

**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 KYLE D. WHITE

I. INTRODUCTION AND QUALIFICATIONS

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

2 A. Kyle D. White, 625 Ninth Street, P.O. Box 1400, Rapid City, South
3 Dakota, 57701.

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

5 A. I am Vice President of Corporate Affairs for Black Hills Corporation
6 (Black Hills). My areas of responsibility include regulatory affairs,
7 governmental affairs, and corporate marketing and public relations.

8 **Q. FOR WHOM ARE YOU TESTIFYING ON BEHALF TODAY?**

9 A. I am testifying on behalf of Black Hills Power, Inc. (Black Hills Power).

10 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND BUSINESS
11 BACKGROUND.**

12 A. I graduated with honors from the University of South Dakota in 1982
13 with a Bachelor of Science degree in Business Administration,
14 majoring in management. In 1989 I graduated with a Masters degree
15 in Business Administration, also from the University of South Dakota. I
16 have been employed by Black Hills in rate-related and marketing-
17 related work since 1982 and have been in my present position since
18 January of 2001. For much of my career, I was responsible for the

1 preparation of Black Hills Power's rate studies and filings. In addition
2 to on-the-job training in utility rate making, I have attended numerous
3 seminars, trade association meetings, and regulatory conferences
4 covering a variety of subjects including utility rate-making principles.

5 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION**
6 **OR OTHER COMMISSIONS?**

7 A. Yes, I have testified before the South Dakota Public Utilities
8 Commission and the Wyoming Public Service Commission on
9 numerous occasions.

10 **II. PURPOSE OF TESTIMONY**

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

12 A. To provide historical perspective regarding Black Hills Power and to
13 outline the reasons we are filing this rate change application.

14 **III. OPERATIONS PRIOR TO 1995 AND SINCE**

15 **Q. PLEASE EXPLAIN TO THE COMMISSION HOW BLACK HILLS**
16 **POWER FUNCTIONED PRIOR TO THE 1995 RATE CASE.**

17 A. Prior to the 1995 rate case, Black Hills Power viewed itself as a
18 traditionally regulated utility and operated as such. We were, and still
19 are, a vertically integrated company that serves a growing customer
20 base. Our tariffs included a customized comprehensive fuel and
21 purchased power adjustment clause (FAC). The FAC was critical to
22 our financial stability since our business model was to buy capacity
23 and energy from other utilities until our load grew to a level that would

1 support the construction of rate-based generation. Then, as now, any
2 scheduled or forced outages required the purchase of more expensive
3 replacement power. Due to the FAC and Black Hills Power's ability to
4 balance expense and revenue growth, rate cases were largely
5 reserved for additions of major transmission and power plants.

6 **Q. DID THE 1995 SOUTH DAKOTA RETAIL RATE CASE CHANGE**
7 **BLACK HILLS POWER'S APPROACH TO OPERATING ITS UTILITY**
8 **BUSINESS?**

9 A. Yes. There were many issues that influenced the settlement
10 stipulation and the Order of the South Dakota Public Utilities
11 Commission (Commission) in Docket EL95-003. A major driver for the
12 case was adding the newly constructed 85 megawatt Neil Simpson II
13 coal-fired generating station to the rate base. The rate impact of this
14 major plant addition was mitigated due to its replacement of purchased
15 capacity and energy and the anticipated sale of capacity and energy to
16 Montana-Dakota Utilities Company for the Sheridan, Wyoming, service
17 area beginning in January, 1997.

18 Another major influence on the outcome of the rate case was the
19 movement toward deregulation of retail electric service that was being
20 pushed by many large industrial consumers, their national association
21 (ELCON), and marketers like Enron. Their arguments regarding the
22 benefits of competition had taken hold in some states such as
23 California with its "Blue Book" blueprint for retail electric competition.

1 Utilities such as Black Hills Power that had made prudent and “used
2 and useful” investments in generation and long-term purchased power
3 contracts became concerned.

