell Technical Institute
9 (“MIT”) to provide scholarships for MIT students that require employment with
10 the sponsoring company following graduation.”

11 While Mr. Kollen is correct that the Future Track Program is not the only way to
12 attract the needed employees, Future Track only focused on replacing retiring
13 employees in positions critical to maintaining safe and reliable service. The
14 Company would still be in the “market” looking for employees related to normal
15 employee turnover, which may increase due to expected higher industry demand
16 for employees with the desired skill sets. Since the employees included in the
17 proposed Future Track program would be in high-skill technical positions which
18 require significant training (often years) to become qualified, it would likely be
19 necessary to increase staffing and compensation levels in order to maintain the
20 appropriate staffing levels required to meet operational and safety standards.

21 **Q. DID MR. KOLLEN PROPERLY DESCRIBE THE PROPOSED**
22 **REGULATORY ASSET AND THE TRACKING OF PROGRAM COSTS?**

1 A. No, he says the “request is inappropriately open-ended.” This is false. The
2 program identified specific positions that would be open solely due to retirements,
3 identifies specific trackable cost categories (like scholarships and training), a
4 specific time frame (8 years) and the opportunity for the Commission to review
5 program costs for reasonableness on an annual basis.

6 He also says, “The Company has not proposed a measurement baseline that
7 defines how the payroll and related expenses associated with this program can and
8 will be differentiated from any other payroll and related expenses.” This again is
9 false, Ms. Landis on page 13 describes in detail how program costs would be
10 tracked and charged to the regulatory account. She also provides program specifics
11 through Exhibit JCL-1.

12 Finally, Mr. Kollen claims, “The Company is not adequately incentivized to
13 operate efficiently if there is no defined measurement baseline and it can defer
14 (and later recover) any amount in excess of the allowed amount.” This claim is
15 also false. The final paragraph of Exhibit JCL-1 states:

16 **“Program Expense True-Up:** Retirement decisions are highly personal and
17 workers may decide to alter their retirement plans to either work longer or retire
18 sooner. Because of this, the cost of the program is expected to fluctuate over time.
19 In addition to reporting the program’s status to the Commission annually, we
20 recommend a true-up audit be performed in 5 years. Any expenses planned for but
21 not realized will be returned to Black Hills Power customers. Likewise, any

1 reasonable and documented expenses that exceed the approved Future Track
2 regulatory account will be brought before the Commission for reimbursement.”

3 **V. INCENTIVE COMPENSATION**

4 **Q. HAVE ANY OF THE PARTIES TO THIS RATE CASE DEMONSTRATED**
5 **THAT INCENTIVE COMPENSATION IS AN “IMPRUDENT” EXPENSE**
6 **FOR INCLUSION IN BLACK HILLS POWER’S REVENUE**
7 **REQUIREMENT?**

8 A. No, the BHII’s have only alleged through Mr. Kollen’s testimony that for
9 subjective reasons the Commission should reject board and management decisions
10 regarding the required compensation practices needed to staff the organization and
11 meet the obligation to serve. No evidence was presented that the total
12 compensation paid to employees was imprudent or unreasonable based upon what
13 the market pays employees for similar positions.

14 **Q. IS IT COMMISSION PRECEDENT TO DENY RECOVERY OF**
15 **INCENTIVE COMPENSATION EXPENSE TIED TO OPERATING AND**
16 **FINANCIAL PERFORMANCE, AS MR. KOLLEN STATES ON PAGE 35**
17 **OF HIS TESTIMONY?**

18 A. Although I am not aware of a specific Commission decision regarding the
19 inclusion of incentive compensation for determining a utility’s revenue
20 requirement, I do know that the Commission has approved rate case settlements
21 where the revenue requirement included expenses for employee incentive
22 compensation. In fact, some of Mr. Kollen’s clients in this docket have been

1 parties to prior settlements approved by the Commission that included incentive
2 compensation expense within the revenue requirement.

3 **Q. MR. KOLLEN STATES ONE OF THE REASONS TO DENY RECOVERY**
4 **OF INCENTIVE COMPENSATION EXPENSE IS THAT, “THE**
5 **COMPANY’S FINANCIAL PERFORMANCE IS A DIRECT FUNCTION**
6 **OF THE REVENUES RECOVERED FROM CUSTOMERS, INCLUDING**
7 **THE RATE INCREASES THAT ARE AUTHORIZED BY THE**
8 **COMMISSION.” DO YOU SHARE THIS VIEW?**

9 A. Revenues are an important component of the financial performance of all
10 businesses. What Mr. Kollen has failed to acknowledge is that a company’s ability
11 to serve customers and meet customer demands is also a direct function of the
12 revenues recovered from customers. If revenues are inadequate to support the
13 needs of the business, then changes to the business must occur or customer and or
14 owner expectations will not be met. He also fails to acknowledge that the
15 financial performance of any company is also a direct function of how well the
16 company controls costs and expenses. Effective cost controls in a business where
17 revenue levels are regulated is a critical aspect of avoiding even higher rate
18 requests in the future.

19 **Q. ON PAGE 36 OF MR. KOLLEN’S TESTIMONY HE STATES, “THERE IS**
20 **AN INHERENT CONFLICT BETWEEN LOWER RATES AND GREATER**
21 **FINANCIAL PERFORMANCE.” DO YOU AGREE?**

1 A. No. Financial performance is not solely the result of rate increases. Financial
2 performance (profitability) for a utility is primarily influenced by the level of its
3 expenses. Profitability can be enhanced through efficiency and lowering of costs,
4 increasing sales or increasing prices.

5 **Q. ANOTHER POINT MR. KOLLEN MAKES IS THAT, “THE REVENUE**
6 **REQUIREMENT SHOULD NOT EMBED RECOVERY OF AN EXPENSE**
7 **THAT IS BASED ON PERFORMANCE” BECAUSE, “IF THE COMPANY**
8 **IS ENSURED RECOVERY OF THE EXPENSE FROM CUSTOMERS,**
9 **THEN THERE IS NO PERFORMANCE THAT IS AT RISK OR THAT**
10 **MUST BE ACHIEVED IN ORDER TO RECOVER THAT EXPENSE.” DO**
11 **YOU AGREE?**

12 A. No, I do not. The Company’s incentive compensation practices are designed to
13 incent and reward employees for achieving planned operating and financial
14 results. The practices are designed to encourage employee initiative and other
15 behaviors that will result in a sustainable and successful company. There are
16 numerous benefits for customers when a company’s employees receive incentive
17 income to achieve these results.

18 **Q. MR. KOLLEN TELLS THE COMMISSION IT “SHOULD NOT**
19 **INCENTIVIZE THE COMPANY TO SEEK GREATER RATE**
20 **INCREASES AND ACT AGAINST THEIR CUSTOMERS’ INTERESTS.”**
21 **DO YOU BELIEVE THAT FUTURE SOUTH DAKOTA REGULATORS**
22 **WOULD FAIL TO SET JUST AND REASONABLE RATES IF THE**

1 **COMMISSION APPROVED A SETTLEMENT THAT INCLUDES**
2 **EXPENSES FOR INCENTIVE COMPENSATION?**

3 A. No. The Staff and the Commission have demonstrated exceptional competence in
4 auditing and assessing Black Hills Power’s business and ensuring that rate
5 changes are just and reasonable. If Mr. Kollen’s premise is that incentive
6 compensation leads to more frequent rate increases, then this would have come to
7 be true once the Company began utilizing incentive compensation practices. Black
8 Hills Power’s rate case history does not support this outcome.

9 **Q. MR. KOLLEN STATES ON PAGE 36 OF HIS TESTIMONY, “THIS FORM**
10 **OF INCENTIVE COMPENSATION IS PRIMARILY DIRECTED**
11 **TOWARD ACHIEVING SHAREHOLDER GOALS, NOT CUSTOMER**
12 **GOALS.” DO YOU AGREE?**

13 A. No. As explained in the direct testimony of Laura Patterson, incentive
14 compensation is a component of most utilities’ and corporations’ direct
15 compensation paid to attract and retain qualified employees. Our employment
16 locations are frequently in the less populated locations of the Country. This means
17 employees coming to these locations will have few local employment options if
18 they choose to leave. Their spouses will also see their employment options limited.
19 Historically, we could expect employees to stay and “earn” their pension. This
20 retention mechanism has diminished since the Corporation froze its defined
21 benefit pension plan. With these factors already in play, a competitive total direct

1 compensation offering is essential for meeting our obligation to serve South
2 Dakota electric customers.

3 **Q. MR. KOLLEN STATES THAT BOTH THE RESTRICTED STOCK**
4 **EXPENSE AND THE PERFORMANCE PLAN EXPENSE ARE TIED TO**
5 **THE COMPANY'S FINANCIAL PERFORMANCE. IS THE**
6 **RESTRICTED STOCK EXPENSE TIED TO FINANCIAL**
7 **PERFORMANCE?**

8 A. No. As explained in Ms. Patterson's direct testimony on page 14, "restricted stock
9 is granted to key employees and vests ratably over a 3-year period. The purpose of
10 the 3-year vesting period for both the restricted stock and the performance shares
11 is to get retention of key employees." Once restricted stock is granted to a key
12 employee the only requirement for pay-out is the employee's continued
13 employment.

14 **Q. HAS BLACK HILLS POWER BEEN GRANTED RECOVERY OF**
15 **INCENTIVE COMPENSATION EXPENSES IN OTHER**
16 **JURISDICTIONS?**

17 A. Yes, last summer the Wyoming Public Service Commission approved a settlement
18 with the Office of Consumer Advocate that included 100% of the requested
19 incentive compensation in the revenue requirement.

20 **Q. DOES THE SETTLEMENT WITH STAFF INCLUDE 100% OF THE**
21 **COMPANY'S INCENTIVE COMPENSATION COSTS?**

1 A. No, as Mr. Kollen points out, \$666,000 has been removed from expense for
2 determining the proposed revenue requirement.

3 **Q. IF THE COMMISSION ACCEPTED MR. KOLLEN'S POSITION AND**
4 **REMOVED THE REMAINING INCENTIVE COMPENSATION FROM**
5 **THE UTILITY'S REVENUE REQUIREMENT, WHAT WOULD BE THE**
6 **RESULT?**

7 A. I believe he has recommended, on page 35, that the entire incentive compensation
8 expense be disallowed. This would be the equivalent of the Commission lowering
9 Black Hills Power's authorized return on equity by in excess of 20 basis points.
10 The substance, depth and nature of Mr. Kollen's testimony in no way justifies a
11 punitive outcome for the Company for utilizing normal and reasonable employee
12 compensation practices that are prevalent across the utility industry and other
13 companies in the Black Hills region. For the Commission to remove from the
14 Settlement Agreement incentive compensation expense would be contrary to the
15 principle of utility regulation which requires a utility be allowed a reasonable
16 opportunity to recover actual costs prudently incurred in providing service to its
17 customers. The Settlement Agreement as presented will result in just and
18 reasonable rates for Black Hills Power's South Dakota customers.

19 **VI. CLASS COST OF SERVICE**

20 **Q. MR. WHITE, HAVE YOU READ THE ANSWER TESTIMONY FILED ON**
21 **BEHALF OF BHII BY MR. BARON?**

22 A. Yes, I have.

1 **Q. DOES MR. BARON RECOMMEND THAT THE COMMISSION REJECT**
2 **THE CLASS COST OF SERVICE THAT IS REFLECTED IN THE**
3 **SETTLEMENT AGREEMENT?**

4 A. No, he does not. After 32 pages of testimony on the subject, Mr. Baron
5 recommends that the Commission adopt the apportionment of the overall revenue
6 increase to the rate class as reflected in the Settlement Agreement.

