

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA**

**APPLICATION OF BLACK HILLS)
POWER INC. FOR AN INCREASE)
IN ELECTRIC RATES)**

DIRECT TESTIMONY OF JACQUELINE A. SARGENT

1 **I. INTRODUCTION AND QUALIFICATIONS**

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

3 A. My name is Jacqueline A. Sargent. My business address is 625 Ninth
4 Street, Rapid City, South Dakota, 57701.

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

6 A. I am currently employed by Black Hills Service Company, L.L.C.
7 (Service Company), a wholly-owned subsidiary of Black Hills
8 Corporation (Black Hills), as Director of Rates for Black Hills
9 Corporation's Retail Operations which includes Black Hills Power, Inc.
10 (Black Hills Power) and Cheyenne Light, Fuel and Power Company
11 (Cheyenne Light).

12 **Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS DOCKET?**

13 A. I am appearing on behalf of Black Hills Power, a wholly-owned operating
14 subsidiary of Black Hills Corporation.

15 **Q. WOULD YOU BRIEFLY DESCRIBE YOUR DUTIES AND
16 RESPONSIBILITIES IN YOUR CURRENT POSITION?**

17 A. I am primarily responsible for the Black Hills rate department and the
18 administration of associated electric and gas tariffs. Additionally, I am

1 responsible for monitoring revenue requirements and assuring that the
2 retail operations receive adequate revenues for services provided.

3 **Q. WOULD YOU PLEASE OUTLINE YOUR EDUCATIONAL AND**
4 **PROFESSIONAL BACKGROUND?**

5 A. I graduated with honors from the South Dakota School of Mines and
6 Technology with a Bachelor of Science Degree in Electrical
7 Engineering with an emphasis on advanced control systems in May of
8 1989. In May of 2002, I graduated with a Master of Science Degree in
9 Technology Management, also from the South Dakota School of Mines
10 and Technology. I am a registered licensed Professional Engineer in
11 the state of South Dakota. I have been employed by Black Hills since
12 May of 1988 and have held a number of positions with advancing
13 responsibilities since that time. Initially, I started as Customer Service
14 Representative and in 1990 accepted the position of Combustion
15 Turbine Instrumentation and Control Engineer. In 1993, I moved into
16 generation and was the Project Engineer and Start-Up Coordinator for
17 the Neil Simpson II power plant project. In this role, I reviewed
18 specifications and drawings, supported construction, organized and
19 lead the plant start-up. The project was completed six months ahead
20 of schedule and under budget. Upon completion of this project I
21 moved into the role of Power Generation and Technical Support
22 Engineer. In 1998 I accepted the position of Planning Coordinator in
23 which I evaluated the generating resources available to best meet

1 Black Hills Power's load obligations and in 2001 I advanced to the
2 position of Manager of Generation Technical Services where I
3 supported the engineering and project needs of both our wholesale
4 generation and retail power supply departments. It was also at this
5 time that I was first introduced to our generation dispatch and power
6 marketing group. In 2003 I was promoted to Director of Generation
7 Support and Resource Planning and in 2004 was promoted to Director
8 of Wholesale Generation and Power Marketing where I was
9 responsible for the operations and maintenance of our wholesale
10 generation fleet and our Black Hills Power generation dispatch and
11 power marketing group. I accepted my current position as Director of
12 Rates in December of 2005.

13 **II. PURPOSE OF TESTIMONY**

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

15 A. The purpose of my testimony is to provide an overview of adjustments
16 to the cost of service study of Black Hills Power and to describe the
17 annual adjustments to certain utility costs that we propose going
18 forward.

