

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA

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

SOUTH DAKOTA PUBLIC
UTILITIES COMMISSION

DIRECT TESTIMONY OF LINDEN R. EVANS

I. INTRODUCTION AND QUALIFICATIONS

1 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A. Linden R. Evans. My business address is 625 Ninth Street, Rapid
3 City, South Dakota, 57701.

4 Q. WHAT IS YOUR EMPLOYMENT POSITION WITH BLACK HILLS
5 CORPORATION?

6 A. My present position with Black Hills Corporation is President and Chief
7 Operating Officer of the Retail Business Segment, which includes
8 Black Hills Power, Inc. (Black Hills Power) and Cheyenne Light, Fuel
9 and Power Company (Cheyenne Light).

10 Q. WHAT IS YOUR EDUCATIONAL, TRAINING AND EMPLOYMENT
11 BACKGROUND?

12 A. I received a Bachelor of Science degree in Mining Engineering from
13 the University of Missouri, Rolla, Missouri, and a Juris Doctorate
14 degree from Northwestern School of Law of the Lewis and Clark
15 College, Portland, Oregon. I am a registered professional engineer
16 with the State of South Dakota. From 1984 to 1988 I was employed as
17 a mining engineer with St. Joe Minerals Corporation fulfilling

1 engineering and management responsibilities at underground mining
2 operations located throughout North America. My primary
3 responsibilities involved engineering and management of various
4 aspects of underground lead, zinc and iron ore mining, beneficiation
5 and maintenance operations. From 1988 to 1990 I was employed as a
6 mining engineer with Homestake Mining Company of California, in
7 Lead, South Dakota. My primary responsibilities involved engineering
8 and management of various aspects of underground and surface gold
9 mining, gold ore beneficiation and maintenance operations. I was in
10 the private practice of law from 1993 to 2001 with the following law
11 firms: Jackson and Kelly, LLC, in Charleston, West Virginia; Marvin D.
12 Truhe Law Offices, Rapid City, South Dakota; and Truhe, Beardsley,
13 Jensen, Helmers and VonWald, in Rapid City, South Dakota. My law
14 practice primarily involved mining and natural resources law,
15 environmental law, contracts law, insurance defense law, and related
16 litigation. From May 2001 to December 2003 I served as Associate
17 Counsel in the Office of General Counsel of the Black Hills Corporation
18 providing legal services for the corporation and its divisions, including
19 for Black Hills Power. My primary responsibilities involved providing
20 corporate legal advice, counsel and litigation services and
21 representation on behalf of Black Hills Corporation's various business
22 entities, with a focus on the legal services provided to Black Hills
23 Power. From December 2003 to October 2004 I served as the Vice

1 President and General Manager of Black Hills FiberCom, a former
2 communication subsidiary of Black Hills Corporation. My primary
3 responsibilities involved the overall management and oversight of all
4 functions of the competitive cable television, telephone and Internet
5 provider.

6 **Q. WHAT ARE YOUR DUTIES AND RESPONSIBILITIES AS**
7 **PRESIDENT AND CHIEF OPERATING OFFICER OF THE RETAIL**
8 **BUSINESS SEGMENT?**

9 A. I am the executive within Black Hills Corporation responsible for
10 managing and implementing the strategic objectives of the Retail
11 Business Segment, which includes Black Hills Power and Cheyenne
12 Light. My responsibilities include ensuring the retail companies are
13 managed efficiently and in a manner to provide long-term value to our
14 customers and shareholders. This responsibility manifests itself in
15 several ways, including the Company's ongoing ability to provide
16 reliable, reasonably-priced and safe electricity to customers,
17 maintaining open and quality relationships with our stakeholders,
18 including customers, regulators, communities served and
19 shareholders. A critical responsibility is ensuring Black Hills Power's
20 long-term financial integrity and implementation of sound financial
21 policies and principles to continue to attract sufficient and affordable
22 capital, while maintaining sound credit rating agency relationships.
23 Ensuring a strong financial position provides the financial flexibility

1 necessary to meet the ongoing demand for utility services provided to
2 customers. My responsibilities also include the health and welfare of
3 the Retail Segment employees and ensuring that a well-trained,
4 reasonably-equipped workforce is continually available to meet the
5 needs of our customers.

