IN THE SUPREME COURT

OF THE

STATE OF SOUTH DAKOTA

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

No. 27751

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

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# APPELLEE BLACK HILLS POWER, INC.'S BRIEF

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Notice of Appeal was filed on February 8, 2016

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## JURISDICTIONAL STATEMENT

Appellants appeal the Circuit Court's Order and Memorandum Decision dated January 8, 2016 ("*Order*"), affirming the April 17, 2015, Final Decision ("*Final Decision*") of Appellee South Dakota Public Utilities Commission (the "*Commission*"). This Court has jurisdiction of the appeal pursuant to SDCL 15-26A-3 and SDCL 1-26-37.

## STATEMENT OF ISSUES

Appellants Black Hills Industrial Intervenors ("BHII") appeal the Circuit Court's affirmance of the Commission's Final Decision. Appellee Black Hills Power, Inc. ("BHP") submits that the three issues on appeal are as follows:

**A. Whether the Circuit Court properly affirmed the Commission's long-standing interpretation of ARSD 20:10:13:44 and approval of post-test year cost adjustments that became known and measurable within 24 months following the test year.**

The Circuit Court properly affirmed the Commission's interpretation of ARSD 20:10:13:44 and decision regarding post-test year adjustments.

**Relevant Cases:**

*Citibank, N.A. v. S.D. Dep't of Revenue*, 2015 S.D. 67, 868 N.W.2d 381.

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

*Martinmaas v. Engelmann*, 2000 S.D. 85, 612 N.W.2d 600.

*App. of Nw. Pub. Serv. Co.*, 297 N.W.2d 462 (S.D. 1980).

**Relevant Statutes and Rules:**

ARSD 20:10:13:44.

ARSD 20:10:13:01.

SDCL 49-34A-19.

SDCL 49-34A-8.

SDCL 49-34A-8.4.

**B. Whether the Circuit Court properly affirmed the Commission's approval of the five-year normalization of pension expenses from 2010-2014.**

The Circuit Court properly affirmed the Commission and found that the Commission's approval of the normalization of pension expenses from 2010-2014 was not clear error.

**Relevant Cases:**

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

*Tucek v. S.D. Dep't of Soc. Servs.*, 2007 S.D. 106, 740 N.W.2d 867.

*Behrens v. Wedmore*, 2005 S.D. 79, 698 N.W.2d 555.

**Relevant Statutes and Rules:**

ARSD 20:10:13:44.

**C. Whether the Circuit Court properly affirmed the Commission's finding that BHP met its burden to prove that the inclusion of limited incentive compensation in BHP's cost of service was just and reasonable.**

The Circuit Court properly affirmed the Commission and found that the inclusion of BHP's employee incentive compensation in BHP's cost of service was not clear error.

**Relevant Cases:**

*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-11.

SDCL 49-34A-8.

## I. STATEMENT OF THE CASE AND FACTS

BHP filed its Application for Authority to Increase Its Electric Rates ("*Application*"), including a cost of service analysis, on March 31, 2014. *Final Decision*, BHII-A-25.[1] On June 6, 2014, BHII and Dakota Rural Action ("DRA") filed a Petition to Intervene, which the Commission granted. *Id.* DRA did not appeal the Final Decision.

During the pendency of BHP's Application, the Commission's Staff ("*Staff*") served over 330 discovery requests, and BHII served over 60 discovery requests, to which BHP responded. *Peterson Direct*, BHP-A-30. The parties engaged in settlement negotiations to stipulate to the terms of the rate increase. *Final Decision*, BHII-A-26. Ultimately, BHP and Staff resolved all issues and entered into a Settlement Stipulation ("*Original Stipulation*") filed with the Commission on December 9, 2014. *Id.* BHII chose to not be a party to the Original Stipulation. *Id.*

The Commission held an evidentiary hearing on January 27 and 28, 2015, ("*Evidentiary Hearing*") to determine whether to approve the Original Stipulation and, if not, to determine what rates, terms, and conditions were just and reasonable. *Order* at BHII-A-4. The parties, including BHII, pre-filed testimony of witnesses, a typical practice for evidentiary hearings. *Id.* The Commission set the Application and Original Stipulation for voting on March 2, 2015. *Id.* On February 10, 2015, before the deadline for post-hearing briefs, BHP and Staff filed an Amended Settlement Stipulation ("*Amended Stipulation*") reflecting two changes based on additional information submitted in pre-filed testimony and evidence introduced during the Evidentiary Hearing.

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[1] Appellee BHP's appendix is referred to herein as "BHP-A," and Appellant BHII's appendix is referred to herein as "BHII-A."

*Final Decision*, BHII-A-25; *Order*, BH11-A-4. The Amended Stipulation did not change the overall revenue deficiency agreed to in the Original Stipulation. *Amended Stip. Memo.*, BHP-A-19.

On March 2, 2015, the Commission held open meeting deliberations on the Amended Stipulation, which BHII attended. *Order*, BH11-A-6. On April 17, 2015, the Commission filed and served its Final Decision approving the Amended Stipulation in its entirety. *Final Decision*, BHII-A-25. The Commission denied BHII's petition for rehearing and reconsideration. *Order*, BH11-A-7.

BHII then appealed to the Circuit Court the three issues noticed for appeal before this Court. *Order*, BHII-A-5. The Circuit Court affirmed the Commission in all respects. *Id.* at BHII-A-3. The Circuit Court's decision has now been appealed to this Court by BHII.

## II. ARGUMENT

### A. The Circuit Court properly affirmed the Commission on all of the issues raised by BHII in this appeal.

The first issue, the Circuit Court's affirmance of the Commission's interpretation and application of ARSD 20:10:13:44, should be affirmed for several reasons. First, the Circuit Court simply enforced the plain language of ARSD 20:10:13:44, which allows a utility company to submit post-test year adjustments that became known and measurable within 24 months following the test year. Second, if any interpretation of ARSD 20:10:13:44 was necessary, the Circuit Court properly deferred to the Commission's interpretation of its own rule as such interpretation was of long-standing and the Commission is afforded great weight in interpreting its rules. Third, even if a de novo review is necessary, the Circuit Court and Commission's interpretation is the only

interpretation which complies with South Dakota's rules of statutory interpretation. Fourth, the Circuit Court and Commission's interpretation protects customers' due process rights as all parties had appropriate notice and the opportunity to be heard throughout the proceeding. Finally, the Commission's approval of certain post-test year adjustments complied with the correct interpretation of ARSD 20:10:13:44.

The Circuit Court also properly affirmed the Commission on the second issue, namely the Commission's approval of the normalization of BHP's pension expenses from 2010-2014. There is no dispute that BHP's pension expenses are volatile, and that normalization is a method to ensure that an expense is fair to both BHP and its customers. The only evidence before the Commission on the timeframe in which BHP's pension expenses should be normalized was 2010-2014. Therefore, the Commission's approval of the normalization of pension expenses from 2010-2014 was not clear error.