4 **Q. WHAT WAS THAT CONCERN?**

5 A. Our concern was that as result of deregulation and the potential loss of
6 customers, we would face stranded costs in connection with our
7 continuing obligation to provide safe and reliable service to our
8 customers.

9 **Q. WHAT DO YOU MEAN BY “STRANDED COSTS”?**

10 A. These are costs that we could not recover from the very customers
11 that the power supply assets were intended to benefit. As a small
12 investor-owned utility, Black Hills Power viewed these changing market
13 conditions as threats to its survival and became determined to make
14 the changes necessary to be successful in a more competitive
15 environment.

16 **Q. IN WHAT WAYS DID THE 1995 RATE CASE CHANGE THE**
17 **BUSINESS PLAN FOR BLACK HILLS POWER?**

18 A. In many respects, the 1995 rate case became the blueprint for how we
19 would adapt our business to meet the demands of a more competitive
20 regulatory structure. We were confident that common sense would
21 prevail and South Dakota would reject the “inevitability” of electric
22 deregulation, but we remained concerned that the federal government

1 might force states to deregulate. As a result, we felt compelled to get
2 ready.

3 **Q. WHAT WERE THE KEY COMPONENTS OF THE 1995**
4 **COMMISSION SETTLEMENT ORDER?**

5 **A.** There were several key components: (1) We were compelled to
6 accept a rate increase lower than we felt was justified in our rate case
7 application; (2) We were driven to find ways to increase earnings and
8 returns by developing long-term and short-term wholesale
9 opportunities; (3) We were also driven to become more efficient in our
10 operations. The retirement of the Kirk Power Plant was the first
11 evidence of our commitment to this effort; and, (4) We accepted
12 operational risks that were unexpected at the time. These risks
13 included a rate freeze through January 1, 2000 (with limited and
14 stringent outs) and elimination of our innovative fuel and purchased
15 power adjustment clause.

16 Many of those risks would simply not be acceptable today. However,
17 based on our 1995 perspective of the future, we were passionate
18 about changing our culture and continuing our legacy of successfully
19 serving the Black Hills region which began with our predecessors in
20 the 1880s. The changing utility environment and the Commission
21 Order provided significant incentives for us to be innovative in re-
22 positioning our business. We adapted over time and continued to be

1 successful by making adjustments that met the ever-changing
2 operating conditions.

3 **Q. DID THE PARENT CORPORATION CHANGE DURING THIS TIME**
4 **AS WELL?**

5 A. Yes. Black Hills Corporation was driven to understand and capitalize
6 on the changing wholesale and retail markets. We began diversifying
7 our interests and became active in natural gas marketing through an
8 acquisition and a start-up of energy marketing companies. Part of this
9 effort was to develop products and services that could be bundled with
10 electricity to increase the attractiveness of Black Hills Power's offerings
11 to its customers. Ultimately, this led to the creation of Black Hills
12 FiberCom, LLC, our former subsidiary that provided telephone, cable
13 television, and high-speed Internet access to thousands of customers
14 in Rapid City and the Northern Black Hills. We also continued to
15 expand our wholesale power supply efforts, both within Black Hills
16 Power and through subsidiaries operating as independent power
17 producers in multiple western states. Part of this expansion was the
18 completion of our independent coal-fired power plant, Wygen I, in
19 2003, which also brought efficiencies to Black Hills Power's operations
20 through shared resources and lower coal prices. Although we did not
21 believe deregulation would benefit our retail electric customers, we
22 worked hard to prepare ourselves for its possible implementation in our
23 service areas.

1 **Q. WHAT HAS BEEN THE RESULT OF THESE EFFORTS?**

2 A. Black Hills Corporation and its subsidiaries are more innovative,
3 entrepreneurial, and competitively oriented as compared to a decade
4 ago. We believe that these changes have and will benefit customers,
5 and in the future we want to maintain much of the business model that
6 has successfully served our customers since 1995.