6 **II. PURPOSE OF TESTIMONY**

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

8 A. The purpose of my testimony is to give an overview of Black Hills
9 Power. I will discuss its retail and wholesale segments, its financial
10 and growth history, and what I see for the future. Finally, I will give a
11 brief introduction to our rate case with the caveat that other witnesses
12 will be testifying in detail about the specifics.

13 **III. BLACK HILLS CORPORATION ENTITIES**

14 **Q. BRIEFLY DESCRIBE BLACK HILLS CORPORATION'S**

15 **BUSINESS.**

16 A. Black Hills Corporation is a South Dakota corporation and is a
17 diversified energy company. It operates principally in the United States
18 with two major business groups, retail electric and gas service, and
19 wholesale energy.

20 **Q. WHAT IS THE RELATIONSHIP BETWEEN BLACK HILLS**

21 **CORPORATION AND BLACK HILLS POWER?**

1 A. Black Hills Power is a wholly-owned subsidiary of Black Hills
2 Corporation. Black Hills Power is a division within Black Hills
3 Corporation's Retail Business Segment.

4 **Q. WHAT OTHER UTILITIES ARE OWNED BY BLACK HILLS**
5 **CORPORATION?**

6 A. In January, 2005 Black Hills Corporation acquired Cheyenne Light,
7 which is a combination electric and gas utility segment. Cheyenne
8 Light is a regulated utility and serves approximately 38,700 electric and
9 32,500 natural gas customers in Cheyenne and parts of Laramie
10 County, Wyoming.

11 **IV. BUSINESS OVERVIEW OF BLACK HILLS POWER**

12 **Q. BRIEFLY DESCRIBE BLACK HILLS POWER'S BUSINESS.**

13 A. Black Hills Power is a regulated electric utility engaged in the
14 generation, transmission and distribution of electricity to approximately
15 63,800 customers in western South Dakota, northeastern Wyoming,
16 and southeastern Montana, with a service territory of 9,300 square
17 miles. Approximately 90 percent of Black Hills Power's retail electric
18 revenues in 2005 were generated in South Dakota.

19 **Q. WHAT ARE BLACK HILLS POWER'S SUMMER AND WINTER**
20 **PEAK LOADS?**

21 A. Black Hills Power established a new summer peak load of 401
22 megawatts in July 2005 and a new winter peak load of 356 megawatts
23 in December 2005. Black Hills Power owns 406 megawatts of electric

1 utility net generating capacity and purchases an additional 50
2 megawatts under a long-term agreement expiring in 2023.

3 **Q. WHAT IS THE BREAKDOWN OF BLACK HILLS POWER'S**
4 **ENERGY SALES?**

5 A. The revenue mix for the year ended December 31, 2005 was comprised
6 of 26 percent commercial, 21 percent residential, 11 percent industrial,
7 37 percent wholesale, and 5 percent municipal sales and other
8 revenue.

9 **Q. WHAT ARE YOUR LONG-TERM WHOLESale CONTRACTS?**

10 A. Black Hills Power has agreements with Montana-Dakota Utilities
11 Company to serve Sheridan, Wyoming, the City of Gillette, Wyoming,
12 and with the Municipal Energy Agency of Nebraska, also known as
13 MEAN. Tom Ohlmacher will discuss these long term contracts in more
14 detail in his testimony.

15 **Q. WHAT IS YOUR FORECAST FOR FUTURE ENERGY SALES?**

16 A. We forecast energy sales in our retail service territory to increase by
17 one and one half to two percent annually over the next 10 years, with
18 the system demand forecasted to increase at a rate of approximately
19 two percent annually. These forecasts are derived from regional
20 information that was examined and analyzed to forecast changes in
21 the needs for electrical energy and demand over a 20-year period in
22 Black Hills Power's service area. This is, of course, a forecast, and the
23 actual changes in electric sales may be different. Finally, deviations

1 from normal weather forecasts have the most significant impact on
2 energy sales predictions.

