IN THE SUPREME COURT

OF THE

STATE OF SOUTH DAKOTA

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

#27751

Appeal from the Circuit Court, Sixth Judicial Circuit
Hughes County, South Dakota
The Honorable Mark W. Barnett
Circuit Court Judge

APPELLANTS' BRIEF

Notice of Appeal was filed on February 8, 2016

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JURISDICTIONAL STATEMENT

This is an appeal taken from the Circuit Court's Order and Memorandum Decision (the "*Order*") dated January 8, 2016, and filed in Hughes County, affirming the April 17, 2015 Final Decision (the "*Final Decision*") of the South Dakota Public Utilities Commission (the "*Commission*"). Black Hills Industrial Intervenors ("*BHII*") filed a Notice of Appeal on February 8, 2016. This Court has jurisdiction of the appeal under SDCL 15-26A-3 and 1-26-37.

STATEMENT OF ISSUES

The broad issues before this Court are:

A. Whether the Circuit Court erred by affirming the Commission's interpretation of ARSD 20:10:13:44.

The Circuit Court affirmed the Commission.

Relevant Cases:

In re Application of Black Hills Power, Inc. for an Accounting Authority Order, EL-13-036 (Jan. 9, 2014)

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

Murray v. Mansheim, 2010 S.D. 18, 779 N.W.2d 379

Nelson v. Bd. of Dentistry, 464 N.W.2d 621 (S.D. 1991)

Relevant Statutes and Rules:

SDCL 1-26-4
SDCL 49-34A-8.4
SDCL 49-34A-19
ARSD 20:10:13:44
ARSD 20:10:13:46
ARSD 20:10:13:104

B. Whether the Circuit Court erred by concluding that the Commission did not arbitrarily and capriciously approve the calculation of a five-year average pension expense.

The Circuit Court affirmed the Commission.

Relevant Cases:

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

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

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

Relevant Statutes and Rules:

SDCL 1-26-36
ARSD 20:10:13:44

C. Whether the Circuit Court erred by concluding that Black Hills Power, Inc. ("*BHP*") met its burden under SDCL 49-34A-8.4, -11 and ARSD 20:10:13:44 with respect to BHP's incentive compensation costs.

The Circuit Court affirmed the Commission.

Relevant Cases:

Erdahl v. Groff, 1998 S.D. 28, 576 N.W.2d 15

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

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

Relevant Statutes and Rules:

SDCL 49-34A-6
SDCL 49-34A-8.4
SDCL 49-34A-11
ARSD 20:10:13:44

I. STATEMENT OF THE CASE AND FACTS

Over BHII's objections and upon reconsideration, the Commission approved the Amended Settlement Stipulation dated February 10, 2015 (the "*Amended Settlement*"), between BHP and Commission staff ("*Staff*") with respect to BHP's application for authority to increase electric rates (the "*Application*"). BHII timely appealed the Final Decision to the Circuit Court in Hughes County. On January 8, 2016, the Circuit Court affirmed the Commission. *Order* at 1, App. A-2. In its appeal, BHII seeks to resolve the following disputed issues of law that are matters of first impression and bear directly on the calculation of a public utility's cost of service: (1) the proper interpretation of ARSD 20:10:13:44, and (2) the evidentiary standard a utility must meet to satisfy its burdens of proof under SDCL 49-34A-8.4, -11 and ARSD 20:10:13:44. The undisputed facts giving rise to this appeal are set forth below.

BHP submitted its Application to the Commission on March 31, 2014. *Final Decision* at 1, App. A-25. The Application proposed an increase in electric rates of approximately $14.6 million annually, or 9.7%. *Id*. As part of the Application, and in compliance with South Dakota law, BHP submitted a cost of service analysis.[1] *Id*.

On June 6, 2014, BHII and Dakota Rural Action ("*DRA*") filed petitions to intervene in the proceeding, and on June 26, 2014, the Commission granted them. *Id.* at 2, App. A-26. During the Fall of 2014, the parties engaged in settlement discussions in

[1] Generally speaking, a utility's "cost of service" or "revenue requirement" is the amount of money asserted by the utility as necessary to operate and maintain facilities, cover capital expenses, and provide a rate of return to its investors. Charles F. Phillips, Jr., *The Regulation of Public Utilities* 176-77 (1993). The terms are used interchangeably. The cost of service, when considered along with the utility's sales revenue, is the foundation for any increase in a utility's electric rates and state law dictates how it must be determined. *Id.*

an effort to avoid contested proceedings. *BHII's Post-Hearing Brief* at 2 (Feb. 17, 2015) ("*BHII's Post-Hrg. Br.*"). BHII and DRA were not privy to all settlement discussions between BHP and Staff. *See, e.g.*, *id.* at 2, n.4.

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

Pursuant to the Hearing Notice and SDCL Ch. 1-26, the Commission conducted a contested hearing on January 27 and 28, 2015. *Final Decision* at 2, App. A-26. Pertinent to this appeal, BHP and Staff admitted that the Original Settlement contained a $0.286 million error in the allocation from BHP's affiliate, Black Hills Utility Holdings ("*BHUH*"). *Evidentiary Hearing Transcript* at 279:24-280:5 ("*Evid. Hrg. Tr.*"). After the hearing, and upon BHII's motion, the parties were afforded the opportunity to submit post-hearing briefs. *Final Decision* at 2, App. A-26.

One week before the due date for post-hearing briefs, on February 10, 2015, BHP and Staff filed the Amended Settlement, which reflected two changes to the Original Settlement. *Final Decision* at 2, App. A-26. Specifically, the Amended Settlement (1)

removed the erroneous $0.286 million affiliate allocation from BHUH and (2) added a new $0.413 million affiliate allocation from BHUH for operations and maintenance expenses related to BHP's Wyodak power plant (the "*Wyodak Expense Adjustment*")—an amount that was first submitted into evidence in BHP witness Thurber's rebuttal testimony on January 15, 2015. *Staff Memorandum Supporting Amended Settlement Stipulation* at 2 (Feb. 10, 2015) ("*Am. Staff Mem.*"). Despite these changes, the overall revenue deficiency agreed upon between BHP and Commission Staff in the Amended Settlement remained the same at $6,890,746. *Am. Staff Mem.* at 3.

On February 17, 2015, BHII and BHP submitted their respective briefs, *Final Decision* at 3, App. A-27, and on February 23, 2015, Staff and BHP filed a Joint Motion for Approval of Amended Settlement Stipulation, *id.* Less than 10 days later, at a hearing on March 2, 2015, the Commission voted to grant that motion. *Id.*

On June 26, 2015, BHII filed a Notice of Appeal with the Circuit Court. *Order* at 3, App. A-5. The Circuit Court held oral argument on November 23, 2015, *Oral Argument Transcript* at 1, App. A-101 ("*Oral Arg. Tr.*"), and entered an Order on January 8, 2016, affirming the Commission's Final Decision, *Order* at 1, App. A-2.

