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SIXTH JUDICIAL CIRCUIT

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RE: Hughes County Civ. No. 15-146: In the Matter of the Application of Black Hills Power, Inc. for Authority to Increase its Electric Rates

MEMORANDUM DECISION

Black Hills Industrial Intervenors appeal the Public Utility Commission's Final Decision to approve the Amended Settlement Stipulation with respect to Black Hills Power's application for authority to increase electric rates. This Court affirms.

BACKGROUND

On March 31, 2014, Black Hills Power, Inc. ("BHP") filed an Application for Authority to Increase Electric Rates with the South Dakota Public Utility Commission ("Commission"). The Application included supporting exhibits. The requested increase in electric service rates was approximately $14.6 million annually or about 9.27% based on BHP's test year ending September 30, 2013. The Application stated that a typical residential electric customer using 650 kWh per month would see an increase of $10.91 per month. The change would affect approximately 65,500 customers in the service territory. As required, the Application included a cost of service analysis.

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 Black Hills Industrial Intervenors or "BHII") filed a Motion to Intervene. Dakota Rural Action ("DRA") also filed a Motion to Intervene. The Commission granted Intervention on June 26, 2014.

The Staff of the Commission ("Staff") served over 330 discovery requests and BHII served over 60 discovery requests, to which BHP responded. The parties began negotiations to settle and stipulate to the rates, terms, and conditions for the increase of electric rates. On December 9, 2014, BHP and Staff filed a Joint Motion for Approval of Settlement Stipulation, the Settlement Stipulation, and Exhibits. BHII and DRA were not parties to the settlement. Notice of Hearing set this matter for Commission hearing on January 27-29, 2015. The parties, including BHII, pre-filed testimony of several witnesses.

The hearing was held on January 27 and 28, 2015. After the hearing, the Commission set the matter for voting on March 2, 2015. On February 10, 2015, BHP and Staff filed an Amended Settlement Stipulation reflecting two changes in the factual basis supporting the revenue requirement, due to new information contained in pre-filed testimony and evidence introduced at the hearing. (The Amended Stipulation did not change the agreed upon overall revenue deficiency). Further post-hearing briefs were accepted. On February 23, 2015, BHP and Staff filed a Joint Motion for Approval of Amended Settlement Stipulation.

During an open meeting deliberation on March 2, 2015, Commissioners asked questions of the parties and made their decision. The Commissioners voted unanimously to grant the Joint Motion and approved the terms and conditions stipulated to in the Amended Settlement Stipulation, as the decision of the Commission on the rate increase requested by BHP, effective on April 1, 2015. The Commission issued its Final Decision on April 17, 2015. "The Commission [found] that the agreements, adjustments, and rates proposed in the Amended Stipulation,

considered together with the rate case moratorium, are just and reasonable, and the Amended Stipulation is approved by the Commission." FOF 19.

BHII filed a Petition for Rehearing and Reconsideration but the Commission denied the motion on May 29, 2015. BHII filed its Notice of Appeal on June 26, 2015.

QUESTIONS PRESENTED

I. Whether the Commission erred in allowing any adjustments to the cost of service analysis under ARSD 20:10:13:44 when the proposed adjustments were made *after* the initial filing of the Application *but* which had become "known and measurable" at the time of *filing the adjustment*, and the adjusted costs would be effective within 24 months after the end of the test year?

II. Whether the Commission erred by using 2010–2014 in its five-year normalization calculation for pension expenses instead of 2011–2015?

III. Whether the Commission erred when it included $888,000 of BHP's incentive compensation package expense, in its cost of service analysis?

STANDARD OF REVIEW

This court's review of a decision from an administrative agency is governed by SDCL 1-26-36.

> The court shall give great weight to the findings made and inferences drawn by an agency on questions of fact. The court may affirm the decision of the agency or remand the case for further proceedings. The court may reverse or modify the decision if substantial rights of the appellant have been prejudiced because the administrative findings, inferences, conclusions, or decisions are:
>
> > (1) In violation of constitutional or statutory provisions;
> >
> > (2) In excess of the statutory authority of the agency;

> (3) Made upon unlawful procedure;
>
> (4) Affected by other error of law;
>
> (5) Clearly erroneous in light of the entire evidence in the record; or
>
> (6) Arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.
>
> A court shall enter its own findings of fact and conclusions of law or may affirm the findings and conclusions entered by the agency as part of its judgment.

SDCL 1-26-36.

"[Q]uestions of law, including statutory interpretation, are reviewed de novo." *Pesall v. Montana Dakota Util. Co., et al.*, 2015 S.D. 81, ¶ 6, __ N.W.2d __. "The final construction of an administrative rule is a question of law fully reviewable by this Court on appeal." *State v. Guerra*, 2009 S.D. 74, ¶ 32, 772 N.W.2d 907, 916. "Whether the Department correctly applied its rules presents a question of law[.]" *Media One*, 1997 S.D. 17, ¶ 11, 559 N.W.2d at 878. "However, 'an 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*.'" *Krsnak v. S. Dakota Dep't of Env't & Natural Res.*, 2012 S.D. 89, ¶ 16, 824 N.W.2d 429, 436 (quoting *Guerra*, 2009 S.D. 74, ¶ 32, 772 N.W.2d at 916) (emphasis added).

The Commission's "findings of fact are reviewed under the clearly erroneous standard . . . [a] reviewing court must consider the evidence in its totality and set the [Commission's] findings aside if the court is definitely and firmly convinced a mistake has been made." *In re Otter Tail Power Co. ex rel. Big Stone II*, 2008 S.D. 5, ¶ 26, 744 N.W.2d 594, 602 (citing *Sopko v. C & R Transfer Co., Inc.,* 1998 SD 8, ¶ 7, 575 N.W.2d 225, 228-29)).

