

STATE OF SOUTH DAKOTA)
)
COUNTY OF HUGHES)

IN CIRCUIT COURT

SIXTH JUDICIAL CIRCUIT

IN THE MATTER OF THE)
APPLICATION OF BLACK HILLS)
INC. FOR AUTHORITY TO INCREASE)
ITS ELECTRIC RATES)

PUBLIC UTILITIES COMMISSION
APPELLEE'S BRIEF
32CIV15-146

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PRELIMINARY STATEMENT

The Appellant, GCC Dacotah, Inc., Pete Lien & Sons, Inc., Rushmore Forest Products, Inc., Spearfish Forest Products, Inc., Rapid City Regional Hospital, Inc., and Wharf Resources (U.S.A.), Inc., will be referred to collectively as "BHII." The Appellee, the South Dakota Public Utilities Commission, will be referred to as the "Commission." The Appellee, Black Hills Power, Inc., will be referred to as "BHP." The Appendix of the Commission as filed with this Court will be referred to as "A" with reference to the appropriate page number(s). Cites to "AR" followed by the appropriate page number(s) refer to the chronological Administrative Record. The transcript of the administrative hearing held before the Commission on January 27-28, 2015, will be referred to as "TR" followed by the page number(s). The Appellant's brief will be referred to as "BHII Br." followed by the page number(s). Attached as an appendix to the brief are Joint Motion for Approval of Settlement Stipulation, Settlement Stipulation, Staff Memorandum Regarding Settlement Stipulation, Amended Settlement Stipulation, Staff Memorandum Regarding Amended Settlement Stipulation, Evidentiary Hearing - Staff Exhibit 1, Evidentiary Hearing - Staff Exhibit 2, Excerpts of Evidentiary Hearing Transcript, January 27 & 28, 2015, Final Decision and Order; Notice of Entry with Appendix A, Order for and Notice of Hearing on Petition for Reconsideration, and Order Denying Rehearing and Reconsideration.

JURISDICTIONAL STATEMENT

BHII appealed to this Court from the Commission's Final Decision and Order; Notice of Entry in Docket EL14-026, issued April 17, 2015, which was affirmed in the Order Denying Rehearing and Reconsideration, issued May 29, 2015. This appeal is taken pursuant to SDCL 1-26-30 and 1-26-30.2.

STATEMENT OF ISSUES

- A. WHETHER THE COMMISSION CORRECTLY INTERPRETED ITS RATEMAKING STATUTES AND RULES PERMITTING ADJUSTMENTS TO A UTILITY'S COST OF SERVICE ANALYSIS THAT ARE KNOWN WITH REASONABLE CERTAINTY AND MEASURABLE WITH REASONABLE ACCURACY.**

The Commission held in the affirmative.

- B. WHETHER THE COMMISSION'S DECISION TO ACCEPT THE NORMALIZATION OF THE FIVE-YEAR AVERAGE PENSION EXPENSE IS PERMISSIBLE UNDER THE RATEMAKING STATUTES AND RULES.**

The Commission held in the affirmative.

- C. WHETHER ACCEPTANCE OF A UTILITY'S INCENTIVE COMPENSATION PACKAGE AS A PART OF A SETTLEMENT AGREEMENT IS PERMISSIBLE UNDER THE RATEMAKING STATUTES AND RULES.**

The Commission held in the affirmative.

STATEMENT OF THE CASE

As part of its regulatory obligations under SDCL 49-34A, the South Dakota Public Utilities Commission is tasked with the responsibility of determining just and reasonable rates for the six investor-owned utility companies that provide electric service to specific geographic areas in South Dakota. Black Hills Power, Inc. sought permission to increase its electric rates for each of its customer classes. On June 26, 2014, the Commission issued an Order Granting Intervention, granting intervention to Black Hills Industrial Intervenors and Dakota Rural Action. On December 9, 2014, BHP and Commission Staff jointly filed a Joint Motion for Approval of Settlement Stipulation, Settlement Stipulation and Exhibits (Original Settlement). Black Hills Industrial Intervenors and Dakota Rural Action did not join in the Original Settlement.

The hearing on the Joint Motion for Approval of Settlement Stipulation was held on January 27-28, 2015. At the close of the hearing, the Commission took the matter under advisement. On February 10, 2015, Black Hills Power and Commission Staff filed an Amended Settlement Stipulation. On April 17, 2015, the Commission entered its Final Decision and Order; Notice of Entry that granted approval to the Amended Settlement Stipulation. Thereafter Black Hills Industrial Intervenors filed a Petition for Rehearing and Reconsideration. On May 11, 2015, Black Hills Industrial Intervenors filed an Amended Petition for Rehearing and Reconsideration, and the Commission issued an Order for and Notice of Hearing on the Petition for Reconsideration. On May 26, 2015, the Commission considered the Amended Petition for Rehearing and Reconsideration. On May 29, 2015, the Commission issued its Order Denying Rehearing and Reconsideration. Black Hills Industrial Intervenors appealed the Commission's decision. Dakota Rural Action did not file a notice of appeal.

STATEMENT OF THE FACTS

On March 31, 2014, Black Hills Power, Inc. (BHP) filed with the South Dakota Public Utilities Commission (Commission) an Application for Authority to Increase Electric Rates (Application) and supporting exhibits requesting approval to increase rates for electric service to customers in its South Dakota service territory by approximately \$14.6 million annually or approximately 9.27% based on BHP's test year ending September 30, 2013. The Application included an extensive, detailed set of schedules and pre-filed testimony in support of the proposed rates. The Application stated that a typical residential electric customer using 650 kWh per month would see an increase of \$10.91 per month. The proposed changes would affect approximately 65,500 customers in BHP's South Dakota service territory. The Application requested an effective date of October 1, 2014, for the proposed rate increase which was the

anticipated start-up date for BHP's Cheyenne Prairie Generating Station, then under construction, and coinciding with the 180 day limitation on suspension of a requested rate increase pursuant to SDCL 49-34A-14. AR 36-1724.

On April 11, 2014, BHP filed revised Exhibits A, B, C, and D. AR 1786-1807. On June 6, 2014, GCC Dacotah, Inc., Pete Lien & Sons, Inc., Rushmore Forest Products, Inc., Spearfish Forest Products, Inc., Rapid City Regional Hospital, Inc., and Wharf Resources (U.S.A.), Inc. (collectively, BHII) and Dakota Rural Action, Inc. (DRA) each filed a Petition to Intervene. On June 26, 2014, the Commission issued an Order Granting Intervention, granting intervention to BHII and DRA, subject to the condition that DRA file an affidavit attesting to the members of DRA who were then current customers of BHP.

On September 3, 2014, BHP filed a Notice of Intent to Implement Interim Rates advising the Commission and the public of BHP's intent to implement its requested rate increase as of October 1, 2014. On December 9, 2014, BHP and Commission Staff (Staff) jointly filed a Joint Motion for Approval of Settlement Stipulation, Settlement Stipulation, and Exhibits (Settlement Stipulation). AR 2380-2471. On December 30, 2014, the Commission issued an Order for and Notice of Hearing setting this matter for hearing on January 27-29, 2015.