Finally, the Circuit Court properly affirmed the Commission's inclusion of limited incentive compensation in BHP's cost of service. The Commission approved of the inclusion because BHP met its burden to prove that the incentive compensation is necessary for BHP to remain competitive and retain employees, which benefits customers.

### B. This Court reviews the Commission's factual findings for clear error and provides great weight to the Commission's legal conclusions.

Key to this appeal are the applicable standards of review for the issues raised by BHII. This Court reviews the Commission's findings of fact and factual inferences using the clearly erroneous standard of review. *In re Otter Tail Power Co. ex rel. Big Stone II*, 2008 S.D. 5 ¶ 26, 744 N.W.2d 594, 603; *see also* SDCL 1-26-36. The Court resolves any conflict of evidence in favor of the Commission's findings, and does not substitute its

judgment for that of the Commission. *In re Estate of Schnell*, 2004 S.D. 80 ¶ 8, 683 N.W.2d 415, 418. The Court considers the evidence in its totality and may only set aside the Commission's factual findings if the Court is definitely and firmly convinced that the Commission made a mistake. *In re Otter Tail*, 2008 S.D. 5 ¶ 26.

Conclusions of law are generally reviewed under the de novo standard of review. *Id.* Two relevant exceptions exist, however, for the interpretation of statutes and regulations. First, an agency's interpretation of a statute is given "great weight" when the agency has been charged with the statute's administration. *Matter of Sales & Use Tax Refund Request of Media One, Inc.*, 1997 S.D. 17 ¶ 10, 559 N.W.2d 875, 878. Second, "[a]n agency is usually given a reasonable range of informed discretion in the interpretation and application of its own rules when the language subject to construction is technical in nature or ambiguous, or when the agency interpretation is one of long standing." *Krsnak v. S.D. Dep't of Env't & Nat. Res.*, 2012 S.D. 89 ¶ 16, 824 N.W.2d 429, 436. Both of these exceptions exist here. *See infra* § D.2.

### C. The rate-making process in South Dakota uses a historic test year to match costs and revenue under the matching principle.

The South Dakota legislature created a regulatory system for a utility to increase its rates and tasked the Commission with implementing such system. *See generally* SDCL Ch. 49-34A.[2] Pursuant to its authority, the Commission promulgated detailed

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[2] Although treatises, such as Charles F. Phillips, Jr., *The Regulation of Public Utilities*, as cited by BHII, may assist the Court if the law is unclear, such treatise is unnecessary here because the South Dakota regulatory scheme is clear. Regardless, Mr. Phillips acknowledges that a utility may adjust its test year costs so that the commission can determine whether a rate is just and reasonable under the matching principle. Charles F. Phillips, Jr., *The Regulation of Public Utilities*, 2005 WL 998367 (1988), BHP-A-145-46 ("For many years, commissions have adjusted test-year data for 'known changes'; *i.e.*, a

regulations a public utility must follow to increase its rates. *See generally* ARSD Ch. 20:10:13. The Commission employs the matching principle, wherein the utility must prove that its costs match the revenue it expects to receive. The utility presents such evidence through a cost of service analysis using a historic test year and post historic test year adjustments.

**1. The test year and post-test year adjustments are central to a utility's application to increase rates.**

Central to both a utility's application to increase its rates and to this appeal is what is known as the "historical test year" (also referred to as the "test year") and adjustments to that historical test year. SDCL 49-34A-19; ARSD 20:10:13:43-44. A historical test year contains a utility's required cost of service analysis. ARSD 20:10:13:40. Once the cost of service analysis for the historical test year is complete, the utility may file an application to increase rates with the Commission. *Id.*

The test year is forward-looking, and its purpose "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." *App. of Nw. Pub. Serv. Co.*, 297 N.W.2d 462, 469 (S.D. 1980).[3] The historical test year must end no earlier than six months before the utility files its application. ARSD 20:10:13:44. Here, BHP's historical test

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change that actually took place during or after the test period"); *Id.* at BHP-A-149 (recognizing that commissions use the matching principle).

[3] BHII's argument that *Northwestern Public Service* has limited precedential value is without merit. In *Northwestern Public Service*, this Court outlined the Commission's procedure and confirmed that a historic test year provides a basis for which adjustments may be made to reflect current costs. During the pendency of that case, the Commission promulgated ARSD 20:10:13:44, which confirms this Court's reasoning and sets out in further detail the manner in which post-test year adjustments may be made. Thus, *Northwestern Public Service* remains good law for the issues raised in this appeal.

year was for the year ending September 30, 2013, and its Application was filed on March 31, 2014.

A utility may update its cost of service analysis with post-test year adjustments which are known with reasonable certainty and measurable with reasonable accuracy when filed by the utility with the Commission, as long as such adjustment will become effective within the 24 months following the end of the test year. ARSD 20:10:13:44. Adjustments to the test year are allowed to avoid a regulatory lag between the time a utility submits its application and the time the Commission rules on the application. Allowing adjustments to a forward-looking test year ensures that the Commission is not reviewing stale data. This Court has previously approved this rate-making process:

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

*Nw. Pub. Serv.*, 297 N.W.2d at 464-65 (emphasis added).

**2. The matching principle ensures that a rate is just and reasonable.**

The Commission uses the historical test year and post-test year adjustments in applying the matching principle, in which the Commission evaluates whether the utility's application "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.*, 297 N.W.2d at 469; SDCL 49-34A-8 ("The commission . . . shall give due consideration . . . to the need of the public utility for revenues sufficient to enable it to meet its total current cost of furnishing such service"). Essentially, the Commission

matches test year costs, as adjusted, to revenues in determining whether the overall rate is just and reasonable. *In re Nw. Pub. Serv. Co.*, 18 P.U.R.4th 291, 294, 1976 WL 419254 (S.D.P.U.C. 1976), BHP-A-104. This "matching principle" is a "fundamental rate-making principle." *In re Minn. Gas Co.*, 32 P.U.R.4th 1, 4, 1979 WL 461903 (S.D.P.U.C. 1979), BHII-A-48. In applying the matching principle, the Commission engages in a discretionary balancing of costs and revenues to arrive at a just and reasonable rate. *Order*, BHII-A-22.

**D. The Circuit Court properly enforced the plain language of ARSD 20:10:13:44 and, further, appropriately deferred to the Commission's interpretation of its rule in affirming the Commission's approval of certain post-test year adjustments.**

In compliance with the adjustment rules, after filing its Application on March 31, 2014, BHP filed additional material with the Commission in response to over 390 discovery requests from Staff and BHII. *Peterson Direct*, BHP-A-30. This additional material formed the basis of BHP's adjustments, which were known with reasonable certainty and measurable with reasonable accuracy at the time that BHP responded to the discovery requests. *Thurber Rebuttal*, BHP-A-40-41.