ANALYSIS

Generally, BHII's argument is that the Commission should have rejected the Amended Settlement Stipulation because certain adjustments were either not "fully supported" or were not "known with reasonable certainty and measurable with reasonable accuracy" at the time BHP filed its *initial* Application, in claimed violation of ARSD 20:10:13:44. In other words, they argue that once the initial Application is filed, no "adjustments" can be made at all. The Commission's and BHP's (collectively, the "Appellees") argument is that the Commission's long

standing interpretation of ARSD 20:10:13:44 regarding adjustments was correct and should be given a reasonable range of informed discretion; the Commission's decision was not clear error; and the Amended Settlement Stipulation provided for an increase of rates that was "just and reasonable."

I.

Whether the Commission erred in allowing any adjustments to the cost of service analysis under ARSD 20:10:13:44 when the proposed adjustments were made *after* the initial filing of the Application *but* which had become "known and measurable" at the time of *filing the adjustment*, and the adjusted costs would be effective within 24 months after the end of the test year?

The first and foremost question before this Court is whether adjustments can be made after a public utility submits its *initial* application for a rate increase. This issue pivots on the interpretation of ARSD 20:10:13:44.

Standard of Review

The parties disagree on the applicable standard of review. BHII asserts that the interpretation of rules and statutes are questions of law, which allow this Court to fully review the decisions of the Commission. BHP agrees that questions of law are fully reviewable but claims that the Commission's conclusions of law on regulatory interpretation are entitled to great weight, and that the court must give a "reasonable range of informed discretion [for interpreting rules]." *BHP Br.* at 5. The Commission asserts that it is an agency with expertise and that courts must give appropriate "deference to PUC's expertise and special knowledge in the field of electric utilities." *Pesall v. Montana Dakota Util. Co., et al.*, 2015 S.D. 81, ¶ 8, __ N.W.2d __; *see In re W. River Elec. Ass'n, Inc.*, 2004 S.D. 11, ¶ 25, 675 N.W.2d 222, 230.

Regarding the interpretation of ARSD 20:10:13:44, this Court does not believe that the rule is ambiguous or in need of interpretation. Even if it were found ambiguous, the Court would give the Commission a reasonable range of informed discretion when interpreting and applying this Rule because the Commission's interpretation is one of long standing.[1]

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[1] FOF 26; *Krsnak*, 2012 S.D. 89, ¶ 16, 824 N.W.2d at 436. *See* TR. at 271-79 for a full explanation of Peterson's interpretation that has been "precisely the standard that the Commission Staff has relied on since the inception of this rule." TR. at 276. Staff Witness Peterson testified that "It is my understanding that the Commission's long-standing policy has been to consider post-test year adjustments up to twenty-four months . . . beyond the end of the test year provided they are known with reasonable certainty and measureable with reasonable accuracy. . . . [I]t is my understanding that both the Commission Staff and the Commission have previously interpreted this rule to mean

While ARSD 20:10:13:44 has been interpreted and applied at the Commission level on many occasions, its construction has not been decided in the courts.

Construction

"Administrative 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." *Krsnak*, 2012 S.D. 89, ¶ 16, 824 N.W.2d at 436 (citations omitted).

> The purpose of statutory [and regulatory] construction is to discover the true intention of the law [or rule] which is to be ascertained primarily from the language expressed in the statute [or rule]. The intent of a statute [or rule] is determined from what the legislature said, rather than what the courts think it should have said, and the court must confine itself to the language used. Words and phrases in a statute [or rule] must be given their plain meaning and effect. When the language in a statute [or rule] is clear, certain and unambiguous, there is no reason for construction, and the Court's only function is to declare the meaning of the statute [or rule] as clearly expressed. Since statutes [or rules] must be construed according to their intent, the intent must be determined from the statute [or rule] as a whole, as well as enactments relating to the same subject. But, in construing statutes [or rules] together it is presumed that the legislature did not intend an absurd or unreasonable result.

Hayes v. Rosenbaum Signs & Outdoor Adver., Inc., 2014 S.D. 64, ¶ 28, 853 N.W.2d 878, 885 (quoting *Martinmaas v. Engelmann,* 2000 S.D. 85, ¶ 49, 612 N.W.2d 600, 611).

The first step is to analyze the plain language and effect of the Rule in question to determine if there is ambiguity. ARSD 20:10:13:44 provides the requirements of the cost of service analysis.

> 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

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that for any post-test year change in expense or investment that has an incremental revenue component . . . a corresponding revenue adjustment must also be recognized." *Exh. Staff 1* at 8-9.

> 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. . . .

This 12-month period is commonly called the "test year" or "test period". ARSD 20:10:13:01(11).[2] BHP chose its test year ending September 30, 2013. "The purpose of a test year is to establish with a reasonable degree of accuracy the revenue and expenses that a utility will experience during the period when the new rates will be in effect." *In the Matter of the Application of Northwestern Pub. Serv. Co. for a Proposed Increase in Rates for Electric Serv.*, 297 N.W.2d 462, 469 (S.D. 1980). The Rule goes on to provide conditions for submitting adjustments to the test year data.

> . . . 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.

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

BHII reads "at the time of the filing" to mean at the time of BHP's *initial* application filing on March 31, 2014. BHII's position is that the Rule only allows adjustments which are known and measurable as of March 31, 2014; thereby arguing any adjustments made to costs after this filing date should have been rejected *even if* the actual cost became known and measurable after the initial filing of the application. Appellees argue that because there are voluminous filings,[3] the phrase refers to the filing *of the adjustment* as long as that adjusted

[2] " 'Test period,' the test period outlined in § 20:10:13:44, except that if additional material is filed by the utility, a test period is any 12 consecutive months beginning no later than the proposed effective date of the rate application."

[3] The administrative record spans more than 7,800 pages, stored in more than three bankers' boxes. *See* Chronological Index. Some of the proposed adjustments became known by responding to over 390 discovery requests from Staff and BHII. FOF 10 (citing *Exh. Staff* 1 at 5; TR. at 263, 268-68).

cost is known and measurable at the time BHP filed the adjustment with supporting materials. The Rule is only "ambiguous when it is capable of being understood by reasonably well-informed persons in either of two or more senses." *State v. Mundy-Geidd*, 2014 S.D. 96, ¶ 7, 857 N.W.2d 880, 884.