7 **Q. IF MR. BARON DOES NOT OPPOSE THE CLASS COST OF SERVICE,**
8 **THEN WHAT ACTIONS HAS HE RECOMMENDED THAT THE**
9 **COMMISSION TAKE ON THIS SUBJECT?**

10 A. Mr. Baron identifies a number of alternative methodologies that he believes should
11 be utilized by the Company in its class cost of service. While he characterizes his
12 proposed alternative as corrections of “errors” in the Company’s class cost of
13 service, in most instances the changes he proposed are simply different approaches
14 that he believes could be taken. Ultimately, Mr. Baron states, “The commission
15 should require BHP to file a class cost of service study in its next base rate case
16 reflecting the corrections that I have discussed in my testimony. At a minimum,
17 the Company should be required to file an alternative class cost of service study
18 (in addition to its preferred method) reflecting the corrections that I am
19 recommending. The changes to the company’s study that I have presented provide
20 a more appropriate basis to evaluate the reasonableness of the Company’s rates.”

21 **Q. DO YOU SUPPORT MR. BARON’S REQUEST THAT BLACK HILLS**
22 **POWER BE ORDERED TO PREPARE A CLASS COST OF SERVICE**

1 **STUDY THAT INCORPORATED BHII'S RECOMMENDATIONS FOR**
2 **ITS NEXT BASE RATE APPLICATION?**

3 A. No.

4 **Q. WHY ARE YOU NOT SUPPORTIVE OF MR. BARON'S REQUEST?**

5 A. First, I disagree with Mr. Baron's suggestion that the proposed alternative
6 methodologies are "corrections" to the class cost of service study.

7 Second, the Company has the burden of proof regarding the reasonableness of its
8 rates and should be free to determine the evidence it believes is necessary and
9 appropriate to support its future applications. Mr. Baron's approach, particularly
10 the requirement of an "alternative study" to Black Hills Power's "preferred
11 method," only works to burden the Company and its customers with the costs that
12 should be borne by BHII as part of its review of the application and litigation
13 preparation. I believe our other customers already shoulder too much of the
14 litigation cost resulting from BHII's participation in Black Hills Power's base rate
15 case proceedings.

16 Third, I don't agree with many of Mr. Baron's conclusions and as a result, the
17 Company would not want to have to work around class cost of service
18 requirements designed to benefit a handful of large customers.

19 **Q. GIVEN THE NUMEROUS PROPOSED MODIFICATIONS THAT MR.**
20 **BARON IDENTIFIES IN HIS TESTIMONY, WHY DO YOU THINK HE**
21 **SUPPORTS STAYING WITH THE CLASS COST OF SERVICE THAT IS**
22 **REFLECTED IN THE SETTLEMENT AGREEMENT?**

1 A. I don't know, but I believe that it is fair to assume that his clients are benefitting
2 through lower cost allocations by the Company's approach and the rate increase
3 mitigation it has implemented.

4 **Q. MR. WHITE, GIVEN THAT MR. BARON HAS SUGGESTED THAT THE**
5 **COMMISSION ORDER THE COMPANY TO MAKE MODIFICATIONS**
6 **TO ITS CLASS COST OF SERVICE STUDIES IN THE FUTURE, WOULD**
7 **YOU CARE TO RESPOND TO SOME OF MR. BARON'S FINDINGS**
8 **REGARDING BLACK HILLS POWER'S CLASS COST OF SERVICE?**

9 A. Yes, I first will address the suggested modifications that the Company agrees
10 should be changed.

11 **Q. WHAT AREAS OF AGREEMENT DO YOU HAVE WITH MR. BARON'S**
12 **TESTIMONY?**

13 A. The Company agrees, as he suggests on page 11 of his testimony, that it would
14 have been more appropriate to determine the annual system load factor using a
15 single coincident peak demand. The Company also agrees, as pointed out on page
16 11, that it was an oversight to not include "excess demand" for our total-electric
17 customers. The Company also accepts his recommendation on page 23 that a
18 separate allocation of 69kV sub transmission costs should occur in the manner that
19 is demonstrated in my CONFIDENTIAL Exhibit KDWR-1.

20 **Q. DOES THE COMPANY ACCEPT MR. BARON'S SUGGESTION THAT**
21 **ACCOUNT 369 SERVICES SHOULD BE ALLOCATED UTILIZING**
22 **MORE OF A CUSTOMER-RELATED ALLOCATOR?**

1 A. The Company agrees that the allocation should not be based on non-coincident
2 peak. For purposes of this docket a customer count allocation is acceptable. For
3 its next rate case application the Company intends to utilize a customer oriented
4 allocation.

5 **Q. IF THE COMPANY WERE TO FILE A CLASS COST OF SERVICE**
6 **STUDY IN THE FUTURE, WOULD THESE SUGGESTED CHANGES BE**
7 **MADE?**

8 A. Yes. In addition, the changes are also reflected in CONFIDENTIAL Exhibit
9 KDWR-1.

10 **Q. DO YOU HAVE A RECOMMENDATION REGARDING HOW BEST TO**
11 **ALLOCATE 69KV SUB TRANSMISSION FACILITIES AND RELATED**
12 **COSTS?**

13 A. Yes. There are two customers that receive service at 69kV. One customer is
14 currently served under a Business Development Service agreement. The other has
15 contracted for service under the Industrial Contract Service tariff. For much of my
16 career, General Service Large and Industrial Contract Service were separate
17 classes for allocating costs. Based upon Mr. Baron's desire to ensure that his
18 69kV service client is not allocated distribution costs, I would recommend
19 returning to a separate Industrial Contract Service class.

20 **Q. DO YOU HAVE AN EXHIBIT THAT SHOWS THE CLASS COST OF**
21 **SERVICE THAT RESULTS FROM THIS CHANGE?**

1 A. Yes, CONFIDENTIAL Exhibit KDWR-1 shows how this would work in this case
2 and includes the other recommended modifications that I have indicated above
3 that the Company supports.

4 **Q. DOES THAT CONCLUDE THE AREAS OF AGREEMENT?**

5 A. Yes.

6 **Q. ARE THERE MODIFICATIONS THAT MR. BARON HAS SUGGESTED
7 THAT YOU DO NOT SUPPORT?**

8 A. Yes. I disagree with Mr. Baron's recommendations that the Commission make
9 changes to future class cost of service studies for a "minimum Distribution
10 System" and for curtailable/interruptible loads.

11 **Q. DOES THE COMPANY AGREE THAT A MINIMUM DISTRIBUTION
12 SYSTEM APPROACH SHOULD BE USED FOR ALLOCATING
13 DISTRIBUTION COSTS BETWEEN CUSTOMER CLASSES?**

14 A. No. Black Hills Power believes that the historic approach should be continued for
15 purposes of the South Dakota class cost of service studies. Consistency can be
16 important in rate making and we see no material overall benefit in determining just
17 and reasonable rates that would result from this change.

18 **Q. DOES BLACK HILLS POWER HAVE ANY SIGNIFICANT
19 INTERRUPTIBLE LOAD ON ITS SYSTEM?**

20 A. No.

21 **Q. DOES MR. BARON REPRESENT THAT THE COMPANY HAS 2,300 KVA
22 OF INTERRUPTIBLE/CURTAILABLE LOAD ON ITS SYSTEM?**

1 A. Yes.

2 **Q. WHY DO YOU THINK HE BELIEVES THIS?**

3 A. **The existence, substance and terms of the contract that are referenced in my**
4 **testimony are strictly confidential.** The BHII's indicated in response to Black
5 Hills Power discovery request No. 1 that the basis for Mr. Baron's representation
6 is one of his client's February 2014 contract with the Company. However, Mr.
7 Baron's analysis is flawed for two reasons. First and foremost, the particular
8 provisions upon which he relies were not renewed by his client. Second, as I
9 explain below, Mr. Baron's conclusion that the load in question constitutes
10 interruptible load is incorrect.

11 **Q. NOTWITHSTANDING THE FACT THAT MR. BARON IS INCORRECT**
12 **IN HIS BELIEF THAT THERE IS INTERRUPTIBLE LOAD ON BLACK**
13 **HILLS POWER'S SYSTEM, DO YOU WANT TO ADDRESS HIS**
14 **TESTIMONY ON THIS TOPIC?**

15 A. Yes, I would like to address his testimony on this topic to ensure that the
16 Commission has accurate information before it upon which it can base the
17 decisions that it will make in this docket.

18 **Q. DOES BLACK HILLS POWER HAVE 300 KW OF LOAD THAT COULD**
19 **BE VIEWED AS CURTAILABLE?**

20 A. Yes, the Company confirmed this in response to BHII-34.

21 **Q. PLEASE EXPLAIN HOW YOU DIFFERENTIATE BETWEEN**
22 **INTERRUPTIBLE AND CURTAILABLE SERVICE.**

1 A. Interruptible service is where the utility has complete control over whether the
2 defined electric load is served. This often is accomplished with a remote
3 disconnect that is operated solely by the utility. The customer has no ability to
4 maintain utility provided electric service if the utility determines that the load
5 should be interrupted for the benefit of the electric system.

6 Curtailable service occurs when a customer has contracted to reduce its load by a
7 specified amount or to a specified level when requested to do so by the utility.
8 Compliance with the request is at the discretion of the customer and failure to do
9 so frequently results in a financial consequence to the customer. The level of
10 financial consequence is determined by the customer's willingness to pay and the
11 utility's perspective regarding whether the curtailable load is viewed as a firm
12 long-run resource or a vehicle to justify pricing concessions. Black Hills Power
13 has experience treating curtailable load both ways. Our experience has also been
14 that our customers like the pricing provisions but not the curtailments.

15 **Q. DO YOU DEFINE THE 2,000 KVA LOAD IN QUESTION AS AN**
16 **INTERRUPTIBLE LOAD?**

17 A. No. The utility does not have direct control over whether the load referred to by
18 Mr. Baron is served by its electric system.

19 **Q. DO YOU CONSIDER THIS TO BE A CURTAILABLE LOAD?**

20 A. It has curtailable characteristics, but the contract provision has limitations as long-
21 run curtailable load. The curtailments are constrained, no more than three
22 consecutive days of curtailment per week, and no more than 20 days per year. In

1 addition, the \$0.12/kwh “penalty” for non-compliance may not exceed the cost to
2 serve the load under system peak conditions. Finally, the provision grants a
3 unilateral annual right of renewal to the customer, making the long-term
4 availability of the “resource” uncertain for more than annual planning purposes.

5 **Q. WHAT IS THE HISTORY OF HOW THIS PROVISION CAME INTO**
6 **EXISTENCE?**

7 A. The Industrial Contract Service tariff allows the customer to receive an off-peak
8 demand forgiveness of up to 1.5 times the on-peak Billing Capacity at no
9 additional charge. Due to the nature of the processes required to produce cement,
10 the customer has utilized this provision for decades. Many years ago, in order to
11 accommodate extraordinary demand for cement, the customer inquired as to
12 whether for a set monthly Billing Capacity the Company would be willing to
13 “flex” its off-peak periods. The Company agreed to do this and the customer
14 agreed to not exceed the firm Billing Capacity when requested by the Company.
15 The customer found that this approach provided an opportunity for increased sales
16 and beneficial flexibility as to how the plant was operated. Until 2014, the practice
17 was by mutual agreement and did not occur in all years. To my knowledge, 2014
18 was the first year where the customer had a requirement to reduce load to a set
19 amount below the firm Billing Capacity.