3 **Q. WHAT ARE SOME INDUSTRY TRENDS AND MARKET TRENDS**
4 **THAT COULD IMPACT BLACK HILLS POWER'S FUTURE**
5 **OPERATIONS?**

6 A. There are several notable trends. We are especially aware that
7 continued or more extreme fuel price volatility, particularly natural gas,
8 and purchased power expenses could dramatically change our
9 business model as we seek to add coal-fired generation facilities to our
10 generation portfolio. With regard to Black Hills Power specifically,
11 forecasted skilled labor shortages could negatively impact our
12 business as our workforce ages.

13 **V. ISSUES RELATED TO FUTURE GROWTH**

14 **Q. WHAT IS YOUR OUTLOOK FOR GROWTH IN CUSTOMERS?**

15 A. Black Hills Power is experiencing relatively rapid and accelerated
16 growth in customers of a little over two percent as compared to an
17 average of one to one and a half percent growth in prior years,
18 necessitating additional infrastructure and expenditures.

19 **Q. BEYOND GROWTH IN YOUR TRADITIONAL CUSTOMER BASE,**
20 **WHAT DO YOU SEE AS THE FUTURE AREAS OF GROWTH FOR**
21 **YOUR COMPANY?**

22 A. Black Hills Power's opportunity for growth must be viewed in the context
23 of South Dakota's 1975 Utility Territory Act which established permanent

1 service territory boundaries for Black Hills Power and other South Dakota
2 utilities. Consequently, Black Hills Power's customer growth is limited
3 geographically to those homes and businesses within its existing territory
4 boundaries.

5 **Q. WHAT ARE SOME EXAMPLES OF POTENTIAL GROWTH?**

6 A. We were encouraged by the relatively recent decision to not close
7 Ellsworth Air Force Base. While Black Hills Power does not currently
8 serve the Base's electricity requirements, the Base employs
9 approximately 4,100 military personnel who live and shop in Rapid City
10 and other communities that we serve. In addition, Ellsworth has been
11 given an expanded mission which will bring additional personnel and
12 families to our region. Also worth noting, is the state's decision to
13 move forward with its effort to establish an underground laboratory at
14 the Homestake Mine in Lead, South Dakota and the recent
15 announcement of the N.E.W. call center to be located in Rapid City,
16 which reportedly will add up to 500 new jobs for the region.

17 **VI. POWER MARKETING**

18 **Q. DOES BLACK HILLS POWER SELL EXCESS ELECTRICITY TO**
19 **THIRD PARTIES?**

20 A. Yes. Beginning in 1995, Black Hills Power developed in earnest a
21 power marketing function that sells excess electricity and electricity
22 that it may purchase for purposes of resale into the open power
23 market. I will hereafter refer to this as "power marketing."

1 **Q. HOW DID BLACK HILLS POWER DEVELOP ITS POWER**
2 **MARKETING FUNCTION?**

3 A. There were several factors which contributed to making the power
4 marketing successful: (1) Completion of the Neil Simpson II coal-fired
5 power plant in 1995 marked the first time in several years that Black
6 Hills Power had any surplus energy beyond its utility customers' needs;
7 (2) Shortly thereafter Black Hills Power became a member of the
8 Rocky Mountain Reserve Group which allowed us to reduce our hourly
9 reserve requirement and thus market our surplus energy without
10 impacting our retail reliability; (3) We established marketing or re-
11 designation rights through use of our Colstrip Contract with PacifiCorp;
12 and (4) We developed a very active and successful power marketing
13 group.

14 **Q. WHAT HAS BEEN BLACK HILLS POWER'S EXPERIENCE WITH**
15 **POWER MARKETING?**

16 A. Power pricing in the western power markets has allowed Black Hills
17 Power's power marketing arm to obtain approximately \$4.5 million in
18 annual operating income through power marketing energy transactions
19 over the past several years. Black Hills Power has an experienced team
20 that is responsible for energy marketing and transmission scheduling.
21 Their first obligation is to provide least-cost, reliable power to the utility,
22 and any power marketing sales are a result of efforts beyond that retail
23 obligation. The experience of the generation dispatch and power

1 marketing operations, along with the recent addition of the Rapid City
2 Converter Tie, which provides us reliable access to economical power
3 from eastern system markets, provides access to the eastern grid for
4 maximizing reliability for our retail customers, allows us to secure the
5 lowest cost energy resources for retail customers, and also allows us
6 to maximize margins with power marketing from time-to-time.