19 **III. PROFORMA ADJUSTMENTS**

20 **Q. PLEASE SUMMARIZE THE SIGNIFICANT ADJUSTMENTS THAT**
21 **HAVE BEEN MADE TO BLACK HILLS POWER'S COST OF**
22 **SERVICE STUDY.**

1 A. First, I will list the major adjustments and later I will provide more
2 detail. We have removed the incremental purchased power costs
3 related to the Neil Simpson II outage in July and August of 2005.
4 Additionally, we have removed the revenues and expenses associated
5 with our power marketing activities. Included are the increases in
6 general and administrative costs resulting from inflation and more
7 accurate tracking and allocation of costs through the Service
8 Company. We have excluded expenses related to the buy-out of
9 Change-in-Control agreements with certain key employees. The rate
10 case expenses have been included and amortized over three years.
11 Also included are additional expenses for wage increases and
12 expenses for additional positions that were not included in our 2005
13 test year. Consideration has been given to capital deployment for
14 projects that will be completed in 2006, with the rate base adjusted
15 accordingly. We have made an increase to depreciation based upon a
16 recently completed study by our consultants, Black and Veatch.
17 Advertising expenses have been omitted with the exception of those
18 expenses related to safety and conservation programs.

19 **Q. HAVE YOU MADE ANY OTHER ADJUSTMENTS?**

20 A. Other significant adjustments include the removal of the Federal
21 Energy Regulatory Commission (FERC) regulated transmission
22 system from Black Hills Power's retail rate base, and removal of
23 transmission system operations and maintenance expenses from the

1 cost of service. Transmission tariff charges now flow through as an
2 expense in our cost of service model. An adjustment for increases in
3 transmission expense has been included while transmission
4 purchased from PacifiCorp for serving the Montana-Dakota Utilities'
5 Sheridan, Wyoming, load has been removed. Adjustments have been
6 made for increases in 2006 coal expense for our steam generation
7 facilities based on increased mining operations costs.

8 **Q. WHAT OTHER ITEMS ARE YOU PROPOSING?**

9 A. Other significant items included in our rate application include a
10 Transmission Cost Adjustment, a Steam Plant Fuel Cost Adjustment,
11 and a Conditional Energy Cost Adjustment (CECA). Our application
12 includes a Return on Equity (ROE) of 11.75 percent which will be
13 supported in testimony by William Avera, our cost of capital consultant
14 from the firm FINCAP, Inc. Our cost of debt is our actual cost of 7.57
15 percent and is supported in testimony by Garner Anderson. We have
16 utilized a capital structure of 46 percent debt and 54 percent equity
17 which is supported in testimony by Garner Anderson and our
18 consultant William Avera. Our resulting regulated rate of return is 9.83
19 percent which will be supported in testimony by Garner Anderson.

20 **Q. PLEASE TELL ME MORE ABOUT THE ADJUSTMENT MADE FOR**
21 **THE NEIL SIMPSON II OUTAGE.**

22 A. In July of 2005, the Neil Simpson II power plant, one of Black Hill's
23 Power's facilities, was forced off-line due to a significant mechanical

1 failure of the main steam valve which resulted in major damage to the
2 steam turbine. The extended outage lasted approximately thirty days.
3 Black Hills Power had to replace this power and the least cost option
4 was to purchase replacement energy rather than run Black Hills
5 Power's natural gas-fired combustion turbines. The expense incurred
6 for securing the replacement power was \$3,258,995 more than the
7 expense would have been had the power been generated by the Neil
8 Simpson II plant. This increased our cost of service for 2005 by that
9 amount, but we have removed this expense from the cost of service
10 model. In the future increased expenses for outages may be shared
11 by both Black Hills Power and our customers through the proposed
12 CECA; therefore, no normalization adjustment for replacement power
13 has been included for any plant outages. In addition to removing this
14 expense, we evaluated our plant scheduled outages and have
15 included an increase to operations and maintenance expense of
16 \$294,400. This amount was calculated by amortizing over five years
17 the total scheduled operations and maintenance expenses for the
18 Wyodak Plant in 2006. Chris Kilpatrick will provide more detail
19 regarding this in his testimony.