20 **Q. DO YOU CONSIDER THIS ARRANGEMENT TO BE ONE THAT**
21 **WARRANTS BEING VALUED AS AVOIDING FUTURE COMBUSTION**
22 **TURBINE INVESTMENTS, AS MR. BARON RECOMMENDS?**

1 A. No. The provision does not create a long-run reliable resource for meeting Black
2 Hills Power's obligation to serve.

3 **Q. IN PREPARING ITS CLASS COST OF SERVICE, DID BLACK HILLS**
4 **POWER INCLUDE ALL OF THE BILLING UNITS AND ASSOCIATED**
5 **REVENUES FOR THE INDUSTRIAL CONTRACT SERVICE**
6 **CUSTOMER'S FIRM LOAD WITHOUT A REDUCTION FOR THE NON-**
7 **STANDARD NATURE OF THE BILLING ARRANGEMENT?**

8 A. Yes. The Industrial Contract Service Customer's load is not interruptible and there
9 is no "revenue credit" for the 2,000 kVA of expected load reduction. The 16,000
10 kVA Billing Capacity is billed whether the customer's summer season monthly
11 metered demand is below or above this amount. It is the "deemed" on-peak
12 demand.

13 **Q. DID THE INDUSTRIAL CONTRACT SERVICE CUSTOMER PROVIDE**
14 **WRITTEN NOTICE PRIOR TO NOVEMBER 1, 2014, AS REQUIRED BY**
15 **PARAGRAPH H, OF ITS INTENT TO RENEW THE PROVISIONS OF**
16 **SECTION 9 FOR 2015?**

17 A. No, and as a consequence, the provisions of Section 9 are no longer effective. As a
18 result, it does not now matter whether this is an interruptible, curtailable or some
19 other type of load.

20 **Q. WHAT ACTIONS DO YOU RECOMMEND THE COMMISSION TAKE**
21 **WITH RESPECT TO THE CLASS COST OF SERVICE?**

1 A. Black Hills Power fully supports the Settlement Agreement. However, the
2 Company would likely not object if the Commission elected to make the
3 modifications that I addressed above in my testimony and are reflected in
4 CONFIDENTIAL Exhibit KDWR-1.

5 **Q. WHAT IS THE RESULT IF THE COMMISSION ELECTS TO MAKE THE**
6 **MODIFICATIONS DEPICTED IN CONFIDENTIAL EXHIBIT KDWR-1?**

7 A. As show in CONFIDENTIAL Exhibit KDWR-1, the settled rates are more than
8 \$750,000 below the allocated costs and the rates could be increased to benefit
9 other customers and reduce the subsidy the ICS customer is receiving.

10 **VII. CONCLUSION**

11 **Q. WHAT IS THE COMPANY'S VIEW REGARDING POSSIBLE**
12 **COMMISSION MODIFICATION TO ITS SETTLEMENT OF ALL RATE**
13 **CASE ISSUES WITH COMMISSION STAFF?**

14 A. Normally, I would be advocating only for a bench decision of approval of the
15 settlement and related electric tariffs without Commission modification. This
16 would be required because all parties had agreed to comprehensive settlement of
17 all contested issues. This often is referred as a "package deal" and is defended
18 because of the compromise of the parties to reach a common agreement. To
19 change one component of the settlement could diminish the perceived and/or
20 expected value of one of the parties to the settlement.

21 In this case, Black Hills Power's primary interest is in the agreed upon \$6.89
22 million increase to its revenue requirement, along with a reasonable expectation

1 that the Commission approved rates and tariffs will allow for the recovery of this
2 revenue requirement from South Dakota electric customers. In this situation,
3 where the rate case is being litigated by some of the parties, the Company, with
4 Staff's support, can more readily accept changes in cost allocations to the
5 customer classes, along with rate schedule and tariff changes. In fact, a litigated
6 case such as this may afford the Commission the opportunity to reduce inter and
7 intra class subsidies, along with consolidation of legacy rate schedules or pricing
8 practices that it believes are no longer warranted by today's circumstances.

9 **Q. WHAT LEGACY PRICING PROVISIONS WOULD YOU LIKE THE**
10 **COMMISSION TO BE AWARE OF?**

11 A. There are three. The first is a substantial under recovery of one customer's cost of
12 service. This has been highlighted in my rebuttal testimony where I propose
13 returning to including an Industrial Contract Service Class due to its 69kV service
14 voltage and size and load characteristics (refer to CONFIDENTIAL Exhibit
15 KDW-1). As I indicated above, the annual benefit of the proposed settlement rates
16 to the customers is in excess of \$750,000.

17 The second is the Large Power Contract Service tariff where, with the exception of
18 the pricing, minimum service capacity of 6,000 kVA and the term of service
19 provisions, the tariff largely mirrors the General Service Large (Optional
20 Combined Account Billing). The sole customer receiving service under this tariff
21 combined loads have not reached the 6,000 kVA minimum and are not distinctly
22 different from those of the customers receiving service under the General Service

1 Large (Optional Combined Account Billing). As illustrated in CONFIDENTIAL
2 Exhibit KDWR-2, the annual benefit of this tariff to the customer is approximately
3 \$240,000. In this situation, the Commission could close the rate schedule, set the
4 rate equal to the General Service Large (Optional Combined Account Billing) and
5 require the Company to give the appropriate notice to terminate the service
6 agreement.

7 The third legacy pricing provision is within the contract with deviations for Pete
8 Lein and Sons, Inc. This customer's service and load characteristics today also are
9 not distinctly different from the customers receiving service under the General
10 Service Large (Optional Combined Account Billing). As illustrated in
11 CONFIDENTIAL Exhibit KDWR-2, the annual benefit to the customer of the
12 legacy pricing provision is approximately \$60,000. In this case, the Commission
13 could order a modification to the approved contract with deviations to remove
14 legacy base rate pricing provisions.

15 **Q. ARE YOU ASKING THE COMMISSION TO MAKE THESE**
16 **MODIFICATIONS TO THE SETTLEMENT AGREEMENT PRIOR TO**
17 **APPROVING IT?**

18 A. No, I am only advising the Commission that it has this opportunity and that the
19 Company would likely not oppose changes of this nature.

20 **Q. ARE THERE OTHER MODIFICATIONS TO THE SETTLEMENT**
21 **AGREEMENT THAT THE COMPANY MAY SUPPORT?**

1 A. Yes, as discussed in the testimony of Jon Thurber, the Company would also be
2 supportive of an adjustment to the O&M costs associated with the Wyodak
3 facility.

4 **Q. ARE YOU ASKING THE COMMISSION TO MAKE THESE**
5 **MODIFICATIONS TO THE SETTLEMENT AGREEMENT BEFORE**
6 **APPROVING IT?**

7 A. No. I am only advising the Commission that the Company may not object if the
8 Commission thought these modifications were justified.

9 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

10 A. Yes.

Rebuttal Testimony
Christopher J. Kilpatrick

Before the South Dakota Public Utilities Commission
of the State of South Dakota

In the Matter of the Application of
Black Hills Power, Inc., a South Dakota Corporation

For Authority to Increase Rates
In South Dakota

Docket No. EL14-026

January 15, 2015

Co. App. A-55

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1 **I. INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Christopher J. Kilpatrick. My business address is 625 Ninth Street,
4 P.O. Box 1400, Rapid City, South Dakota 57701.

5 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

6 A. I am currently employed by Black Hills Utility Holdings, Inc. (“Utility
7 Holdings”), a wholly-owned subsidiary of Black Hills Corporation (“BHC”), as
8 the Director of Regulatory.

9 **Q. ON WHOSE BEHALF ARE YOU APPEARING ON IN THIS**
10 **APPLICATION?**

11 A. I am testifying on behalf of Black Hills Power, Inc., (“Black Hills Power” or the
12 “Company”).

13 **Q. DID YOU FILE DIRECT TESTIMONY IN THIS DOCKET?**

14 A. Yes.

15 **II. PURPOSE OF REBUTTAL TESTIMONY**

16 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

17 A. The purpose of my rebuttal testimony is to explain and support the portion of the
18 Settlement Stipulation (“Settlement Agreement”), reached between Black Hills
19 Power and the South Dakota Public Utilities Commission Staff (“Staff”), that
20 pertains to corporate allocations. I also explain why the positions advanced by
21 Black Hills Industrial Intervenors’ (“BHII”) witness Mr. Lane Kollen on this
22 subject are not appropriate.

1 the adjusted customer records and collection expense included in the Settlement
2 reflects an annualized known change in allocation that went into effect on April 1,
3 2014. Second, the September 2013 through August 2014 labor costs were
4 annualized to reflect the 2014 and 2015 wage increases.

5 **Q. DOES THE UTILITY HOLDINGS ADJUSTMENT INCLUDED IN THE**
6 **SETTLEMENT AGREEMENT REFLECT CURRENT COSTS AND**
7 **KNOWN AND MEASURABLE CHANGES?**

8 A. Yes. The September 2013 through August 2014 billings from Utility Holdings are
9 actual costs that are accurate, reliable, and verifiable. The change in customer
10 records and collection expense allocation went into effect in April 2014, and has
11 been annualized by applying the allocation change to the historic department costs
12 from September 2013 through August 2014. In addition, the September 2013
13 through August 2014 labor costs have been annualized to reflect known salary
14 increases that were effective after the end of the historic test year. Accordingly,
15 the settlement adjustment reflects known and measurable changes.

16 **Q. PLEASE EXPLAIN THE ALLOCATION CHANGE TO THE CUSTOMER**
17 **RECORDS AND COLLECTION EXPENSE.**

18 A. During the historic test year, costs from the customer service call centers that serve
19 all BHC owned utilities were charged to Black Hills Power using direct and
20 allocated charges. In early 2014, Utility Holdings reviewed the call volumes and
21 call minutes from the call centers to determine if costs were being charged to the
22 appropriate companies. The expenses incurred by these call centers are primarily

1 related to the support of all utility customers. Based on the total call volume and
2 total call minutes, it was determined that the cost driver for these costs is the
3 number of customers. Therefore, the costs should be allocated based upon the
4 Customer Count Ratio. This change in allocation is annualized in the Settlement
5 Agreement.

6 **Q. MR. KOLLEN PROPOSED AS AN ALTERNATIVE TO THE SETTLED**
7 **TREATMENT OF THIS ADJUSTMENT THAT THE COMPANY ONLY**
8 **BE PERMITTED TO RECOVER THE COSTS INCURRED DURING THE**
9 **HISTORIC TEST YEAR WITH NO ADJUSTMENT. DO YOU AGREE**
10 **WITH MR. KOLLEN'S PROPOSED ADJUSTMENT TO UTILITY**
11 **HOLDINGS COSTS?**

12 A. No. Mr. Kollen's proposed adjustment is flawed because the October 2012
13 through September 2013 Utility Holdings costs do not reflect current operations
14 costs or any known and measurable increases that have occurred since the end of
15 the test year.

16 **Q. IN HIS TESTIMONY, MR. KOLLEN IS CRITICAL OF THE**
17 **INFORMATION THE COMPANY SUPPLIED TO SUPPORT**
18 **CORPORATE ALLOCATIONS. DID THE COMPANY PROVIDE**
19 **EVIDENCE OF KNOWN AND MEASURABLE CHANGES?**

20 A. Yes. The Company provided a description of some of the major cost drivers in the
21 Utility Holdings budgeted increase in the Supplemental Response to BHII Request
22 6. In the Supplemental Response to SDPUC Request 3-96 provided on October

1 22, 2014, the Company also provided the actual costs from September 2013
2 through August 2014 with supporting work papers.