BHII seeks reversal from this Court (the "Court") of the Circuit Court's Order, and with it the Commission's Final Decision, based on: (1) the Commission's misinterpretation of ARSD 20:10:13:44, and (2) the Commission's misapplication of the legal standard a utility is obligated to meet when satisfying its burdens of proof under SDCL 49-34A-8.4, -11. With respect to the first basis upon which reversal is warranted, BHII asserts that the Commission and the Circuit Court misinterpreted and misapplied the law, resulting in certain adjustments to BHP's filed cost of service analysis that

should have been rejected. Specifically, the Amended Settlement approved by the Commission and affirmed by the Circuit Court includes both (1) adjustments to test-year book costs originally proposed by BHP in its Application ("*Pre-Filing Adjustments*") and (2) adjustments to test-year book costs and Pre-Filing Adjustments originally proposed by BHP after filing its Application ("*Post-Filing Adjustments*"), that the Commission was legally obligated to reject. Critical to the Court's analysis, the issues on appeal do not challenge the Commission's authority to approve settlement agreements based on facts properly before it. Nor do the issues on appeal address the give-and-take that occurs between parties in settlement negotiations based on such facts. Instead, BHII raises only legal issues that strike at the heart of what facts may be on the table for negotiation by the parties in the first place. As to the second ground for reversal, each utility bears the burden of proof to demonstrate that the underlying costs of any rates or charges are prudent, efficient, and economical and are reasonable and necessary in rendering service. SDCL 49-34A-8.4. BHII submits that this burden cannot be satisfied where, as here, the witness proffered by the BHP to support the cost is unable to cite any evidence supporting the cost.

The impact of this appeal on BHP's South Dakota ratepayers is significant. Depending on the Court's interpretation of State law, the $6.9 million rate increase approved by the Commission could be reduced by an amount ranging from 15% to 20%.

II. ARGUMENT

A. Overview of Regulatory Theory and Applicable Law

Utility regulation is based upon what is referred to as the "regulatory compact." Charles F. Phillips, Jr., *The Regulation of Public Utilities* 21 (1993). There are two facets of this compact. First, utilities accept an obligation to serve all customers requesting

service in return for a monopoly franchise in a given area. *Id.* Second, utilities are allowed an opportunity to recover, and earn a reasonable rate of return on, the prudent capital investments that are reasonable and necessary to serve its captive customers. *Id.* When a utility believes its sales revenues are no longer sufficient to recover these costs, the utility is entitled to submit a petition to increase rates with the agency having jurisdiction over its operations. *Id.* at 176-77. In general terms, a utility rate case has two sets of issues: (1) the revenue requirement—*i.e.* "how much" rates should increase, analyzing the utility's filed cost of service analysis; and (2) the revenue allocation—*i.e.*, "who pays" for the rate increase ultimately resolved under (1). *Id.* This appeal involves only the revenue requirement.

For public utilities operating in South Dakota, an application to increase rates is governed by SDCL Ch. 49-34A and ARSD Ch. 20:10:13. The utility requesting a rate increase bears the burden of proving both that the proposed costs supporting its request are justified and that the proposed rates are just and reasonable. SDCL 49-34A-8.4, -11. As part of its review of a utility's rate case filing, the Commission is obligated to consider the utility's historical costs and, depending on what additional information is filed by the utility, the Commission may consider future income and expenses. SDCL 49-34A-19. To assist the Commission in its review of issues regarding the revenue requirement, the Commission promulgated rules setting forth the schedules and information that must be included in any rate case filing. *See* ARSD Ch. 20:10:13. For example, the utility's application must include an analysis of its cost of service over a 12-month period known as the "test period" or "test year." ARSD 20:10:13:43. The objective of this analysis is to examine in detail the utility's costs and revenues over a

discrete period to arrive at just and reasonable rates going forward. The cost of service analysis must include the statements and schedules identified in ARSD 20:10:13:51 through 20:10:13:102, and each is subject to the burdens of proof referenced above. ARSD 20:10:13:104.

The cost of service analysis must analyze the utility's book costs for a test period consisting of 12 months of actual data. ARSD 20:10:13:44. In other words, the rules provide for a historic (*i.e.*, backward-looking) test period, and the utility must file its application for a rate increase within 6 months of the end of that historic test period. *Id.* As one would expect, changes to a utility's historic costs are bound to occur because no operating year for any utility is exactly like the year before. South Dakota law accounts for this fact by providing the utility seeking a rate increase with two mechanisms to adjust historic costs. First, the utility is allowed to adjust historic costs based on changes that are "known with reasonable certainty and measurable with reasonable accuracy" at the time the utility files its application for a rate increase. *Id*. In other words, ARSD 20:10:13:44 only allows adjustments to the historic test year that become known with reasonable certainty and measurable with reasonable accuracy between the end of the historic test period and the filing of the application for a rate increase. *Id.*

Second, South Dakota law permits utilities to file a forecasted test period in addition to the historic test period. ARSD 20:10:13:104 states, "Although §§ 20:10:13:51 to 10:10:13:102, inclusive, provide for a historical test period, the utility, in addition, may submit cost of service information for a non-historical test period beginning no later than

the proposed effective date of the new rates."[2] ARSD 20:10:13:104. Thus, the utility can "update" its cost of service information using the procedure laid out in ARSD 20:10:13:104.[3]

Regardless of whether the utility seeking an increase introduces new cost information to augment the historical test period analysis, the utility bears the burden of proof under SDCL 49-34A-8.4, -11 to demonstrate that the underlying costs of any rates or charges are prudent, efficient, and economical and are reasonable and necessary in rendering service.

B. The Circuit Court violated the plain language of ARSD 20:10:13:44 by affirming the Commission's interpretation of the rule.

1. Standard of Review

The standard of review for this issue is *de novo*. *See Order* at 5, App. A-7. Both the construction of an administrative rule and its correct application by the agency are questions of law that are fully reviewable by the Court and no deference need be given to the agency's or the Circuit Court's interpretation. *Nelson v. Bd. of Dentistry*, 464 N.W.2d 621, 624 (S.D. 1991). An agency's interpretation of its own rule is only given "a reasonable range of informed discretion" in three scenarios: "when the language subject

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[2] During oral argument before the Circuit Court, counsel for the Commission stated "we don't accept forecasted test years." The Circuit Court judge then asked, "The rule allows it, but you guys don't use it? Don't do it?" To which counsel answered, "We just do not accept a forecasted test year." *Oral Arg. Tr.* at 66:18-25, App. A-110. As the Circuit Court judge acknowledged, the Commission's apparent practice of refusing to accept forecasted test years from a utility directly violates the plain language of ARSD 20:10:13:104.