"Staff accepted some Company adjustments, made corrections where necessary, modified other adjustments, and rejected those that [did] not qualify as known and reasonably measurable. Lastly, Staff introduced new adjustments not reflected in BHP's filed case." *Order* at BH11-A-16. Staff and BHP then entered into the Original Stipulation, and later the Amended Stipulation, and, thereafter, the Commission "concluded that adjustments in the Amended Stipulation are within the allowable adjustment periods set forth in SDCL 49-34A-19 and ARSD 20:10:13:44." *Final*

*Decision*, BHII-A-32, BHII-A-42. On appeal to the Circuit Court, BHII contested the Commission's interpretation of ARSD 20:10:13:44.

The Circuit Court offered alternative holdings for affirming the Commission's interpretation of its statutes and regulations, specifically ARSD 20:10:13:44. First, the Circuit Court affirmed the Commission's interpretation as such interpretation simply affirmed the plain language of ARSD 20:10:13:44. Second, if statutory construction was necessary, the Circuit Court properly gave the Commission deference as the Commission is the expert in utility regulation and its interpretation is long-standing.

**1. ARSD 20:10:13:44 is not ambiguous and should be enforced pursuant to its plain language.**

"Administrative regulations are subject to the same rules of construction as are statutes. When regulatory language is clear, certain and unambiguous, [the Court's] function is confined to declaring its meaning as clearly expressed." *Citibank, N.A. v. S.D. Dep't. of Revenue*, 2015 S.D. 67 ¶ 12, 868 N.W.2d 381, 387 (quotation omitted). A 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.

In reviewing the plain language of ARSD 20:10:13:44, the Commission and Circuit Court determined that such rule is not ambiguous and should be enforced according to its plain language, i.e., a utility may file post-test year adjustments that will become effective in the 24 months following the test year if the adjustments are known with reasonable certainty and measurable with reasonable accuracy when filed with the Commission.

### a. ARSD 20:10:13:44 has two distinct passages.

As the Circuit Court reasoned, ARSD 20:10:13:44 is divided into two distinct passages. *Order*, BHII-A-9-10. The first passage addresses the utility's cost of service analysis for the historical test year used in its application:

> **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 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.

ARSD 20:10:13:44. The second passage concerns post-test year adjustments to the cost of service:

> 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).

### b. An adjustment may be allowed if the adjustment will be effective within 24 months of the end of the historic test year.

Central to the interpretation of ARSD 20:10:13:44 is the phrase "at the time of the filing" in the second passage. The Commission and Circuit Court both found that "at the time of the filing" relates to the filing of the adjustment, not the filing of the Application. By contrast, BHII argues that "at the time of the filing" means that adjustments may only be filed "between the end of the historic test period and the filing of the application for a

rate increase." *BHII Brief* at 6. BHII's interpretation violates South Dakota's well-established rules of statutory interpretation.

"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 speaking." *Farmland Ins. Cos. of Des Moines, Iowa v. Heitman*, 498 N.W.2d 620, 624 (S.D. 1993) (quotation omitted). This Court "long ago" adopted this doctrine, otherwise known as the doctrine of the last antecedent. *Rogers v. Allied Mut. Ins. Co.*, 520 N.W.2d 614, 615 (S.D. 1994).

The second (or the "adjustments") passage of ARSD 20:10:13:44 does not relate to "application," but rather to "adjustments." *Order*, BHII-A-10 ("The subject of each sentence in this adjustment passage is 'adjustments' and all modifiers refer to 'adjustments.'"). The last antecedent prior to the operative phrase, "at the time of the filing," refers to adjustments, which must be based on changes in facilities, operations, or costs. *See* ARSD 20:10:13:44 ("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" (emphasis added)). Under this plain language, a utility may file a proposed adjustment which is "known with reasonable certainty and measurable accuracy" at the time the utility files the adjustment if such adjustment "will become effective within 24 months of the last month of the test period[.]" ARSD 20:10:13:44.

In order for BHII's interpretation to prevail, the Court would have to add the phrase "of the initial application" after the word "filing" in the adjustments passage of ARSD 20:10:13:44. Such an interpretation is prohibited. *City of Sioux Falls v. Ewoldt*,

1997 S.D. 106 ¶ 13, 568 N.W.2d 764, 767 (the Court "may not, under the guise of judicial construction, add modifying words to the statute or change its terms.").

BHII's interpretation would also violate the purpose of statutory interpretation, which is to discover and enforce "the true intention of the law." *Hayes v. Rosenbaum Signs & Outdoor Advertis., Inc.*, 2014 S.D. 64 ¶ 28, 853 N.W.2d 878, 885. If the Commission intended for the filing deadline for adjustments to be cut off when the utility files the application, it would have used "application" instead of "filing."

The interpretation of ARSD 20:10:13:44 by the Commission and the Circuit Court conforms to the plain language of the rule and, thus, should be affirmed.

**2. The Circuit Court properly affirmed the Commission's long-standing interpretation of ARSD 20:10:13:44.**

Alternatively, if ARSD 20:10:13:44 is ambiguous (which it is not), the Circuit Court properly affirmed the Commission's long-standing interpretation. An agency is given a reasonable range of informed discretion in interpretation of its rules, and such interpretation is given "great weight" when the agency has been charged with the rule's administration. *Media One*, 1997 S.D. 17 ¶ 10; *Krsnak.*, 2012 S.D. 89 ¶ 16.

The South Dakota legislature has charged the Commission with the administration of public utilities. *See, e.g.*, SDCL 49-1-11; SDCL Ch. 49-34A-4; *see also App. of N. States Power Co.*, 328 N.W.2d 852, 855 (S.D. 1983) (the Commission has "broad" regulatory authority). This Court has previously reasoned that it gives "deference to PUC's expertise and special knowledge in the field of electric utilities[.]" *Pesall v. Montana Dakota Utilities, Co.*, 2015 S.D. 81 ¶ 8, 871 N.W.2d 649, 652.

Rule 20:10:13:44 is technical in nature, and the Commission is afforded a reasonable range of informed discretion in interpreting its own rule. Moreover, the

Commission's interpretation of ARSD 20:10:13:44 is long-standing, such that the Court affords the Commission discretion in its interpretation.

BHII, ignoring the evidence presented by BHP to the Commission and Circuit Court about the long-standing nature of the Commission's interpretation, takes issue with the Circuit Court's citation to Staff witness Peterson's testimony. Mr. Peterson's testimony, however, summarizes the Commission's long-standing interpretation:

> Staff expert witness Peterson testified that during the four plus decades that he has worked with Staff on rate cases, the consistent interpretation of ARSD 20:10:13:44, read together with SDCL 49-34A-19, has been that because a historic test year is used to set rates for a future period, the analysis and substance of a proposed change in utility rates should include both known expenses during the test year and also adjustments to reflect any changes that occurred after the test year that become known and measurable within the 24-month period provided for in ARSD 20:10:13:44 and SDCL 49-34A-19. . . This is the standard that Staff has relied on for years, and the Commission has approved numerous rate case settlements based on that standard.