Consider again the portion of the rule at issue:

> 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.

ARSD 20:10:13:44 (emphasis added). The initial application is not the subject of this passage. The cost of service analysis shall be submitted with the initial application,[4] but nowhere in the rule does it refer to the "application." Instead, this Rule is about the content of the cost of service analysis and when adjustments can be proposed and how they can be permitted. The subject of each sentence in this adjustment passage is "adjustments" and all modifiers refer to "adjustments." "It is a general rule of statutory construction that modifying phrases or clauses should be referred to the word, phrase, or clause with which they are grammatically connected." *Farmland Ins. Companies of Des Moines, Iowa v. Heitmann*, 498 N.W.2d 620, 624 (S.D. 1993). The phrase, "at the time of the filing" refers to when the "changes in facilities, operations, or costs" can be made. "Changes in facilities, operations, or costs" (a phrase synonymous with adjustments) refers to the pronoun, "they", which is the antecedent for "adjustments" in the beginning of the sentence. The only reasonable interpretation based on the sentence structure is that adjustments are permitted after the initial application is filed.

"[The court] may not, under the guise of judicial construction, add modifying words to the statute or change its terms." *State v. Moss*, 2008 S.D. 64, ¶ 15, 754 N.W.2d 626, 631. Adopting BHII's interpretation would have this Court adding the words "of the initial application" after "filing." If the Legislature intended that adjustments were cut off at the time of application, it could have used the word "application" instead of "filing". On the contrary, interpreting "filing" to be the filing of the adjustment does not add words when the subject and the dominant

[4] ARSD 20:10:13:43 instructs that "[t]he initial application for a rate increase under this chapter shall include a cost of service study . . ."

purpose of the sentence is "adjustment." The clear intention of the Rule is to allow proposed adjustments to the statement of cost of service, even after filing the initial application, but only if the adjustment is shown separately and is fully supported. Then, the adjustment will only be approved if the two-part test ("known and measurable" and "effective within 24 months" provisions) is met when the adjustment is proposed and filed.

Also, the Court cannot "adopt an interpretation of a [Rule] that renders the [Rule] meaningless when the [agency] obviously passed it for a reason." *Schafer v. Shopko Stores, Inc.*, 2007 S.D. 116, ¶ 7, 741 N.W.2d 758, 761 (citation omitted). To adopt BHII's interpretation that no adjustments can be made after the moment the utility files its application would render the entire passage about adjustments meaningless. The Rule obviously permits adjustments that meet a certain test, even when the adjustment is made after filing the application. If those adjustments could only be made before the application is submitted to the Commission, then those changes would not be "adjustments," they would just be edits to a draft cost of service analysis. Put another way, if the application is final and cannot be changed from the moment it is filed with the Commission, no adjustment would ever be contemplated and that entire passage of the Rule would be useless verbiage. Similarly, if no changes could be made after the initial filing, what need would there be in the rule, to discuss ". . . changes in facilities, operations, or costs"? They would not be changes at all. If anything seems clear in this Rule, it is that the words "adjustments" and "changes" mean that utilities can propose adjustments and changes to the initial application. No interpretation is needed. However, even if the Rule needs interpretation, the Commission still prevails.

Adjustments Ensure Finding a "Just and Reasonable" Rate

The Commission's ultimate mission is stated in SDCL 49-34A-6: "Every rate made, demanded or received by any public utility shall be just and reasonable." SDCL 49-34A-8 explains the criteria the Commission must consider when determining whether a rate is just and reasonable:

> [The Commission] 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.

SDCL 49-34A-8 (emphasis added). Appellees correctly assert that adjustments should be allowed (if they meet the two test provisions) after the initial filing

because it will result in the most accurate basis for determining "just and reasonable" utility rates, whether that adjustment to the test year cost is an increase or a decrease. In order to determine if a rate is adequate, efficient, and economical, the Commission needs to know the most *current* actual costs of providing the utility service so the result is just and reasonable for the public and the utility. The Commission's intention for this Rule was to allow adjustments to the test year. If no adjustments were allowed after filing the rate application, then actual costs and changes later known and measurable would have to be ignored, or the utility would have to withdraw its application every time an expense changed.[5]

The Commission's interpretation of ARSD 20:10:13:44 is also harmonious with other related statutes and rules. SDCL 49-34A-19 provides:

> In determining the revenue requirement the commission shall consider revenue, expenses, cost of capital and any other factors or evidence material and relevant thereto. *The commission may take into consideration the reasonable income and expenses* that will be forthcoming in a period of twenty-four months in advance of the test year.

SDCL 49-34A-19.[6] This statute allows the Commission discretion to consider costs that will be effective within 24 months of the end of the test period; likewise under

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[5] The Court cannot construe a rule to an absurd or unreasonable result. *Hayes v. Rosenbaum Signs & Outdoor Adver., Inc.*, 2014 S.D. 64, ¶ 28, 853 N.W.2d 878, 885. BHII's interpretation would require a utility to withdrawal its entire application and refile if one expense needs to be adjusted after filing the application. Withdrawing the application would waste the utility's resources (the filing fee is $100,000), the Commission's time, and is unreasonable considering the expressed permission to file adjustments. Most importantly, the Rule does not require a utility to withdraw its application when a cost is missed or needs to be adjusted; instead, the Rule expressly allows the cost to be adjusted.

Furthermore, BHII recognizes that their interpretation will cause a new issue in rate cases. Appellant's Br. at 16, fn. 6. If a utility erred by failing to include a known expense in its cost of service before filing its application, then the utility must now prove when it knew about the expense, regardless of the fact that is an actual current cost the company must pay. This would unreasonably add irrelevant, substantive evidence to a rate case where the contested issue should be whether the proposed rate is just and reasonable. By interpreting the Rule as Appellees have, there is no issue about when the utility knew about an expense, and inadvertent omissions do not result in tangential issues.