[3] This rule also aligns with the requirement in ARSD 20:10:13:44 that any adjustment to test-year book costs become effective within 24 months of the last month of the historic test period, because 24 months from the end of the test period is also the time in which the forecast period is allowed.

to construction is technical in nature or ambiguous, or when the agency interpretation is one of long standing." *Id.* None of those circumstances exist in this case. First, the language of the rule is not technical because it involves a simple phrase, "at the time of filing," which the Court is well-equipped to construe, rather than complicated industry terms. *Id.* at 625 (noting that medical terms in rules are "technical in nature"). Second, the language of the rule is not ambiguous because the meaning of the disputed language is clear when viewed in the context of the rule as a whole as well as State statutes governing a utility's cost of service. Third, even if the language is ambiguous, the Court should not defer to the Commission's interpretation as one of long standing.

An agency is "allowed a reasonable range of informed discretion" for long standing interpretations only "as long as its construction is reasonable and not inconsistent with the rules." The testimony that the Circuit Court cites to support the Commission's interpretation of ARSD 20:10:13:44 as one of long standing highlights both the Commission's and the Circuit Court's misunderstanding of the plain language of the rule. *Order* at 5 n.1, App. A-7. The Circuit Court quotes Staff witness Peterson's statement that "[i]t 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 measurable with reasonable accuracy . . . ." *Id.* Staff Witness Peterson's statement conflates the rule's requirement that adjustments be known and measurable and the requirement that adjustments become effective within 24 months of the test year. *See* ARSD 20:10:13:44. *Nelson*, 464 N.W.2d at 625. Furthermore, the Commission's interpretation is unreasonable and inconsistent with the plain language of the rule. *Infra.* at 16-21. Thus,

the agency's interpretation "is fully reviewable by the [C]ourt without deference to the agency determination." *Id.* at 624.

The Court is therefore free to modify the Commission's decision and remand directly to the Commission to implement the modification. *See* SDCL 1-26-36 (providing grounds for modification of agency order); *Application of Nebraska Pub. Power Dist.*, 354 N.W.2d 713, 719 (S.D. 1984) (modifying the Commission's decision on several issues); *Nw. Bell Tel. Co., Inc. v S.D.P.U.C.*, 467 N.W.2d 468, 469 (S.D. 1991) (reversing circuit court's order affirming the commission and remanding directly to agency for further proceedings). Furthermore, when reviewing an agency decision on appeal, the Court "appl[ies] the same standard as the circuit court, with no assumption that the court's ultimate decision was correct." *In re GCC License Corp.*, 2001 S.D. 32, ¶ 8, 623 N.W.2d 474, 479 (citations omitted). Thus, the Court owes no deference to the Circuit Court's decision.

BHII's argument on this issue is separated into three parts to clearly demonstrate the meaning of the rule, explain why the Circuit Court's policy arguments were misguided and reflected a misunderstanding of the ratemaking process and the interests at stake, and describe the particular adjustments the Commission should have rejected. Should the Court accept BHII's arguments on this issue, the revenue requirement approved by the Commission in the Amended Settlement would be reduced by at least $505,107.[4]

[4] This figure accounts for both the additions ($219,000 for Neil Simpson Complex Shared Facilities Adjustment; $244,000 for Neil Simpson Complex Common Steam Allocation; and $885,000 for the Cost of Debt Adjustment), *see Kollen Direct* at 49; *BHP Circuit Court Response Brief* at 15-16, and the deductions ($64,107 for LIDAR plus the unamortized cost in rate base), *see Thurber Rebuttal Testimony & Exhibits* at 14 (Jan. 15,

2. Judicial Review of ARSD 20:10:13:44 Should be Informed by the Other Applicable Statutes and Rules Governing Utility Rate Cases.

In order to understand the meaning of ARSD 20:10:13:44, one must also understand the other relevant statutes and rules regarding ratemaking. "[I]t is fundamental that the words of a [rule] must be read in their context and with a view to their place in the overall [regulatory] scheme." *In re Certification of a Question of Law from U.S. Dist. Court, Dist. of S. Dakota, S. Div.*, 2014 S.D. 57, ¶ 8, 851 N.W.2d 924, 927 (quotation omitted). For example, SDCL 49-34A-19 sets the general parameters for evaluating any proposed revenue requirement filed in a utility's application to increase rates and states, in relevant part, that:

> In determining the revenue requirement the [C]ommission *shall* consider revenue, expenses, cost of capital and other factors or evidence material and relevant thereto. The [C]ommission *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.

(emphasis added).

Hence, the Legislature (1) directed the Commission to consider "revenue, expenses, cost of capital, and other [material and relevant] factors or evidence" and (2) gave the Commission the option to consider reasonable income and expenses that "will be forthcoming in a period of twenty-four months in advance of the test year." It is axiomatic in administrative law that an agency's interpretation of a statute is reflected in the rule it adopts. *See, e.g.*, SDCL 1-26-1(8) (defining "rule" as "each agency statement

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(. . . continued)
2015) ("*Thurber Rebuttal*"), *Kollen Direct* at 45-46; $527,000 in affiliate allocations, *see Kollen Direct* at 39; $130,000 in wages, *see Staff Memorandum Supporting Settlement Stipulation* at 7 (Jan. 15, 2015) ("*Original Staff Memorandum*"); and $1.132 million for new affiliate allocations from BHSC, *see Kollen Direct* at 40-41.

of general applicability that . . . interprets . . . law"); *Krsnak v. Dep't of Env't & Nat. Res.*, 2012 S.D. 89, ¶ 13, 824 N.W.2d 429, 435 (describing how the legislature delegates power to an agency to interpret and execute a statute). Contrary to the Circuit Court's belief, nothing in SDCL 49-34A-19 bears upon the question of whether adjustments to test-year costs should be permitted after the end of the test year. By promulgating ARSD 20:10:13:44, the Commission cleared up the inherent ambiguity in the phrase "forthcoming in a period . . . in advance of the [historic] test year" by allowing the utility to argue for including any costs that will become effective within 24 months of the end of the test year.

Other provisions in the ratemaking regulatory scheme also shed light on the meaning of ARSD 20:10:13:44 and bolster BHII's interpretation. By contrast, the Circuit Court and Commission's interpretation renders these provisions superfluous. When the Court interprets a rule "[n]o wordage should be found to be surplus. No provision can be left without meaning. If possible, effect should be given to every part and every word." *Maynard v. Heeren*, 1997 S.D. 60, ¶ 14, 563 N.W.2d 830, 835. For instance, ARSD 20:10:13:46, regarding "other data" relied upon by the utility outside of the data required by ARSD 20:10:13:51-102, states that such other data "shall be limited to the test period prescribed in § 20:10:13:44." ARSD 20:10:13:46. There is no reason to limit that "other data" to the test period if adjustments are allowed after the application is filed. Furthermore, as explained above, the rules allow the utility to offer updated cost of service information through a forecast test year by following the procedure laid out in ARSD 20:10:13:104. The Commission's interpretation of ARSD 20:10:13:44 is inconsistent with ARSD 20:10:13:104, because there is no reason to allow a forecast test

year if the utility is allowed to simply adjust the cost of service in a piecemeal and ad hoc manner throughout the ratemaking proceedings. Thus, other ratemaking statutes and rules support BHII's interpretation of ARSD 20:10:13:44.