7 **Q. DID BLACK HILLS POWER CHANGE ITS APPROACH TO POWER
8 SUPPLY ALONG WITH THE RISKS IT ACCEPTED IN 1995?**

9 A. Yes. As we became more familiar with the evolving western power
10 markets, it became clear to us that dependence upon short-term
11 purchased power for meeting native load electricity requirements could
12 be expensive and that having the ability to sell electricity at times of
13 high demand could be profitable. With this understanding, we worked
14 to reposition our power supply and to maximize the opportunities the
15 market was presenting. During the past eleven years that our South
16 Dakota retail electric rates have been frozen, we made numerous
17 changes to ensure that high power prices did not negatively impact our
18 business.

19 **Q. WHAT ARE THOSE CHANGES?**

20 A. In his testimony, Linn Evans has already mentioned the Neil Simpson
21 II power plant, our membership in the Rocky Mountain Reserve Group,
22 the Colstrip Contract power purchase agreement with PacifiCorp, and
23 development of our power marketing group. In addition, Black Hills

1 Power retired the remaining 16 megawatt unit at the Kirk Station,
2 constructed two 40 megawatt combustion turbines, and converted the
3 remaining combustion turbines at Rapid City from fuel oil to natural
4 gas. The completion of the Rapid City Power Converter Station (also
5 known as the AC-DC-AC Tie) also increased our access to affordable
6 power by connecting Black Hills Power to the eastern transmission
7 grid. Black Hills Power was committed to meeting its obligations under
8 the rate freeze and, through active management of its business, was
9 able to successfully do so.

10 **Q. AFTER NEARLY ELEVEN YEARS OF FLAT RATES FOR ITS**
11 **SOUTH DAKOTA CUSTOMERS, WHY DOES BLACK HILLS**
12 **POWER NOW BELIEVE THAT IT IS NECESSARY TO MAKE AN**
13 **APPLICATION TO THE COMMISSION FOR A RATE INCREASE?**

14 A. The business environment within which Black Hills Power operates has
15 changed significantly over the last decade. In addition to overall cost
16 increases we face greater uncertainty in key areas than experienced
17 previously. This has made the financial results less predictable and
18 more volatile than is expected by investors for a vertically integrated
19 electric utility. This rate application is designed to respond to today's
20 utility operating environment.

21 **IV. SPECIFICS OF RATE CASE APPLICATION**

22 **Q. WHAT IS BLACK HILLS POWER PROPOSING?**

1 A. First, Black Hills Power is seeking a rate increase to recover additional
2 costs related to capital investments to meet customer growth, general
3 inflation, and corporate compliance related expenses. Our proposal is
4 for a revenue increase of \$9,593,688 for its South Dakota retail electric
5 customers. Along with the revenue increase is a package of tariff
6 changes and adjustments that we believe will, when taken together,
7 result in just and reasonable rates for our South Dakota retail
8 customers. Second, we are proposing two traditional cost pass-
9 through tariffs in which cost changes are periodically passed on to or
10 refunded to customers. These are a wholesale transmission cost
11 adjustment and a steam plant fuel adjustment. Finally, we are
12 proposing an innovative pass-through tariff for costs related to natural
13 gas, fuel oil, and purchased power which provides benefits to both
14 customers and shareholders compared with conventional pass-through
15 methods. This conditional clause applies to natural gas, fuel oil, and
16 purchased power expenses and we call it a Conditional Energy Cost
17 Adjustment tariff, or CECA.

18 **Q. WHY IS BLACK HILLS POWER PROPOSING COST PASS-**
19 **THROUGH TARIFFS WHEN IT HAS OPERATED DURING THE**
20 **PAST ELEVEN YEARS WITHOUT THOSE TARIFFS?**

21 A. During the past eleven years, Black Hills Power has essentially
22 operated under a price cap form of regulation where the price
23 customers pay is constant regardless of changes to our revenues and

1 expenses. We were able to successfully adapt to both this form of
2 regulation as well as the changing utility operating conditions in the
3 western United States, while delivering significant benefits to both
4 customers and shareholders. Under the price cap approach, we
5 operated without the typical fuel and purchased power adjustment that
6 is allowed under South Dakota statute. We were willing to forego our
7 fuel adjustment clause because we felt that our risks related to price
8 volatility for coal, natural gas, fuel oil, and purchased power were
9 predictable and therefore manageable. We have learned, however,
10 that these risks are unpredictable. As a result, we believe that
11 adjustment clauses are appropriate to include in Black Hills Power's
12 tariffs.