[6] The Commission recognized the peculiar use of "in advance of" in this statute. It concluded,

> 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[.]

ARSD 20:10:13:44, the Commission permits adjustments if they are effective within the 24 months of the end of the test period. This statute does not prohibit considering reasonable income and expenses, which will be forthcoming, but are not known until after the utility files its initial application. The statute supports the principle of determining a just and reasonable rate by allowing consideration of more than just the test year data.

Staff witness Peterson explained the Commission's long-standing policy of accepting adjustments after the initial filing of the application. Peterson concluded that when read together, ARSD 20:10:13:44 and SDCL 49-34A-19 permit the use of known expenses during the test year and any known changes that occur up to 24 months after the test year and are known "at the time of their submission for Staff review." The Commission agreed with Peterson's interpretation. FOF 26, 27; COL 9. This informed conclusion is consistent with the plain language of the statute and the practical, reasonable interpretation of the Rule.

Accurate and Up-To-Date Costs

BHII argues that their interpretation "helps ensure that the utility's cost of service is as accurate as possible as of the date it files its application." *BHII Br.* at 12. This interpretation would mean the rate analysis is *only* as accurate as of the day the application was filed, yet it may take up to a year to make a decision on a rate case. During that time, things change within the utility.[7] Thus, a correct reading of ARSD 20:10:13:44 accommodates for the length of time (or "administrative lag") and for the fact that costs or revenues legitimately change during the year. Within the next 12 months or more following the initial application, discovery occurs, testimony is heard, and a contested hearing may be held where it may become apparent adjustments are needed to some figures. All the while, the utility continues to conduct business which may result in new costs.[8] It seems the entire purpose of the Rule is to acknowledge and accommodate not only the shifting nature of the information in a dynamic industry, but to make sure the Commission has the very latest information available to it on account of the administrative lag. So, if new data becomes available during the pendency of the case, which could raise or lower a fair rate, the Rule allows the utility to propose the change and the Rule gives guidance to the Commission of the circumstances in which it may accept the adjustment. Allowing for this administrative lag and permitting adjustments to the test year throughout the rate case proceeding

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COL 9. BHP offers that this statute means "the Commission may consider reasonable expenses that will be forthcoming within 24 months of the last month of the test period (until September 30, 2015), as post-test year adjustments. *BHP Br.* at 10. This reading is consistent with ARSD 20:10:13:44.

[7] Business decisions change. The markets move. Old facilities wear out or new facilities are put online. Data may be overlooked during the initial process, or data can be sharpened.

[8] It takes time to give notice of the application for a rate increase, to serve all the parties, to allow time from intervenors' participation, to perform discovery and make motions, to prepare expert testimony, to participate in settlement negotiations, and to conduct a hearing and vote.

provides the *most accurate* and *up-to-date* cost of service analysis possible. What is more, if the Court applied the interpretation offered by BHII, it would mean that no adjustments would be permitted, even when the adjustment could lower rates for customers, and that cannot be the intent of the Rule.

Specific Adjustments were Fully Supported

BHII highlights three expenses: LiDAR costs,[9] affiliate allocations,[10] and open position expenses,[11] and argues that these initially were only unreliable budget amounts improperly included on the cost of service statement,[12] and likewise should have been rejected because the actual value was not known at the time BHP filed its initial application. BHII cites to *Nw. Pub. Serv. Co.* for the principle that a public utilities commission acts "arbitrarily by using predictions of income and expenses based on test-year data and ignoring available evidence of actual post test-year earnings." *In re Application of Nw. Pub. Serv. Co. for a Proposed Increase in Rates for Electric Serv.*, 297 N.W.2d 462, 469 (S.D. 1980) (citing *W. Ohio Gas Co. v. Pub. Util. Comm'n*, 294 U.S. 79, 55 S. Ct. 324, 79 L. Ed. 773 (1935)[13]). BHP responds that none of the costs in the *Settlement Stipulation* were budget numbers

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[9] The LiDAR expense was initially submitted as a budget amount because BHP knew it would incur expenses for surveying costs for LiDAR within 24 months but the amount was not known or measurable when it submitted its initial rate application. The Staff of the Commission rejected the budget amount. But then, the actual amount became known and measurable soon thereafter when "the LIDAR surveying work and data acquisition was completed in the fourth quarter of 2014." *BHII Br. Appx.* A-380 (Thurber Rebuttal Testimony 13). Then, BHP filed an adjustment with supporting materials to fully support to the adjustment, which the Staff revised and the Commission accepted. *See* FOF 53. This is exactly what ARSD 20:10:13:44 allows.

[10] The second adjustment was to affiliate allocations. This expense was first submitted as a budget amount and was rejected. *See Orig. Settl. Memo* at 7. But after receiving a detailed summary of its most recent annualized expenses, an adjustment was made to include the actual annual amounts billed to BHP, and the Commission approved it. FOF 49.

[11] A third adjustment was made to payroll and expenses relating to filled positions as of December 2014. In March 2014 when BHP submitted its application, BHP could not have known how many positions would be filled in the future. So, Staff and BHP agreed on a cut-off date as of the December Settlement Stipulation for submitting an adjustment based on a cost that would be known and measurable at that time. FOF at 33, 34. Therefore, the cost of service was adjusted to reflect only the employee additions for actual employees hired because those were known and measurable. The Commission approved this adjustment. *See* FOF 33.

[12] *In re Minnesota Gas Co.*, 1979 WL 461903, at * 4 (S.D.P.U.C. Sept. 26, 1979) (finding that "a projected test year based upon estimates is in total contravention of the rational and sound rate-making principle of utilizing a test year adjusted for known and measurable changes.").