7 **Q. WHAT DO YOU SEE IN THE FUTURE FOR POWER**
8 **MARKETING SALES?**

9 A. Black Hills Power's power marketing energy sales are a function of and
10 influenced by available excess Black Hills Power energy, available
11 generation supply resources, fuel cost, market demand for energy, and
12 prevailing market prices. Black Hills Power's power marketing energy
13 sales have been impacted in the past few years due to volatility in natural
14 gas fuel prices causing it to be impractical to operate natural gas-fired
15 combustion turbines for purposes of power marketing energy sales.
16 When additional, relatively lower variable operating cost, coal-fired
17 generation is built in the future, the western and eastern markets may
18 provide opportunities to Black Hills Power for improved power marketing
19 opportunities.

20 **VII. GENERATION COSTS**

21 **Q. HOW DO YOU MANAGE TO CONTROL BLACK HILLS**
22 **POWER'S PRODUCTION COSTS?**

1 A. Black Hills Power's current regulatory model naturally encourages
2 innovation and efficient operations. Since the 1995 settlement with the
3 SDPUC, Black Hills Corporation's shareholders have benefited from
4 productivity and efficiencies obtained by Black Hills Power. This has
5 provided a natural incentive to carefully manage costs. Black Hills
6 Power and its customers have also benefited from the low cost fuel
7 from the mine-mouth plants, which also eliminates transportation costs
8 that often represent the largest component of the delivered cost of
9 coal. We have access to low production costs for many reasons,
10 including obtaining fuel from the Company's mining operations, and
11 operating plants at high availability and high load factors. Each of
12 these factors is managed with the objective of achieving low production
13 and operation costs.

14 **Q. WHAT IS YOUR BUSINESS PLAN REGARDING YOUR**
15 **GENERATION FACILITIES?**

16 A. As we experience growth within our territory, we expect to expand our
17 portfolio of power plants. We will build plants that have relatively low
18 marginal costs. As an increasing number of natural gas-fired power
19 plants have been and will likely continue to be built in the United
20 States, natural gas prices are anticipated to remain volatile and to
21 likely increase. Thus, when necessary, additional coal-fired generation
22 facilities will be built with access to coal reserves to provide low-cost,
23 stably priced power for our customers.

1 **Q. DOES BLACK HILLS CORPORATION HAVE ANY NEW**
2 **GENERATION FACILITIES COMING ONLINE IN THE NEAR**
3 **FUTURE?**

4 A. Yes. Construction has begun on Wygen II, a 90-megawatt baseload
5 coal-fired power plant at our energy complex near Gillette, Wyoming,
6 which will be owned by Cheyenne Light. This power plant is expected
7 to be in commercial operation in early 2008. We are also seeking
8 necessary permits to construct Wygen III, a 90-megawatt baseload
9 coal-fired power plant at our energy complex near Gillette.

10 **VIII. 1995 RATE CASE**

11 **Q. WHEN DID BLACK HILLS POWER LAST APPLY TO THE SOUTH**
12 **DAKOTA PUBLIC UTILITIES COMMISSION TO INCREASE ITS**
13 **ELECTRICAL PRICES?**

14 A. In 1995, Black Hills Power submitted an application for a rate increase
15 which resulted in a Settlement Agreement being reached with the
16 SDPUC and certain large customers.

17 **Q. WHAT WERE THE PRINCIPAL PROVISIONS OF THAT**
18 **AGREEMENT?**

19 A. Black Hills Power received a revenue increase of approximately six
20 percent. Black Hills Power also agreed to freeze electric rates until
21 December 31, 1999, and the rate freeze was formally extended for South
22 Dakota customers through December 31, 2004, pursuant to a
23 subsequent Settlement Agreement in 1999. Despite the expiration of

1 the rate freeze at the end of 2004, Black Hills Power's current rates in
2 South Dakota have remained in place since the end of 2004. Another
3 provision of the settlement was the suspension of Black Hills Power's
4 fuel and purchased power adjustment clause for the duration of the rate
5 freeze. Accordingly, Black Hills Power assumed all the risk of unplanned
6 generation outages, purchased power volatility, and fuel price volatility.