3 **Q. HAVE THE EMAILS REFERENCED IN MR. KOLLEN'S DIRECT**
4 **TESTIMONY ON PAGE 39, LINES 6 – 9, BEEN PRODUCED IN**
5 **DISCOVERY?**

6 A. Yes, the Company provided the email responses to Staff's informal discovery and
7 the associated attachments in the Second Supplemental Response to SDPUC
8 Request 3-96, on January 5, 2015. The emails contained the monthly Utility
9 Holdings charges by FERC account from the general ledger for September 2013
10 through August 2014, a revised calculation of the customer records and collection
11 expense allocation annualization, and the supporting work paper for the labor
12 annualization. Notably, the information reflected in the emails is virtually
13 identical to the information that was produced in October 2014 in the
14 Supplemental Response to SDPUC Request 3-96.

15 **Q. WAS MR. KOLLEN ALSO CRITICAL OF SOME OF THE COST**
16 **INCREASES THAT ARE REFLECTED IN THE SETTLEMENT**
17 **ADJUSTMENT?**

18 A. Yes, he was critical of the cost increases to FERC Account 920, administrative
19 salaries, and to FERC account 923, outside services.

20 **Q. PLEASE EXPLAIN THE COST DRIVERS THAT INCREASED THE**
21 **UTILITY HOLDING CHARGES TO FERC ACCOUNT 920,**
22 **ADMINISTRATIVE SALARIES, FROM THE TEST YEAR.**

1 A. The increase in administrative salaries is associated with an increase in headcount
 2 at Utility Holdings and the wage annualization that is reflected in the cost update.
 3 The headcount at Utility Holdings as of 9/30/2013 was 376, and increased to 389
 4 as of 8/31/2014. The costs associated with the increased headcount were allocated
 5 consistent with the Utility Holdings Cost Allocation Manual. In addition, the
 6 update to the most recent twelve months of actual costs from October 2012
 7 through September 2013 and for the period September 2013 through August 2014
 8 contained a partial wage increase for 2013 and 2014.

9 **Q. PLEASE EXPLAIN THE CHANGE IN UTILITY HOLDING CHARGES**
 10 **TO FERC ACCOUNT 923, OUTSIDE SERVICES, FROM THE TEST**
 11 **YEAR.**

12 A. The increase in outside services appears high because the test year expense was
 13 abnormally low. Please see below for the outside service expense charged to
 14 Black Hills Power from Utility Holdings from October 2010 through August 2014.

Account	10/1/10-9/30/11	10/1/11-9/30/12	10/1/12-9/30/13	9/1/13-8/31/14
923 - Outside Services	\$337,588	\$365,339	\$270,757	\$426,566

15
 16 If the test year expense is ignored from the four year period, the expense is
 17 trending in a predictable manner and the most recent annual expense appears
 18 reasonable.

19 **Q. DO YOU AGREE WITH MR. KOLLEN'S CRITICISM OF THE**
 20 **TREATMENT OF THE COSTS IN THESE TWO FERC ACCOUNTS?**

1 A. No. As indicated above, the costs that are reflected in FERC accounts 920 and
2 923 are appropriately adjusted to the Company's most recent actual costs, which
3 are reflective of costs going forward.

4 **Q. ALSO IN HIS UTILITY HOLDINGS ADJUSTMENT TESTIMONY, MR.**
5 **KOLLEN INDICATED THAT THE STAFF REVENUE REQUIREMENT**
6 **MODEL INCLUDES AN ERROR IN ALLOCATION TO SOUTH**
7 **DAKOTA FOR TRANSMISSION LOAD DISPATCH COSTS. DOES THE**
8 **COMPANY AGREE THAT AN ERROR WAS MADE?**

9 A. Yes, please refer to the rebuttal testimony of Jon Thurber for the Company's
10 proposed treatment of the error.

11 **Q. SHOULD THE COMMISSION ADOPT THE SETTLEMENT**
12 **ADJUSTMENT FOR UTILITY HOLDINGS COSTS?**

13 A. Yes, the adjustment reflects costs and operational changes known at the time of
14 the Settlement Agreement. In addition, the inclusion of the most recent twelve
15 months of actual expenses adjusted for known and measurable changes is
16 consistent with the treatment of corporate costs included in past Commission
17 approved rate case settlements for Black Hills Power and other utilities in South
18 Dakota.

19 **IV. SERVICE COMPANY ADJUSTMENT**

20 **Q. DID BLACK HILLS POWER INCLUDE A SERVICE COMPANY**
21 **ADJUSTMENT IN ITS APPLICATION?**

1 A. No. Black Hills Power's filed position requested recovery of Service Company
2 costs that were allocated during the historic test year.

3 **Q. DID THE COMPANY SUBSEQUENTLY PROPOSE AN ADJUSTMENT**
4 **TO SERVICE COMPANY COSTS IN THIS DOCKET?**

5 A. Yes. On October 22, 2014, in its Supplemental Response to SDPUC Request 3-
6 96, the Company indicated that it would propose an adjustment in rebuttal
7 testimony for the corporate costs charged to Black Hills Power from Service
8 Company. In particular, Black Hills Power indicated it would seek to reflect the
9 actual Service Company billings from September 2013 through August 2014 for
10 all accounts except for property insurance expense. The pro forma property
11 insurance expense was separately addressed because it reflects the actual expense
12 for October 2014 through September 2015.

13 **Q. DOES THE SETTLEMENT AGREEMENT INCLUDE THIS SERVICE**
14 **COMPANY ADJUSTMENT?**

15 A. Yes. In addition, the Settlement Agreement also annualizes the Service Company
16 September 2013 through August 2014 labor costs to reflect the 2014 and 2015
17 wage increases.

18 **Q. DOES THE SERVICE COMPANY ADJUSTMENT INCLUDED IN THE**
19 **SETTLEMENT REFLECT A KNOWN AND MEASURABLE CHANGE?**

20 A. Yes. The September 2013 through August 2014 billings from Service Company
21 are actual costs that are accurate, reliable, and verifiable. The property insurance
22 for October 2014 through September 2015 was paid in October 2014, reflects the

1 property insurance for the Cheyenne Prairie Generating Station, and removes the
2 property insurance associated with Ben French, Osage, and Neil Simpson I. In
3 addition, the September 2013 through August 2014 labor costs have been
4 annualized to reflect known salary increases that were effective after the end of the
5 historic test year.

6 **Q. MR. KOLLEN PROPOSED AS AN ALTERNATIVE TO THE SETTLED**
7 **TREATMENT OF THIS ADJUSTMENT THAT THE COMPANY ONLY**
8 **BE PERMITTED TO RECOVER THE COSTS INCURRED DURING THE**
9 **HISTORIC TEST YEAR WITH NO ADJUSTMENT. DO YOU AGREE**
10 **WITH MR. KOLLEN'S PROPOSED ADJUSTMENT TO SERVICE**
11 **COMPANY COSTS?**

12 A. No. The test year Service Company costs do not reflect current operations or any
13 known and measurable increases that have occurred since the end of the test year.

14 **Q. IN HIS TESTIMONY, MR. KOLLEN IS ALSO CRITICAL OF THE**
15 **INFORMATION THE COMPANY SUPPLIED TO SUPPORT SERVICE**
16 **COMPANY COSTS. DID THE COMPANY PROVIDE ANY EVIDENCE**
17 **OF KNOWN AND MEASURABLE CHANGES?**

18 A. Yes. In the Supplemental Response to SDPUC Request 3-96, the Company
19 provided the actual costs from September 2013 through August 2014 with
20 supporting work papers.

1 **Q. HAVE THE EMAILS REFERENCED IN MR. KOLLEN'S DIRECT**
2 **TESTIMONY BEGINNING ON PAGE 40, LINE 20, THROUGH PAGE 41,**
3 **LINE 1, BEEN PRODUCED IN DISCOVERY?**

4 A. Yes. The Company provided the email responses to Staff's informal discovery
5 and the associated attachments in the Second Supplemental Response to SDPUC
6 Request 3-96, on January 5, 2015. The emails contained the monthly Service
7 Company charges by FERC account from the general ledger for September 2013
8 through August 2014, and the supporting work paper for the labor annualization.
9 Notably, the information reflected in the emails is identical to the information that
10 was produced in October 2014 in the Supplemental Response to SDPUC Request
11 3-96.

12 **Q. WAS MR. KOLLEN CRITICAL OF ANY OF THE COSTS CONTAINED**
13 **IN THE SERVICE COMPANY ADJUSTMENT?**

14 A. Yes, Mr. Kollen was critical of the cost increases to FERC Account 920,
15 administrative salaries, and to FERC account 921, office supplies and expenses.

16 **Q. PLEASE EXPLAIN THE COST DRIVERS THAT INCREASED THE**
17 **SERVICE COMPANY CHARGES IN FERC ACCOUNT 920,**
18 **ADMINISTRATIVE SALARIES, FROM THE TEST YEAR.**

19 A. The increase in administrative salaries is associated with an increase in headcount
20 at Service Company and the wage annualization that is reflected in the cost update.
21 The average headcount during the historic test year at Service Company was
22 approximately 367, and the average headcount during the September 2013 through

1 August 2014 was approximately 378. The costs associated with the increased
2 headcount were allocated consistent with the Service Company Cost Allocation
3 Manual. In addition, the update to the most recent twelve months of actual costs
4 from October 2012 through September 2013 and for the period September 2013
5 through August 2014 contained a partial wage increase for 2013 and 2014.

6 **Q. PLEASE PROVIDE AN EXPLANATION FOR THE INCREASE IN**
7 **SERVICE COMPANY CHARGES TO FERC ACCOUNT 921, OFFICE**
8 **SUPPLIES AND EXPENSES, FROM THE TEST YEAR.**

9 A. The increase in office supplies appears high because the test year expense was
10 abnormally low. Please see below for the office supplies and expenses charged to
11 Black Hills Power from Service Company from October 2010 through August
12 2014.

Account	10/1/10-9/30/11	10/1/11-9/30/12	10/1/12-9/30/13	9/1/13-8/31/14
921 - Office Supplies	2,329,590	2,213,036	2,199,768	2,456,138

13

14 Using the office supplies expense from October 2010 through September 2011 as
15 the baseline, the actual September 2013 through August 2014 expense reflects less
16 than 2% annual inflation. The most recent twelve month of office supplies
17 charged by Service Company is a reasonable reflection of costs going forward.

18 **Q. DO YOU AGREE WITH MR. KOLLEN'S CRITICISM OF THE**
19 **TREATMENT OF THE COSTS IN THESE TWO FERC ACCOUNTS?**

1 A. No. As indicated above, the costs that are reflected in FERC accounts 920 and
2 921 are appropriately adjusted to the Company's most recent actual costs, which
3 are reflective of costs going forward.

4 **Q. PLEASE EXPLAIN WHY THE COMMISSION SHOULD ADOPT THE**
5 **SERVICE COMPANY ADJUSTMENT REFLECTED IN THE**
6 **SETTLEMENT AGREEMENT.**

7 A. The most recent twelve months of actual Service Company expenses adjusted for
8 known and measurable changes reflects current costs and operational changes at
9 the time of the Settlement Agreement. In addition, the adjustment is consistent
10 with corporate cost treatment in past Commission approved rate case settlements
11 for Black Hills Power and other utilities in South Dakota.