The hearing was held as scheduled on January 27 and 28, 2015. The issues at the hearing were: (i) shall the Commission grant the Joint Motion for Approval of Settlement Stipulation and approve the Settlement Stipulation as just and reasonable and as its decision in this matter, including the approval of the contract with deviations between BHP and SDSTA? or (ii) what rates, terms, and conditions shall the Commission approve as just and reasonable? At the close of the hearing, the Commission took the matter under advisement. On February 10, 2015, BHP and Staff filed an Amended Settlement Stipulation between BHP and Staff reflecting two changes to

the factual bases supporting the agreed upon revenue requirement due to new information contained in pre-filed testimony filed after the Original Settlement was entered into and filed as evidence introduced at the hearing. The first change corrected an error in the South Dakota jurisdictional allocation of transmission load dispatch expense, FERC Account 561, for the Black Hills Utility Holdings (BHUH) intercompany charges adjustment, reducing the revenue requirement by \$286,041. The second change reflected in the Amended Settlement Stipulation accepted the \$412,988 Wyodak operations and maintenance (O&M) adjustment as provided by BHP in BHP Exhibit 71. This adjustment updated production O&M costs at the Wyodak power plant from \$3,045,652 incurred during the test year to \$3,458,640 incurred from October 2013 through September 2014. This represented a known and measurable increase to test year expense. AR 6473-6495. On February 10, 2014, Staff filed a Staff Memorandum Supporting Amended Settlement Stipulation. AR 6496-6516.

On February 23, 2015, BHP and Staff filed a Joint Motion for Approval of Amended Settlement Stipulation. AR 7506-7509. On March 2, 2015, after questions by Commissioners of the parties, the Commission voted unanimously to grant the joint motion for approval of amended settlement stipulation between BHP and Staff and approve the terms and conditions stipulated therein as the decision of the Commission on the rate increase requested by BHP with an effective date of April 1, 2015. On April 17, 2015, the Commission issued its Final Decision. AR 7714-7735. Thereafter BHII filed a Petition for Rehearing and Reconsideration. On May 11, 2015, BHII filed an Amended Petition for Rehearing and Reconsideration that was affirmed in the Order Denying Rehearing and Reconsideration, issued May 29, 2015. AR 7796-7815.

ARGUMENT

Standard of Review

The standard of review for administrative appeals is set by SDCL 1-26-36. Questions of fact are reviewed under the standard of “clearly erroneous.” *Sopko v. C & R Transfer Co., Inc.* 1998 SD 8, ¶ 7, 575 N.W.2d 225, 228-229. The Court is to give great weight to findings and inferences of an agency on fact issues. *Id.* Factual findings are reviewed under the clearly erroneous standard, while conclusions of law are reviewed de novo. *In re Otter Tail Power Co. ex rel. Big Stone II*, 2008 SD 5, ¶ 26, 744 N.W.2d 594, 602. “A reviewing court must consider the evidence in its totality and set the [PUC’s] findings aside if the court is definitely and firmly convinced a mistake has been made.” *Id.* (citing *Sopko*). Mixed questions of fact and law that require the Court to apply a legal standard are reviewed de novo. *Permann v. Department of Labor*, 411 N.W.2d 113, 119 (S.D. 1987).

A court must sustain any findings supported by substantial evidence. *Abild v. Gateway 2000, Inc.*, 1996 S.D. 50, ¶ 6, 547 N.W.2d 556, 558. (“The question is not whether there is substantial evidence contrary to the findings, but whether there is substantial evidence to support them.”) On factual issues, courts “give great weight to the findings and inferences” made by the Commission. *Woodcock v. City of Preston*, 2005 SD 95, ¶ 8, 704 N.W.2d 32, 34. This Court cannot substitute its view of the evidence for the Commission’s view. *City of Brookings v. Dep’t of Environmental Protection*, 274 N.W.2d 887, 890 (S.D. 1979). In *In re West River Electric Ass’n, Inc.*, 2004 S.D.11, ¶ 25, 675 N.W.2d 222, 229-30, the South Dakota Supreme Court recognized the Commission is an administrative agency with expertise. As such, courts “give ‘appropriate deference to PUC’s expertise and special knowledge in the field of electric utilities.’” *Id.* (quoting *In re Northern States Power Co.*, 489 N.W.2d 365, 370 (S.D. 1992)).

A. THE COMMISSION CORRECTLY INTERPRETED ITS RATEMAKING STATUTES AND RULES PERMITTING ADJUSTMENTS TO A UTILITY'S COST OF SERVICE ANALYSIS THAT ARE KNOWN WITH REASONABLE CERTAINTY AND MEASURABLE WITH REASONABLE ACCURACY.

BHII argues that the Commission should have rejected the Amended Settlement Stipulation because certain pre-filing adjustments in BHP's Application were not "fully supported" and because certain post-filing adjustments were not "known with reasonable certainty and measurable with reasonable accuracy" at the time BHP filed its Application. BHII's argument should be rejected. Substantial and sufficient evidence was offered at the hearing and the Commission's interpretation of its statutes and rules are well grounded allowing it to determine new rates that were just and reasonable.

1. The Commission's Final Decision Allowing Adjustments to a Utility's Cost of Service Was Permissible under Its Long-Standing Policy of Ratemaking.

The Commission's long-standing interpretation of ARSD 20:10:13:44 read together with SDCL 49-34A-19, permits the consideration of cost of service evidence that becomes known and measurable during the twenty-four month period following the last month of the test year. Such an interpretation is not inconsistent with the phrase "at the time of the filing", as found in ARSD 20:10:13:44, due to the voluminous filings made during the pendency of a rate case. The interpretation results in the most accurate basis for utility rates, thus minimizing the need for an immediate or near term filing by the utility of a follow-on rate case to recover such costs.

Here, after hearing the evidence, the Commission specifically found by preponderance of the evidence that BHP met its burden of proving that the underlying costs of its new rates were prudent, efficient, and economical, and reasonable and necessary to provide service. The Commission thus followed the law and granted the Joint Motion for Approval of the Amended

Settlement Stipulation which included interpreting that SDCL 49-34A-19 and ARSD

20:10:13:44 allow adjustments up to 24 months following the test year.

BHII acknowledges that ARSD 20:10:13:44 permits adjustments to a utility's book costs provided the adjustments are fully supported and are known with reasonable certainty and measurable with reasonable accuracy. BHII goes on to argue however, that the adjustments to the cost of service must be known with reasonable certainty and measurable with reasonable accuracy at the time the utility files its application for a rate increase. (BHII's Br. at p. 7). BHII's argument should be rejected. ARSD 20:10:13:44 does not contain the words "files its application." Rather the rule states, in part, "[N]o adjustments shall be permitted unless they are based on changes in facilities, operations, or costs which are known with reasonable certainty and measurable with reasonable accuracy at the time of the filing and which will become effective within 24 months of the last month of the test period used for this section and unless expected changes in revenue are also shown for the same period." For decades this sentence has been interpreted to mean that the adjustments have to be sufficiently known and measurable at the time the utility files the information for Staff review in support of the adjustments. Contrary to BHII's argument, the term "filing" is not restricted in time to the date the application is filed with the Commission.

2. The Legal Standard for Utility Rates Is that the Rates Must Be Just and Reasonable.

BHII initially argues the Amended Settlement Stipulation contained adjustments to BHP's 12-month test period that were not fully supported at the time BHP filed its Application. This argument ignores the substantial and sufficient evidence that was offered at the hearing as well as decades of Commission interpretation of its statutes and rules that it must follow in order to determine a rate that is just and reasonable. BHII also ignores the plain language of ARSD

20:10:13:44 as it does not have a requirement that the adjustment be fully supported when the application is filed.