13 **Q. WHAT IS THE STEAM PLANT FUEL ADJUSTMENT TARIFF?**

14 A. This is a traditional pass-through adjustment tariff designed to pass
15 through all changes in fuel related expenses for our steam generation.
16 As those expenses increase or decrease from our base year
17 expenses, those changes will be passed on to our customers dollar for
18 dollar. Consistent with Commission practice regarding Black Hills
19 Power's purchase of coal from its affiliate, Wyodak Resources
20 Development Corporation, coal is priced using utility-type rate of return
21 principles. Under this pricing methodology, price equals expense plus
22 return on investment. Changes in price result from changes in
23 investment rate of return (interest rates), changes in mining costs, and

1 changes in the volume of coal produced (sold). With expected
2 changes in mining costs, interest rates, and coal tonnage sold, coal
3 prices will be less stable and less predictable in the future, and, as a
4 result, are more appropriately recovered through our proposed annual
5 adjustment. Besides the coal cost, the steam plant fuel adjustment will
6 track coal transportation costs and other fuel costs necessary to
7 operate our coal fired steam generation. The actual operation of this
8 annual adjustment will be described in more detail by Jackie Sargent
9 and Chris Kilpatrick in their testimony.

10 **Q. WHY IS BLACK HILLS POWER PROPOSING A TRANSMISSION**
11 **COST ADJUSTMENT?**

12 A. The regulation of transmission for investor owned utilities such as
13 Black Hills Power has changed dramatically since the mid-1990s.
14 Under the Federal Energy Regulatory Commission's (FERC) Order
15 888, Black Hills Power was required to establish an open access
16 transmission tariff. Under the tariff, Black Hills Power was treated as if
17 it were a transmission service customer. With the construction of the
18 Rapid-City Converter Station, Black Hills Power and the area electric
19 cooperatives renegotiated the Common Use Transmission System
20 Agreement which had governed the parties' ownership and use of the
21 region's 69 kV and 230 kV transmission infrastructures. In 2003, the
22 FERC accepted for filing a joint open access transmission tariff for the
23 regional 230 kV transmission facilities of Black Hills Power, Basin

1 Electric Power Cooperative and Powder River Energy Corporation.
2 Over time, the expansion of the 230 kV transmission system caused
3 the 69 kV transmission that was originally constructed to link the
4 communities of the Black Hills with remotely located central generating
5 stations to become largely distribution in nature. The new tariff
6 resulted in the 69 kV transmission assets being transferred from
7 transmission plant to distribution plant. We are proposing that the
8 transmission costs that Black Hills Power incurs on behalf of its South
9 Dakota retail customers under the joint transmission tariff be handled
10 with a traditional form pass-through tariff in which transmission costs
11 are tracked and recovered from, or credited to, its South Dakota
12 customers dollar-for-dollar. In her testimony Jackie Sargent will
13 explain the design and application of this new pass-through
14 mechanism.

15 **Q. HAS BLACK HILLS POWER UTILIZED A PERIODIC**
16 **TRANSMISSION PASS-THROUGH PREVIOUSLY AS PART OF ITS**
17 **TARIFFS?**

18 A. No. When Black Hills Power last had a fuel and purchased power
19 adjustment, transmission service was provided under FERC approved
20 customer specific transmission service agreements. In addition,
21 purchased power prices typically included delivery. Today, under open
22 access transmission protocol, transmission service is often billed
23 separately. Black Hills Power is requesting pass-through of all costs,

1 and credits, related to service under FERC jurisdictional open access
2 transmission tariffs.