12 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

13 A. Yes, it does.

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THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA

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IN THE MATTER OF THE APPLICATION EL14-026
OF BLACK HILLS POWER, INC., FOR
AUTHORITY TO INCREASE ITS ELECTRIC
RATES

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Transcript of Proceedings
January 27 & 28, 2015

Volume I of II
January 27, 2015
REDACTED PUBLIC TRANSCRIPT

= = = = =

BEFORE THE PUBLIC UTILITIES COMMISSION

CHRIS NELSON, CHAIRMAN
KRISTIE FIEGEN, VICE CHAIRMAN
GARY HANSON, COMMISSIONER

COMMISSION STAFF

John Smith
Karen Cremer
Greg Rislov
Tina Douglas
Katlyn Gustafson

APPEARANCES

Amy Koenig and Lee Magnuson, Black Hills Power, Inc.
Mark Moreno, Andrew Moratzka, and Chad Marriott, Industrial
Interveners
Caitlin Collier, Dakota Rural Action
Karen Cremer, Public Utilities Commission Staff

Reported By Cheri McComsey Wittler, RPR, CRR

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THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA

=====

IN THE MATTER OF THE APPLICATION EL14-026
OF BLACK HILLS POWER, INC., FOR
AUTHORITY TO INCREASE ITS ELECTRIC
RATES

=====

Transcript of Proceedings
January 27 & 28, 2015

Volume II of II
January 28, 2015
REDACTED PUBLIC TRANSCRIPT

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BEFORE THE PUBLIC UTILITIES COMMISSION

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KRISTIE FIEGEN, VICE CHAIRMAN
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TRANSCRIPT OF PROCEEDINGS, held in the
above-entitled matter, at the Joe Foss Building,
Matthews Training Center, 523 East Capitol Avenue,
Pierre, South Dakota, on the 27th day of January, 2015.

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(Joint Exhibits 1 through 6 are marked.)
(BHP Exhibits 1 through 73 are marked.)
(BHII Exhibits 1 through 4 are marked.)
(Staff Exhibit 1 is marked.)

1 6 percent.

2 A. That's correct.

3 Q. So just to be clear then, the rate mitigation
4 proposed by Black Hills Power in its initial filing for
5 the residential customers was greater than that proposed
6 for general service large?

7 A. It is greater based upon our Application, yes.

8 Q. And if I understand the Settlement correctly,
9 Mr. White, the Settlement makes a pro rata adjustment
10 from the proposed increases to account for the reduced
11 Settlement requirement?

12 A. Yes. The Rate Mitigation Plan is no class receives
13 less than 75 percent of the average increase, and no
14 class receives more than 120 percent of the average base
15 rate increase.

16 And my rebuttal testimony actually addresses
17 allocations beyond these classes. And then my statement
18 that primary beneficiaries would relate to my rebuttal
19 testimony as well.

20 Q. Mr. White, on your rebuttal testimony, Exhibit 65,
21 page 4.

22 A. I'm there.

23 Q. Line 5, it's my understanding that your testimony
24 with the Settlement Agreement will result in just and
25 reasonable rates.

1 A. Yes. I believe so.

2 Q. Later in your testimony you are suggesting, are you
3 not, that some changes to customer rates would be
4 accepted by Black Hills Power?

5 A. Yes. I believe the Commission has discretion, and
6 there's a range of just and reasonable rates that are
7 possible when you allocate the total revenue
8 requirement.

9 Q. And, Mr. White, wouldn't the flip side also be true?
10 In other words, if there's a range of rates that could be
11 considered just and reasonable by the Commission for
12 customers, then there is a range of revenue requirements
13 that could also be considered just and reasonable for the
14 company.

15 A. That's why we're here.

16 Q. Thank you, Mr. White.

17 Looking a little bit further down on lines 13 to 16
18 of page 4, Exhibit 65, I understand that you are agreeing
19 that the approval of -- if the Commission were to approve
20 the Settlement Agreement, that would not set precedent
21 for future rate cases; is that correct?

22 A. That's correct. As provided for in the Settlement
23 Agreement.

24 Q. Correct. Could I have you turn to page 8 of your
25 rebuttal testimony.

1 A. I'm there.

2 Q. And lines 20 to 22 it appears that you're referring
3 to prior rate case settlements as support for including
4 certain incentive compensation expense?

5 A. I'm indicating that there is no precedence and that
6 the parties can agree to include incentive comp and have
7 done so previously.

8 Q. But just to confirm, Mr. White, you're not saying
9 that prior case settlements have precedential value in
10 this proceeding?

11 A. I am not.

12 Q. Could I have you turn to page 12. Between lines
13 14 through 19 I understand your testimony to be that the
14 Wyoming Public Service Commission has approved
15 settlements that include 100 percent of the requested
16 incentive compensation?

17 A. Yes. And we have also had a recent decision from
18 the Colorado Commission where it was litigated, and the
19 Commission accepted 100 percent that the incentive comp
20 paid by our Colorado utility.

21 Q. And is that the decision provided for in the record
22 in this case?

23 A. It is not.

24 Q. In your testimony are you implying that the Wyoming
25 Public Service Commission has precedential value in this

1 proceeding?

2 A. I'm implying that other commissions have reviewed
3 the company's compensation practices and found them to be
4 acceptable and to be prudent.

5 Q. Have you included a copy of the Settlement referred
6 to on page 12 in the record?

7 A. I have not.

8 Q. So we have no evidence in the record to know why the
9 Office of Consumer Advocate agreed to 100 percent of
10 incentive compensation?

11 MS. KOENIG: Objection. Calls for a legal
12 conclusion.

13 MR. SMITH: I'm going to overrule it.

14 A. No. We have not provided the opinion of the
15 Office of Consumer Advocate, which was the party to the
16 Black Hills Power rate case or the Cheyenne Light rate
17 case. Nor have we provided the opinion of the
18 industrial customers that also were signatory to the
19 Cheyenne Light rate case.

20 Q. Thank you, Mr. White.

21 And just to circle back and talk about settlements,
22 the reason that settlements generally don't have
23 precedential value is because there is a give and a take
24 between the parties.

25 Is that fair?

1 (End of confidential portion of transcript.)

2 MR. SMITH: I think we're good to go,
3 Mr. Chairman.

4 CHAIRMAN NELSON: Thank you.

5 Are you the appropriate witness to talk about
6 Atlas storm damage?

7 THE WITNESS: I can talk about it generally, but
8 Mr. Thurber is also qualified.

9 CHAIRMAN NELSON: I think that will get me where
10 we need to go.

11 My recollection at the time, and it may or may
12 not be accurate, is there were some media discussions,
13 some statements made that Black Hills Power incurred 9 to
14 10 million dollars worth of storm damage.

15 Does that figure ring a bell at all of what
16 might have been thrown out at that time?

17 THE WITNESS: It's possible. There's always
18 estimates as to the work that's being done.

19 Mr. Thurber, I think, could probably specify
20 what's in the rate case.

21 CHAIRMAN NELSON: Well, my question was what
22 might have been thrown around at that particular time.
23 In the Settlement, as I understand, we're down to about
24 2.5 million.

25 Can you help me understand how we go from a

1 figure of 9 or 10 million at the time and now we're down
2 to 2.5?

3 That's a significant difference. Help me
4 understand that.

5 THE WITNESS: I think Mr. Thurber would be
6 better prepared to answer that for you, Chairman.

7 CHAIRMAN NELSON: I will save then those
8 questions for him.

9 We've spent quite a bit of time this morning
10 talking about incentive compensation. I want to talk
11 about salary just a little bit more generally.

12 A lot of the public comments that have come in
13 to us on this particular case from folks that are your
14 customers, there have been a lot of comments alleging
15 that Black Hills Power employees are paid too much.

16 And I can understand that, that some of that
17 may simply be jealousy, folks that maybe wish they had
18 Black Hills Power as their employer, as certainly a good
19 company.

20 The flip side of that might be it may be that,
21 you know, within the community these folks say, you know,
22 hey, maybe those salaries are too high.

23 And then this morning we spent a lot of time
24 talking about incentive compensation that goes on top of
25 that.

1 And so my first question is have you in any of
2 your discovery requests filed with us a list of your
3 salaries, perhaps by classification, job type, anything
4 in detail that would help us analyze really where you're
5 at with salaries?

6 THE WITNESS: I'm not recalling any, but
7 Mr. Thurber may be able to answer that question.

8 CHAIRMAN NELSON: Okay.

9 THE WITNESS: We have provided testimony that
10 talks about the documents that we use, the studies that
11 we use, the compensation philosophy of the corporation,
12 the fact that we target our compensation and benefits at
13 about the median for the industry. And so we do a
14 substantial amount of benchmarking. And the challenge is
15 many of those documents are confidential and proprietary.

16 CHAIRMAN NELSON: So how do you assure the
17 Commission then that your salaries are commensurate with
18 the industry? Is there anything in the record that would
19 help us be assured of that?

20 THE WITNESS: Well, there's our testimony. We
21 also make comparisons to other industries. But as far as
22 benchmarking in the record, nothing at this point.

23 What you'll see is a company that targets its
24 annual merit increases to the industry. We view our
25 compensation annually at the board. We maintain budgets.

1 We have to attract, hire, and motivate employees, and
2 we're successful largely in doing that but not on all
3 instances. We have difficult service territories to
4 attract people to, as I talked about in my rebuttal
5 testimony as well.

6 So our philosophy and our approach is to meet
7 our obligation to serve at basically a median
8 compensation level, which has worked successfully for us
9 in our service territory.

10 CHAIRMAN NELSON: There are several instances
11 where apparently in the Settlement there's been some
12 normalization of Worker's Comp cost and pension
13 normalization.

14 Are those questions for Mr. Thurber?

15 THE WITNESS: I could talk to the pension
16 normalization.

17 CHAIRMAN NELSON: Well, let me ask perhaps maybe
18 a more general question.

19 I mean, we take the test year pretty seriously.
20 I mean, that's what this is all based on. And yet as we
21 go through, we find these particular areas that seem to
22 be maybe cherry picked out of the expenses, a particular
23 account, and for those we decide, okay, those we're going
24 to normalize.

25 How do you decide which of those get picked

1 out as opposed to the one with the strict test year
2 number?

3 And I'll tell you I'm concerned about that
4 because I don't have a good understanding of how do we
5 decide what we cherry pick out and what we go with a
6 strict number.

7 THE WITNESS: Well, I wouldn't characterize it
8 as cherry picking.

9 CHAIRMAN NELSON: Well, explain to me why I'm
10 wrong on that characterization.

11 THE WITNESS: Yes. Businesses have certain
12 costs that are variable, depending upon the circumstances
13 that you're operating within. And so normalization
14 addresses those more variable areas.

15 And what you would do is you would look at the
16 history and look at several years and say, is there
17 volatility within this account? Is there volatility
18 within this rate base item? For example, materials and
19 supplies.

20 And then you would look to that and say we
21 should normalize this for common practice because there's
22 too much volatility within that particular expense,
23 within that particular part of the rate base.

24 For the purposes of the pension expense, it's
25 one that we see pretty high volatility. High volatility

1 driven in this case recently by two things:

2 First, we have a new actuary study. Our
3 employees are actually living longer. That increases the
4 expenses associated with the plan.

5 The second is there is an investment assumption
6 associated with the plan funds and what they're likely to
7 earn over the plan duration. Those change with changes
8 in the stock market, changes in interest rate, all
9 affected by inflation.

10 And so that's why you see quite a bit of
11 variability in the pension expense and why we saw more
12 than a million dollar increase from one year to the
13 next.