The legal standard for utility rate changes is that the new rates must be just and reasonable. SDCL 49-34A-6 provides as follows:

Every rate made, demanded or received by any public utility shall be just and reasonable. Every unjust or unreasonable rate shall be prohibited. The Public Utilities Commission is hereby authorized, empowered and directed to regulate all rates, fees and charges for the public utility service of all public utilities, including penalty for late payments, to the end that the public shall pay only just and reasonable rates for service rendered.

The Commission's statutory mandate for setting rates that are just and reasonable is more specifically delineated in SDCL 49-34A-8:

The commission, in the exercise of its power under this chapter to determine just and reasonable rates for public utilities, shall give due consideration to the public need for adequate, efficient, economical, and reasonable service and to the need of the public utility for revenues sufficient to enable it to meet its total current cost of furnishing such service, including taxes and interest, and including adequate provision for depreciation of its utility property used and necessary in rendering service to the public, and to earn a fair and reasonable return upon the value of its property.

In *South Dakota Public Utilities v. Otter Tail*, 291 N.W.2d, 291, 294 (SD 1980), the South Dakota Supreme Court stated: “[T]he PUC need not follow any single formula in arriving at the rates fixed so long as the method used, when applied to the facts and viewed as a whole, does not produce an arbitrary result.” See also, *Application of Montana-Dakota. Utilities Co., Etc.*, 278 N.W.2d 189 (S.D. 1979) wherein the Supreme Court stated, “In determining reasonableness, the Commission is not restricted to any single formula in arriving at the rates

fixed for MDU 'so long as the method followed and the order entered when applied to the facts and viewed as a whole not produce an unjust or arbitrary result.'”

As part of its regulatory obligations under SDCL Ch. 49-34A, the Commission is tasked with the responsibility of determining just and reasonable rates for BHP and its customers when BHP seeks a rate increase for each of its customer classes. The Commission has adopted the “cost of service” method of ratemaking as noted in *Application of Northwestern Public Service Co.*, 297 N.W.2d 462, 464 (S.D. 1980)

The PUC has adopted the “cost of service” method of rate making. This method entails four steps as follows: (1) Properly determine company’s rate base, i.e., investment devoted to public service; (2) determine a fair and reasonable rate of return; (3) multiply the base [(1) above] by the rate [(2) above]; and (4) add to company’s cost of operations referred to above (including taxes and depreciation). To assist in the computation of the steps above, a historical test year is adopted. The data from this year must be adjusted as to the cost of operations and the rate base to reflect changes which will be in effect subsequent to the historical test year.

(emphasis added).

3. The Historical Test Year is the Starting Point for Establishing Just and Reasonable Rates.

The Commission uses a historical test year as the starting point for establishing just and reasonable rates for both the regulated utility and its customers. A historical test year is employed to establish representative levels of revenues, expenses, rate base, and capital structure for use in the rate-setting formula. The historical test year is used to ensure a matching of revenue and costs; that is, the historical test year is for the purpose of setting rates based on the costs expected to be incurred when the rates come into effect. If revenues and costs are mismatched in the revenue requirement, the resulting rates will either over or under recover costs, causing rates to not be just and reasonable. An assumption in using a historical test year is that recent costs are a fair predictor of future costs. In *NorthWestern Public Service v. Cities of*

Chamberlain, etc., 265 N.W.2d 867, 879 (S.D. 1978), the Court stated, “The purpose of using a test year is to establish with a reasonable degree of accuracy the revenue and expenses that a utility will experience during the period when the new rates will be in effect.”

The use of a historical test year for the purposes of establishing rates represents a snapshot in time that may or may not precisely reflect the rate base, revenues, and cost of service in place at the time that revised rates will take effect. Therefore, to account for this inherent imprecision, ARSD 20:10:13:44 allows for adjustments for known and measurable changes.

4. Test Year Adjustments Are Permitted to Establish Just and Reasonable Rates.

When determining just and reasonable rates, SDCL 49-34A-8 requires the Commission to give due consideration to the need of the public utility to meet its total current cost of furnishing service. Utilizing updated data based upon actuals rather than estimates allows the Commission to set rates based upon data that will most closely match the time period during which rates will take effect. The end goal for all parties and the Commission is to reach just and reasonable rates. Using updated data will best satisfy this purpose. The rates charged to customers should reflect the costs incurred by the utility on a prospective basis so that the rates, when they go into effect, provide sufficient revenue to cover the actual prudent costs incurred to supply safe, reliable electric service to ratepayers. If this Court were to accept the argument put forth by BHII, the Commission would be in violation of SDCL 49-34A-8.

Here the Commission applied Staff’s well-known and accepted practice of permitting adjustments for costs based on reliable documentation that will be effective within 24 months of the last month of the test period to supplant the pro forma cost of service. AR 42-73. As noted by

the Commission, permitting such adjustments resulted in rates that are just and reasonable. AR 7714-7735, Finding of Fact #23-27, #61; Conclusion of Law # 9.

BHII criticized, at great length, the use of estimates and budgets in BHP's cost of service. BHII did admit that the adjustments about which it complained were later adjusted (some upward and some downward) based on actual costs. BHII Br. at 14. The facts, as supported by the record, demonstrate that the Amended Settlement Stipulation does not contain any allowances or adjustments that were based on non-fixed priced budgeted amounts. All of the adjustments included in the Amended Settlement Stipulation were indeed fully supported. BHP's LIDAR surveying costs as submitted in the Application were based on a budget. This is the very reason that Staff did not accept the adjustment. When actual costs became known with reasonable certainty and measurable with reasonable accuracy, Staff accepted an amended adjustment reflecting known changes through October 15, 2014. A18, -21. As for the affiliate allocations from BHUH, Staff initially rejected this adjustment, as it was an estimate of future costs. Once actual costs became known with reasonable certainty and measurable with reasonable accuracy, Staff accepted an amended adjustment reflecting known changes through August 31, 2014. A19. As for the adjustment for payroll and expenses related to 17 open positions, this cost was initially rejected by Staff until such time as the number of actual employees hired and actual wage increases became known with reasonable certainty and measurable with reasonable accuracy. The adjustment was amended to reflect actual positions filled through October 2014 (A19) and known wage increases through April 1, 2015. A19. BHP did file the required schedules to support the adjustments with its Application. AR 36-1727. More information was forthcoming as it became available. The purpose of discovery is to be able to get these updated adjustments as they become known with reasonable certainty and measurable with reasonable accuracy. If the

Court were to accept BHII's argument, there would be little to no reason for Staff to conduct discovery and make a thorough examination of an application.

Known and measurable changes are required in order to meet the statutory mandate of providing a public utility its total current costs. Ratemaking proceedings generally take one year to complete. During this time, costs continue to change and investment occurs. This administrative lag can cause gaps in the ability of utilities to recover prudently incurred costs or, depending on the circumstances, may cause costs in the test year to be overstated. For this reason, ARSD 20:10:13:44 allows utilities to adjust test year costs for those costs that are certain to be expended within or for up to (12) months after the pendency of the rate case that would otherwise not be captured by the test year calculation. Its purpose is that costs that are certain to occur when the rates go into effect so rates should reflect the costs incurred. This avoids unfairly penalizing the utility for on-going investment and avoids potentially forcing the utility to immediately file a new rate case. It is well-settled, however, that when reliable evidence of actual experience is available, it should supplant evidence of a purely theoretical and predictive nature. See *Application of NorthWestern Public Service Co.*, 297 N.W.2d 462, 469 (S.D. 1980).