*Final Decision*, BHII-A-32. In its Final Decision, the Commission applied its long-standing interpretation. *Id.* at BHII-A-28 ("the analysis . . . of a proposed change in utility rates should include both known and measurable expenses during the test year and adjustments to reflect any changes that occurred after the test year that become known and measurable within the 24-month period for case processing provided for in ARSD 20:10:13:44 and SDCL 49-34A-19" (emphasis added)); *see In re App. of N. States Power Co.*, No. F-3382, at *2-3 (S.D.P.U.C. 1981), BHP-A-117-18 (summarizing Staff testimony that a utility "could offer known change adjustments occurring prior to the

Commission Order")[4]; *In re App. of N. States Power Co.*, No. F-3422, (S.D.P.U.C. 1983), BHP-A-124 (Staff, in a memorandum, stated that "[t]he refined adjustments were included in Company's rebuttal testimony. . . One was presented for the first time during settlement discussions. All of the amounts reflected as updates would have been accepted by Staff had the case gone to hearing.").

The Commission's interpretation of ARSD 20:10:13:44 is decades-old. Thus, the Commission is afforded a reasonable range of informed discretion in its interpretation.

**3. The Commission's interpretation of ARSD 20:10:13:44 is consistent with the regulatory scheme and is a practical, common sense result.**

Regardless of whether the Court enforces the plain language of ARSD 20:10:13:44, defers to the Commission's interpretation, or reviews the issue de novo, the only interpretation which complies with the rules of statutory construction is that advanced by the Commission and approved by the Circuit Court.

**a. The Commission's interpretation of ARSD 20:10:13:44 is a harmonious reading of the relevant statutes and regulations.**

"[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 Cert. of a Question of Law from U.S. Dist. Court*, 2014 S.D. 57 ¶ 8, 851 N.W.2d 924, 927 (quotation omitted). To that end, the Court construes a statute and its implementing regulations "together to make them harmonious and whole." *Citibank*, 2015 S.D. 67 ¶ 20. An absurd or

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[4] By Memorandum Decision dated October 28, 1982, Presiding Circuit Judge Robert Miller of the Sixth Judicial Circuit affirmed the Commission's decision. Memorandum of Decision, *In re App. of N. States Power Co. for Auth. to Est. Increase Rates for Elec. Serv. in S.D.*, Civ. No. 82-6 (S.D. 6th Jud. Cir., Oct. 28, 1982).

unreasonable result must be avoided in construing statutes or rules together. *Martinmaas v. Engelmann*, 2000 S.D. 85 ¶ 49, 612 N.W.2d 600, 611.

The interpretation of ARSD 20:10:13:44 by the Commission (as affirmed by the Circuit Court) to allow adjustments to the historic test year in the 24 months after the end of the test year, is harmonious with the relevant statutes and regulations. The interpretation advanced by BHII is not. For example, SDCL 49-34A-19, which governs the determination of a utility's revenue requirement, provides that the Commission may consider adjustments in costs that are known within 24 months of the historic test year:

> 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 (emphasis added). Under this statute, and the use of the word "may," the Commission maintains discretion to consider adjustments for expenses that will be forthcoming for a period of 24 months. *See Final Decision*, BHII-A-18 ("the intent of SDCL 49-34A-19 is to permit the consideration of the cost of service evidence that becomes known and measurable during the twenty-four month period following the end of the test year").[5]

Further, ARSD 20:10:13:01(11) defines test period as "the test period outlined in ARSD 20:10:13:44, except that if additional material is filed by the utility, a test period is

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[5] While it may be argued that the phrase, "in advance of," in SDCL 49-34A-19 is not clear, it would be illogical to interpret the statute in a manner that only allowed for adjustments for costs that occurred during the two years prior to the test year. A reasonable interpretation of the statute justifies consideration of expenses that will be forthcoming in the 24 months following the test year. The Commission's interpretation of SDCL 49-34A-19 as meaning "following the test year" is consistent with the plain language and ordinary meaning of the statute.

any 12 consecutive months beginning no later than the proposed effective date of the rate application" (emphasis added). Therefore, the reasonable interpretation of "at the time of filing" in ARSD 20:10:13:44 is the time that additional material is filed by the utility as referenced in ARSD 20:10:13:01(11).

On the other hand, BHII's interpretation is contrary to the statutes and regulations stated above. Further, BHII's new reliance on ARSD 20:10:13:46, ARSD 20:10:13:104, and SDCL 49-34A-7 does not alter the conclusion that only the Circuit Court and Commission's interpretation is ARSD 20:10:13:44 is proper. *BHII Brief* at 11. The Court should disregard BHII's reliance on these rules and statues as BHII did not raise the argument before either the Commission or the Circuit Court. *Kan. Gas & Elec. Co. v. Ross*, 521 N.W.2d 107, 116 (S.D. 1994). Regardless, the rules cited by BHII show only that BHII's interpretation is contrary to the requirement that ARSD 20:10:13:44 be read harmoniously with the other statues and regulations.

Rule 20:10:13:46 concerns a utility's "supporting data other than that in statements A through R. . . Such data shall be limited to the test period prescribed in § 20:10:13:44." This rule allows a utility to supply supporting data for its application other than the data required in statements A through R, but it must do so at the time it files its application. Rule 20:10:13:46 relates to a utility's application and, therefore, is wholly unrelated to the adjustments passage of ARSD 20:10:13:44 at issue in this matter.

A portion of ARSD 20:10:13:104 concerns a forecasted test year: "Although §§ 20:10:13:51 to 20:10:13:102, inclusive, provide for a historical test period, the utility, in addition, may submit cost of service information for a nonhistorical test period beginning no later than the proposed effective date of the new rates." (emphasis added).

This rule does not concern adjustments to a historic test year. Instead, it allows (but does not mandate) that a utility may provide data for a nonhistorical test period. BHP submitted adjustments to a historic test year, not data on a nonhistorical test period. The Commission's interpretation of ARSD 20:10:13:44 (adjustments) cannot be inconsistent with ARSD 20:10:13:144 (forecasted test year) because the two rules provide for entirely different sets of data.[6]

Only the interpretation of ARSD 20:10:13:44 advanced by the Commission and approved by the Circuit Court results in a harmonious reading of the statutes and regulations.

**b. The Circuit Court and Commission's interpretation of ARSD 20:10:13:44 complies with the rule of interpretation that meaning should be given to all rules.**

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.W2d 758, 761 (citation omitted). The Commission's interpretation of the adjustment rules is reasonable and logical, and adopting BHII's interpretation would render ARSD 20:10:13:44 meaningless.