14 And Mr. Thurber can talk about the numbers more
15 specifically than I. But we agreed with Staff that
16 because of that variability, it would be appropriate to
17 normalize it on a five-year basis today, and we accepted
18 that for a five-year period all future rate cases filed
19 by the company would also recognize the five-year
20 normalization, thereby eliminating this idea of cherry
21 picking that you get it one time but you don't commit to
22 it next time.

23 We believe that's an account that has a high
24 enough volatility in it that's appropriate to
25 normalize.

1 CHAIRMAN NELSON: So how does that suggestion
2 that we're going to pick a particular account to
3 normalize come about? Is there a particular deviation
4 range that you look at or that our Staff looks at? Who
5 suggests that? Are these things that --

6 I'm assuming this happened in your settlement
7 negotiations. Is this something we can talk about in
8 public, or do we need to go into confidential?

9 Help me understand how that comes about, how
10 that comes into the settlement. And is it something you
11 propose or Staff proposes?

12 THE WITNESS: It happens both ways. And it's
13 based upon comfort level with whether or not the expense
14 represents a fair cost for inclusion in the revenue
15 requirement.

16 CHAIRMAN NELSON: So is there a particular
17 deviation level that would be your flag to let's look at
18 this, or how does that come about?

19 THE WITNESS: It's a materiality standard. So
20 it would largely depend on probably being a few hundred
21 thousand dollars difference of variability. You would
22 also look at trend lines.

23 Some of it is whether you can explain that the
24 volatility actually is recurring volatility. There's
25 some systematic situation that's happening, rather than

1 MS. CREMER: -3, Schedule 10. It's 1 of 1. And
2 the caption on it is Storm Atlas Regulatory Asset In
3 System Inspection Cost.

4 CHAIRMAN NELSON: Which page?

5 MS. CREMER: Under -- if you looked on the web
6 page under Staff's memo, it's Schedule 10, following
7 Schedule 9.

8 CHAIRMAN NELSON: I'm sorry. I was on
9 Schedule 1. That doesn't work.

10 MS. CREMER: Okay.

11 CHAIRMAN NELSON: I see the figure.

12 Mr. Thurber, I have no further questions.

13 MR. SMITH: Other Commissioner questions?

14 CHAIRMAN NELSON: I'd just like to make a
15 statement. I don't want anyone in this proceeding to
16 construe that I disapprove in any way of how your company
17 handled that storm recovery. That is not a question in
18 my mind whatsoever.

19 I think you all did a fine job in that. Simply
20 looking at some of the dollar figures.

21 COMMISSIONER FIEGEN: Mr. Thurber, in your
22 rebuttal testimony on page 16 you address an error in the
23 allocation to South Dakota for transmission load dispatch
24 cost.

25 CHAIRMAN NELSON: That's correct.

1 COMMISSIONER FIEGEN: So do you believe that the
2 Commission should correct that in the Settlement?

3 THE WITNESS: No, I do not. The reason that I
4 don't believe the Commission should correct that in the
5 Settlement is because we agreed to an overall revenue
6 requirement figure. And we came to that figure, each
7 party, with our own unique analysis.

8 During the process when errors were found the
9 company had an opportunity to negotiate differently or to
10 propose other adjustments as part of the process.

11 I think I've shown through testimony that there
12 were other costs that went up from the test year that
13 weren't adjusted that more than cover the error that has
14 been identified. So I would request that the Commission
15 not adjust the Settlement.

16 COMMISSIONER FIEGEN: So, Mr. Thurber, are you
17 talking about Wyodak?

18 MR. THURBER: Yes, I am.

19 COMMISSIONER FIEGEN: So what is the difference
20 between the Wyodak adjustment that you would possibly
21 propose if we looked at the transmission adjustment?
22 What would be the difference in that?

23 THE WITNESS: I'm just going to look to find the
24 exhibit. One moment.

25 So according to JTR-1, the South Dakota

1 pro forma adjustment would be \$412,000 to adjust the
2 Wyodak O&M costs to the most recent 12 months. Whereas
3 the transmission allocation error was approximately
4 \$280,000.

5 COMMISSIONER FIEGEN: Thank you. Just to review
6 your pension expense on page 21, you gave us five years.
7 And it certainly shows that a defined benefit is a
8 volatile type of expense. I continue to ask this
9 question of why utilities -- and I understand defined
10 benefit is a standard in utilities, but it certainly
11 isn't in the business world, why you would not go to a
12 defined contribution, which is more of a reliable or a
13 more forebudgetable expense, if that's a word -- probably
14 not -- so the ratepayers aren't always stuck if the
15 market goes down?

16 THE WITNESS: As we have -- new employees are no
17 longer eligible for the defined benefit plan, defined
18 pension plan.

19 You know, when I joined the company I'm only
20 eligible for the 401(k) plan so it's a defined
21 contribution rather than a defined benefit plan.

22 So we're taking measures to normalize that
23 expense so that it isn't as volatile in the future. So
24 new employees are no longer eligible for the pension
25 plan.

1 COMMISSIONER FIEGEN: Thank you. I did not
2 realize that or didn't read that properly. So thank you
3 for taking steps to make sure ratepayers are paying a
4 cost but not always taking the risk. I appreciate that.

5 MR. SMITH: Additional Commissioner questions?
6 Chairman Nelson.

7 CHAIRMAN NELSON: I want to follow up on
8 Commissioner Fiegen's question regarding the transmission
9 adjustment error. And I think we all understand that
10 that was an error to the tune of 280,000.

11 In my mind something that's an admitted error is
12 different than a Wyodak situation where you're looking at
13 using a different time period, not necessarily an error
14 but just using a different time period.

15 Can you understand why it would be difficult for
16 Commissioners that has a known error in it?

17 THE WITNESS: I certainly can understand. This
18 information wasn't available to us during the settlement
19 discussions. We first found out on December 30.

20 Generally speaking, when you have a settlement
21 you have a firm revenue requirement that everybody agrees
22 to that any material modifications to the settlement, you
23 know, either party can back away from the settlement.

24 I would just ask the Commission to consider that
25 if you open up the Settlement to consider an error or new

1 information, that you also consider other new information
2 that's presented to the Commission.

3 CHAIRMAN NELSON: Thank you.

4 MR. SMITH: Additional Commissioner questions?
5 I'm not seeing any.

6 So with that, I think I'll turn to Mr. Moratzka
7 so we can wind up with Black Hills on proper redirect
8 here.

9 MR. MORATZKA: Thank you. Just a moment.

10 RE CROSS-EXAMINATION

11 BY MR. MORATZKA:

12 Q. Thank you. Mr. Thurber, just a quick clarification
13 for my own understanding of the Settlement.

14 I heard you just testify in response to one of the
15 Commissioner's questions that you and Commission Staff
16 agreed to an overall revenue requirement figure. Is that
17 correct?

18 A. That's correct.

19 Q. And so am I reading into that statement correctly
20 that this Settlement is more akin to a black box than it
21 is to a line item by line item revenue adjustment?

22 A. No. It's not a black box settlement. Commission
23 Staff has a very detailed Staff memorandum that outlines
24 how they calculated the revenue requirement. The company
25 in its Settlement Stipulation that we signed said that

1 both parties may have had differing views on how we came
2 to the total revenue requirement.

3 You know, Commission Staff justifies it by line item
4 by line item, but the company's not in exact agreement in
5 how we justified getting to that number.

6 Q. And just to put a finer point on it, the line item
7 by line item adjustment that the Commission Staff has
8 contains the error regarding -- yeah. The BH Utility
9 Holdings Company allocation; correct?

10 A. That's correct.

11 MR. MORATZKA: Thank you. No further questions.

12 MR. SMITH: Ms. Collier?

13 MS. COLLIER: No questions.

14 MR. SMITH: Okay. Staff.

15 MS. CREMER: Thank you. I do have a question.

16 CROSS-EXAMINATION

17 BY MS. CREMER:

18 Q. Mr. Thurber, earlier Commissioner Nelson had asked
19 Mr. White about salary studies or possibly what Black
20 Hills had provided Staff.

21 Could you summarize that for us, please.

22 A. Sure. Commission Staff submitted multiple data
23 requests requesting information regarding our salaries.
24 For example, we provided union contracts, which
25 specifically identify wage rates by employee position.

1 We also provided over 50 salary studies provided by
2 outside consulting firms to help justify and form our
3 salary compensation practices. There was also another
4 data request that compared Black Hills Power's salaries
5 to local cooperatives in the area.

6 So Commission Staff did inquire and we produced
7 information to support our current salaries. If the
8 Commission decides necessary, we could submit those
9 responses to those data requests in this proceeding, if
10 it would like.

11 MS. CREMER: Thank you. That's all I have.

12 So I didn't know if you wanted us to put
13 something like that in. That data request and response
14 is not in the record. It is -- the one I'm looking at is
15 2-6. I'm not sure of the second one you're referring to.
16 But we could find all of that if you wanted it, but that
17 is not in the exhibits as they currently exist.

18 CHAIRMAN NELSON: I would like that. I'm
19 assuming that would be confidential or -- it would be
20 confidential, but I would have access to that to
21 consider. I would appreciate that, yes.

22 MS. CREMER: Certainly. So that will just go in
23 as Staff Exhibit 2. I can put it in. And we'll get that
24 filed by the end of the hearing -- or not today maybe but
25 by Thursday.

1 decommissioning expense that it hasn't yet incurred.

2 We don't have an issue with the net book value of
3 the plan or the obsolete inventory. Our focus is only on
4 the decommission expense. And our proposal is that the
5 recovery right now is premature. It doesn't fit within
6 South Dakota Law, the Administrative Rule that I
7 mentioned previously, and it's something that you can
8 authorize the company to defer.

9 They can come in the next case when it is known and
10 measurable, it's actually been spent, and you can
11 determine the appropriate rate recovery at that time.
12 The company is not harmed by that approach.

13 The next item is the LIDAR survey. And the
14 company's request for costs that had not been incurred
15 when it filed its case and now the settlement seeks to
16 recover the actual costs that were incurred but not
17 subject to deferral when those costs were incurred. We
18 don't believe that it is appropriate under South Dakota
19 Law, the Administrative Rule.

20 The next thing is the FutureTrack workforce and
21 other employee additions. These were absolutely not
22 supported in the company's filing, the requirement under
23 the Administrative Rule. And you can't then just move
24 ahead 12 months after the end of the historic test year
25 and say, well, we now have X number of employees and so

1 we're just going to put those costs in -- into the
2 Settlement. That doesn't comply with the rule.

3 It has to be known and measurable at the time of the
4 filing. It has to be fully supported. Neither one were
5 true.

6 And the third thing with respect to that is there's
7 no reason that the company has given that it requires
8 additional employees to do the same work that it was
9 doing in the historic test year.

10 We have the same point in the next two issues that
11 the Black Hills Utility Holding and Black Hills Service
12 Company affiliate charges. Again, the company just
13 simply put in a schedule in the filing, and these were
14 not known and measurable changes. They came out of the
15 Black Hills Utility Holding Company.

16 The company did propose adjustments. They were not
17 fully supported. They were not known and measurable with
18 reasonable certainty. And we recommend that the
19 Commission not allow those.

20 In fact, the company didn't even propose in its
21 filing a Black Hills Service Company adjustment. It came
22 in later in October of 2014 some seven months after it
23 made its filing and proposed a 1.1 million dollar
24 adjustment. There is no way that that could comply with
25 the Administrative Rule. It wasn't even in the filing,

1 and yet it shows up in the Proposed Settlement.