BHII argues that the adjustments to test-year book costs must be "known with reasonable certainty and measurable with reasonable accuracy at the time of filing its application." BHII adds the words "its application" to the end of the sentence in order for its argument to prevail however there is no need to add any language to this rule in order for it to make sense. In fact by adding the words "its application" to the rule, the rule becomes pointless. Even BHII admits this in footnote 6. However by simply leaving the rule as it is written, and has been interpreted for decades by the agency that uses this rule, the rule makes perfect sense and can continue to be used along with all the other ratemaking rules and statutes. The rule is there to permit

adjustments throughout the pendency of a rate case so that when the new rate is determined, it is the most current rate possible on a going-forward basis. This is then a just and reasonable rate.

The South Dakota Supreme Court addressed the issue of an agency's ability to interpret and apply ambiguously worded rules. In *Krsnak v. SDDENR*, 2012 SD 89, ¶ 16, 824 N.W.2d 429 (2012), the Court stated,

“Administrative rules have the ‘force of law and are presumed valid.’” (internal citations omitted). “[A]n agency is usually given a reasonable range of informed discretion in the interpretation and application of its own rules when the language subject to construction is technical in nature or ambiguous, or when the agency interpretation is one of long standing.” (internal citation omitted). Further, “[a]dministrative regulations are subject to the same rules of construction as are statutes.” “When regulatory language is clear, certain and unambiguous, our function is confined to declaring its meaning as clearly expressed.”

In *Nelson v. S.D. Board of Dentistry*, 464 N.W.2d 621, 624 (SD 1991), the Court stated that “[W]here there is an ambiguity in an agency rule, a court must give effect to the agency’s intention in promulgation of the rule, and must look to the object of the rule and the evil or mischief which it is designed to remedy and apply a reasonable construction which best accomplishes the purpose of the rule. (internal citation omitted). The purpose of the rule must be determined from the rule as a whole, as well as other rules relating to the same subject. (internal citation omitted). When a statute or rule does not define a term, it should be construed according to its accepted usage and a strained, unpractical, or absurd result should be avoided. (internal citation omitted).

Here the Commission has been interpreting ARSD 20:10:13:44 for decades. Many other states have a similar rule and interpret it similarly. TR 277-278. There is nothing new or novel about the rule or the Commission’s interpretation of it.

BHII also argues that the title of the rule calls for a 12-month historical test year and not a forecast year. Allowing adjustments that are known with reasonable certainty and measurable with reasonable accuracy does not make it a forecasted test year. It makes the historical test year current, therefore the new rate is the most current rate possible and therefore, it is a just and reasonable rate.

BHII is correct that the Supreme Court did not interpret ARSD 20:10:13:44 in *NorthWestern Public Service Co., supra*. However the case does have precedential value in that the Court did rule that reliance on speculative data and refusal to consider evidence of actual results was arbitrary and not supported by the evidence. *Id.* at 469-70.

5. The Commission's interpretation of ARSD 20:10:13:44 and SDCL 49-34A-19 resulted in just and reasonable rates.

BHII argues that if the Commission's interpretation of ARSD 20:10:13:44 is correct; a utility would be able to propose adjustments up to the date of the Commission's decision. Basically this is true and the reason for this has been stated previously—an adjusted test year should be “forward-looking.” Rates should be based on a revenue requirement reflective of on-going costs. BHII goes on to state that the continually updating in the cost of service would undermine due process because ratepayers would never know exactly what revenue requirement the utility was proposing. BHII Br. at 19. This is not true. A public utility company is statutorily bound by the revenue requirement it initially proposes and notice is sent to ratepayers before the rate increase goes into effect so they will always know the maximum increase that is being

requested. SDCL 49-34A-21¹. What this means then is that whatever the utility proposes for adjustments after the application is filed, and as in this case when there is a settlement, the resulting revenue requirement must be at or below that initially proposed revenue requirement. It would only be in the ratepayers' benefit to permit the Commission's interpretation. It is not fundamentally unfair to ratepayers. Acceptance of BHII's argument as to the interpretation of ARSD 20:10:13:44 would mean that no new adjustments could be proposed by either BHP or Staff, including those that decrease the revenue requirement. That would be fundamentally unfair to ratepayers.

The Court should reject BHII's arguments and affirm the Commission's Final Decision.

B. THE COMMISSION'S DECISION TO APPROVE THE CALCULATION OF A FIVE-YEAR AVERAGE PENSION EXPENSE BASED ON DATA FROM 2010-2014 WAS GROUNDED ON SUBSTANTIAL AND SUFFICIENT EVIDENCE THAT RESULTED IN JUST AND REASONABLE RATES WAS NOT ARBITRARY AND CAPRICIOUS NOR WAS IT A CLEARLY UNWARRANTED EXERCISE OF DISCRETION.

The Court should affirm the Commission's Final Decision that included an adjustment to normalize the five-year average pension expense based on the 2010-2014 period and reject BHII's request to modify the Final Decision based on the use of 2011-2015 pension expense data. The Court should find that the Commission's decision to approve a five-year average pension expense, based on substantial and sufficient evidence, was not arbitrary and capricious nor was it a clearly unwarranted exercise of discretion. The Commission's long-standing interpretation of ARSD 20:10:13:44 read together with SDCL 49-34A-19, see previous Issue,

¹ 49-34A-21. Determination of rates--Order--Maximum rate--Classification adjustment. If, after the hearing, the Public Utilities Commission fails to find the rates to be just and reasonable or if the commission finds the rate to be discriminatory, the commission shall determine the level of rates to be charged or applied by the utility for the service in question and shall fix the same by order to be served upon the utility; and the rates are thereafter to be observed until changed, as provided by this chapter. In no event shall the rates exceed the level of rates requested by the public utility. Rate classifications may be adjusted upward or downward by the commission; provided the anticipated receipts will not exceed the amount of return requested.

permits the consideration of cost of service evidence that becomes known and measurable during the twenty-four month period following the end of the test year. Such an interpretation is not inconsistent with the phrase “at the time of the filing” due to the voluminous filings during the pendency of a rate case. The interpretation results in the most accurate basis for utility rates, thus minimizing the need for an immediate or near term filing by the utility of a follow-on rate case to recover such costs.

Further, the Court should: (1) find the issue in this matter is one of fact, review the matter under the clearly erroneous standard and sustain the Commission’s findings as they are supported by substantial evidence; (2) find that BHII did not timely raise the issue of using 2015 pension expense data and therefore waived this issue for appeal purposes; (3) find that use of the 2015 pension expense data is outside of the twenty-four month period following the end of the test year; and (4) find the Commission’s exclusion of the 2015 pension expense combined with the inclusion of the Wyodak O&M expenses is not a clearly unwarranted exercise of discretion.

1. The Commission’s Detailed Findings of Fact Regarding Pension Expense, Based on Documents and Live Witness Testimony Presented at the Evidentiary Hearing, Are Not Clearly Erroneous.

BHII argues that the standard of review for this issue is de novo as the Commission’s findings were based on documentary evidence. This argument should be rejected as the findings pertaining to the pension expense are not a question of law but one of facts.