20 **Q. EXPLAIN THE ADJUSTMENT YOU HAVE MADE FOR POWER**
21 **MARKETING REVENUES AND EXPENSES.**

22 A. Tom Ohlmacher will testify about our power marketing activity and how
23 that business is conducted. In 2005, Black Hills Power had

1 expenditures of \$44,002,747 for its power marketing activity and
2 received revenues of \$47,647,276, resulting in a gross margin of
3 \$3,644,529, with a net income contribution of \$2,368,944. Included in
4 these expenses is \$3,006,811 which Black Hills Power incurred as
5 legal expenses in a dispute with PacifiCorp Power Marketing, Inc. (now
6 PPM Energy, Inc.) relating to power marketing. This legal expense is
7 an example of the risks associated with power marketing. Details for
8 this activity are included in Schedule H-6 of the application. Chris
9 Kilpatrick will address the specific details of this adjustment in his
10 testimony.

11 **Q. WHAT IS THE ADJUSTMENT YOU ARE PROPOSING FOR**
12 **SERVICE COMPANY COSTS?**

13 A. Black Hills began operating as a holding company on January 1, 2006
14 and therefore had to formally establish a Service Company for those
15 employees who provide services to the regulated and unregulated
16 subsidiaries of Black Hills. Mark Thies' testimony will address the
17 specific cost allocations associated with this business model. In 2005,
18 and previously, costs for these services to Black Hills Power and the
19 other subsidiaries were assigned strictly on an allocation basis. In
20 2006, Service Company employees began directly charging and
21 allocating costs to the subsidiary for which they performed services.
22 The time entry and accounting systems now require a specific location
23 code for allocating time and expenses which enables the system to

1 track these expenses directly to the entity receiving the benefit. Thus,
2 Black Hill Power's allocated costs have been identified to date and
3 forecast for calendar year 2006. Those costs will be greater in 2006
4 than in 2005 and we have therefore adjusted this expense in the cost
5 of service model. Chris Kilpatrick will address the details of this
6 adjustment in his testimony.

7 **Q. WHY ARE YOU ASKING FOR AN INCREASE IN WAGE AND**
8 **BENEFIT COSTS?**

9 A. First, we have experienced increases in wages for all employees. For
10 example, bargaining unit employees and Black Hills Power recently
11 renegotiated the union contract. As a result, as of April 1, 2006, all
12 bargaining unit employees received an across the board 5 percent
13 wage increase, which will be followed by an additional 6 percent
14 increase in 2007, and another 6 percent increase in 2008. It should be
15 noted that the adjustment for the bargaining unit pay increases
16 includes only the 2006 wage increase, and not the 2007 and 2008
17 increases.

18 Second, the review of labor expense in 2005 identified positions that
19 were not filled for the entire year and therefore the per-books
20 expenses did not accurately reflect the labor costs going forward. This
21 is due to the significant tightening in the labor market which leads to
22 difficulty in recruiting and retaining a talented work force and an
23 inability to fill needed positions. This is becoming a national issue for

1 the energy sector as a whole. Further, as union employees are
2 promoted, they are not allowed to start their new position until a
3 replacement for their old position has been found. Finally, the
4 evaluation of staffing needs revealed a number of positions that will
5 need to be filled to allow the continued provision of reliable service to
6 customers. Chris Kilpatrick, in his testimony, will provide support for
7 the specific dollar amounts of these adjustments.

8 **Q. HOW MANY NEW POSITIONS ARE INCLUDED IN THIS RATE**
9 **CASE?**

10 A. We are including a total of seven additional positions. One staff
11 addition has been added to our generation dispatch group because of
12 increasing North American Electric Reliability Council (NERC)
13 operations requirements to address reliability criteria. One addition to
14 our rate department has been included to manage tariffs, adjustment
15 clauses, and riders; and one addition to our accounting staff to meet
16 regulatory accounting needs. Two radio technicians are being added
17 to support Black Hills Power's radio communications system, and one
18 communications engineer is being added to manage the
19 communications infrastructure. Finally, one administrative assistant
20 has been included for the engineering department. The rate
21 department and accounting support staff have been allocated one half
22 to Black Hills Power, and one half to Cheyenne Light. Chris Kilpatrick,

1 in his testimony, will provide support for the specific dollar amounts
2 associated with these additional positions.