2 And the same thing then with the Black Hills
3 Utility Holding Company. The company said, well, our
4 actual costs from the two service companies through
5 September 30, 2014, were X and Y, and then that's what
6 appeared in the Proposed Settlement, including the
7 \$286,000 error. And we don't think any of that complies
8 with South Dakota Law.

9 And then also incentive compensation. Basically,
10 the Settlement does have some incentive compensation
11 excluded. We believe that there are additional amounts
12 tied to financial performance of the company that should
13 be excluded. And we'll go through all of that but --

14 And then pension expense, the company proposes a new
15 methodology where it takes a five-year average of the
16 years 2008 through -- I'm sorry. 2010 through 2014, even
17 though it knew what 2014 pension expense was because that
18 comes out of actuarial reports. So that not only was
19 known and measurable, it was actual at the time of the
20 company's filing.

21 Instead it just came up with a new method. I
22 described it as opportunistic simply because it was lower
23 in 2014. And I don't believe the Commission should adopt
24 the five-year average.

25 And then, finally, I'd like to talk about

1 depreciation expense. I'd like to start out by saying
2 with respect to that, that the representations by
3 Mr. Spanos are simply incorrect.

4 I did not recommend that you not provide terminal
5 net salvage in the depreciation rates. That simply is
6 wrong. I recommended that you use a negative 5 percent
7 net salvage for both interim and terminal salvage. And
8 that is the same net negative salvage rate that is
9 presently included in depreciation rates.

10 I don't believe that the company has fully supported
11 an increase to as much as a negative 28 percent. And
12 this is really only on production planned. So I first
13 wanted to clarify that Mr. Spanos's understanding of my
14 testimony or his representation of it, either one, are
15 simply incorrect.

16 And so with that -- oh. And then I have one
17 other -- two other things briefly.

18 Mr. Thurber addressed the cost of debt. And he
19 stated that I did not use the right cost of debt that
20 reflected the actual issuance of debt in 2014. I simply
21 used what was in the Proposed Settlement.

22 In other words, what I have in our quantification is
23 the same thing that the Staff or the -- in the Proposed
24 Settlement.

25 So really if, in fact, it is an error and that the

1 Q. Did you complete any physical observation of
2 Black Hills Power's plant or equipment?

3 A. No. Nor do I think one was necessary for the
4 discussion that I addressed.

5 Q. Okay.

6 MR. MAGNUSON: I'm going to move to strike his
7 answer after the word "no." It was a simple yes or no
8 question, and he's trying to get more into evidence.

9 MR. SMITH: I'll sustain that.

10 Q. You did not do a full depreciation study to justify
11 your rates; correct?

12 A. I did not. I addressed only specific issues. I
13 addressed the lifespan issue for the Cheyenne Prairie
14 Generating Station, and I addressed net negative salvage
15 on production plant. That did not require a full
16 depreciation study.

17 MR. MAGNUSON: Move to strike everything after
18 when he said he did not do a full depreciation study. If
19 he would listen to my question and answer the question, I
20 would appreciate it.

21 MR. SMITH: Okay. I'm going to overrule that.

22 Q. And, in fact, you agreed with everything in the
23 depreciation study completed by Mr. Spanos except for one
24 component; correct?

25 A. No.

1 Q. The one component you disagreed with was terminal
2 net salvage; correct?

3 A. That's correct.

4 Q. And you did not complete or submit a net salvage
5 study to support your position on terminal net salvage;
6 correct?

7 A. That's correct. I don't know how to answer it yes
8 or no. There were a couple of double negatives in there.

9 What I did was I recommended that the Commission
10 stick with the net negative 5 percent that is reflected
11 in present rates.

12 MR. MAGNUSON: And, again, I'll move to strike
13 the last part of his answer.

14 MR. SMITH: And I'm going to overrule.

15 MR. MAGNUSON: No further questions for this
16 witness.

17 MR. SMITH: Ms. Collier.

18 MS. COLLIER: I do have a couple of questions,
19 if you'll bear with me, though, with my notes.

20 CROSS-EXAMINATION

21 BY MS. COLLIER:

22 Q. Mr. Kollen, I believe that you testified and were
23 allowed to testify as to a brief history of Black Hills
24 Power rate increases. Did you -- and you laid out ones
25 for 2006, 2009, and 2012.

1 Excepting the current rate increase, do you know
2 what those other three totalled?

3 A. Quite frankly, not sitting here. Somebody else has
4 my opening statement where I had that information.

5 THE WITNESS: Oh, thanks.

6 A. It's about 30 percent, just for the three.

7 Q. And so the rate increase that's at issue would be on
8 top of that?

9 A. That's right. Bring it up to about 40 percent.

10 Q. I believe that -- I wanted to ask you a
11 clarification question from your testimony regarding the
12 incentive compensation. And you, if I understood it
13 correctly, referred to BHP -- I believe it was
14 Black Hills Power coming up with a new methodology for
15 expenses in that area; is that correct?

16 A. That would be pension expense. And the company
17 proposed a five-year average rather than the 2014 actual
18 known and measurable at the time of its filing. It's a
19 new methodology.

20 Q. So when you say it's a "new methodology" is it one
21 that's simply new to you or new to, I guess, the field in
22 which we're talking about?

23 A. New to Black Hills Power. And in prior cases my
24 understanding is that the company has used the test year
25 amount rather than a five-year average. There may have

1 been pro forma adjustments to the test year amount, but
2 the methodology using a five-year average is new. That's
3 a new proposal.

4 MS. COLLIER: Thank you.

5 MR. SMITH: Staff.

6 MS. CREMER: Thank you.

7 CROSS-EXAMINATION

8 BY MS. CREMER:

9 Q. Good afternoon. And I was -- maybe I didn't catch
10 it.

11 What did you say the total increase was over the
12 rate increases? What was the number you used?

13 A. I think it was 30 percent. Just looking at these
14 9 and a half -- oh, I'm sorry. I double counted one.

15 8 percent on the 2006 case, 12.7. So that would
16 make it 21. And then another 6. So it was about 27 or
17 28 percent.

18 Q. Okay. Thank you.

19 And I want to talk about those for a moment. In
20 2006 what was Black Hills Industrial Interveners -- what
21 was their increase that year?

22 A. I don't know.

23 Q. Would you agree with me that it was considerably
24 less than everybody else's?

25 A. I don't know.

1 Q. And what about 2009? What was Black Hills
2 Industrial Interveners' increase that year?

3 A. I don't know.

4 Q. Then I might as well ask you. What about 2012?

5 A. I don't know that either.

6 Q. And so subject to check would you agree with me that
7 in each of those rate increases the Black Hills
8 Industrial Interveners' rate increase was considerably
9 less because they reached settlement with Black Hills
10 Power than everybody else?

11 MR. MORATZKA: Objection. That actually
12 mischaracterizes the Settlement Agreements. And if we're
13 going to bring those up, then we should, you know -- we
14 have confidential versions.

15 I don't think they go in through this witness
16 because there's no foundation.

17 MS. CREMER: Well, he brought them up.

18 MR. MORATZKA: No. These are the public
19 settlements. The private settlements with Black Hills
20 Power are not part of the record and not something that
21 Mr. Kollen has.

22 MS. CREMER: Okay. You know, I guess I
23 misinterpreted what he was trying to tell us.

24 I'll move on.

25 Q. Did you add up all of the data requests that just

1 MR. SMITH: I'm going to call the hearing back
2 to order after we went into recess last evening. Where
3 we ended was at the conclusion of Mr. Kollen's testimony
4 and a Motion by Mr. Magnuson.

5 And to begin with, I don't know, do
6 Commissioners want to weigh in at all on the Motion
7 before I make a ruling that I'm going to make, or should
8 I just make it and then you can react to it?

9 COMMISSIONER HANSON: I say make it.

10 MR. SMITH: I am going to deny the Motion. I
11 read through everything, and I do not see anything in
12 there that, in my opinion, rises to the level of offering
13 legal testimony, a legal opinion.

14 He offers an interpretation of that rule. He's
15 a rate analyst. To me, rate analysts have to look at the
16 rule and attempt to comply with it. And I think that's
17 what I see in there. And is his interpretation maybe
18 different than some other people's? So be it.

19 But that's my ruling, and you Commissioners can
20 either accept it or reject it.

21 CHAIRMAN NELSON: I would support the ruling and
22 your conclusions.

23 COMMISSIONER HANSON: If I don't accept it, then
24 I'll voice that when you make it. So without voicing it
25 means that I support it.

1 The law is the law here in South Dakota. We have
2 to recognize changes that are known and measurable up to
3 24 months beyond the end of the test year. But the
4 Commission Staff is very careful to identify any of those
5 changes that have a revenue aspect to it. And those
6 changes the Staff considers are not reasonably known and
7 measurable and have been excluded from the Staff's
8 proposed revenue requirement in this case and ultimately
9 excluded in the Settlement Stipulation.

10 So I don't think it's unfair, the treatment that the
11 Staff is afforded posttest year changes, given the
12 24-month rule in South Dakota.

13 Q. Thank you, Mr. Peterson.

14 Just to clarify, you would agree that according to
15 the rule, that any adjustments would have to be known and
16 measurable at the time the company filed its case;
17 correct?

18 A. No. I wouldn't agree with that, no.

19 Q. And could you point me to the spot in the rule that
20 would support that interpretation?

21 A. Yeah. Unfortunately, the rule was written by
22 legislators or legislative research assistants, not by
23 rate consultants or utility analysts.

24 It says at the time of the filing. The term "the
25 filing" is not defined. There are many filings within a

1 rate case. There's the application and initial direct
2 testimony of the company.

3 If the drafters of this rule intended it to be at
4 the time of the application, the word would be
5 application, not filing.

6 The Interveners filed testimony. The Staff filed
7 testimony. You're asking for permission to file
8 posthearing briefs. Like I said, there are many filings
9 in the case, and the term is simply not defined in the
10 rule.

11 So the Commission Staff has interpreted it that the
12 adjustments have to be sufficiently known and measurable
13 at the time of their review within the filings of the
14 case.

15 Q. Thank you, Mr. Peterson.

16 You would agree, wouldn't you, that the word
17 "filing" is used multiple times in 20:10:13:44, would you
18 not?

19 A. Yes.

20 Q. Thank you.

21 Briefly, Mr. Peterson, could I have you turn to
22 page 19 of your testimony?

23 A. Yes. I'm there.

24 Q. And you would agree that -- or at least as I
25 understand your testimony, you agree that Mr. Kollen

1 properly identified -- or correctly identified an error
2 in certain Black Hills Utility Holding Company figures
3 that were allocated to the South Dakota retail
4 jurisdiction under the Settlement?

5 A. Yes. That's correct.

6 Q. In other words then, the revenue requirement as set
7 forth in the Proposed Settlement includes \$286,000 that
8 the customers of -- or at least per Black Hills Power's
9 books, will not be paying?

10 A. I'm not sure that I would go that far. We believe
11 that the end result of the -- of the Settlement is --
12 results in just and reasonable rates, and it reasonably
13 reflects the cost that the company will incur going
14 forward.

15 There were a number of issues with which the Staff
16 and the company disagree on. The Staff's resolution of
17 those issues are stated in the Settlement Memorandum, but
18 the company had its own basis for settling certain
19 issues which were either advantageous or adverse to the
20 company.

21 We did not -- we don't see the company's analysis of
22 that. But the end result, we believe, was just and
23 reasonable rates and reasonably reflects the cost that
24 the company expects to incur going forward.