7 **Q. DID THE SETTLEMENT ADDRESS BLACK HILLS POWER'S POWER**
8 **MARKETING FUNCTION?**

9 A. Yes, along with the risks associated with plant outages and purchase
10 power expenses, Black Hills Power retained all of the potential financial
11 benefits of power marketing sales.

12 **Q. DID THE SETTLEMENT AGREEMENT ALLOW FOR ANY**
13 **EXCEPTIONS TO THE RATE FREEZE?**

14 A. Yes. Some extraordinary events were listed which, if they occurred,
15 would have allowed Black Hills Power to reinstate a fuel adjustment
16 clause or request a rate increase.

17 **Q. DID ANY OF THOSE EXTRAORDINARY EVENTS OCCUR DURING**
18 **THE PERIOD OF THE RATE FREEZE?**

19 A. Yes. One of the defined extraordinary events was the possibility of
20 Black Hills Power experiencing a revenue loss of more than \$2 million
21 per year from a single customer. That in fact occurred when
22 Homestake Mining Company closed its mining operations, which

1 resulted in its energy payments dropping from over \$8 million in 1994
2 to less than \$1 million in 2001.

3 **Q. WHY DIDN'T BLACK HILLS POWER SEEK RELIEF FROM THE**
4 **RATE FREEZE?**

5 A: Rather than return to our customers for relief, we were able to take the
6 energy previously dedicated to Homestake Mining Company and utilize
7 it in power markets at acceptable margins. This is an example of how
8 the power marketing opportunities have served the interests of our
9 retail customers. Utilizing the expertise developed by our generation
10 dispatch and power marketing group, we were able to use our
11 marketing presence to turn a potential revenue reduction into an
12 opportunity, while extending the rate freeze for several years after the
13 closure of the Homestake Mine.

14 **Q. WHAT WERE SOME OF THE RISKS THAT BLACK HILLS POWER**
15 **ASSUMED, AND WHICH SUBSEQUENTLY MATERIALIZED**
16 **DURING THE RATE FREEZE, THAT BLACK HILLS POWER HAS**
17 **ABSORBED?**

18 A. Examples include: (1) the loss of revenue from Homestake Mining
19 Company's closure; (2) the unplanned, forced outage of the Neil
20 Simpson #2 generation plant during the summer of 2005, which shut
21 down for several weeks and incurred additional expenses of
22 approximately \$3.2 million; (3) the need for additional significant

1 investments in utility plants; and, (4) the volatile costs of natural gas
2 and purchased power that have developed since 1995.

3 **Q. HOW HAVE NATIONWIDE OVERALL ELECTRICAL ENERGY**
4 **PRICES INCREASED IN THE PAST TEN YEARS COMPARED TO**
5 **NON-ENERGY RELATED CONSUMER PRICES?**

6 A. Non-energy related consumer prices have risen substantially faster
7 than electrical energy prices. Attached as Exhibit LRE-1 is a graph
8 showing the increases since 1995 in consumer prices for medical
9 services, food, housing, and national electricity rates. Increases in
10 national electrical energy prices have risen far less when compared to
11 those other consumer prices, and of course Black Hills Power's
12 electricity rates have remained unchanged during that period. In short,
13 contrary to some public perceptions, national energy price increases
14 have been relatively modest compared to those of other goods and
15 services.

16 **Q. WHAT IS THE HISTORY OF RATE INCREASES THAT BLACK**
17 **HILLS POWER HAD PRIOR TO 1995?**

18 A. Between 1974 and 1995 Black Hills Power had several rate increases,
19 yet those increases still remained substantially below the overall
20 increase in the Consumer Price Index (CPI) during that same period.