BHII ignores the Commission's distinction in ARSD 20:10:13:44 between the historical test year, as discussed in the first passage, and adjustments thereto, discussed in

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[6] Further, SDCL 49-34A-7 provides as follows: "The Public Utilities Commission shall designate a system of accounts to be kept by public utilities subject to its jurisdiction." That statute does not address or relate to the adjustments procedure allowed in ARSD 20:10:13:44. BHII's discussion of BHP's deferred accounting for certain costs is similarly irrelevant. Deferred accounting is a mechanism used to spread out large costs over a period of years, such as the damage to the Winter Storm Atlas, which was an estimated cost of approximately $5-6 million. Deferred accounting is a common practice with utilities to amortize extraordinary losses.

the second passage. BHII contends that a utility may only file an adjustment which will become effective within 24 months of the test year between the end of the historic test year and the filing of the application. *BHII Brief* at 14. BHII's interpretation renders the entire second passage on adjustments meaningless and should be rejected.

BHII's proposed interpretation further fails to consider the customers they allegedly seek to protect because their interpretation forecloses a utility from adjusting costs to save customers money. As the Circuit Court reasoned, BHII's interpretation of ARSD 20:10:13:44 would result in an absurd result:

> BHII's interpretation would require a utility to [withdraw] 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. . .
>
> [BHII's] 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. 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. . .
>
> 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.

*Order*, BHII-A-12-13 (first emphasis in original; second emphasis added). An absurd result, such as the one advanced by BHII, must be rejected. *Martinmaas*, 612 N.W.2d at 611. The Commission and Circuit Court's sound reasoning should be affirmed.

### 4. The Commission's interpretation of ARSD 20:10:13:44 violates neither due process nor rulemaking requirements.

The Circuit Court properly found that the Commission's interpretation and application of ARSD 20:10:13:44 does not violate the due process clause. Further, the Commission has not violated rulemaking requirements.

BHII bears the burden to prove a due process violation. *Daily v. City of Sioux Falls*, 2011 S.D. 48 ¶ 14, 802 N.W.2d 905, 911. Although BHII contends that its due process rights were violated, BHII does not cite any authority outlining their property interest or the due process accorded to that interest. "Failure to cite any authority is waiver of an argument." *Behrens v. Wedmore*, 2005 S.D. 79 ¶ 55, 698 N.W.2d 555, 577.

Regardless, any property interest subject to due process must be defined by state law. *Hollander v. Douglas Cnty.*, 2000 S.D. 159 ¶ 12, 620 N.W.2d 181, 185. As intervenors, BHII had the statutory right to present evidence to the Commission and participate in the hearing on the rate change. *See, e.g.*, SDCL 49-34A-13-13.1; ARSD 20:10:01:15.

BHII was provided notice of the adjusted changes prior to submitting their post-hearing brief to the Commission, and the Commission held another open meeting to determine whether to approve the Amended Stipulation with the adjustments. BHII attended all hearings. *Final Decision*, BHII-A-25-27. BHII was provided all notice due under the law and participated in the hearings, and, thus, their due process rights were not violated.

After oral argument before the Circuit Court and the Circuit Court's order, BHII now takes issue with the administrative practice of maintaining an "internal cut-off date" after which Staff, as a practical matter, stops accepting de minimis adjustments. *See Oral*

*Arg. Transcript before Circuit Court*, BHII-A-103-09. Once a utility files an application to increase rates, the Commission has one year to approve or deny the rate increase request, or otherwise the rate as proposed goes into effect. SDCL 49-34A-17. The Commission's Staff reviews the application and determines whether settlement is appropriate on some or all issues. Staff then drafts a memorandum for the Commission at least six weeks before the Commission's decision is due. *Id.* at BHII-A-104. During this time, the Commission must comply with numerous due process requirements, which creates a regulatory lag between the time that a utility files an application and the time that the Commission reviews and approves an application.

Contrary to BHII's argument, a practical cut-off deadline is an administrative practice[7] which is necessitated not by the Commission's interpretation of ARSD 20:10:13:44 but by the significant amount of work Staff must complete to prepare the memorandum for the Commission. *Id.* Due to this significant amount of work, the Commission and its Staff must, as a practical matter, stop accepting de minimis adjustments at some point. The Commission clarified during oral argument that it will continue to accept adjustments after any internal cut-off deadline which could have a significant impact on a rate, either to increase or decrease the rate. *Id.* at BHII-A-106-07. As the Circuit Court aptly reasoned, "[t]his practice continues to reflect the discretionary

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[7] The internal cut-off deadline is an administrative practice, not a rule. The Commission's statement during oral argument concerns only the Commission's internal management and actually protects, rather than harms, the rights of interested parties. Thus, the internal cut-off deadline is not a rule, and the Commission did not need to engage in rulemaking. *See* SDCL 1-26-1(8) (which excludes from the definition of "Rule" "[s]tatements concerning only the internal management of an agency and not affecting privacy rights or procedure available to the public").

balancing act the Commission must do when determining a fair end result and a just and reasonable rate." *Order*, BHII-A-22.

### 5. The approval of BHP's adjustments by the Commission and the Circuit Court was not clearly erroneous.

Although BHII's expert agreed with adjustments that benefited BHII (some of which were based on data not actually known at the time of filing), BHII alleges that three adjustments and one line item addition fall outside the parameters of permitted adjustments. BHII's arguments are based solely on its incorrect interpretation of ARSD 20:10:13:44 and, thus, should be rejected. Regardless, the Commission properly approved the adjustments to which BHP and Staff agreed in the Amended Stipulation.

#### a. BHP met its burden of proof on the three adjustments contested by BHII.

BHP had the burden to prove by a preponderance of the evidence that the adjustments to its costs were "prudent, efficient, and economical and reasonable and necessary to provide service" for its customers. SDCL 49-34A-8.4; *Irvine v. City of Sioux Falls*, 2006 S.D. 20 ¶ 10, 711 N.W.2d 607, 610 (burden of proof before an agency is preponderance of the evidence). The Commission's application of its interpretation of ARSD 20:10:13:44 and its determination of whether BHP met its burden of proof on the adjustments are factual findings reviewed for clear error. *Isack v. Acuity*, 2014 S.D. 40 ¶ 7, 850 N.W.2d 822, 825. Regardless of the standard, however, the Commission correctly approved the following adjustments:

First, the Commission approved the Light Detection and Ranging ("LIDAR") adjustment. At the time that BHP filed its Application, it planned to perform LIDAR imaging of certain facilities. *Thurber Rebuttal*, BHP-A-49-50. The LIDAR work was completed in the fourth quarter of 2014 pursuant to a fixed price contract. *Id.* at BHP-A-

51. Staff and BHP included the LIDAR costs as an adjustment to the test year, as the costs were known, measurable, and incurred within 24 months following the historic test year. The Commission's approval of the LIDAR adjustment is consistent with the Commission's interpretation of its rules. *See also Nw. Pub. Serv.*, 297 N.W.2d at 469 (reasoning that a historical test year does not necessarily 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.").