25 Q. Thank you, Mr. Peterson.

1 Could I have you turn to page 6 of your rebuttal
2 testimony.

3 A. I'm there.

4 Q. And it's my understanding that your testimony is
5 that the Settlement is not a black box; is that correct?

6 A. From Staff's point of view it's not. The company
7 had to analyze the Staff's offer using whatever methods
8 they wished.

9 You know, we weren't privy to those discussions that
10 the company held within itself. But from Staff's point
11 of view, it is not a black box. And in all the terms --
12 or the resolution of each issue it's set forth in the
13 Staff's memorandum.

14 And that's really Staff's position.

15 Q. Thank you, Mr. Peterson.

16 But just to confirm, that analysis contains an
17 error.

18 A. Yes, it does.

19 MR. MORATZKA: Thank you.

20 No further questions.

21 MR. SMITH: Ms. Collier?

22 MS. COLLIER: No questions.

23 MR. SMITH: Okay.

24 Commissioners.

25 CHAIRMAN NELSON: Yes.

1 Mr. Peterson, this is Commissioner Nelson.

2 Several questions.

3 You have listened to the past day's worth of
4 questions, and several times I've questioned this concept
5 of the five-year normalization. We're seeing that with
6 pension expenses, and I think we also see it with some
7 Worker's Comp costs. And in both of those cases those
8 normalizations benefit the company.

9 How do you know that there may not be other
10 five-year normalization opportunities that would benefit
11 ratepayers?

12 What is your analysis process to determine if
13 those opportunities are there and take advantage of
14 those?

15 THE WITNESS: Yeah. First of all, one is to
16 make it clear that the company itself isn't the primary
17 beneficiary or the only beneficiary of this normalization
18 adjustment.

19 The expense, the pension expense in particular
20 that is reflected in the Settlement Agreement, reflects
21 nearly a -- or over a \$500,000 reduction in expense from
22 the test year level.

23 But as far as are there other opportunities
24 for -- for normalization that may cut in the opposite
25 direction? Yeah. There's always that possibility in any

1 rate case.

2 In fact, in nearly all the rate cases that I do
3 for myself, you know, that's one of the analyses I
4 perform is essentially the same thing that was shown on
5 Table 1 of page 16 of my testimony.

6 I usually ask the utility for five years worth
7 of detailed O&M expenses by account, and I do a variance
8 analysis to identify abnormalities in the test year. And
9 that's part of any rate case review.

10 CHAIRMAN NELSON: Thank you. I appreciate
11 knowing that.

12 Let me visit just a minute about Staff's memo
13 comment on weather normalization. Now if I'm
14 understanding this correctly, BHP did a weather
15 normalization adjustment and came up with a reduction
16 figure of 644,000. And Staff did their analysis and only
17 came up with a reduction of 264,000.

18 Would we have been better off if Staff had not
19 done that analysis?

20 THE WITNESS: No. That's just the opposite.
21 The company reduced its test year revenues by 644,000 in
22 their adjustment. We reduced it by -- or the Staff
23 reduced it by only 264,000. So the test year -- the
24 going forward, the pro forma revenues under Staff's
25 revenue requirement analysis, showed a higher revenue

1 at existing rates, therefore, a lower revenue
2 deficiency.

3 CHAIRMAN NELSON: Thank you. I see where my
4 thinking was in error on that, and I appreciate your
5 pointing that out.

6 I think the only other question I've got, and
7 this goes back to one of Mr. Moratzka's last questions
8 dealing with page 19 of your testimony where we've got
9 this acknowledged error, would you agree that it would be
10 difficult for a Commissioner to approve a settlement that
11 has a known error?

12 THE WITNESS: Yeah. I could see where it places
13 the Commission in an awkward position. And I can also
14 state that had the Staff been aware of this error during
15 settlement negotiations, it would have been corrected.

16 CHAIRMAN NELSON: Thank you.

17 No further questions.

18 MR. SMITH: Commissioner Fiegen.

19 COMMISSIONER FIEGEN: Mr. Peterson, one
20 question on your direct testimony that you provided for
21 January 15, I believe it was filed.

22 On page 17 of 30 you talk about incentive
23 compensation. And the Commission Staff ever since I've
24 seen them work on rate cases and what I get to see anyway
25 is they've been pretty hard on performance based on

1 financial and they have taken that always out of
2 incentive compensation and they continue to do it again.

3 But in your testimony I can't quite tell. Could
4 you kind of rephrase it for me because it kind of looks
5 like you agree with Mr. Kollen on some of the
6 characteristics that he has put in his direct testimony.

7 THE WITNESS: Yes. And I think your assessment
8 or understanding of my testimony is probably correct.

9 The Staff raised issues with the incentive
10 compensation plan the company had and the payments made
11 under the plan.

12 But in the end through these settlement
13 discussions we agreed to exclude the 666,000 related
14 specifically to financial performance. And this is the
15 way that the issue has been treated for Black Hills on
16 prior settlements and for all other utilities in the
17 state on prior settlements.

18 But yeah. I have concerns about every utility's
19 incentive compensation plan, not just Black Hills.

20 COMMISSIONER FIEGEN: Hello.

21 I have a different mic. I now have Ms. Cremer's
22 mic., and it's a little tricky to run over here.

23 I still don't understand your testimony, though,
24 on your concerns that you have with incentive pay. And
25 you've agreed with the Staff Settlement, yet you still

1 have some concerns, and I don't -- I just can't quite
2 understand it.

3 I've read it a couple of times, and I'm still
4 not getting what you're trying to let me know.

5 THE WITNESS: Well, I'll try to say it again.
6 I'm very critical of many incentive compensation plans.
7 And I will say that Black Hills' incentive compensation
8 plan is much different than most or many other
9 utilities.

10 Most utilities I have seen have financial
11 triggers in their incentive compensation plan. Those
12 financial triggers work to -- the employees are only
13 compensated if corporate financial goals are met first.
14 In other words, if the stockholders get paid first, and
15 if the workers achieve their performance or safety or
16 customer satisfaction goal, then they'll get their
17 incentive compensation if certain corporate financial
18 targets are met.

19 Black Hills doesn't have those triggers in their
20 plan. If customer safety goals are met, the employees
21 eligible will receive their incentive compensation
22 regardless of the company's earnings, even if they have
23 negative earnings.

24 So I applaud Black Hills for having a plan like
25 that. But there are things like service, supplemental

1 and executive retirement programs that grant additional
2 incentive compensation to a very few people that are --
3 that are -- by definition, exceed the plans that abide to
4 the general body of eligible employees. I'm critical of
5 those types of plans.

6 So I have a lot of questions and concerns about
7 incentive compensation plans, but in the end the
8 trade-offs in the negotiations involving this issue and
9 other issues, that Staff felt it best to go back to the
10 way that we've treated incentive compensation for all of
11 the utilities and for this utility in prior settlements
12 and include just those related specifically to achieving
13 financial performance goals.

14 COMMISSIONER FIEGEN: Thank you, Mr. Peterson.
15 Now I understand that you were talking about the utility
16 history in general.

17 Thank you.

18 MR. SMITH: Additional Commissioner questions.

19 CHAIRMAN NELSON: Commissioner Nelson again. I
20 want to follow up on that. And you talked about -- I'm
21 focused on the figure that -- I'm not sure if it's
22 confidential or not, but the figure we talked about
23 yesterday dealing with restrictive stock.

24 You just mentioned a trade-off. What did the
25 company trade off to get that?

1 THE WITNESS: Well, I think there were a number
2 of trade-offs. We didn't -- like I say, we don't know
3 exactly what induced Black Hills to accept any of these
4 adjustments that the Staff proposes but we do know that
5 we got a two-year rate moratorium and we got what we
6 believe is a reasonable award on return on equity.

7 We think we have a fair apportionment of the
8 increases to the rate classes. You know, I think there
9 are a number of benefits to not only residential
10 customers but to the Industrial customers also.

11 CHAIRMAN NELSON: Thank you. But I've got to
12 just ask a couple of other questions on a couple other
13 issues.

14 Yesterday we spent some time talking about the
15 FutureTrack program.

16 Do you believe the settlement legitimately
17 covers the Industrial Interveners' concerns with that
18 program?

19 THE WITNESS: Yes. I think it should. The
20 Staff did not accept the FutureTrack program the company
21 proposed.

22 What we did agree to in place of that is to
23 reflect the actual cost of employees actually hired. Not
24 to a target level of employees that they haven't hired or
25 intend to hire at some point in the future but to reflect

1 the actual cost of employees that have actually been
2 hired.

3 And in addition we also insisted that the cost
4 of those employees be split between operating expenses
5 and capitalize that, activities, so that today's
6 ratepayers aren't excessively burdened with costs that
7 appropriately should have been capitalized.

8 That too is a difference between the Settlement
9 position and the workforce plan as filed.

10 CHAIRMAN NELSON: No further questions.

11 MR. SMITH: Commissioner Fiegen.

12 COMMISSIONER FIEGEN: So this is really our last
13 opportunity to ask about the Settlement document also?
14 Because I have questions a little bit about the
15 Settlement, but I better start asking; right?

16 Okay. So, Mr. Peterson, you're still on.

17 THE WITNESS: Okay.

18 COMMISSIONER FIEGEN: We certainly appreciate
19 the Settlement and especially the two-year moratorium.
20 But I'm just about wondering -- and, of course, I'm a --
21 I'm just wondering, Black Hills for the past several
22 years has been in an expansion mode of generation. So
23 their rates have been certainly -- and they're expensive.
24 Has certainly been different than the utilities across
25 the state that aren't building generation.

1 But they stated yesterday that they are kind of
2 done with expansion of generation. So a two-year
3 moratorium shouldn't be as hard as it was a few years ago
4 when they were in the expansion mode, and the Settlement
5 could have even extended that two-year moratorium because
6 of the generation expansion being done.

7 Would you agree with that, Mr. Peterson, that
8 that could have been looked at?

9 THE WITNESS: I will say that it certainly was
10 looked at. But generation expansion isn't the only
11 expansion that a utility has to deal with.

12 More and more people are requiring greater and
13 greater reliability of the distribution system, and
14 that's causing many utilities, including Black Hills
15 Power, to upgrade its distribution facilities.

16 And the trade-offs for a longer moratorium
17 probably would have meant a much greater rate increase to
18 make sure that the rate awards would cover necessary
19 distribution expansion projects.

20 So it's not just the ability to ask for a
21 two-year versus three-year, four-year moratorium. Each
22 one of those years comes at a different cost. And I
23 can virtually guarantee that you wouldn't have the
24 6.9 percent -- or 6.9 million dollar revenue increase if
25 there was a three or four-year rate moratorium.

1 COMMISSIONER FIEGEN: Thank you.

2 MR. SMITH: Any additional Commissioner
3 questions?

4 Or, Greg, do you have any?

5 Okay. I'm going to give them the -- I give them
6 another opportunity, Karen, after Commissioner questions.

7 So, Mr. Magnuson, anything?

8 MR. MAGNUSON: Thank you. I have no further
9 questions.

10 Thanks.

11 MR. SMITH: Okay. Mr. Moratzka?

12 MR. MORATZKA: No further questions.

13 Thank you.

14 MR. SMITH: Ms. Collier?

15 MS. COLLIER: No further questions.

16 Thank you.

17 MR. SMITH: Okay. And Staff?

18 MS. CREMER: Staff does not have anything.

19 Thank you.

20 MR. SMITH: Okay. I guess, Mr. Peterson, you
21 may step down. All right. Thank you.

22 (The witness is excused.)

23 MR. SMITH: Is that it for Staff's case?

24 Correct?

25 MS. CREMER: Yes. Except Commissioner Nelson