3. The Plain and Unambiguous Language of ARSD 20:10:13:44 Aligns with BHII's Interpretation of the Rule.

A major component of any utility rate case is careful scrutiny of the utility's cost of service in order to ensure that those costs are "prudent, efficient, economical and are reasonable and necessary to provide service." SDCL 49-34A-8.4. Neither SDCL 49-34A-8.4 nor any other South Dakota statute establishes the criteria the Commission must use to determine whether the utility has met its burden of proving that its costs meet the standard enumerated in SDCL 49-34A-8.4. But the Commission has promulgated ARSD 20:10:13:44 to guide its analysis of the completeness and accuracy of a utility's filed cost of service. The rule, in its entirety, reads as follows:

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

(emphasis added).

The Commission can only find that a utility has met its burden of proof under SDCL 49-34A-8.4 if the utility's cost of service satisfies the provisions of ARSD 20:10:13:44.

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

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

The Court has previously stated that "[t]he purpose of using a test year is to establish *with a reasonable degree of accuracy* the revenue and expenses that a utility will experience during the period when the new rates will be in effect." *In the Matter of the Application of Nw. Pub. Serv. Co. for a Proposed Increase in Rates for Electric Service*, 297 N.W.2d 462, 469 (S.D. 1980) (quotation omitted) (emphasis added). ARSD 20:10:13:44 takes into account the imperfect nature of the historical test year by incorporating two mechanisms that ensure test-year data is representative of the utility's cost of service on the date it files for a rate increase. First, the rule requires the utility to file its application within six months after the end of the test year. By mandating that a utility file within six months, the rule helps protect the contemporaneousness of the

historical test year data. Second, the rule allows the utility to propose adjustments to test-year book costs that become known and measurable in the time between the end of the historical test year and the date the utility chooses to file its case. In particular, the rule allows the utility to propose an adjustment for any cost that "will become effective" (*i.e.*, that the utility will incur) within 24 months after the end of the test year so long as it is (1) "fully supported" by the evidence and (2) "known with reasonable certainty and measurable with reasonably accuracy" when the application is filed. Since a historical test year is backward-looking, these mechanisms account for circumstances that may change between the end of the test year and the date a utility files its application.

b. The Plain Language of ARSD 20:10:13:44 Requires Proposed Adjustments Be Known with Reasonable Certainty and Measurable with Reasonable Accuracy "at the Time of Filing."

BHP has argued, and the Circuit Court agreed, that ARSD 20:10:13:44 requires that adjustments to test-year book costs be known and measurable at the time the adjustment is filed, not at the time the utility files its application for a rate increase. *See Order* at 6-9, App. A-8-11. This interpretation is wrong because it ignores the context of the rest of the rule and its place in the regulatory scheme. "Each [rule] must be construed according to its manifest intent as derived from the [rule] as a whole." *Moore v. Michelin Tire Co., Inc.*, 1999 S.D. 152, ¶ 16, 603 N.W.2d 513, 518.

The Circuit Court concluded that because the rule does not contain the word "application," and because the "subject of each sentence in this adjustment passage is 'adjustments' and all modifiers refer to 'adjustments,'" the phrase "at the time of filing" must refer to the filing of the adjustment rather than the application. *Order* at 8, App. A-11. This reasoning considers only one sentence in isolation and ignores the fact that the other use of the term "filing" in the rule refers to the time when the application is filed:

"The statement of the cost of service shall contain an analysis . . . 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.*" ARSD 20:10:13:44 (emphasis added). ARSD 20:10:13:40 describes the "contents of applications for rate increases," and ARSD 20:10:13:43 describes the cost of service data that is filed along with the application. ARSD 20:10:13:44 goes on to state that "[p]roposed adjustments to book costs shall be *shown separately*," (emphasis added), meaning that adjustments shall be "shown separately" from the historic test-year data filed with the application. Thus, when read "as a whole," and not in the vacuum of one sentence, it is clear that the rule refers to the application for a rate increase and the sentence in question simply requires that adjustments to book costs filed with that application be "shown separately" and "known and measurable" at the time the application is filed.

BHII's interpretation does not "render the entire passage about adjustments meaningless," as the Circuit Court stated, *see Order* at 9, App. A-11, because it allows the utility to file adjustments to book costs that become known and measurable between the end of the test year and the filing of the application.[5] "[W]hen this Court interprets legislation, it cannot add language that simply is not there." *In re: Petition for Declaratory Ruling Re: SDCL 62-1-1(6)*, 2016 S.D. 21, ¶ 9, 2016 WL 929339 at *3 (S.D.

[5] BHII acknowledges that there may be a very unlikely circumstance in which the utility discovers, after filing its application, that certain adjustments that were known and measurable at the time of the filing were erroneously excluded from the utility's application. Contrary to the Circuit Court's assertion, this scenario will not "cause a new issue in rate cases." *Order* at 10 n.5, App. A-12. Rather, the utility would simply have to prove that the proposed adjustment was known and measurable at the time it filed its application.

March 9, 2016) (quotations omitted). In order to justify the Circuit Court's and Commission's interpretation the words "of the adjustment" must be added after "at the time of filing." BHII's interpretation requires no additional language, because the entire rule refers to the application. This interpretation comports with the plain meaning of the rule and the Circuit Court's and Commission's does not.

4. The Commission's Interpretation of 20:10:13:44 is Unreasonable and Inconsistent with South Dakota Law.

Even if this Court determines that ARSD 20:10:13:44 is ambiguous, the Commission's interpretation is not entitled to deference because its construction is unreasonable and inconsistent with South Dakota law.

a. The Commission's Interpretation of ARSD 20:10:13:44 Violates Due Process and Rulemaking Requirements.