3 **Q. DESCRIBE THE ADJUSTMENT MADE FOR THE BUYOUT OF**
4 **CHANGE-IN-CONTROL AGREEMENTS, AND WHY IT WAS MADE.**

5 A. In 2005, Black Hills Power incurred a one-time expense of \$390,087 to
6 buy out change-in-control agreements with key employees. When
7 these agreements were initially put in place there was a much different
8 business climate than what currently exists. Having these agreements
9 in place no longer fit our business model and therefore the buy-out
10 was appropriate. Since this was a one-time expense that will not occur
11 in future years, it has been removed from the cost of service so that
12 the expenses accurately reflect normal operating costs.

13 **Q. EXPLAIN THE ADJUSTMENT FOR THE INCREASE IN CAPITAL**
14 **EXPENDITURES.**

15 A. We completed a thorough review of our year-to-date capital
16 expenditures and forecast our capital expenses for the remainder of
17 2006. The 2006 capital budget included a forecast of capital
18 expenditure additions in excess of \$29 million. Following our review
19 process, however, we adjusted that budget amount downward by
20 taking out all items that provide additional revenues. In addition,
21 managers were required to review the remaining items and identify
22 those projects already underway and other projects that would be
23 completed prior to the end of 2006. Through this process, the amount

1 of additional capital expenditures for items that are not revenue
2 producing and that will be used and useful at the time our requested
3 rates go into effect was reduced to approximately \$19.4 million.
4 Additionally, capital expenditures for construction work completed in
5 2005 but not yet classified, FERC account 106, were annualized and
6 an increase in capital of approximately \$5.5 million was included,
7 resulting in a total increase in capital expenditures of approximately
8 \$24.9 million. Details of these costs are found in the supporting work
9 papers section of the application and will be explained in testimony by
10 Chris Kilpatrick.

11 **Q. HOW DID YOU ADDRESS YOUR RATE CASE EXPENSES IN YOUR**
12 **APPLICATION?**

13 A. In addition to staff support we have had to enlist support from outside
14 counsel and a number of consultants. Total rate case expenses are
15 expected to be \$550,000 which includes \$100,000 for assessment
16 fees. This total expense has been amortized over three years.

17 **Q. PLEASE EXPLAIN THE ADJUSTMENT YOU ARE MAKING FOR**
18 **DEPRECIATION EXPENSE.**

19 A. In order to more accurately identify our depreciation expense we
20 retained Black & Veatch as consultants to conduct a complete
21 depreciation study to assess our depreciation rates. The testimony of
22 consultant Larry Loos supports the depreciation rates used in
23 preparation of the cost of service. An upward adjustment to the cost of

1 service model has been made due to an increase in depreciation
2 expense of approximately \$467,000 for the additional capital
3 expenditures. Chris Kilpatrick will provide further explanation of this in
4 his testimony.

5 **Q. WHAT ADJUSTMENT ARE YOU MAKING TO ADVERTISING**
6 **EXPENSE?**

7 A. We have removed \$159,629 of advertising expense and included only
8 those advertising expenses associated with safety and conservation
9 programs, in the approximate amount of \$5,000.

10 **Q. WHY HAVE YOU SEPARATED THE TRANSMISSION SYSTEM**
11 **FROM BLACK HILLS POWER'S RATE BASE?**

12 A. The transmission system and the rates for use of the system are
13 regulated by FERC. As a transmission customer, Black Hills Power
14 has contracts for service under the Common Use System Open
15 Access Transmission Tariff. The rates have been established through
16 that tariff in accordance with FERC Order 888. FERC has approved
17 an authorized rate of return for these transmission assets and the
18 system has its own pricing methodology. By removing the
19 transmission system assets and related revenues and operating
20 expenses from our per-books cost of service, and by including only the
21 tariff charges as a transmission expense, we can more accurately
22 identify the cost of transmission used to serve our customers.