As to the issue presented here, normalization of the pension expense, there was substantial evidence produced at the evidentiary hearing both in the form of live testimony and documentary evidence by BHP Witness White (BHP Exhibit 21), Staff Witness Peterson (Staff Exhibit 1; TR 282) and BHII Witness Kollen (TR 175,184, 210, 214, 215, 216). These witnesses

testified in their respective cases-in-chief, were cross-examined by all the parties and the Commission, and the exhibits related to this issue were introduced through these witnesses at the evidentiary hearing. *Id.*

BHII's argument that the Commission's findings on this issue should be reviewed de novo must be rejected as its reliance on *Tucek v. Department of Social Services*, 2007 SD 106, ¶ 13, 700 N.W.2d 867, 871, is misplaced. The Supreme Court held that the standard of review for agency decisions varies depending on the type of evidence presented: "When findings of fact are made based on live testimony, the clearly erroneous standard applies. Deference and great weight are given to the hearing examiner on fact questions. When factual determinations are made on the basis of documentary evidence, however [courts] review the matter de novo, unhampered by the clearly erroneous rule." In *Tucek*, the documentary evidence was offered as rebuttal testimony as to whether the annuity company's annuity policies were all the same. They were not offered to prove that Tucek failed to provide sufficient evidence of Medicaid eligibility—the stated purpose of the hearing.

In contrast, BHP witness White and Staff witness Peterson each provided evidence, both oral and in documentary form, to prove that the average annual pension expense during the five-year period 2010-2014 included a year in which the pension expense was high at \$3.25 million (2012) and a year in which the expense was low -- \$976, 122 (2014). Staff Exhibit 1, pgs 16-17. The five-year average expense used for rate setting purposes was \$2,336,305. The Commission's findings of fact pertaining to pension expense normalization are set forth below. These findings were clearly made based on the testimony presented at the hearing and therefore are reviewed under the clearly erroneous standard.

Pension Expense Normalization

41. As documented in the evidence presented in the case, BHP's pension expense varies significantly year-by-year. Ex Staff 1, p. 16. For example, the Company's test year pension expense was \$2,844,759. For 2014, however, the expense dipped down to \$976,122. To remedy the problem caused by the fluctuating expense for ratemaking purposes, BHP proposed, and the Staff accepted for settlement purposes, a normalization adjustment based on the average annual expense during the five-year period 2010-2014. These years included a year in which the pension expense was high at \$3.25 million (2012) and a year in which the expense was low -- \$976, 122 (2014). The five-year average expense used for rate setting purposes was \$2,336,305. As pointed out in Staff witness Peterson's testimony at hearing, the five-year average that was agreed upon by BHP and the Staff represented over a \$500,000 reduction in the test year expense. TR 282.

42. BHII objected to the treatment of the pension expense in the Stipulation characterizing it as "opportunistic" in that it does not reduce the test year expense far enough and it prevents BHP ratepayers from receiving the benefit from the lower pension expense in 2014 that the Company enjoyed. Rather, BHII witness Mr. Kollen recommended that BHP's 2014 pension expense be recognized for ratemaking purposes. Ex BHII 1, pp. 33-34.

43. The Commission finds that it is BHII's position, not that of BHP and the Staff, which is opportunistic in this instance with respect to the pension expense. BHII's recommendation would set rates based on the lowest pension expense experienced in the last five years. BHII's recommendation is particularly egregious in this instance given that BHP's witness Thurber testified that the Company's most recent estimate of its 2015 pension expense is \$2,056,581 - which is considerably higher than its 2014 expense that Mr. Kollen recommends and similar to the five-year average reflected in the Settlement Agreement Ex BHP 70, pp. 22-23. The Commission also finds that the normalization treatment of a widely varying expense is consistent with sound regulatory principles and that the Commission has routinely relied on the normalization treatment in prior cases before the Commission, e.g. storm damage expense and uncollectible expenses. The facts and circumstances surrounding the pension expense make it appropriate to apply normalization treatment in this instance. Finally, the Commission further finds that Mr. Kollen's recommended adjustment is internally inconsistent with BHII's position regarding post-test year adjustments in that BHII's witness did not include a revenue adjustment to correspond to its proposed expense adjustment even though BHII incorrectly contends that a revenue adjustment is required for each post-test year adjustment.

2. The Commission Did Not Have An Opportunity to Fully Address and Consider BHII's Proposal of Using the Years 2011-2015 for the Average Pension Expense as BHII Did Not Raise the Issue Until Appeal.

In its Appellant's brief, for the first time, BHII raised the issue of using the years 2011-2015 to calculate BHP's average pension expense rather than using the years 2010-2014 as had been discussed since the Application was filed in March 2014. BHII Br. at 22. This issue was not properly raised before the Commission and therefore it is waived. The Commission did not have an opportunity to fully address and consider the different time period that BHII is now proposing. In *Kreisers Inc., v. First Dakota Title Ltd. Partnership*, 2014 S.D. 56, ¶ 46, 852 N.W.2d. 413, 425 (2014), this Court stated, "We have consistently stated that we will not address issues raised for the first time on appeal not raised before the lower court."

As BHII did not present this argument to the Commission, it did not have an opportunity to fully address and consider the different time period that BHII would now like this Court, on appeal, to consider. BHII had ample opportunity to raise this issue to the Commission as this proposal was included in BHP's Application filed in March 2014. In fact, at the evidentiary hearing, BHII's witness recommended that BHP's 2014 pension expense be recognized for ratemaking purposes. TR 175, 5-10. This was an opportune time to have addressed the issue with the Commission. BHII's argument should be rejected as it failed to timely raise the issue below and therefore it has waived this issue.

3. ARSD 20:10:13:44 permits adjustments 24 months beyond the end of the test year that are known with reasonable certainty and measurable with reasonable accuracy at the time a company files the information that supports the adjustment.

The Commission's interpretation of ARSD 20:10:13:44 did not change when it permitted the normalization of pension expense for the years 2010-2014 in its Final Decision. As set forth in the previous analysis in Issue I, ARSD 20:10:13:44 permits adjustments 24 months beyond the end of the test year that are known with reasonable certainty and measurable with reasonable accuracy at the time a company provides the information that supports the adjustment.

In this case, BHP's test year ended on September 30, 2013. Twenty-four months beyond the end of the test year is September 30, 2015. Pension expense for 2015 was not known at the time of the Original Settlement when BHP and Staff agreed to a normalization adjustment based on the most recent five-year average of actual costs. The five-year average pension expense approved in the Final Decision was \$2,336,305. AR 7714-35, Finding of Fact #41. The 2015 pension expense (\$2,056,581) became known in early 2015, after the Original Settlement was executed, and was submitted into the record by BHP in order to support the reasonableness of the 2010-2014 average included in the Amended Settlement Stipulation. AR 7714-35, Finding of Fact #43.

At the hearing, BHII advocated using the 2014 pension expense even though it was abnormally low (\$976,122) and not indicative of future ongoing costs. In its brief, BHII advocates using 2011-2015 data to determine a five-year average. ARSD 20:10:13:44 only allows adjustments 24 months beyond the end of the test year. The test year ended September 30, 2013. Twenty-four months later is September 30, 2015. Staff agreed to use calendar years 2010-2014 so that the adjustment was within the 24-month period permitted under ARSD 20:10:13:44. BHII's advocacy to use 2011-2015 data to determine the average pension expense would go beyond the 24 months, thus violating the rule.

This argument should be rejected for two reasons. First, as shown above, BHII waived this issue by failing to raise it before the Commission. Second, using the 2015 pension expense would fall outside of the 24-month window permitted in ARSD 20:10:13:44.