[13] The United States Supreme Court reasoned,

> We think the adoption of a single year as an exclusive test or standard imposed upon the company an arbitrary restriction in contravention of the Fourteenth Amendment and of 'the rudiments of fair play' made necessary thereby. The earnings of the later years were exhibited in the record and told their own tale as to the possibilities of profit. To shut one's eyes to them altogether, to exclude them from the reckoning, is as much arbitrary action as to build a schedule upon guesswork with evidence available.

Id. at 469.

so there was no error approving the Stipulation. Instead, in the initial application, BHP included some budget numbers but all were either struck later or adjusted if the actual value became known and measurable. Staff agreed and rejected those expenses as budgets at first, but allowed adjustments to these three expenses when the actual amount became known.

BHII claims that only one case has allowed a utility to adjust the estimate of costs to account for actual post test-year expenses after filing the initial application. BHII attempts to distinguish that case, *Nw. Pub. Serv. Co.*, 297 N.W.2d 462 (S.D. 1980), because it did not interpret ARSD 20:10:13:44. In that case, the Big Stone Power Plant went on line during the test year and was the motivating factor for requesting a rate increase. Without historical data for the new power plant, the cost was based on a prediction calculated in a letter by a co-owner of the plant, who made certain assumptions for production. By the time the Commission heard the rate increase case, "the plant had been in operation for nearly a year. [The] Company presented evidence of its actual experience with the plant during that year which showed that the power production prediction contained in the Johnson letter was highly overestimated." *Nw. Pub. Serv. Co.*, 297 N.W.2d at 469. The court found that the Commission erred by ignoring the actual experience data and failing to adjust the cost, which was based on speculative data.

Whether or not this case factually matches the instant case, the reasoning is sound and useful. BHP knew it would have actual expenses for LiDAR surveying costs, payroll expenses for new employees, and an affiliate allocation during the period the new rate would be in effect. Once those expenses became known and measurable, even as late as at the Commission hearing, the Commission cannot completely ignore that available evidence of actual post test-year data; they might deem it insignificant, but they are not required to deem it inadmissible. An historic test year may not represent current costs but rather "establish[es] 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." *Nw. Pub. Serv. Co.*, 297 N.W.2d at 469. When the test year expenses are called into question by concrete evidence of actual post test-year experience, ARSD 20:10:13:44 allows adjustments so that the cost of service is more accurate.

BHII argues the fact that these three budget amounts were later adjusted is irrelevant; that because those expenses on the initial cost of service statement were unsupported budget values, they should have been rejected, and they cannot later be resurrected by evidence of the actual experience after the initial application is filed. This argument runs contrary to the holding of *Nw. Pub. Serv. Co.* and *In re Minnesota Gas Co.* While a rate cannot be based on predictions, the Commission cannot "ignor[e] available evidence of actual post test-year earnings" but "it should supplant evidence of a purely theoretical and predictive nature." *Nw. Pub. Serv. Co.*, 297 N.W.2d at 469.

Once the actual values of these three expenses were known and measurable, BHP proposed an adjustment to the test year amount, fully supported the change, and the Commission approved it. The Commission's interpretation of ARSD 20:10:13:44, as well as SDCL 49-34A-6[14] and SDCL 49-34A-8[15], contemplate and permit these adjustments for determining just and reasonable rates. Because this Court finds that adjustments of costs known after filing the initial application are permissible, it will not reverse the approval of the Settlement based on these known and measurable expenses.

"Staff accepted some Company adjustments, made corrections where necessary, modified other adjustments, and rejected those that do not qualify as known and reasonably measurable. Lastly, Staff introduced new adjustments not reflected in BHP's filed case." *Id.* at 2. Some of these adjustments were proposed after the initial application was filed, but were not identified by BHII on appeal. *See generally Orig. Settl. Memo* at 2-15. One example is the adjustment to the Neil Simpson Complex Common Steam Allocation. (*See BHP Br.* at 15 for two other examples.) Staff replaced budget numbers for the Steam Allocation with actual costs ending August 2014; hence the adjustment was based on values not known until after the date of filing the application. *Id.* at 9. This adjustment had the effect of *reducing operating expense*, but of course, was not one identified by BHII as a ground for reversal in this appeal. In fact, BHII's expert, Lane Kollen, concurred with this adjustment. *Kollen Testimony,* at 49. The point here is that if BHII was correct in its interpretation, new expenses that actually reduced rates would be equally inadmissible as expenses that raise the rates. The argument, therefore, ignores the objective of just and reasonable rates.

Propose new costs

BHII offers another argument that by their interpretation of ARSD 20:10:13:44, "the rule does not permit a utility to use the mechanism for proposing adjustments as a tool to introduce new costs to its filed cost of service that were not known and measurable at the time the utility filed its application." *BHII Br.* at 21 (no new line-item increases). BHP argues that "[f]or the few categories of costs that were not incurred during this time period, those costs are known with reasonable certainty and measurable with reasonable accuracy." *BHP Br.* at 11. None of the rules or statutes differentiates between adjustments of costs incurred during the

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[14] "Every rate made, demanded or received by any public utility shall be just and reasonable." SDCL 49-34A-6.

[15] [The Commission] 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.

SDCL 49-34A-8 (emphasis added).

test year and adjustments of costs that were not incurred until after the test year. The same practical and reasonable interpretation necessitates equal treatment of the new costs. The new costs adjusted in the Amended Settlement Stipulation would be effective within 24 months of the end of the test period, thus even for new costs, ARSD 20:10:13:44 allows their adjustment when the result is a just and reasonable rate.

No Due Process Violation

From a functional standpoint, allowing adjustments as they become known and measurable is practical and results in using the most current known costs in the calculation of a just and reasonable rate. BHII contests this assertion by describing how it is actually impractical, arguing that allowing adjustments during the pendency of the action makes the revenue requirement calculation a "moving target subject to continuous updates" until the day of final decision. BHII argues this "undermine[s] due process because ratepayers would never know exactly what revenue requirement the utility was proposing."[16] *BHII Br.* at 19.