1 **Q. PLEASE EXPLAIN THE ADJUSTMENT YOU ARE MAKING FOR**
2 **THE INCREASE IN TRANSMISSION EXPENSE?**

3 A. At the end of 2005, FERC approved an increase to the Common Use
4 System rates for services other than those across the Rapid City
5 Converter Tie (also referred to as the AC-DC-AC Tie). This increase is
6 based on actual costs for January 1, 2006 through April 30, 2006, and
7 forecasted costs for the remainder of 2006. The total upward
8 adjustment to expenses for these costs is \$1,324,770. Chris Kilpatrick
9 will provide further detail regarding this adjustment in his testimony.

10 **IV. FUTURE ADJUSTMENTS**

11 **Q. EXPLAIN THE TRANSMISSION COST ADJUSTMENT.**

12 A. This adjustment has been designed to pass through changes in our
13 transmission costs. The increase in 2006 transmission expenses will
14 be included in base rates allowing the transmission cost adjustment
15 factor to be set to zero on January 1, 2007. Additionally, the
16 transmission expense for power marketing has been excluded. We
17 have also decreased transmission expense by \$610,015 for the
18 PacifiCorp transmission service used to serve the Montana-Dakota
19 Utilities' wholesale contract. In January of 2008 when the final
20 transmission costs for 2007 have been identified, those costs will be
21 compared to the established base cost and an adjustment will be
22 made to reflect the change in expense, either up or down. This new
23 amount will then be added or subtracted from our customers' base

1 rates effective March 1, 2008 and continuing for twelve months
2 thereafter. This process will be repeated on an annual basis with a
3 subsequent informational filing submitted to the South Dakota Public
4 Utilities Commission (Commission) supporting the adjustment. Costs
5 will be captured in the appropriate FERC accounts and will be
6 recovered or refunded with interest. Further detail is provided in the
7 transmission adjustment tariff included with my testimony as Exhibit
8 JAS-1 and in Statement P, page 2, of the application.

9 **Q. WHAT ARE YOU PROPOSING IN REGARD TO THE STEAM PLANT**
10 **FUEL COST ADJUSTMENT?**

11 A. This adjustment has been designed to pass through changes in fuel
12 related expenses for our steam generation. Fuel related expenses
13 include costs that are currently captured in FERC account 501. The
14 cost of coal from our affiliate Wyodak Resources Development
15 Company is determined by a Commission approved methodology that
16 caps the rate of return the mine is allowed to earn on sales to Black
17 Hills Power. Changes in mining conditions, mining operations, and
18 market conditions impact the price of this commodity. For example,
19 additional overburden increases the stripping ratios and the cost of
20 uncovering the coal resources. An increase in the cost of diesel fuel
21 increases the operational costs of haul trucks and other mine
22 equipment.

1 **Q. HOW IS THE STEAM PLANT FUEL COST ADJUSTMENT HANDLED**
2 **IN YOUR APPLICATION?**

3 A. As with the transmission cost adjustment, the 2006 increase in steam
4 plant generation costs will be included in base rates. The forecast
5 increase in 2006 for these costs is \$386,894 which Wyodak
6 Resources passes on to Black Hills Power through the previously
7 approved pricing methodology. Again as with the transmission clause,
8 this allows the steam generation cost adjustment factor to be set to
9 zero on January 1, 2007. Chris Kilpatrick will elaborate on this cost
10 increase in his testimony. In January of 2008 when the final steam
11 generation costs for 2007 have been identified, these costs will then
12 be compared to the established base cost and an adjustment will be
13 made to reflect the change in expense, either up or down.

14 **Q. WILL THE COST CHANGES BE PASSED ON TO THE**
15 **RATEPAYERS IN THE SAME WAY AS WITH THE TRANSMISSION**
16 **EXPENSES?**

17 A. Yes. This new amount will then be added or subtracted from our
18 customers' base rates effective March 1, 2008 and continuing for
19 twelve months thereafter. This process will be repeated on an annual
20 basis with a subsequent informational filing submitted to the
21 Commission. Further detail is provided in the adjustment tariff
22 included with my testimony as Exhibit JAS-2 and in Statement P,

1 page 1 of the application. Discussion of the coal pricing methodology
2 is included in the testimony of Perry Krush.