- 4. The Commission's exclusion of the 2015 pension expense combined with the inclusion of the Wyodak O&M expenses is not a clearly unwarranted exercise of discretion as there is a rational explanation for the Commission's action.**

Lastly, BHII argues that the Commission's exclusion of the 2015 pension expense combined with the inclusion of the Wyodak O&M expenses is a clearly unwarranted exercise of discretion as there is no rational explanation for the Commission's action. The exclusion of the 2015 pension expense was previously explained—it falls outside of the 24-month window to make known and measurable adjustments. As for the inclusion of the Wyodak O&M expenses, it is the Commission's long-standing interpretation of ARSD 20:10:13:44 that permits this adjustment, see Issue I. The Amended Settlement Stipulation corrected the \$286,041 error in the Original Settlement. It also accepted and included an expense adjustment of \$412,988 to update the Wyodak O&M expenses incurred through September 2014, prior to twenty-four months after the Application filing date. AR 6473-6516.

The Commission's actions were not a clearly unwarranted exercise of discretion that unjustly enriched BHP and unjustly burdened its ratepayers. In fact, it is just the opposite. The approval of the Amended Settlement Stipulation retains the \$6,890,746 revenue deficiency agreed to in the Original Settlement even though the Amended Settlement SD Electric Revenue Requirement cost of service calculation showed a higher revenue deficiency of \$7,010,894. A41 The Amended Settlement Stipulation also extended the rate case moratorium provision for an additional three months from what was agreed to in the Original Settlement. This "stay out" provision keeps BHP from filing a rate case application for an increase in base rates which would go into effect prior to January 1, 2017. These provisions in the Amended Settlement Stipulation did not unjustly enrich BHP and the ratepayers are financially better off with the approval of the Amended Settlement Stipulation than they were with the Original Settlement.

BHII argues that the standard of review for this issue is de novo as the Commission's decision was based on documentary evidence included in the record. This argument should be

rejected, as the issue is not a question of law. BHII argues that the Commission's Final Decision did not follow its own interpretation of the rulemaking statutes and rules when it approved the normalization of BHP's five-year average pension expense based on data from 2010-2014 and such a decision prejudices all of BHP's ratepayers. BHII requests this Court to modify the Final Decision and to instead use a 2011-2015 average pension expense calculation. This argument too must fail as the Commission has consistently interpreted the ratemaking statutes and rules when making its decision and BHII waived its right to have this Court modify the Final Decision as the issue of a new time frame for determining the normalization of the pension expense was not timely presented to the Commission, and therefore, it did not have an opportunity to fully address and consider the matter. Finally, the Commission's exclusion of the 2015 pension expense combined with the inclusion of the Wyodak O&M expenses is not a clearly unwarranted exercise of discretion as there is a rational explanation for the Commission's action.

The Commission's Final Decision which approved the calculation of a five-year average pension expense based on data from 2010-2014, was based on substantial and sufficient evidence that resulted in just and reasonable rates, was not arbitrary and capricious nor was it a clearly unwarranted exercise of discretion. This Court should affirm the Commission's Final Decision.

C. THE COMMISSION'S ACCEPTANCE OF A UTILITY'S INCENTIVE COMPENSATION PACKAGE AS A PART OF A SETTLEMENT AGREEMENT IS PERMISSIBLE UNDER THE RATEMAKING STATUTES AND RULES.

Pursuant to SDCL 49-34A-8.4, BHP has the burden of proof to establish that its underlying costs for its rates are prudent, efficient, and economical and are reasonable and necessary in order for the Commission to determine that the rates are just and reasonable. The utility must prove these elements by a preponderance of the evidence. The Commission found

that BHP met its burden by establishing, through substantial and sufficient evidence provided at the evidentiary hearing that its costs were prudent, efficient, and economical and these costs were reasonable and necessary to provide service to its customers. As BHP met this burden by a preponderance of the evidence, the Commission determined that the resulting rates were just and reasonable. The Commission's Final Decision was fully supported by the evidentiary record and was not a clear error of judgment.

1. BHP provided an extensive record of testimony and supporting documents for the inclusion of the employee incentive compensation plan in the utility's cost of service and revenue requirement.

BHII argues that the Commission misapplied the legal standard a utility is obligated to meet when satisfying its burden of proof under SDCL 49-34A-8.4, 49-34A-11, and ARSD 20:10:13:44. In particular, BHII takes exception to the Commission's approval of the inclusion of an employee incentive compensation plan cost proposed by BHP and later adjusted by Staff. According to BHII, the testimony given by Mr. White was conclusory and therefore insufficient to justify the inclusion of the employee compensation plan cost in the overall rates. As such, according to BHII, the Commission's approval of the Amended Settlement Stipulation was a clear error of judgment.

BHII's argument belies what is in the evidentiary record. The record is replete with substantial and sufficient evidence as shown in the Commission's Findings of Fact #37-40; 61. AR 7714-35.

Before the Commission can determine if a utility's request for a rate increase will result in just and reasonable rates, the public utility must start with the Commission's rules for filing. ARSD Chapter 20:10:13 is titled, **PUBLIC UTILITIES RATE FILING RULES**. This chapter sets forth a public utility's filing obligations regarding tariffs and rate applications.

ARSD 20:10:13:40 and 20:10:13:104, below, sets forth what is required for a rate increase. As required by ARSD 20:10:13:40 and 20:10:13:104, BHP filed its rate application, testimony, and exhibits.

20:10:13:40. Contents of applications for rate increases. Applications for rate increases shall include the cost of service to be supplied and shall include the additional material required in §§ 20:10:13:41 to 20:10:13:107, inclusive. Additional materials may be supplied by the utility if the utility feels that it is necessary. All applications for rate increases shall be submitted at least 30 days prior to the date that the rate increase is proposed to become effective.

20:10:13:104. Testimony and exhibits. A utility filing for an increase in rates and charges shall be prepared to go forward at a hearing on reasonable notice on the data, testimony, and exhibits which have been submitted and sustain the burden of proof of establishing that its proposed charges are just and reasonable and not unduly discriminatory or preferential or otherwise unlawful. In addition to the material the utility chooses to submit as part of its case, except for

- (1) Increases filed under § 20:10:13:26
- (2) Increases resulting from changes made in fuel clauses or gas adjustment clauses; and
- (3) Increases of rates comprising an integral part of coordination and interchange arrangements in the nature of power pooling transactions.

The exhibits shall include full cost of service data, as identified in §§ 20:10:13:51 to 20:10:13:102, inclusive. Although §§ 20:10:13:51 to 20:10:13:102, inclusive, provide for a historical test period, the utility, in addition, may submit cost of service information for a nonhistorical test period beginning no later than the proposed effective date of the new rates. Statements A through R and the accompanying testimony shall include an explanation of these exhibits.

Once Staff and any intervenors have completed their analysis of the case, made an independent determination of the appropriate revenue requirement, and held settlement negotiations, these rate cases are generally settled. Regardless of whether there is a settlement or if the matter is heard at a contested case hearing, the Commission must always determine whether the resulting rates are just and reasonable.

SDCL 49-34A-6, set forth below, is the legal standard for utility rate changes stating that the new rates must be just and reasonable:

49-34A-6. Rates to be reasonable and just--Regulation by commission. Every rate made, demanded or received by any public utility shall be just and reasonable. Every unjust or unreasonable rate shall be prohibited. The Public Utilities Commission is hereby authorized, empowered and directed to regulate all rates, fees and charges for the public utility service of all public utilities, including penalty for late payments, to the end that the public shall pay only just and reasonable rates for service rendered.

Further, the public utility has the burden to prove what is set out in SDCL 49-34A-8.4:

49-34A-8.4. Burden on public utility to establish criteria for determination of rates. The burden is on the public utility to establish that the underlying costs of any rates, charges, or automatic adjustment charges filed under this chapter are prudent, efficient, and economical and are reasonable and necessary to provide service to the public utility's customers in this state.