The Circuit Court found no due process issue because "notice and opportunity to participate were provided." *Order* at 16, App. A-18. Due process, however, does not merely require an opportunity to participate, but rather an "opportunity to be *heard*." *Hollander v. Douglas County*, 2000 S.D. 159, ¶ 17, 620 N.W.2d 181, 186 (emphasis added). To permit a utility to continually update its cost of service during the pendency of the case, and then only for selected cost increases, incentivizes utilities to "throw in the kitchen sink" with their applications in hopes that they would be able to prove some of the costs later.[6] Under the Commission's interpretation, the utility is allowed to update

[6] One only needs to compare BHP's proposed $14.6 million rate increase to the $6.89 million rate increase approved by the Commission in this case to understand how wildly exaggerated a utility's filed cost of service can be. *Compare Final Decision* at 1, App. A-25, *with Am. Staff Mem.* at 3. And when a utility recovers less than half of its grossly inflated proposed recovery, one can see that SDCL 49-34A-21, which prohibits the Commission from approving a rate increase higher than what is proposed in the application, does not provide any real protection against unjust and unreasonable rates.

its cost of service continually until the Commission files its order. Any meaningful opportunity to be heard on the central issue of the utility's cost of service is illusory if that cost of service is a moving target until the final decision is issued.

The Commission appears to have recognized that allowing the utility to file adjustments up to the Commission's order is procedurally unworkable and violates due process. During oral argument below, the Commission explained that it has avoided a scenario where adjustments could be filed up to the date of the Commission's order by instituting a secret, "internal cut-off date set by Staff for accepting adjustments to the cost of service" of which BHII (and likely other parties) was previously unaware.[7] *Order* at 20, App. A-22. That cut-off date allegedly "coincides with the test period" because the Commission "really [doesn't] want to see any more updated costs" more than twelve months after the end of the test period. *Oral Arg. Tr.* at 60:14-15, App. A-104. Ignoring the fact that ARSD 20:10:13:44 provides for no such "internal cut-off date," and does not reference a 12-month test period after the end of the test year for submitting adjustments, the Circuit Court accepted the Commission's addition to the rule, explaining that "if an adjustment comes in too close to the date set for decision and would have a *de minimis* . . . effect on the rate, then, in its discretion, [the Commission] will not accept the adjustment." *Id.* The Commission's "internal cut-off date" illustrates two points: (1) the Commission's interpretation of ARSD 20:10:13:44 is necessarily wrong because the Commission was forced to create a cut-off date in order to avoid an absurd result (*i.e.*, the utility's opportunity to file new costs up to the date of the Commission's order), *see*

[7] Counsel for the Commission also stated that "the parties agreed to" a cut-off date, but that agreement did not include BHII. *Oral Arg. Tr*. at 59:11-13, App. A-103. It is unclear from the transcript whether Staff always uses the same time period for the cutoff date or whether it changes with every case. *Id.* at 59-66, App. A-103-10.

Murray v. Mansheim, 2010 S.D. 18, ¶ 7, 779 N.W.2d 379, 382 (stating that courts "have an obligation to interpret law in a manner avoiding 'absurd results'"); and (2) the Commission violated South Dakota law by engaging in rulemaking to set the internal cut-off date without following the necessary notice and comment procedures. *See* SDCL 1-26-4. The first point is self-evident. The second is explained below.

The Circuit Court's assertion that "the purpose of this internal regulation is practicality and administrative only," *Order* at 20, App. A-22, belies any foundation in statute and case law and ignores the statutory requirements for rulemaking. South Dakota statutes define "rule" as "each agency statement of general applicability that implements, interprets, or prescribes law, policy, *procedure*, or practice requirements of any agency. The term . . . does not include: . . . [s]tatements concerning only the internal management of an agency and *not affecting private rights or procedure available to the public*." SDCL 1-26-1(8) (emphasis added). The Commission's secret internal cut-off date is a "rule" because it is a statement of general applicability that implements procedure and affects the private rights and procedure available to the public. SDCL 1-26-4 requires agencies to comply with the "notice, service, and public hearing procedure" that "shall be used to adopt, amend, or repeal a permanent rule." The statute further provides that "[n]o agency rule may be enforced by the courts of this state until it has been adopted in conformance with the required procedures set forth in this chapter." SDCL 1-26-6.8. The Commission's "internal cut-off date" is thus invalid because the Commission failed to subject that portion of the rule to the procedures under State law. And without this "internal cut-off date," the Commission's interpretation leads to an absurd result, which

demonstrates why BHII's interpretation, and not the Commission's, is consistent with the plain language of the rule.

b. The Commission's Interpretation of ARSD 20:10:13:44 Ignores the Mechanisms Utilities Have Under South Dakota Law to Recover Costs that Vary from the Test Period.

The Circuit Court justified the Commission's interpretation by stating that "[i]f 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." *Order* at 10, App. A-12. This is incorrect. As noted above, the filing utility can include adjustments to the test period under ARSD 20:10:13:44 or submit a non-historic test-period in addition to the historic test-period. ARSD 20:10:13:104 ("Although §§ 20:10:13:51 to 20:10:13:102 . . . provide for a historical test period, the utility, in addition, may submit cost of service information for a non-historical test period beginning no later than the proposed effective date of the new rates."). Thus, if the utility wishes to update its cost of service with information that was not known and measurable when it filed its application, then it may do so by submitting its costs and revenue for a non-historical test period as well. That way, the Commission is able to examine the entire picture of the utility's updated finances rather than just its costs.

For large, unforeseen expenditures, the utility can petition for deferred accounting, which allows the utility to account for unexpected costs on its books differently than it accounts for other costs. SDCL 49-34A-7 (directing the Commission to "designate" the accounting methods used by utilities). For example, BHP petitioned for a deferred accounting for the incremental costs of repairing the damage of Winter Storm Atlas, which caused approximately $5-6 million in damage to BHP's system.

Application of Black Hills Power, Inc. for an Accounting Authority Order, Docket no. EL 13-036, APPLICATION at 5 (Nov. 15, 2013), App. A-92. The Commission approved BHP's application, allowing it to "accumulate and defer for potential recovery in base rate proceedings" the costs associated with the storm repairs. *Application of Black Hills Power, Inc. for an Accounting Authority Order*, Docket no. EL 13-036, ORDER at 1 (Jan. 9, 2014), App. A-99. BHP requested an accounting authority order in the rate case to include additional costs associated with Winter Storm Atlas, as well as costs associated with a ground patrol project of Black Hills communities. *Testimony of Christopher J. Kilpatrick* at 14-16; *Ex.CJK-3*.

c. Case law does not support the Commission's interpretation of ARSD 20:10:13:44.

Neither the Commission nor the Court has considered the meaning of ARSD 20:10:13:44 until now. The Circuit Court improperly relied on *In re Minnesota Gas Co.* and *Northwest Public Service Co.* to support the Commission's contention that Post-Filing Adjustments are permitted. Neither case interpreted ARSD 20:10:13:44.

Contrary to the Circuit Court's assertion, BHII's interpretation of ARSD 20:10:13:44 is bolstered by *In re Minnesota Gas Co. Order* at 13, App. A-15. In *In re Minnesota Gas Co.*, the Commission held that a "budget is an unreliable basis for establishing rates." F-3302, 32 P.U.R. 4th 1 (S.D.P.U.C. 1979), App. A-48. This case strongly supports BHII's argument that several of BHP's adjustments filed with its Application were not "fully supported," as required by ARSD 20:10:13:44, because they were mere budgets. *See infra* at Sec. B.5.a., pg. 21-22.