3 **Q. PLEASE DESCRIBE THE CONDITIONAL ENERGY COST**
4 **ADJUSTMENT (CECA) YOU ARE PROPOSING.**

5 A. Our customers have enjoyed the stability and predictability of our rates
6 over the past eleven years and we do not want to migrate to a
7 traditional adjustment clause that would in effect change rates for
8 customers on a monthly basis. The premise of this adjustment is to
9 provide Black Hills Power's customers with the benefit of a \$2,000,000
10 offset such that costs for other fuel and purchased power would have
11 to first exceed the base cost by that amount before a rate adjustment
12 could be made, and even that rate adjustment could be offset in whole
13 or in part by power marketing net income. The CECA is a means that
14 allows us to recover a portion of the costs incurred for serving our load
15 obligations from resources other than our coal fired generation and
16 provides us an incentive to manage costs, optimize assets, and
17 continue our power marketing activity which in turn will minimize the
18 costs passed on to our customers.

19 **Q. DESCRIBE HOW THE CECA WILL WORK IN ACTUAL PRACTICE.**

20 A. The CECA adjustment will be determined on an annual basis with,
21 again, the first \$2,000,000 of increase in CECA costs (above the base
22 costs of 2006) being absorbed by Black Hills Power, regardless of
23 whether any power marketing net income is realized. If the

1 \$2,000,000 threshold above base cost is exceeded, the power
2 marketing net income is used to offset that excess amount based on a
3 formula that will determine how much of the excess is borne by the
4 customers, and how much is borne by Black Hills Power. Finally, if
5 costs remain under the \$2,000,000 threshold, customers will see no
6 impact to their rates. This provides an incentive for Black Hills Power
7 to keep the CECA costs as low as possible and avoid any pass
8 through of those costs to the customer.

9 **Q. WOULD YOU SUMMARIZE THE CECA BENEFIT TO CUSTOMERS?**

10 A. Yes. Black Hills Power assumes the first \$2,000,000 of CECA risk.
11 Thereafter, as Black Hills Power's marketing net income increases it
12 absorbs more and more of the CECA risk above that threshold.

13 **Q. HOW WAS THE BASE COST FOR THE CECA DETERMINED?**

14 A. The base for this adjustment clause has been calculated by taking the
15 total other fuel expense and purchased power expenses for 2005, and
16 then excluding the associated expenses for power marketing and the
17 incremental purchased power for the Neil Simpson II outage. The
18 establishment of the base cost will be handled the same as with the
19 other adjustment clauses, and any rate increase will likewise go into
20 effect March 1, 2008 continuing for twelve months thereafter. This
21 process will be repeated on an annual basis with a subsequent filing
22 submitted to the Commission supporting any adjustment. Further

1 details for this adjustment are included with my testimony as Exhibit
2 JAS-3 and Statement P, page 3, of the application.

3 **Q. PLEASE DESCRIBE HOW CUSTOMERS WILL BENEFIT FROM**
4 **THE CHANGES BLACK HILLS POWER IS PROPOSING.**

5 A. The adjustments and adjustment tariffs that we are proposing allow
6 Black Hills Power to continue to operate efficiently and will result in just
7 and reasonable rates for South Dakota customers. The adjustment
8 tariffs will be calculated and put into effect on an annual basis and
9 customers will not be subject to monthly changes in their rates, making
10 it easier for them to manage their budgets. Even as our customers will
11 have enjoyed stable, flat rates for over eleven years our costs of
12 conducting our business have been continually increasing. We believe
13 that our proposed CECA will allow us to manage costs and minimize
14 the impact to customers as we continue to conduct business in an ever
15 changing environment.

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

17 A. Yes, it does.