Appellees admit that its interpretation may result in changes until the day the Commissioners vote;[17] however, they assert that no due process violation occurs because the nature of the cost of service analysis is a forward-looking device that is inherently imprecise. Also, Appellees assert that ratepayers will always know the maximum amount of the increase because the implemented rate cannot be higher than the initial proposed amount.[18] Appellees further offer that all notice requirements were followed to inform the parties of adjustments and BHII (and DRA) were given the opportunity to be heard.

BHII responds that due process is not met by submitting an inflated application with "everything but the kitchen sink" included. This, they argue, encourages padded numbers, including budget amounts, or adding place-holder costs that are wholly unsupported in the record and which the utility can continuously change until the day of decision. *BHII Reply Br.* at 9 (reasoning that "it is not enough, however, for ratepayers to know the maximum potential increase if the utility's application is padded with budgets and estimates it cannot prove at the time of filing.") As evidence of the inflated nature of the initial Application, BHII emphasizes that BHP proposed a $14.6 million rate increase but only $6.89 million was approved.

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[16] No authority is offered to support the argument that due process requires all parties to know the exact cost of service and revenue requirement during the entire rate case litigation. While the rule that the "[f]ailure to cite authority is waiver of an argument" is a Supreme Court rule and not binding here, nonetheless, it is illustrative that BHII cannot cite any cases directly supporting their argument, especially when notice was given to BHII for every adjustment proposed.

[17] *PUC Br.* at 15.

[18] ". . . In no event shall the rates exceed the level of rates requested by the public utility. . . ." SDCL 49-34A-21.

The Court does not see this as a due process issue and declines to reverse the Settlement when notice and opportunity to participate were provided. Ratepayers have every right and opportunity to intervene, participate, litigate, and appeal. The fact that the outcome is uncertain to some extent, merely lands this case alongside virtually every other lawsuit in the courts. So long as the affected parties have notice of the dispute, and have the opportunity to participate fully, they are getting all the process which is due.

Conclusion for Issue I

"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." SDCL 49-34A-8.4. The Court gives the Commission a reasonable range of informed discretion in the interpretation and application of ARSD 20:10:13:44 because the agency's interpretation is one of long standing (in case any interpretation was needed in the first place, which it wasn't). The Commission's interpretation and application of this Rule was correct when considered together with the Commission's expertise in applying the Rule. Combining the long-standing practice of considering adjustments during the pendency of the case, the practicality of such practice, the full evidentiary support of these adjustments, and the harmonious construction of the regulatory scheme with related statutes, the Commission did not err by permitting the proposed adjustments.

II.

Whether the Commission erred by using 2010–2014 in its five-year normalization calculation for pension expenses instead of 2011–2015?

BHP's pension expense varies significantly year-by-year. The 2013 test year pension expense was $2,844,759; in 2014, it was only $976,122; 2012's pension expense was $3.25 million. FOF 41. BHP suggested a normalization adjustment based on the average annual expense of "the most recent five-year average of actual costs", which at the time of the adjustment was from 2010 to 2014, equaling $2,336,305. By late December 2014, however, BHP knew its 2015 actual pension expense, but the Commission still approved the pension expense adjustment for 2010 to 2014. At the hearing below, BHII objected to this treatment, but the Commission found that the normalization method was consistent with sound regulatory principles and accepted the average for the cost of service analysis.

On appeal, BHII argues that if the Commission can accept adjustments after filing the application—if Appellees' interpretation of ARSD 20:10:13:44 prevails in Issue I—then the Commission must use the actual known and measurable data

from 2015, so that the five-year range used for normalization is from 2011 to 2015 (reducing the revenue requirement by $173,855).

Appellees assert that this is not reviewable because no evidence was presented below about the reasonableness of the 2011 to 2015 average for pension expense. Appellees also argue this issue was not timely raised on appeal because BHII never presented any evidence on 2015 data and did not make this argument until after the contested hearing. BHP argues BHII only submitted evidence that 2014 data, alone, was appropriate without normalization and never presented evidence that 2011 to 2015 was the more appropriate period than 2010 to 2014 period. BHP concludes that the Commission did not have the opportunity to review evidence regarding whether the use of 2011 to 2015 data was a better reflection of total current pension costs than 2010 to 2014, and thus this court should not address the issue.

First, this issue is reviewable. Evidence was submitted to the Commission on this issue. The actual 2015 data was presented to the Commission, although not by BHII, but by BHP's witness Thurber, who testified that BHP's "actual total company 2015 pension expense is $2,056,581. The actuarial calculation was provided as a Supplemental Response to SDPUC 2-13." *Thurber Rebuttal* at 22, App. A-389. BHII's Post-Hearing Brief to the Commission dated February 17, 2015 argued for including 2015 in the normalization calculation:

> Should the Commission reject BHII's interpretation of ARSD 10:20:13:44 [sic] and allow post-filing adjustments to costs included in the test-year, the Commission should require BHP to incorporate two additional changes. First, the Commission should incorporate 2015 into the five-year average of pension expense. . . .
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> According to Mr. Thurber, BHP's five year average (years 2010 through 2015 [sic]) for pension expense cost is $2,336,305. *Thurber Rebuttal* at 21 (should be 2014). As support for beginning to use a five-year average, Mr. Thurber points to the fact that the Company now knows the pension expense for 2015. He testified that 'Black Hills Power's actual total company 2015 pension expense is $2,056,581.' *Id.* at 22. If the Commission is inclined to use the most current information, Mr. Thurber's table on page 21 of his rebuttal testimony should be revised to delete the year 2010 and add the year 2015 for purpose of calculating the five year average. The revised five year average would be $2,162,451. . . .

Post-Hearing Br. at App. A-124-25. This very point was addressed by the Commissioners at their March 2, 2015 meeting. *See Post-Brief Hr'g Tr.* at 4-7 (March 2, 2015) at Co. App. A-136-39 (Commissioners asking questions and discussing whether the 2015 actual pension expense shows continued volatility of the expense in light of freezing their pension plan); *see also Petition for Reconsideration,* Reply App. 166, 191-92.