BHII's interpretation also does not run contrary to *Northwest Public Service Co.* First, it is important to recognize that the rate case at issue in *Northwest Public Service*

Co. occurred before ARSD 20:10:13:44 was promulgated by the Commission, so the reasoning in the case has little, if any, bearing on the meaning of that rule.[8] 297 N.W.2d 462, 464 (S.D. 1980). Second, the case is distinguishable because it involved a new cost (the Big Stone Power Plant) for which there was no historical data available at the time the utility filed its application. *Id.* at 468. The reasoning in *Northwest Public Service Co.* is no longer relevant in light of ARSD 20:10:13:44.

5. The Commission Should Have Rejected BHP's Adjustments.

BHP's Pre-Filing Adjustments were not "fully supported," and the Post-Filing Adjustments were not "known with reasonable certainty and measurable with reasonable accuracy" at the time the application was filed.

a. Several of BHP's Pre-Filing Adjustments Were Not Fully Supported.

Any adjustment to test-year book costs proposed by the utility must be "fully supported, including schedules showing their derivation where appropriate." As already discussed, the Commission has previously determined that a Pre-Filing Adjustment is not "fully supported" if it merely represents a budget estimate. *In re Minnesota Gas Co.*, 32 P.U.R. 4th 1, App. A-48. The facts demonstrate that the Amended Settlement contains three Pre-Filing Adjustments based on budgets.

First, the Application contained a budget without actual historical data to support approximately $0.502 million of LIDAR surveying costs and $0.137 million in amortization expense. *Application of BHP for Authority to Increase Electric Rates* § 4, *Statement H, Schedule H-20* ("*Appl.*"); *see BHII's Post-Hrg. Br.* at 48-50. Second,

[8] Northwest Public Service Company filed its request for a rate increase on July 17, 1975, and ARSD 20:10:13:44 was not promulgated until July 7, 1976.

BHP's Application included a Pre-Filing Adjustment of approximately $1.846 million for affiliate allocations from BHUH, an unsupported 19% increase over the historic test- year expense. *Appl.* § 4, *Statem. H, Schedule H-5*; *Kollen Direct* at 38. Indeed, Staff conceded in its memorandum supporting the Original Settlement that "Staff objected to this adjustment because it did not reflect a known and measurable change in BHP's costs; rather, *it was merely BHP's estimate of future costs*." *Orig. Staff Mem.* at 7, App. A-68 (emphasis added). Third, the Application included a Pre-Filing Adjustment of $1.266 million for payroll and expenses related to 17 open positions, without support that these positions would be filled, and it is undisputed that BHP was unlikely to fill all of these open positions. *Kollen Direct* at 31.

Together, these Pre-Filing Adjustments reveal approximately $3.751 million in costs that were added to the total 12-month historical test year expense based on estimates that were unsupported by evidence in the record. The fact that these Pre-Filing Adjustments were later adjusted (in some instances upward and in some instances downward) based on information obtained after the date BHP filed the Application is irrelevant. The Commission should have rejected the Pre-Filing Adjustments. Instead, the Commission incorporated these unsupported Pre-Filing Adjustments into the Amended Settlement by boot-strapping them to Post-Filing Adjustments that should have been rejected in the first instance. The Circuit Court approved of this action by citing a case where the meaning of ARSD 20:10:13:44 was not at issue. *Order* at 13, App. A-15. If a budgeted cost runs afoul of rational and sound ratemaking principles (as the Commission determined it would in *In re Minnesota Gas Co.*, 32 P.U.R. 4th 1, App. A-

48), then unsupported Pre-Filing Adjustments to a 12-month historical test year should not be resurrected or cured later by Post-Filing Adjustments.

b. Several of BHP's Post-Filing Adjustments Were Not Known With Reasonable Certainty and Measurable With Reasonable Accuracy "at the Time of Filing."

Both the Original Settlement and the Amended Settlement contain Post-Filing Adjustments that were admittedly unknown until well after the date of BHP's Application. The Post-Filing Adjustments fall into two categories. The first are Post-Filing adjustments that are designed to cure the insufficiency of Pre-filing Adjustments, of which there are at least three. First, the Original Settlement included a Post-Filing Adjustment to the budgeted cost for LIDAR that was unknown until September 26, 2014 (nearly six months after BHP filed the Application). *BHII's Post-Hrg. Br.* at 49. Second, BHP's Post-Filing Adjustments to affiliate allocations in its Application were based upon informal email correspondence between BHP and Staff that was not provided to BHII or otherwise included in the record. *Kollen Direct* at 39-41. Third, the Original Settlement reflected Post-Filing Adjustments to wages and salaries totaling $130,000, which allegedly included employees hired as of the date of the Original Settlement, and could not have been known or measurable on the date of the Application. *Orig. Staff Mem.* at 7. Each Post-Filing Adjustment described above is based on information obtained well after the date of BHP's Application, and should have been rejected because it was not "known with reasonable certainty and measurable with reasonable accuracy" at the time the Application was filed, as required by ARSD 20:10:13:44.

The second category of Post-Filing adjustments are line item additions to BHP's cost of service analysis that are wholly unrelated to a Pre-Filing Adjustment or otherwise included in the Application. There is at least one such adjustment that was made late in

the proceedings. The record indicates that the Amended Settlement included $1.132 million in affiliate allocations from BHP's affiliate, Black Hills Service Company ("*BHSC*"), an entirely new cost. *Compare Appl., Sched. H-4 with Orig. Staff Mem. at Exhibit __(DEP-1), Schedule 3*. BHP failed to provide any evidence that the increased BHSC allocation was known and measurable at the time BHP filed its Application. BHP should not be allowed to use the rate case discovery process as a vehicle for introducing such a cost under the guise of ARSD 20:10:13:44.

Given these errors, BHII respectfully requests that the Court reverse the Circuit Court's Order affirming the Commission's approval of the Amended Settlement, modify the Commission's Final Decision to exclude the adjustments detailed above, and remand to the Commission for proceedings consistent with that decision.

C. The Circuit Court erred by concluding that the Commission did not arbitrarily and capriciously approve the calculation of a five-year average pension expense that did not incorporate data from 2015.

1. Overview and Standard of Review.

If the Court does not accept BHII's analysis of ARSD 20:10:13:44 set forth in the preceding section, and thereby allows continual Post-Filing Adjustments to test-year book costs that were not known and measurable at the time BHP filed its Application, then the Court should conclude that the Commission is bound by its own interpretation of the rule and therefore obligated to calculate BHP's five-year average pension expense based on data from 2011-2015, rather than 2010-2014, because the data for 2015 was known to the Commission and submitted into evidence by BHP. In light of the Commission's acceptance of other adjustments to test-year book costs that were not known and measurable either at the time BHP filed its Application or when BHP and Staff submitted the Original Settlement, the Commission's approval of a five-year

average pension expense based on 2010-2014 data represents an arbitrary and capricious decision that prejudices all of BHP's ratepayers.