Second, the Commission approved the Black Hills Utility Holdings ("BHUH") affiliate allocations adjustment. Contrary to BHII's assertions, the BHUH affiliate allocations adjustment was not based on informal email correspondence, but rather on BHP's responses to data requests. *Kilpatrick Rebuttal*, BHP-A-90-91. Mr. Peterson (Staff witness) addressed this adjustment in his pre-filed testimony. *Peterson Direct*, BHP-A-35-39. The Original Stipulation reflects increases in the expenses allocated to BHP from its affiliate companies. BHP then proposed an adjustment to test year affiliate expenses based on its post-test year operating budget; Staff responded that they were not willing to recommend an adjustment based solely on BHP's budget projections; and BHP then provided a detailed summary of its most recent annualized expenses from the two affiliated companies. *See id.* at BHP-A-33-36. Accordingly, the affiliate allocation costs were known, measurable, and proper as post-test year adjustments, and the Commission's approval of the same was consistent with its interpretation of its rules. *See also In re Minn. Gas*, 1979 WL 461903, BHII-A-48 ("utilization of an average actual test year adjusted for known and measurable changes avoids the impossible task of evaluating the reasonableness of all the assumptions, predictions, projections, and estimates involved in

such a test year as well as lessens the possibilities of overcollection or undercollection by the utility."(emphasis added)).[8]

Third, the Commission approved the employee additions adjustment. The adjustment only reflects costs for BHP's positions which were hired and filled at the time of the settlement negotiations between Staff and BHP in December of 2014. Although such costs were not known at the time of BHP's Application in March of 2014, such costs were known, measurable, and proper as a post-test year adjustment in December of 2014. *Thurber Rebuttal*, BHP-A-53-54; *Peterson Direct*, BHP-A-31. It is within the context of just and reasonable rates to allow BHP to recover costs for employee positions which were hired and filled before the Commission issued a decision on the Application. *Order*, BHII-A-14; *see also* SDCL 49-34A-8 (a utility to provide data about its "total current cost of furnishing such service." (emphasis added)). As such, the Commission's approval of the employee additions for positions actually hired at the time of the Original Settlement is consistent with the Commission's interpretation of its rules.

**b. The Commission's approval of the BHSC line item addition was not clearly erroneous.**

BHII also argues that BHP improperly added "line item additions," but cites to only one such addition, namely an adjustment in the Amended Settlement in affiliate allocations from BHP's affiliate, Black Hills Service Company ("BHSC"). BHII contends that the BHSC affiliate allocation is a new cost, and new costs, as opposed to adjusted costs, cannot be added at any time during the pendency of a utility's application.

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[8] BHII selectively quotes *In re Minn. Gas* to bolster its argument that the adjustments are improper because they are budgets. At other times in its brief, however, BHII contends that "[t]he Circuit Court improperly relied on *In re Minnesota Gas Co.*" *BHII Brief* at 20. BHP maintains that the decision is precedent this Court should consider.

BHII cites no authority differentiating between adjusted costs and new costs as no such authority exists. The statutes and regulations do not differentiate between adjusted costs and new costs. Instead, a utility may adjust its costs if the adjustments "are based on changes in facilities, operations or costs which are known with reasonable certainty and measureable with reasonable accuracy at the time of the filing[.]" ARSD 20:10:13:44. The Commission's approval of the BHSC affiliate allocation was not clear error.

**c. BHII's own expert recommended that the Commission adopt certain post-test year adjustments, which is contrary to BHII's argument before this Court.**

In contradiction to BHII's present legal position, BHII, through its witness Mr. Kollen, fully supported the following post-test year adjustments agreed upon by BHP and Staff because those adjustments were beneficial to BHII, even though those adjustments were not known and measurable at the time that BHP filed its Application:

> (1) Neil Simpson Complex Shared Facilities Adjustment: Staff and BHP agreed to reduce approximately $219,000 of the allocation of the Neil Simpson Rent Revenue and Expense based upon cost information provided by BHP after filing its Application. *See Orig. Stip. Memo.*, BHP-A-8 ("Staff generally agreed with the adjustment but replaced the budgeted costs used by BHP with actual costs."); *Kollen Direct*, BHP-A-102 (recommending the cost be accepted).
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> (2) Neil Simpson Complex Common Steam Allocation Adjustment: Staff agreed to a post-test year adjustment that reduced operating expense by approximately $244,000. *See Orig. Stip. Memo.*, BHP-A-9 ("Staff generally agreed with the adjustment but replaced the budgeted costs used by BHP with actual year end August 2014 costs."). This adjustment was based on actual costs not known until after BHP filed its Application. Mr. Kollen, however, recommended that the Commission adopt this adjustment. *Kollen Direct*, BHP-A-102.
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> (3) Cost of Debt: In its Application, BHP projected the cost of new debt. After filing the Application, the new debt was issued at a lower rate of interest than projected in the Application. Accordingly, BHII proposed an adjustment to reduce the cost of debt (a reduction of

> approximately $885,000), which Staff and BHP accepted. *Orig. Stip. Memo.*, BHP-A-15. Mr. Kollen recommended that the Commission accept the adjustment and use the actual cost of debt determined after the filing of the Application. *Kollen Direct*, BHP-A-102.

As the Circuit Court reasoned, the true intent of BHII is not to succeed on their interpretation of ARSD 20:10:13:44 but to contest only adjustments which increased rates:

> Some of these adjustments were proposed after the initial application was filed, but were not identified by BHII on appeal. . . 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.

*Order*, BHII-A-16.

In sum, the Circuit Court properly affirmed the Commission's interpretation of ARSD 20:10:13:44 as conforming to the rule's plain language. Alternatively, the Circuit Court properly provided the Commission a reasonable range of informed discretion and gave the Commission's interpretation of ARSD 20:10:13:44 great weight. In either alternative, ARSD 20:10:13:44 allows for post-test year adjustments within 24 months after an application is filed if such adjustments are sufficiently known and measurable at the time the material describing the costs is filed with the Commission. Using this interpretation, the Commission did not clearly err in approving the post-test year adjustments, including both those contested by BHII and other post-test year adjustments which BHII recommended the Commission adopt.

### E. The Circuit Court properly affirmed the Commission's approval of the five-year average pension expense as such approval was not clearly erroneous.

BHP's pension expenses vary significantly from year-to-year and, therefore, BHP offered a normalization of its pension expenses over a five-year timeframe as the historic

test year would not have provided accurate data. BHP proposed a normalization based on data from 2010-2014. The Commission approved this normalization.

The Circuit Court found that the Commission's approval of the pension expense normalization from 2010-2014 was not clearly erroneous. BHII argues that, as a matter of law, the Commission was required to calculate BHP's five-year average pension expense based on the normalization of the 2011-2015 costs, rather than the 2010-2014 costs. The law does not require the Commission to unilaterally adjust costs. Thus, as the Circuit Court found, the Commission's approval of the five-year normalization from 2010-2014 was not clearly erroneous.