21 **Q. WHAT HAS BEEN THE CHANGE IN THE CPI SINCE 1995**
22 **COMPARED TO BLACK HILLS POWER'S RATES?**

1 A. Since the 1995 rate freeze Black Hills Power has had no rate
2 increases. Exhibit LRE-2 shows that in inflation adjusted dollars, Black
3 Hills Power's customers are now paying 28 percent less per kilowatt
4 hour than they were paying eleven years ago.

5 **Q. HOW WAS BLACK HILLS POWER ABLE TO REMAIN**
6 **FINANCIALLY SOUND DURING THAT RATE FREEZE?**

7 A. Black Hills Power's record demonstrates that it has been very
8 proactive and innovative over the past eleven years of the rate freeze
9 in several key areas.

10 **Q. WHAT ARE SOME EXAMPLES?**

11 A. We have been able to sustain continued revenue growth, been
12 aggressive in managing our costs, and have developed our power
13 marketing opportunities. We have optimized our reliability of service
14 which is reflected not only in our service records but also in our current
15 98 percent overall favorable customer rating. We have achieved that
16 by being very responsive to our customers, including keeping each of
17 our ten community offices open and installing modern systems such as
18 our state-of-the-art Outage Management System. Also, Black Hills
19 Power personnel have always been very active in the communities that
20 we serve, including financial support for economic development and
21 charities and civic organizations. In addition, our practice is to attribute
22 our lowest cost resources to our native load. That will be discussed in
23 detail by Tom Ohlmacher. We have also worked very hard to try to

1 minimize the marketplace risks to both our retail customers and our
2 shareholders. Having said that, however, our nation's utilities are now
3 operating in a significantly different environment than existed in 1995
4 during our last rate case.

5 **IX. FACTORS THAT AFFECT UTILITIES**

6 **Q. WHAT HAS CHANGED AND WHAT EFFECT DO THOSE CHANGES**
7 **HAVE ON UTILITIES GOING FORWARD?**

8 A. Probably the most significant change is the volatility and unpredictably
9 of fuel and purchased power costs and its impact on energy prices
10 beginning in about 1999. The energy crisis during that period caught
11 not only the public, but also most industry insiders completely off
12 guard. There is little to suggest that it cannot happen again, and in fact
13 it has happened, on a lesser scale in more recent years.

14 **Q. WHAT ARE THE CAUSES OF THAT VOLATILITY?**

15 A. One reason for that volatility is the relatively close balance that
16 currently exists between supply and demand. In addition, in the past
17 five years natural gas has become the national industrial fuel of choice
18 because of its emissions characteristics, and demand has expanded
19 significantly. As a result, most of the recent increase in power
20 generation capacity has been natural gas-fired, and since there is not a
21 surplus of cheap energy, the industry has been forced to utilize the
22 costly gas-fired combustion turbines, especially for peak loads. Thus,
23 the market is driven by the cost of natural gas for those turbines, which

1 exposes utilities to that greater risk of fuel price volatility when gas is
2 purchased for a utility's own turbines, or when gas-fired power is
3 purchased on the open market.

4 **Q. DESCRIBE THE NEIL SIMPSON #2 OUTAGE?**

5 A. We experienced an unplanned power outage in our Neil Simpson #2
6 plant near Gillette, Wyoming in July and August of 2005 due to
7 mechanical failure of a steam turbine. We responded to that outage by
8 acquiring an additional \$3.2 million of purchased power to assure
9 adequate energy and capacity to serve the native load during the
10 outage.

11 **Q. IS THAT \$3.2 MILLION AMOUNT CREDITED TO YOUR 2005 TEST**
12 **YEAR COST OF SERVICES IN YOUR APPLICATION?**

13 A. No. As will be explained in later testimony, the costs associated with
14 that outage in our cost of services for 2005 is not included.

15 **Q. WHY IS BLACK HILLS POWER FILING A RATE CASE**
16 **APPLICATION AT THIS TIME?**

17 A. First, Black Hills Power is requesting a rate increase to cover some of
18 our increased costs of serving our retail customers.