The standard of review for this issue is *de novo*. Fundamentally, whether or not the Commission correctly and equitably applied its interpretation of ARSD 20:10:13:44 is a question of law, which is reviewed *de novo*. *Matter of Sales & Use Tax Refund Request of Media One, Inc.*, 1997 S.D. 17, ¶ 11, 559 N.W.2d 875, 878. And the standard of review does not change if the Court determines that the Commission's selection of data from 2010-2014, rather than 2011-2015, was a finding of fact because the Commission's determination was based on documentary evidence included in the record, which is also reviewed *de novo*. *Tucek v. Dep't of Soc. Servs.*, 2007 S.D. 106, ¶ 13, 740 N.W.2d 867, 871 (internal citations and quotation marks omitted).

2. The Commission Should Have Calculated BHP's Five-Year Average Pension Expense Based on 2011-2015 Data.

In its Application, BHP proposed, and for settlement purposes Staff accepted, a normalization adjustment to BHP's annual pension expense based on "*the most recent* 5 year average of actual costs." *Final Decision* at 11, ¶ 41, App. A-35 (emphasis added). The five-year average pension expense approved in the Commission's Final Decision was based on data from the years 2010-2014, *id.* at 11, ¶ 43, App. A-35, not the most recent 5 years—*i.e.*, 2011-2015. On January 15, 2015, BHP witness Thurber testified to BHP's 2015 pension expense. *Thurber Rebuttal* at 22-23. Thus, BHP submitted evidence of its actual 2015 pension expense into the record before filing the Amended Settlement, but the Commission chose to ignore it.

Based on testimony given at oral argument before the Circuit Court, it appears that the Commission did not incorporate the 2015 data because Mr. Thurber's evidence

was submitted after the Commission's secret internal cut-off date. *See Order* at 20, App. A-22. This revelation, coupled with the Circuit Court's acceptance of Wyodak Expense Adjustment described below, further supports BHII's argument that the Commission's exclusion of the 2015 data was arbitrary and capricious and a clearly unwarranted exercise of discretion. Using the data in Mr. Peterson's direct testimony for the years 2011-2014, and the information in Mr. Thurber's rebuttal testimony for 2015, the five-year average pension expense should be $2,162,450, not $2,336,305, a difference of $173,855 that ratepayers should not have to pay.[9] *Compare Peterson Test.* at 16 *with Final Decision* at 11, ¶ 43, App. A-35 *and Thurber Rebuttal* at 22-23.

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

Not only did the Commission's exclusion of BHP's actual 2015 pension expenses contradict the Commission's own interpretation of ARSD 20:10:13:44, but it was also arbitrary and capricious and a clearly unwarranted exercise of discretion based on the Commission's inclusion of the Wyodak Expense Adjustment—expenses that were also first set forth in Mr. Thurber's rebuttal testimony. *Thurber Rebuttal* at 17-19, 22-23; *Exhibit JTR-1*.

SDCL 1-26-36 states that "[t]he court may reverse or modify the [Commission's] decision if substantial rights of the appellant have been prejudiced because the administrative findings, inferences, conclusions or decisions are: . . . (6) [a]rbitrary or capricious or characterized by . . . clearly unwarranted exercise of discretion." A decision is arbitrary and capricious (1) when it is "not governed by any fixed rules or

[9] The $2,162,450 average pension expense for 2011-2015 is still greater than the expense for 2015. *Thurber Rebuttal* at 22-23.

standard," *Smith v. Canton Sch. Dist. No. 41-1*, 1999 S.D. 111, ¶ 9, 599 N.W.2d 637, 639-640, or (2) when it is based on "personal, selfish, or fraudulent motives, or on false information, and is characterized by a lack of relevant and competent evidence to support the action taken," *In re Jarman*, 2015 S.D. 8, ¶ 19, 860 N.W.2d 1, 9. Once it adopts an interpretation of ARSD 20:10:13:44 that would permit adjustments to BHP's cost of service that were not known and measurable at the time BHP filed the Application, the Commission must apply that rule with an even hand to the evidence in the record. It did not. Because it failed to follow the notice and comment rulemaking requirements and explain why it included some expenses and not others, the Commission's action was a "clearly unwarranted exercise of discretion."

Like BHP's actual 2015 pension expenses, the Wyodak Expense Adjustment was first introduced into evidence in Mr. Thurber's rebuttal testimony on January 15, 2015—after the Commission's secret internal cut-off date. The Commission offered no explanation for its disparate treatment of these expenses, and it is unclear why one was excluded and the other was not. The Commission failed to conduct a transparent process for assessing adjustments and thus arbitrarily and capriciously applied its own rule.

Furthermore, despite the parties' agreement that BHP's adjustment for affiliate allocations from BHUH in the Amended Settlement included a $0.286 million error, *Evid. Hrg. Tr.* at 279:24-280:5, the Commission did not order BHP and Staff to subtract that amount from the underlying revenue requirement. After BHII uncovered the error, Staff and BHP added in the Wyodak Expense Adjustment so that the overall cost of service did not change. It appears that Staff and BHP agreed to cover the $0.286 million error in the Original Settlement with the $0.413 million in Wyodak expenses. Then,

when BHII noted that the 2015 pension expense should be used to compute the five-year average because that evidence was admitted at the same time as the Wyodak O&M expense, the Commission admitted to (1) an internal cut-off date that it did not apply equitably because it accepted the Wyodak Expense Adjustment and ignored the 2015 pension expense and (2) a *de minimis* threshold. Neither of these concepts is contemplated in the plain language of ARSD 20:10:13:44, and BHII was completely unaware of them. The result was a $0.286 million error "fixed" by adding in a $0.413 million upward adjustment that was not known and measurable at the time BHP filed its Application nor disclosed in the record prior to the Commission's internal cut-off date, and the corresponding rejection of a downward adjustment for pension expense that was disclosed in the record at the same time (and by the same person). Such a result underscores the Commission's clearly unwarranted exercise of discretion.

To reiterate, if the Court rejects the analysis set forth in Section II.B., above, then BHII prays the Court reverse the Circuit Court's affirmation of the Final Decision on this issue, modify the Final Decision by reducing BHP's revenue requirement by an amount equal to the difference between the 2010-2014 and 2011-2015 average pension expense calculations, and remand to the Commission for proceedings consistent with that decision.

D. The Circuit Court erred by concluding that BHP met its burden under SDCL 49-34A-8.4, -11 and ARSD 20:10:13:44 for the unsupported incentive compensation cost.