3 **Q. WHY IS BLACK HILLS POWER PROPOSING A “CONDITIONAL”**
4 **RATHER THAN A TRADITIONAL ADJUSTMENT TARIFF FOR THE**
5 **COSTS ASSOCIATED WITH NATURAL GAS, FUEL OIL, AND**
6 **PURCHASED POWER?**

7 A. Our Conditional Energy Cost Adjustment tariff includes a matching of
8 risks associated with natural gas and purchased power cost volatility
9 with the opportunities of wholesale marketing of short-term power.
10 That “power marketing” has become an important part of the utility’s
11 business since 1995. Because of our success with that business
12 model we believe a better alternative for both our customers and our
13 shareholders is to modify that model rather than return to a traditional
14 fuel and purchased power adjustment. Our proposal shares the risk of
15 volatile natural gas and purchased power costs between customers
16 and shareholders while continuing to provide Black Hills Power
17 substantial opportunities to benefit from its continuing creation of a
18 robust wholesale market for short-term power. We believe our
19 proposal fits our company and its resources and will be beneficial to
20 customers. When taken as a whole, the three adjustment tariffs share
21 risks and opportunities more broadly than traditional regulatory
22 approaches.

1 Q. BLACK HILLS POWER IS ASKING FOR THREE SEPARATE AND
2 DISTINCT ADJUSTMENTS. WHY HASN'T BLACK HILLS POWER
3 COMBINED THE RECOVERY OF THESE COSTS INTO A SINGLE
4 ADJUSTMENT TARIFF?

5 A. Because of the nature of the calculations used to establish the
6 adjustments to rates they cannot be combined into a single pass-
7 through adjustment. However, we propose to combine the three
8 adjustments into a single charge when preparing our customers'
9 monthly bills. The customer bill will include a single line item labeled
10 Energy Adjustment Charge that will encompass all three adjustments.
11 Unlike the first two adjustments I have discussed, the natural gas, fuel
12 oil, and purchased power adjustment does not result in a 100 percent
13 pass-through of actual cost increases. It is designed as a conditional
14 adjustment which is only operational when specified cost levels have
15 been exceeded, taken in conjunction with Black Hills Power's power
16 marketing net income. Until those specified levels are exceeded, all
17 cost increases are the responsibility of the Company.

18 Q. WHY IS BLACK HILLS POWER WILLING TO ACCEPT
19 RESPONSIBILITY FOR A PORTION OF THE NATURAL GAS AND
20 PURCHASED POWER COSTS WHEN THEY EXCEED THE LEVEL
21 OF COSTS INCLUDED IN THE REVENUE REQUIREMENTS WHICH
22 ARE PART OF THIS APPLICATION?

1 A. We know from experience that our customers prefer price stability and
2 predictability. This is why all three adjustments provide for annual
3 changes to our customers' rates. Although consumption levels will
4 vary, we anticipate that most variability in cost levels for the
5 transmission adjustment and the steam plant fuel adjustment will be
6 due to the periodic price adjustments. Natural gas and purchased
7 power are largely priced when contracted for or possibly when
8 delivered. These commodities are subject to extreme price volatility,
9 and the market offers little ability to ensure long-term price stability for
10 day to day requirements.

11 **Q. WHAT DO YOU CONSIDER TO BE THE RIGHT OPPORTUNITIES**
12 **THAT WOULD ALLOW BLACK HILLS POWER TO FOREGO A**
13 **TRADITIONAL FUEL AND PURCHASED POWER ADJUSTMENT**
14 **AND ACCEPT A PORTION OF THE COMMODITY PRICE**
15 **VOLATILITY OF NATURAL GAS, FUEL OIL, AND PURCHASED**
16 **POWER?**

17 A. During the last decade we have developed an innovative approach to
18 making short-term wholesale power sales. Our power marketing
19 experts are astute at identifying opportunities in the energy
20 marketplace and utilizing the resources necessary to profitably transact
21 short-term sales of wholesale power. We are proposing that we
22 continue to be able to profit from that expertise in an unpredictable and
23 uncertain marketplace.