19 **Q. WHY ARE YOU SEEKING TO RECOVER SOME, BUT NOT ALL, OF**
20 **YOUR INCREASED COSTS?**

21 A. We work hard to maintain a high level of customer satisfaction and we
22 know that an important element of that satisfaction is their perception
23 of our prices and value of our services. Therefore, even though our

1 cost of service study supports a larger rate increase, our customers
2 have not experienced any price changes in over 11 years.
3 Accordingly, we feel that a 9.5 percent rate increase is appropriate
4 since it represents less than one percent per year when spread over
5 that 11-year period. We believe that our customers will be accepting of
6 that level of rate increase, especially considering the volatility and
7 substantial increases they have experienced in their non-electrical
8 energy requirements. In addition, we are proposing a package of
9 annual energy adjustments that allow us to otherwise accept the lower
10 rate increase of 9.5 percent. This package provides opportunities for
11 our customers and shareholders under certain market and operating
12 conditions.

13 **Q. WHAT OTHER REASONS DO YOU HAVE FOR FILING YOUR**
14 **APPLICATION AT THIS TIME?**

15 A. The second, equally important, reason is that the energy marketplace
16 has changed and the risks related to price volatility for not only natural
17 gas, but also for coal and fuel oil are no longer either predictable or
18 manageable. Our rate application is designed to respond to the risks
19 inherent in that new utility operating environment. We have spent a
20 considerable amount of time, effort, and analysis incorporating both
21 traditional and conditional energy adjustment clauses in our application
22 to address those risks to both our shareholders and our customers for
23 years to come. We believe that adoption of this model will also provide

1 price stability and predictability to our customers. Finally, the goal is
2 that this risk avoidance model will substantially reduce the frequency of
3 our future rate cases, except those related to major capital
4 expenditures such as for additional generating plants.

5 **Q. WHAT ARE THE KEY COMPONENTS OF YOUR APPLICATION?**

6 A. Black Hills Power continues to be proactive in its attempt to control the
7 risks with a conditional energy adjustment clause for natural gas, fuel
8 oil, and purchased power. The adjustment is structured to provide for
9 operational costs up to a certain stated level to be paid by Black Hills
10 Power and its shareholders, with the balance of those costs above that
11 level being shared with our customers through a graduated cost pass-
12 through tariff. Finally, we are proposing classic pass-through tariffs for
13 wholesale transmission expenses and steam generation fuel
14 expenses. Our overall proposal, as well as each of these components,
15 will be explained in detail in later testimony.

16 **Q. HOW DO YOU PROPOSE THAT YOUR REQUESTED RATE**
17 **INCREASE WILL BE SPREAD AMONG BLACK HILLS POWER'S**
18 **CUSTOMER CLASSES?**

19 A. The request is for an across-the-board rate increase of 9.5 percent for
20 all customer classes, and our rates have been designed to meet this
21 objective.

1 **Q. IN VIEW OF THE COST ALLOCATION METHODOLOGY APPLIED**
2 **TO THE RATE CLASSES, HOW DO YOU JUSTIFY APPLYING THE**
3 **REQUESTED RATE INCREASES EQUALLY TO ALL CLASSES?**

4 A. First of all, all customer classes are in need of a rate increase. In
5 addition, our request to increase rates only 9.5 percent places all rate
6 increases within the just and reasonable range. Rate theory might
7 question our proposal for rate increases and rate design; however, rate
8 theory and rate practice often differ in order to accommodate non-
9 economic factors, such as sensitivity to customer reactions to rate
10 increases. By applying the rate increases equally to all customer
11 classes we are able to retain the integrity of the pricing relationships
12 between the various rate schedule offerings.

13 **Q. WHAT IS YOUR FINANCIAL OUTLOOK FOR BLACK HILLS**
14 **POWER?**

15 A. With approval of the proposals contained in our rate case application
16 we believe that Black Hills Power will experience continued modest
17 revenue growth and stable earnings for the next several years. In
18 order to sustain those earnings, however, we must be able to respond
19 positively to such things as unplanned plant outages and the unknown
20 future of energy costs. As will be explained by other witnesses, our
21 rate case application is designed to address some of those challenges.

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

23 A. Yes.