In its Brief on appeal, BHP argues that "the Commission considered the data from 2015 in determining whether the normalization of pension expense using costs from 2010-2014 was proper", not whether using 2015 in the normalization calculation would result in a just and reasonable rate. *BHP Br.* at 23.

The Commissioners considered the 2015 data and whether it still showed the pension expense was fluctuating and whether 2010 to 2014 was reasonable. The Commissioners had the opportunity to request more information or testimony, if needed, to determine its effect on the rate. But instead, the Commissioners did not find it necessary to adjust for the known 2015 expense.

There are really two inter-related issues here: one, in light of concluding that adjustments can be made during the pendency of the case in Issue I, is the Commission *required* to accept all adjustments with actually known and measurable data as it comes available? (What if the new figure is either anomalous, or irrelevant by dint of being no different than the prior data? Are the commissioners still bound to "plug in" data which they discount or distrust for whatever reason?) And two, whether the Commission's factual finding that the five-year normalization calculation 2010 to 2014 was "just and reasonable" without including the 2015 actual data? The first issue requires the same standard of review as Issue I, *de novo* for statutory and regulatory interpretation. The second issue on the Commission's factual finding is subject to clear error review.[19] The Court will only reverse a finding when it is "firmly convinced a mistake has been made." *Hayes*, 2014 S.D. 64, ¶ 7, 853 N.W.2d at 881.

BHII argues that if the Court approves the Commission's interpretation of ARSD 20:10:13:44, the Commission is *required* to adjust when it has actual data of the most current costs of service. BHII cites no authority or law *mandating* the Commission to use the most recent data and absolving its duty of determining a "just and reasonable" rate.

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[19] BHII argues that the 2015 actual data was documentary evidence; therefore, whether this was a finding of fact or conclusion about interpreting a Rule, the Court's review should be *de novo*. While it is true that documentary evidence can be reviewed de novo by an appellate court, findings based on live testimony are reviewed for clear error. *Tucek v. Dep't of Soc. Servs.*, 2007 S.D. 106, ¶ 13, 740 N.W.2d 867, 871. In this case, three witnesses testified, both in case-in-chief and as rebuttal. BHP witness Thurber (TR. at 132-33); BHP witness White (TR. at 86-87; *see* BHP Exhibit 21); Staff witness Peterson (Peterson Direct, *Exh. Staff* 1 at 16-17; TR. at 282-83); and BHII witness Kollen (TR. at 175, 184, 210, 214-16).

At the heart of SDCL 49-34A-6, -8 and ARSD 20:10:13:44 is the underlying objective of finding the most "just and reasonable" rate, the best representation of future costs. In other words, if the 2010 to 2014 range is a better representation of the future expense incurred during the time the new rate is in effect, and 2015 was an anomalous year for pension expense, BHII's interpretation would require the Commission to ignore a more reasonable rate and impose a less representative cost. Without any citing authority[20] *requiring* the Commission to accept certain adjustments and absent express language in the Rule to that effect, the subjective nature of the Commission's duty of finding a "just and reasonable" rate is paramount. Also, BHII presents no evidence that 2010 to 2014 is unjust or unreasonable. The Commission adopted Peterson's testimony on this point and found the normalization using 2010 to 2014 was just and reasonable.[21]

"The test-year concept is designed to produce a measure of a regulated utility's earnings for a known period of time, to enable the regulatory body to make an accurate prediction of revenues and expenses in the reasonably near future. Based upon the evidence presented, "*the regulatory body undertakes a reasoned exercise of its discretion in altering test-year data to reflect changes of known magnitude occurring subsequent to the test year*." *Nw. Pub. Serv. Co., v. Cities of Chamberlain, et al.*, 265 N.W.2d 867, 878 (S.D. 1978) (citing *Nw. Bell Telephone Co. v. State of Minn.*, 253 N.W.2d 815, 822 (Minn. 1977)) (emphasis added).

Although neither party argues on the subjective nature of determining a rate, that really answers the question. The Commission has discretion to balance the interests of the ratepayers with the interests of the utility to find what is "just and reasonable" according to the Commissioners' expertise. The standard of review is not whether adding 2015 proves that the 2010 to 2014 average was unfair. Instead, the standard is whether, based on the entire record, this court "is definitely and firmly convinced a mistake has been made." *Otter Tail Power Co.*, 2008 S.D. 5, 26, 744 N.W.2d at 602. Based on the entire record, the Court is not firmly convinced that the Commission erred when finding that the normalization calculation using 2010 to 2014 resulted in a just and reasonable rate.

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[20] No authority is offered to support this position except a corollary argument for consistent application of ARSD 20:10:13:44 with the Court's ruling on Issue 1. While the "[f]ailure to cite authority is waiver of an argument" and fatal of the issue at the Supreme Court level, it is illustrative to this Court that BHII cannot cite any rules or statutes that expressly mandate the Commission to use each and every current cost regardless of whether it would make the end result unreasonable. Inherent within the Commission's discretion is the *forecasting* of which data (2010 to 2014 or 2011 to 2015) are most likely to be repeated in the future. This court is reluctant to second guess that forecast. Commissioners are free to pick the data most trusted or representative.

[21] "An understatement of BHP's pension costs could place the Company in a significant under-recovery position necessitating more frequent rate increases. With a highly variable cost such as the pension expense, to avoid wide swings in over-recovery and under-recovery of the underlying expense, it makes sense to employ a normalization procedure, such as that reflected in the settlement . . . unless there is an extraordinary event that makes a five-year normalization method unreasonable." *Peterson Direct, Exh. Staff* 1 at 17.