**1. The evidence before the Commission related to whether the 2010-2014 normalization or the 2014 pension expense should be used to determine BHP's pension expense.**

The evidence presented before the Commission consisted of BHP advocating for the normalization of pension expenses from 2010-2014 and BHII advocating for the 2014 pension expense to be used.

In response to the Original and Amended Stipulations, BHII argued that BHP should use the actual 2014 pension expense, not the five-year normalization from 2010-2014. *Kollen Direct*, BHP-A-102. Although BHII accepted the normalization of other expenses, BHII's expert rejected as "opportunistic" the five-year normalization process for pension expenses. *See id.*

It was only after the Evidentiary Hearing that BHII suggested that the 2011-2015 data should be used for the normalization of pension expenses, and even then stated that 2015 should be used only "if the Commission is inclined to use the most current information." *Order*, BHII-A-19 (citing BHII Post-Hearing Brief). Because the Evidentiary Hearing had concluded by the time BHII argued for inclusion of the 2015

pension expense, there was no evidence in the record regarding whether the use of a 2011-2015 normalization period is a better reflection of BHP's current pension costs than the 2010-2014 period adopted by the Commission.

**2. The standard of review used by the Circuit Court was proper.**

BHII contends that the standard of review on the Commission's factual findings is de novo.[9] South Dakota law, however, provides that the Commission's findings of fact and factual inferences must be reviewed for clear error. *In re Otter Tail*, 2008 S.D. 5 ¶ 26; *see also* SDCL 1-26-36.[10] The Commission's factual findings may only be set aside if the Court is definitely and firmly convinced that the Commission made a mistake. *In re Otter Tail*, 2008 S.D. 5 ¶ 26.

Even if the Commission's holdings on the pension expense issue are conclusions of law, the Court affords the Commission a reasonable range of informed discretion in the application of its statutes and regulations and great weight is provided to an interpretation thereof. *Media One,* 1997 S.D. 17 ¶ 10; *Krsnak,* 2012 S.D. 89 ¶ 16.

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[9] At other times, BHII argues that the standard of review is arbitrary and capricious. *See BHII Brief* at 26-27. The correct standard of review for an agency's factual finding is clear error. Even if the standard of review is arbitrary and capricious, the Commission's determination that pension expenses should be normalized from 2010-2014 is proper for the reasons stated herein.

[10] BHII incorrectly argues, citing *Tucek v. South Dakota Department of Social Services*, 2007 S.D. 106, 740 N.W.2d 867, that the Court must apply a de novo standard of review because the Commission's factual findings were based on documentary evidence. This assertion is incorrect. The Commission's factual findings were based on both live and documentary evidence. *See Order*, BHII-A-10 ("In this case, three witnesses testified[.]"). Thus, the clearly erroneous standard is mandated. *Tucek*, 2007 S.D. 106 ¶ 13.

### 3. The Commission's interpretation of ARSD 20:10:13:44 does not mandate costs to be updated if new data becomes known.

BHII argues that if the Court accepts the Commission's interpretation of ARSD 20:10:13:44, then the Commission is not permitted any discretion in applying that rule to the evidence. BHII essentially asks the Court to interpret ARSD 20:10:13:44 to require the Commission to adjust a cost every time new data for that cost becomes known. BHII's failure to cite any authority for this argument is a waiver of the same. *Behrens*, 2005 S.D. 79 ¶ 55. Moreover, the argument is wholly unsupported by the plain language of ARSD 20:10:13:44.[11]

Rule 20:10:13:44 does not require a utility to adjust a cost if data becomes known after an application is filed. The regulation does require certain actions from a utility: "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[.]" ARSD 20:10:13:44 (emphasis added). The regulation, however, contains no language mandating that a utility provide an adjustment to its cost of service. Instead, ARSD 20:10:13:44 provides a discretionary mechanism for a utility to show a "proposed" adjustment any time that new data becomes available. The Commission has the discretion to accept a post-test year adjustment to ensure that the matching principle is met and that a rate is just and reasonable. *Order*,

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[11] BHII attempts to draw a distinction between the Commission's approval of the Wyodak Expense Adjustment and the Commission's decision to approve the normalization of pension expenses from 2010-2014 instead of requiring BHP to submit a normalization from 2011-2015. No distinction between these factually different scenarios exists. BHP offered the Wyodak Expense Adjustment due to changes in that expense from the date of filing of the Application. By contrast, BHP offered evidence of the 2015 pension expense to show the continued volatility and why normalization of the pension expense was necessary. BHII offers neither evidence nor rationale requiring the Commission to, sua sponte, adjust a utility's expense.

BHII-A-22. If adjustments were mandatory, ARSD 20:10:13:44 would not use the word "proposed."

The allowance of post-test year adjustments does not mean that only the most current data should be used for normalization. For example, the Amended Stipulation includes the normalization of bad debt expense, storm damage, and weather matters using something other than current data, and BHII did not object to the normalization of those items. *Orig. Stip. Memo.*, BHP-A-10; BHP-A-17-19. BHII's argument that the pension expense must be normalized from 2011-2015 is another example of BHII picking and choosing its different interpretations of law as necessary to benefit BHII.

**4. The Commission's factual findings on BHP's pension expense were not clearly erroneous.**

The Commission reviewed substantial evidence on the pension expense issue. For example, the Commission reviewed the pre-filed testimony, questioned BHP's witnesses and experts, Staff's witness, and BHII's witnesses during the Evidentiary Hearing, and considered extensive briefing on the pension expense issue. The vast majority of this evidence focused on the normalization of the pension expense from 2010-2014; the 2015 data was only introduced in rebuttal testimony to show the continued volatility in pension expenses. *Thurber Rebuttal*, BHP-A-60-61.

The Commission reviewed and digested substantial evidence on BHP's 2010-2014 pension expense, including the following:

> BHP's pension expense varies significantly from year to year. BHP's test year pension expense was $2,844,759 but the 2014 pension expense was only $976,122. *Thurber Rebuttal*, BHP-A-59. The five year average expense for settlement was $2,336,305. *Peterson Direct*, BHP-A-32-33.
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> The 2010-2014 data used in the normalization included a low year (2014 at $976,122) and a high year (2012 at $3.25 million). *Peterson*

> *Direct*, BHP-A-28. The Commission is familiar with the normalization process and has used such calculations in other cases and for other costs in this case, namely the weather, bad debt, and storm damage expenses. *Orig. Stip. Memo.*, BHP-A-6-7.
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> The Commission approved the normalization process for pension expense using the 2010-2014 timeframe, which includes a benefit to customers as such calculation saved over $500,000 in expenses. *Peterson Direct*, BHP-A-32; *Evid. Hr'g Tr.*, BHP-A-21.