Regardless of whether the Court agrees with BHII's arguments on the first two issues, the Commission misapplied the legal standard a utility is obligated to meet when satisfying its burdens of proof under SDCL 49-34A-8.4, -11, and ARSD 20:10:13:44. In particular, the evidence BHP provided on incentive compensation did not meet its

burdens of proof. The standard of review for this issue, like the other issues, is *de novo*. When "determining whether the uncontroverted facts or the facts as established satisfy the legal standard of proof, [it] is a mixed question of law and fact, reviewable de novo." *Erdahl v. Groff*, 1998 S.D. 28 ¶ 30, 576 N.W.2d 15, 21 (reviewing agency decision). When reviewing a decision of the Commission, the Court will "give due regard to [a] well-reasoned and fully informed decision" but "will not uphold clear errors of judgment or conclusions unsupported in fact."[10] *In re Otter Tail Power Co. ex rel. Big Stone II*, 2008 S.D. 5, ¶ 29, 744 N.W.2d 594, 603. Should the Court accept BHII's argument on this issue, the $6.9 million rate increase approved by the Commission must be reduced by $0.888 million.

The Commission's decision to approve BHP's incentive compensation plan—and, by extension, the Amended Settlement—was a clear error of judgment, unsupported by the facts in evidence. In SDCL 49-34A-11, the Legislature reinforced the utility's burden, under SDCL 49-34A-8.4, to prove that all costs are reasonable and necessary to provide service: "The burden of proof to show that any rate filed is just and reasonable shall be upon the public utility filing same," and the utility must satisfy this burden by a preponderance of the evidence. *Irvine v. City of Sioux Falls*, 2006 S.D. 20, ¶ 10, 711 N.W.2d 607, 610. The Commission cannot rely on evidence that fails to show that a cost is prudent, efficient, economical and reasonable and necessary to provide service to the public in determining that a rate is just and reasonable. "An agency's decision cannot

[10] The Circuit Court misconstrued BHII's argument regarding the standard of review for this issue. *Order* at 20, App. A-22. BHII argued in its Circuit Court brief that all three issues are legal issues and accordingly receive *de novo* review on appeal. *BHII Circuit Court Opening Brief* at 4, 23-27.

rest significantly on a judgment pulled solely out of the air, without an anchor in the record." *Trans World Airlines, Inc. v. C.A.B.*, 385 F.2d 648, 658 (D.C. Cir. 1967).

The cost of service analysis in BHP's Application included $3,789,297 for incentive compensation. *Orig. Staff Mem. at Exhibit __(DEP-1) Schedule 1.* Of that, $1.554 million was tied to operating and financial performance. *Kollen Direct* at 35. In response to discovery, BHP claimed that (1) it should bear only $0.666 million of the $1.554 million cost because only $0.666 million was related to financial goals, and (2) the remaining $0.888 million (including $0.149 million in performance plan expense and $0.739 million in incentive restricted stock expense) should be added to rates and borne by customers. *Kollen Direct* at 37. The sum-total of BHP's evidence with respect to incentive compensation is a confidential table that was presented in response to Staff Information Request No. 2-11, labeled "Attachment 2-11G," with no underlying work papers or references to other documents. *Evid. Hrg. Tr.* at 59:11-18; *BHII Exhibits 5-6.* When questioned about the sufficiency of the table and the lack of supporting documents, BHP witness Kyle White, a company executive, did not point to any evidence in the record to support the table. *Id.* The Circuit Court acknowledged that BHP did not submit evidence supporting its incentive compensation when it stated, "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." *Order* at 20, App. A-22 (emphasis added). Although Mr. White may "believe" that BHP had submitted sufficient evidence to prove the

reasonableness of that cost, the beliefs of a utility executive are not evidence. Furthermore, BHP's failure to offer any evidence supporting its incentive-compensation adjustment is especially concerning because, as BHII Exhibits 5 and 6 demonstrate, the adjustment decreased the total amount of incentive compensation but increased the amount that BHP proposed to recover from ratepayers. *BHII Exhibits 5-6*.

Contrary to the Circuit Court's reasoning, *Order* at 21, App. A-23, BHII is not arguing that BHP cannot include incentive compensation in electric rates as a matter of law, *BHII Circuit Court Reply Brief* at 14. BHII is simply arguing that BHP failed to carry its burden to prove that the $0.888 million in performance plan expense and incentive restricted stock expense were reasonable and necessary to provide service. By not including $0.666 million related to financial goals in its rate base, BHP acknowledged that costs to achieve financial goals should not be passed on to ratepayers because those costs are not reasonable and necessary to provide retail electric service. Likewise, the Commission should have excluded the additional $0.888 million tied to operational and financial performance because BHP did not prove that those costs were reasonable and necessary to provide retail electric service.

BHII prays the Court reverse the Circuit Court's Order affirming the Commission's Final Decision on this issue, modify the Final Decision to exclude $0.149 million in performance plan expense and $0.739 in incentive restricted stock expense, and remand to the Commission for proceedings consistent with that decision. If the Court agrees, then BHP would still be allowed to recover approximately $2,235,297 in incentive compensation expenses.

III. CONCLUSION

BHII requests that the Court reverse and remand the Circuit Court's Order affirming the Commission's Final Decision on two independent grounds. First, BHII asks the Court to determine, as a matter of law, that the Circuit Court and Commission misinterpreted the plain language of ARSD 20:10:13:44, reverse the Circuit Court's Order, modify the Final Decision to exclude the adjustments that were unsupported or filed after the application, and remand the case to the Commission for consistent proceedings. Second, BHII asks the Court to conclude, as a matter of law, that the Circuit Court and Commission misapplied the legal standard a utility is obligated to meet when satisfying its burdens of proof under SDCL 49-34A-8.4, -11, and ARSD 20:10:13:44, reverse the Circuit Court's Order, modify the Final Decision to exclude the unsupported incentive compensation, and remand to the Commission for consistent proceedings. In the event the Court agrees, the $6.9 million rate increase the Commission approved would be reduced by approximately $1.4 million, or roughly 20.2%. If the Court disagrees with BHII's interpretation of ARSD 20:10:13:44, then BHII requests, at a minimum, that the Court reverse the Circuit Court's Order, modify the Final Decision by incorporating the 2015 pension expense and accordingly reducing the revenue requirement, and remand to the Commission for consistent proceedings. Should the Court accept this alternative argument, as well as the argument on incentive compensation, the $6.9 million rate increase approved by the Commission would be reduced by approximately $1.061 million, or roughly 15.4%.

IV. REQUEST FOR ORAL ARGUMENT

BHII hereby requests oral argument on all issues and matters raised in this appeal.

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Respectfully submitted,

/s/ Mark A. Moreno

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