The Commission posited the argument that the actual data was known *too late* to be included. At first, this argument does not make sense in light of the Commission's prior admission that their interpretation of the adjustment Rule may allow adjustments up to the day of the Commission's Final decision. *PUC Br.* at 15. But at oral argument, the Court (and BHII) learned for the first time of an internal cut-off date set by Staff for accepting adjustments to the cost of service. The purpose of this internal regulation is practicality and administrative only. The Commission explained that if an adjustment comes in too close to the date set for decision and would have a *de minimis* (too minor to merit consideration) effect on the rate, then, in its discretion, it will not accept the adjustment. The Commission's position is that the amount of the adjustment and its overall effect on the rate must be significant enough to expend the time and money making the adjustment to the cost of service and then to change the revenue requirement (if revenue-producing) under the matching principle. This practice continues to reflect the discretionary balancing act the Commission must do when determining a fair end result and a just and reasonable rate.

III.

Whether the Commission erred when it included $888,000 of BHP's incentive compensation package expense in its cost of service analysis?

BHII asserts that the inclusion of the $888,000 adjustment for incentive compensation expense was not fully supported, thus BHP did not meet its burden of proving that, by a preponderance, this adjustment is "prudent, efficient, and economical and [is] reasonable and necessary to provide service to the public utility's customers in this state." SDCL 49-34A-8.4; *Irvine v. City of Sioux Falls*, 2006 S.D. 20, ¶ 10, 711 N.W.2d 607, 610 (the burden of proof for administrative hearings is preponderance of the evidence). In the parties' briefs, it was agreed that the standard of review is clear error; however, at oral argument, BHII argued this issue should be reviewed *de novo*. The Court finds this issue to be one reviewed for clear error, but even if BHII is correct and the review is *de novo*, it would not change the Court's holding.

The specific evidence BHP offered to support this adjustment was a discovery response to Staff Request 2-11, a fund schedule, Attachment 2-11G (Confidential). AR. at 6340. Also, BHP witness White testified that in his opinion, BHP's "programs are prudent and necessary to attract and retain and motivate employees." TR. at 56. He further testified that disallowing the amount on line 6 of the Attachment 2-11G "would result in a very unfair rate of return on equity for [BHP]." TR. at 57. While White could not specifically answer what document or exhibit or evidence supported the amounts in Attachment 2-11G, White believed that through its submitted books and records, the Application, formal and informal discovery, and the expert testimony, BHP has met its burden by showing that BHP has "incurr[ed] these costs in a prudent way and meeting [its] obligation to serve."

TR. at 59. BHII faults BHP for not providing work papers to support Attachment 2-11G. While the Commission did not make a specific finding regarding whether this was sufficient evidentiary support, it did find that including the incentive compensation plan did "not render the Amended Stipulation unjust and unreasonable." FOF 40. This finding is well-supported by the testimony of Patterson, White, and Peterson.[22] Even if the Court's standard of review were *de novo*, as suggested by BHII, the Court would still affirm the inclusion of the incentive plan expense to make a just and reasonable rate.

BHII argues that the inclusion of incentive compensation expenses makes the resulting rate unjust and unreasonable, yet BHII does not explain why this expense cannot be passed on to the customers if it encourages retention of employees and results in better service. BHP offers that there is no legal authority and no reason why an incentive compensation plan cannot be included in the cost of service, regardless of it being connected to performance or retention. The Commission agreed and concluded, "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." COL 12. BHII seems to limit the application of "just and reasonable" to

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[22] BHP provided testimony from several witnesses who discussed the incentive compensation plan and the reasonableness of recovering that expense in this rate case. BHP witness Laura Patterson explained the purpose of the incentive compensation plan and the adjustment. She testified about many studies (Towers Watson study, BHC Human Resources review, Aon Hewitt, Mercer, the Edison Electric Institute, etc.) that provide market incentive compensation comparisons. *BHP Exh.* 22. She also stated that while there is no case law precedent for including the expense, commissions "in Nebraska, Iowa, Wyoming and Colorado in both gas and electric rate cases have approved this employee compensation and benefit structure." *Id.* at 22.

In his rebuttal testimony, Kyle White testified that the inclusion of this expense has not been shown to be "imprudent or unreasonable based upon what the market pays employees for similar positions." *BHP Exh.* 65. White summarizes Patterson's testimony that restricted stock is not tied to financial performance, because "once restricted stock is granted to a key employee, the only requirement for pay-out is the employee's continued employment." *Id.* at 12. White also explained that there is no justification for excluding the entire expense (the additional $888,000), but it would have a "punitive outcome for the Company for utilizing normal and reasonable employee compensation practices that are prevalent across the utility industry and other companies in the Black Hills region." *Id.* at 13.

David Peterson explained that the parts of the plan that were performance-based were excluded from the cost of service (equally an exclusion of $666,000), so BHP is not requesting ratepayers pay for performance-based incentive plan. TR. at 284-87. For the other part of the plan included in the cost of service analysis, Peterson testified that BHP does not have financial triggers in that incentive compensation plan, so it is reasonable to include that expense which is not tied to performance measures. *Id.*; Peterson Direct, *Exh. Staff* 1 at 17-18 ("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, I supported the exclusion that is contained in the settlement and recommend that the Commission reject Mr. Kollen's recommendation to expand the exclusion at this time.")

the perspective of ratepayers only, yet clearly the Legislature intended that the rate also be just and reasonable to the utility as well.

The Commission's responsibility is to apply the criteria of SDCL 49-34A-6 and -8, and judge the rate as a whole. The cost of service analysis and the revenue requirement is the result of a give-and-take negotiation and settlement. The Commission found that, having included the incentive compensation expense, the rate was still just and reasonable. The Court is not definitely or firmly convinced that the Commission erred when it included this expense, nor would it reverse under a *de novo* standard. The adjustment was fully supported and this Court affirms the finding.

CONCLUSION

For the foregoing reasons, the Commission's decision is AFFIRMED.

Dated this 8th day of January, 2016.

Mark Barnett

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Honorable Mark Barnett
Sixth Circuit Court Judge