49-34A-11. Burden of proving reasonableness of rates. The burden of proof to show that any rate filed is just and reasonable shall be upon the public utility filing same.

The utility must prove each of these elements by preponderance of the evidence. *Irvine v. City of Sioux Falls*, 2006 S.D. 20, ¶ 10, 711 N.W.2d 607, 610 (stating, "the burden of proof for administrative hearings is preponderance of the evidence").

The Commission's statutory mandate for determining whether the proposed rates are just and reasonable is found in SDCL 49-34-8 which states:

49-34A-8. Criteria for determination of rates by commission. The commission, in the exercise of its power under this chapter to determine just and reasonable rates for public utilities, shall give due consideration to the public need for adequate, efficient, economical, and reasonable service and to the need of the public utility for revenues sufficient to enable it to meet its total current cost of furnishing such service, including taxes and interest, and including adequate provision for depreciation of its utility property used and necessary in rendering service to the public, and to earn a fair and reasonable return upon the value of its property.

Here, Staff and BHP entered into an Amended Settlement Stipulation. BHP and BHII did not. Once this matter went to hearing, BHP presented direct evidence in its case-in-chief supporting the inclusion of employee incentive compensation in its cost of service through the prefiled testimony of Kyle White, Vice President of Regulatory Affairs., and Laura Patterson, Director of Compensation, Benefits and Human Resources Information Systems. Ms. Patterson's testimony stated that she is responsible for partnering with business leaders to design and execute compensation and benefits strategies and plans. Her prefiled testimony describes and supports the general compensation program for BHC employees, and particularly the employees of Black Hills Power, including the variable compensation program and the equity compensation program. She explained why these programs and their associated costs are reasonable and necessary to attract, motivate and retain well qualified and competent employees to support utility operations. BHP employees, both non-union and union, participate in the compensation and benefit plans sponsored by BHC. Ms. Patterson further described and supported the general benefits programs and policies for BHC employees, particularly the employees of Black Hills Power, including the health, welfare and retirement benefits, and explains why those programs and their associated costs are reasonable and necessary. Her testimony specifically supported employee compensation related adjustments, including base salary, variable compensation, equity compensation, retiree healthcare, pension plan, pooled medical, and the 401(k) plan, that are part of overall benefits adjustment. She stated that employee incentive compensation plans are widely employed by utilities throughout the country and that it is necessary for BHP to provide employee incentive opportunities that are competitive with other companies in the industry. Another goal of the program is to focus employees on important objectives to improve the performance of utility operations by focusing on improvements to operational excellence, safety, reliability, and customer satisfaction. BHP Exhibit 22, pp. 3-4, 8, 10.

Mr. White adopted Ms. Patterson's written testimony as his own and answered all questions regarding this subject matter at the evidentiary hearing. BHII extensively cross-examined Mr. White regarding the matter of the inclusion of employee incentive compensation in the utility's cost of service. Mr. White testified that incentive compensation relating to the goals of shareholders in the amount of approximately \$666,000 was removed from the revenue requirement for settlement purposes. TR 79.

As a part of Staff's review of the Application, it asked BHP hundreds of discovery questions. BHP responded to each request. A number of those dealt with the inclusion of employee incentive compensation in the utility's cost of service and revenue requirement. Staff Exhibit 2. TR 267:21-25; 268:1-4. David Peterson, Staff's consultant, filed prefiled testimony, to address among other matters, the inclusion of the employee incentive compensation plan in the utility's cost of service. A42-73, Staff Exhibit 1. Mr. Peterson testified he did not necessarily disagree with BHII's expert's characterization of the incentive awards and in fact, had initially pursued the same issues on behalf of the Staff earlier in this proceeding. In the end, however, the Commission Staff conceded this issue and agreed to exclude the \$666,000 related specifically to financial performance, recognizing that the incentive compensation exclusion embodied in the settlement is essentially the same type of exclusion the Commission has approved for BHP in prior base rate case settlements and for other South Dakota utilities. Therefore, Mr. Peterson supported the exclusion that is contained in the Amended Settlement Stipulation and recommended that the Commission reject Mr. Kollen's recommendation to expand the exclusion at this time. TR 284:22-287:13; Staff Exhibit 1, pp. 17-18.

- 2. The employee incentive compensation costs included in BHP's final rates were prudent, efficient, economical, reasonable and necessary to provide electric service to its customers.**

BHP was able to demonstrate that the cost of the employee incentive plan was prudent, efficient, economical, and reasonable and necessary to provide service to the public. As shown in the testimony, the employee incentive plan is necessary for BHP to provide employee incentive opportunities that are competitive with other companies in the industry as well as to attract, retain, and motivate employees. TR 56:5-12. Another goal of the program is to focus employees on important objectives to improve the performance of utility operations by focusing on improvements to operational excellence, safety, reliability, and customer satisfaction. Amounts identified as being tied to BHP's financial results were excluded. The treatment of the employee incentive plan cost is essentially the same as the Commission has approved for BHP in the past as well as for other public utilities. The Commission found the evidence to be credible and therefore demonstrated that the resulting rates in the Amended Settlement Stipulation were just and reasonable.

The Commission's duty under the 49-34A-8 is to determine an appropriate balance between the needs of the public to have safe and reliable electric service at reasonable rates and the financial ability of the utility to provide such services on an ongoing basis. Thus the end results must be to establish rates that are just and reasonable. Just in that the rate was based solely on the record developed at the evidentiary hearing following principles of due process and reasonable in light of the range of possible outcomes supported by the evidence. Here, after hearing the evidence, the Commission specifically found BHP met its burden of proving each of the elements by preponderance of the evidence. Findings of Fact #37-40; 61. As determined by the Commission in its findings of fact and conclusions of law, BHP's cost for its incentive compensation plan met these elements. As such it became a cost that was included in the overall just and reasonable rates of BHP. The Commission thus followed the law and found that the

incentive compensation plan cost included in the rates does not render the Amended Settlement Stipulation unjust and unreasonable.

The Commission's findings of fact were fully supported by the record of testimony and documents that provided the basis of its findings of fact. The evidence is substantial and sufficient. If the evidence is substantial and sufficient, the cost can be included in the cost of service. BHP proved the cost for incentive compensation was reasonable and necessary to provide service. A cost, regardless of its purpose, is still a cost. Just because, as in this case, it is for the purpose of employee compensation, that on its own does not automatically require that it be disallowed as a cost. There are no statutes or rules that specifically address incentive compensation. There are however statutes and rules that require the Commission to thoroughly investigate each rate application before it renders a decision. As shown in the following Findings of Fact and Conclusions of Law, the Commission did exactly that:

Findings of Fact

27. As is set forth in Conclusions of Law 8 through 10, the Commission concluded that adjustments in the Amended Settlement Stipulation are within the allowable adjustment periods set forth in SDCL 49-34A-19 and ARSD 20:10:13:44. The Commission accordingly finds that substantial and sufficient evidence was produced, introduced, and received in evidence in this proceeding to demonstrate that the rates agreed to in the Amended Settlement Agreement are just and reasonable and will adequately meet BHP's need for revenues sufficient to enable it to meet its current cost of furnishing adequate, efficient, economical, and reasonable service.

37. BHP's proposed revenue requirement included approximately \$3.8 million for incentive compensation, including amounts billed from BHP's affiliates BHUH and BHSC. Ex BHII 6. In the Amended Stipulation, \$666,000 of the Company's test year incentive compensation expenses is excluded. This is the amount that BHP identified as being tied to the Company's financial results. Ex Staff 1, p. 17. The Amended Stipulation did not change and includes this provision.