1 **V. CUSTOMER AND SHAREHOLDER BENEFITS**

2 **Q. WHAT ARE THE BENEFITS THAT YOU ARE PROPOSING?**

3 A. First, the Conditional Energy Cost Adjustment only becomes active
4 when the total company base cost for these commodities is exceeded
5 by more than \$2,000,000. The adjustment methodology further
6 provides that net income from the Company's short-term wholesale
7 power marketing activities will be used to reduce natural gas and
8 purchased power cost increases as provided for within the tariff.
9 Jackie Sargent will provide the specifics of our proposal in her
10 testimony. Together, these concessions provide real and quantifiable
11 benefits for South Dakota retail customers regardless of whether Black
12 Hills Power continues to be successful in its power marketing activities.
13 Because of our unique capability in this area, we believe that our
14 proposal, when considered in total, provides an appropriate balance
15 between customers' expectations for just and reasonable rates and the
16 need to motivate Black Hills Power to maintain the marketing expertise
17 it developed during the eleven year rate freeze.

18 **Q. ARE THE BENEFITS TO CUSTOMERS GUARANTEED?**

19 A. Yes. Under the proposed approach our customers are shielded from
20 the first stated level of increases in natural gas and purchased power
21 costs regardless of our power marketing net income. They are also
22 shielded from an additional level of increases in those costs depending
23 on the success of our power marketing in any given calendar year.

1 **Q. ARE THE BENEFITS TO BLACK HILLS POWER GUARANTEED?**

2 A. No. Wholesale power sales opportunities vary significantly and may
3 not materialize in the future at levels sufficient to justify the \$2,000,000
4 first obligation to pay for increased natural gas and purchased power
5 costs we are accepting on behalf of all our customers.

6 **Q. WHY IS BLACK HILLS POWER WILLING TO GUARANTEE
7 CUSTOMER BENEFITS UNDER ITS PROPOSAL WHILE ITS OWN
8 BENEFITS REMAIN UNKNOWN AND UNCERTAIN?**

9 A. Black Hills Power has thrived under the culture that formed under the
10 price cap environment that we have operated under the past eleven
11 years. We are conditioned to accepting risk when coupled with
12 appropriate opportunities to be rewarded. We prefer to be motivated to
13 maximize results and the balanced proposal contained within this rate
14 application provides us the incentive we prefer, and need, to make the
15 most of the power sales opportunities and to ensure that we find the
16 lowest cost resources for meeting our long-term energy obligations to
17 our customers.

18 **Q. BESIDES THE BENEFITS YOU HAVE DESCRIBED THAT RESULT
19 FROM THE ADOPTION OF THE CONDITIONAL ENERGY COST
20 ADJUSTMENT, DO RETAIL CUSTOMERS EXPERIENCE OTHER
21 BENEFITS FROM BLACK HILLS POWER'S POWER MARKETING
22 EFFORTS?**

1 A. Absolutely. By being active in this market, we have better connections
2 and market knowledge to identify when it is advantageous to buy
3 power rather than use more expensive peaking generation. In
4 addition, when we have planned or unplanned outages at our steam
5 generation plants, we can acquire replacement power more
6 competitively. Finally, because we buy and sell power on both the
7 eastern and western transmission grids, we maintain broader market
8 knowledge than would a typical small utility that buys power on an as-
9 needed basis only.

10 **Q. HAVE YOU QUANTIFIED THIS BENEFIT?**

11 A. No, and it would be difficult to do so. However, as Tom Ohlmacher
12 explains in his testimony, when we buy or generate power, the lowest
13 variable cost electricity is dedicated to serving native load customers
14 and any excess power after native load requirements have been met is
15 available for short-term wholesale (intersystem) power sales. Although
16 the exact customer benefits are difficult to quantify, the Conditional
17 Energy Cost Adjustment results in material benefits for customers and
18 provides appropriate incentives for Black Hills Power to work to reduce
19 customer exposure to higher costs for natural gas and purchased
20 power.

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

22 A. Yes.