The Commission issued a factual finding consistent with this evidence. *Final Decision*, BHII-A-35. Based on the substantial evidence before the Commission, the Circuit Court properly affirmed the Commission's approval of the normalization of pension expense data from 2010-2014. BHII has raised neither evidence nor argument sufficient for the Court to be definitely and firmly convinced that either the Commission or Circuit Court made a mistake.

### F. The Circuit Court properly affirmed the Commission's approval of the inclusion of certain incentive compensation in the Amended Settlement because such approval was not clearly erroneous.

BHII has changed its position on the standard of review for the Commission's approval of the inclusion of $880,000 in incentive compensation in BHP's cost of service. In briefing before the Circuit Court, BHII agreed that the standard of review was clear error, but, during oral argument, argued for de novo review. *Order*, BHII-A-22. BHII apparently argues before this Court that the Commission's factual finding must be reviewed de novo.

The Commission's approval of the incentive compensation is a factual finding based on both live and documentary evidence. *Final Decision*, BHII-A-34. Therefore,

the Court applies the clearly erroneous standard of review,[12] meaning that the Court must affirm the Commission's approval of incentive compensation as part of the Amended Stipulation unless the Court is definitely and firmly convinced that the Commission made a mistake. *In re Otter Tail*, 2008 S.D. 5 ¶ 26.

The Commission did not make any mistake regarding the incentive compensation issue. The Commission received and reviewed substantial evidence regarding BHP's compensation plan and issued a well-reasoned Final Decision approving the inclusion of the incentive compensation.

Before the Commission, BHP had the burden to prove by a preponderance of the evidence that the underlying costs are reasonable and necessary to provide service to its customers in South Dakota. SDCL 49-34A-11; SDCL 49-34A-8.4; *Irvine*, 2006 S.D. 20 ¶ 10. The Commission found that BHP met its burden.

BHII alleges that "[t]he 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 . . . with no underlying work papers or references to other documents." *BHII Brief* at 30. This statement is incorrect. BHII continues to ignore the substantial other evidence the Commission (and Circuit Court) considered on the compensation issue, some of which is as follows:

> BHII completely disregards the testimony of Laura Patterson, which is fatal to BHII's argument. Ms. Patterson was the Director of Compensation, Benefits and Human Resources Information Systems for Black Hills Service Company, a wholly-owned subsidiary of Black Hills

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[12] A factual finding based on both live and documentary evidence is reviewed for clear error. *Tucek*, 2007 S.D. 106 ¶ 13.

Corporation, with over 23 years of experience in compensation and benefits. *Patterson Direct*, BHP-A-65.

Ms. Patterson testified that BHP must attract, motivate, and retain employees. *Id.* at BHP-A-68. To that end, BHP employs a compensation plan that is competitive and promotes overall performance for BHP. *Id.* at BHP-A-68-69. BHP's compensation program includes a base salary and variable pay, which includes the Annual Incentive Plan ("AIP"). *Id.* at BHP-A-69. The AIP is consistent and competitive with the market.[13]

One of BHP's long-term incentive programs is a restricted stock award, which is offered to key employees on a limited basis. *Id.* at BHP-A-78-79. The restricted stock program is a retention tool and vests ratably over a three-year period, thereby ensuring retention of key employees eligible for the program. *Id.* Independent studies support the use of a restricted stock plan. *Id.* at BHP-A-78-79. Moreover, public utility commissions in Nebraska, Iowa, Wyoming, and Colorado have approved similar compensation plans. *Id.* at BHP-A-86.

BHP also offered the rebuttal testimony of Mr. White, who relied on and explicitly adopted the testimony of Ms. Patterson. *White Rebuttal*, BHP-A-97. Mr. White testified that "[n]o evidence was presented that the total compensation paid to employees was imprudent or unreasonable based upon what the market pays employees for similar positions." *Id.* at BHP-A-94. Mr. White testified that the Wyoming Public Service Commission and the Colorado Commission both accepted 100 percent of the requested incentive compensation in BHP's revenue requirement. *Id.* at BHP-A-95.

Mr. Peterson, who testified on behalf of Staff, rejected BHII's position that the $880,000 should be excluded because "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." *Peterson Direct*, BHP-A-33-35. Mr. Peterson further explained that the incentive compensation had a number of benefits to customers. *Evid. H'rg Tr.*, BHP-A-24-27. Finally, Mr. Peterson applauded BHP's incentive compensation plan because it does not contain a number of financial

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[13] For example, in 2009, Towers Watson conducted an independent review of BHP's compensation program to ensure that the program was consistent with the market. *Patterson Direct*, BHP-A-70. BHP has also used surveys to review its compensation program. *Id.* at BHP-A-71. In addition, BHP reviews the pay structure annually to ensure the structure reflects market conditions. *Id.* AIP is essential to meeting these goals because BHP's base pay is lower than market levels. *Id.* at BHP-A-74.

> triggers (i.e., incentives are paid only if certain corporate financial targets are met) which other utilities' plans have. *Id.* at BHP-A-25.

As findings of fact, the Commission found the following: BHP excluded $660,000 of incentive compensation, which was tied to BHP's financial results; BHP needs to offer incentive compensation plans to remain competitive; and Staff resolved any issues regarding a connection between the incentive compensation and BHP's financial performance. *Final Decision*, BHII-A-34. Viewing all of the evidence presented, the Commission found that the decision to include incentive compensation was within its discretion and "that the incentive compensation plan included in the Amended Stipulation does not render the Amended Stipulation unjust and unreasonable." *Id.* at BHII-A-34-40. As the above evidence demonstrates, BHP offered substantial evidence to support its inclusion of certain employee compensation expenses.

Relying again only on Mr. White's testimony, BHII contends that "[t]he Circuit Court acknowledged that BHP did not submit evidence supporting its incentive compensation," (*BHII Brief* at 30), but such argument is incorrect. The Circuit Court summarized Mr. White's testimony but also found that the Commission's "finding is well-supported by the testimony of Patterson, White, and Peterson." *Order*, BHII-A-23 (emphasis added). Specifically, the Circuit Court found that Ms. Patterson testified about studies on market incentive compensation comparisons, approval of similar plans by other public utilities commissions, and the fact that performance-based parts of the plan were excluded from the cost of service (an exclusion of about $666,000). *Id.*

The Circuit Court properly affirmed the Commission's inclusion of the incentive compensation because BHP proved that inclusion of that incentive compensation was

fully supported by the evidence and, also, resulted in a just and reasonable rate pursuant to the matching principle.

## III. CONCLUSION

Appellee Black Hills Power, Inc. respectfully requests that the Circuit Court's Order affirming the Commission's Final Decision be affirmed in all respects.

## IV. REQUEST FOR ORAL ARGUMENT

Appellee Black Hills Power, Inc. hereby requests oral argument on all issues and matters raised in this appeal.

Dated this 27th day of May, 2016.

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