38. BHP provided evidence that employee incentive compensation plans are widely employed by utilities throughout the country and that it is necessary for

BHP to provide employee incentive opportunities that are competitive with other companies in the industry. Another goal of the program is to focus employees on important objectives to improve the performance of utility operations by focusing on improvements to operational excellence, safety, reliability, and customer satisfaction. TR , 300; Ex BHP 22, pp. 8, 10.

39. BHII's expert witness Kollen offered opinion evidence that in addition to the amount excluded in the Settlement Stipulation, \$149,000 in performance plan expenses and \$739,000 in incentive restricted stock expenses should be excluded because these additional amounts represent incentive awards that are similar in nature to those excluded in the Settlement Stipulation. BHII witness Kollen also offered the opinion that by embedding such incentives in rates, BHP itself is not incentivized to manage toward operational performance. TR 184; Ex BHII 1, pp. 35-37; Ex BHII 6, p. 2.

40. In settlement discussions, Staff raised issues with the incentive compensation plan and the payments made under the plan. Staff's expert witness Peterson testified he did not necessarily disagree with Mr. Kollen's characterization of the incentive awards and in fact, had initially pursued the same issues on behalf of the Commission Staff earlier in this proceeding. In the end, however, the Commission Staff conceded this issue and agreed to exclude the \$666,000 related specifically to financial performance, recognizing that the incentive compensation exclusion embodied in the settlement is essentially the same type of exclusion the Commission has approved for BHP in prior base rate case settlements and for other South Dakota utilities. Therefore, Mr. Peterson supported the exclusion that is contained in the Settlement Stipulation and recommended that the Commission reject Mr. Kollen's recommendation to expand the exclusion at this time. TR 285-287; Ex Staff 1, pp. 17-18. The Commission finds that the incentive compensation plan included in the Amended Stipulation does not render the Amended Stipulation unjust and unreasonable.

61. The Commission finds that the rates, terms and conditions in the Amended Stipulation demonstrate a thorough, penetrating, and credible analysis by Staff and its expert witnesses of the data and assumptions underlying the Application and the Amended Settlement Stipulation; balance fairly the interests of BHP and its customers; recover no more than BHP's current revenue requirements, including a reasonable return to its stockholders commensurate with its cost of equity capital; are supported by substantial evidence; and meet the just and reasonable standard set forth in SDCL 49-34A-6, as more specifically delineated in SDCL 49-34A-8, the unreasonable preference or advantage and unreasonable prejudice or disadvantage prohibitory standards of SDCL 49-34A-3, the fair and reasonable return standard of SDCL 49-34A-8, and are prudent, efficient, and economical and are reasonable and necessary to provide service to the public utility's customers as provided in SDCL 49-34A-8.4. These settlement rates allow BHP a reasonable opportunity to earn a return that is adequate to enable it to continue providing safe, adequate, and reliable service to its South Dakota retail customers.

Conclusions of Law

1. The following statutes and rules are applicable to this proceeding and vest the Commission with jurisdiction over this matter: SDCL Chapters 1-26 and 49-34A, including 1-26-20, 49-34A-3, 49-34A-4, 49-34A-6, 49-34A-8, 49-34A-8.4, 49-34A-10, 49-34A-11, 49-34A-12, 49-34A-13, 49-34A-13.1, 49-34A-14, 49-34A-19, 49-34A-19.1, 49-34A-19.2, 49-34A-21, and 49-34A-22, and ARSD Chapters 20:10:01 and 20:10:13.

8. ARSD 20:10:13:44 provides as follows:

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

9. As set forth in Findings of Fact 24, these provisions have for decades been interpreted together as providing for a historic test year as the cost of service basis period, but also, in part because such cost of service data are used to set rates for a future period, the analysis and substance of a proposed change in utility rates should include both known and measurable expenses during the test year and adjustments to reflect any changes that occurred after the test year that become known and measurable within the 24-month period for case processing provided for in ARSD 20:10:13:44 and SDCL 49-34A-19. Staff has interpreted these provisions to mean that the adjustments have to be sufficiently known and measurable at the time of their submission for Staff review of the responses to hundreds of discovery requests and filings in the case. Although the phrase "in advance of" is anomalous when read together with the word "forthcoming," the Commission concludes that the intent of SDCL 49-34A-19 is to permit the consideration of cost of service evidence that becomes known and measurable during the twenty-four month period following the end of the test year, that such interpretation is not inconsistent with the phrase "at the time of the filing" due to the voluminous "filings" in a rate case over a two year period in most rate cases, and that such interpretation results in the most accurate real-time basis for the utility's rates, thus minimizing the need for an immediate or near term filing by the utility of a follow-on rate case to recover such costs.

12. No statute or rule precludes the inclusion of employee incentive compensation in the utility's cost of service and revenue requirement. The Commission's decision whether to allow incentive compensation and, if so, subject to what limitations are judgment calls concerning what meets the just and reasonable standard.

3. The Commission's Approval of the Amended Settlement Stipulation was Good Public Policy.

In addition to the Commission's statutory determination of whether the new rates were just and reasonable, was the added scrutiny of whether the settlement was considered good public policy, in other words, was the Amended Settlement Stipulation a "good package" overall regardless of BHII's objection to it. Administrative agencies may approve the settlement of a contested case when all the parties do not concur provided the agency makes an independent finding supported by substantial evidence on the record as a whole that the proposal will establish just and reasonable rates. *See Mobil Oil Corp. v. Federal Power Commission*, 94 S.Ct. 2328, 2347 (1974).

As a general rule, settlement is favored by the courts and is considered good public policy. "The law favors the compromise and settlement of disputed claims." *Kroupa v. Kroupa*, 1998 SD 4, ¶25, 574 N.W.2d 208. In this case, one of the elements of the Amended Settlement Stipulation was an agreement by BHP to a moratorium of three years and 3 months. The only way a moratorium can be put into effect is for a utility to voluntarily agree to one—neither a commission nor a court can order a utility to "stay out" for any amount of time. By agreeing to this "stay out" provision, the resulting rates are even more prudent, efficient, economical, just and reasonable.

Here the Commission held an evidentiary hearing so that BHII could offer testimony as to why the Commission should reject the Settlement Stipulation or modify it to appease the intervenors. The Commission weighed the evidence and found that the evidence offered by BHP

and Staff was more credible than that offered by BHII and therefore it found that the Amended Settlement Stipulation resulted in rates that were just and reasonable.

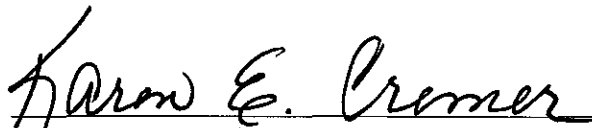
The Commission found that BHP met its burden by establishing, through substantial and sufficient evidence provided at the evidentiary hearing that its costs were prudent, efficient, and economical and these costs were reasonable and necessary to provide service to its customers. As BHP met this burden by preponderance of the evidence, the Commission determined that the resulting rates were just and reasonable. The Commission's Final Decision was fully supported by the evidentiary record and was not a clear error of judgment.

VI. CONCLUSION

Based on the foregoing, the Commission respectfully requests the Court affirm the Final Decision and adopt the Commission's findings of fact and conclusions of law as this Court's findings of fact and conclusions of law.

Dated this 18 day of September, 2015

SOUTH DAKOTA PUBLIC UTILITIES COMMISSION



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