BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF SOUTH DAKOTA

IN THE MATTER OF THE PUBLIC UTILITIES COMMISSION INVESTIGATION INTO THE EFFECTS OF THE 1986 TAX REFORM ACT ON SOUTH DAKOTA UTILITIES	)	(F-3647-4)
IN THE MATTER OF THE INVESTIGATION INTO THE RELATIONSHIP BETWEEN BLACK HILLS POWER AND LIGHT COMPANY AND UNIVERSAL TRANSPORT INC.	)	(F-3735)

This Stipulation is made and entered into by and between Black Hills Power and Light Company (Company) and the Public Utilities Commission Staff (Staff) as a settlement of matters pertaining to both of the above Dockets, F-3647-4 and F-3735.

I.

BACKGROUND

1986 Tax Reform Act -- F-3647-4

On June 26, 1987, the Commission entered its interim order granting the Company various alternatives to respond to the request by the Commission to show cause why rates should not be reduced to reflect the results of the Tax Reform Act of 1986 (TRA) or select other proposed alternative. On July 14, 1987, the Company responded to the order by selecting the Commission's alternative four which allowed a utility to identify special circumstances and to suggest a particular procedure to facilitate analysis of the impact of TRA and to propose such alternative to

Staff to reach a stipulation regarding further proceedings. In the Company's response the Company moved that the Commission enter an order allowing the Company to continue the Company's tariffs in full force and effect notwithstanding TRA. The Company's contention in the response was that while TRA constituted a reduction in the costs of service, the Company had other substantial increases in the cost of service with the offsetting result that the Company's tariffs still remained fair and equitable.

Affiliated Sales Investigation -- F-3735

On January 18, 1988, the Commission entered an order opening this docket to investigate the relationship between the Company and its wholly owned subsidiary Universal Transport Inc. (UTI) and to determine whether any improper subsidization is occurring. Subsequent to this order, Staff submitted to the Company requests for information inquiring both into the relationship between the Company and UTI and the relationship between the Company and its wholly owned subsidiary Wyodak Resources Development Corp. (WRDC) thus broadening the investigation into both sales of trucking service and coal sales from affiliates to the utility parent.

Fuel and Purchased Power Adjustment

SDCL 49-34A-25 authorizes the Company to automatically adjust rates to reflect changes in the cost of purchased power and fuel. The Company's adjustment has increased since 1982 and will substantially increase in September of 1988 largely due to the 40 year Power Sales Agreement dated December 31, 1983 between Pacific Power & Light Company (PPL) and the Company.

II.

COMPANY PROPOSAL

Roll-in

The Company proposes that in order to prevent large fluctuations from month to month in rates caused by the fuel and purchased power adjustment, that a roll-in of the Company's cost of fuel and purchased power into base rates be allowed as of September 1, 1988, the date when the full impact of the PPL contract would be in any event passed on to the ratepayers through the automatic adjustment. Exhibit A attached includes a base energy charge of 2.555¢ which includes the roll-in as of September 1, 1988.

Affiliate Coal Adjustment

The Company proposes that the fuel and purchased power adjustment in the future reflect a cap on the cost of coal purchased from its affiliate consisting of the lowest of (i) the cost as determined by the existing coal supply agreements or (ii) the cost which does not yield the affiliate more than a maximum rate of return.

III.

STAFF'S POSITION

The Staff has determined and, by entering into this Stipulation and Settlement Agreement, recognizes that the Company's costs of providing electric service to South Dakota ratepayers were substantially reduced on July 1, 1987 as a result of the Tax Reform Act of 1986 (TRA) and that its service costs were substantially increased on July 1, 1988 by the terms of its FERC-approved December 31, 1983 Power Sales Agreement (PSA) with PPL. The Staff also recognizes that, by operation of its Fuel and Purchased Power Adjustment, the Company's rates would be increased substantially on September 1, 1988 to reflect the increased costs incurred under the Power Sales Agreement, including amounts needed to eliminate the undercollections of power supply costs between July 1 and August 31, 1988 caused by the tariff provision's two month implementation lag.

It is the Staff's view that this Settlement Agreement benefits the Company's ratepayers by using the accumulated benefits of the TRA to reduce the initial impact of the PSA cost increases ~~and~~ by using the continuing effects of the TRA to offset the ongoing effects of the PSA increases. In addition, the Settlement Agreement benefits ratepayers by establishing an earnings (rate of return) "cap" on coal sales to the Company by its affiliate Wyodak Resources Development Corp. (WRDC) and by obligating the Company, for ratemaking purposes, to credit ratepayers with certain benefits derived by the Company in negotiations with PPL arising out of the termination of a coal supply agreement between PPL and WRDC.

As the result of informal negotiations pertaining to both Dockets between the Company and Staff, the two parties have reached a settlement pursuant to SDCL 1-26-20 in these Dockets as set forth below.

IV.

SETTLEMENT RATES

It is agreed that if the Commission approves this Stipulation and Settlement Agreement:

A. Company will file revised rate schedules effective September 1, 1988 designed to accomplish the following:

(1) Adopt the Fuel and Purchased Power Adjustment as provided by the true and correct copy thereof marked Exhibit A and attached hereto and made a part hereof by express reference.

(2) Adjust the energy charge (kWh) on all of the Company's rates to reflect the full effect of the savings in the cost of service brought about by TRA by decreasing the base energy rate $0.0018 per kilowatt hour and to roll-in the effect of the automatic Fuel and Purchased Power Adjustment by increasing the base energy rate $0.0145 per kilowatt hour to make a net increase in the base energy rate as of September 1, 1988 of $0.0127 per kilowatt hour.

B. The Company shall grant a bill credit on a kWh energy basis to existing South Dakota retail customers who will be customers for the time period commencing September 1, 1988 and ending and including October 31, 1988 in a total amount of

$2,221,674 to reflect savings to the Company arising out of TRA for the 14 month period commencing July 1, 1987 and ending and including August 31, 1988.

C. Staff will end its investigation in Docket F-3647-4 and will continue its investigation in Docket F-3735, but limit the investigation only as to the Company's affiliate UTI.

V.

EFFECT OF CANCELLED COAL CONTRACTS

For rate making purposes in all future retail South Dakota jurisdiction rate cases, the following shall apply:

(a) All test year transactions between PPL and the Company or WRDC pursuant to the Reserve Capacity Integration Agreement, dated May 5, 198~~7~~ shall be recognized in the utility's revenues and expenses.

(b) Any payment or benefit received or to be received by the Company or WRDC from PPL, the City of Hastings or the City of Grand Island (buyers) arising out of buyers' cancellation of coal supply obligations to WRDC and which is not the purchase or sale of electric power, energy or capacity, or other electric utility services, by or to the Company, shall not be reflected in the utility's revenues and expenses. It is expressly recognized that this provision does not affect either (i) the obligation imposed by the preceeding paragraph (a), (ii) the investment adjustments to be made pursuant to paragraph (f) of the Affiliated Coal Adjustment provision of the Fuel and Purchased Power Adjustment, or (iii) the appropriate accounting for WRDC's coal mining and processing costs under the terms of the September 1, 1977 Coal Supply Agreement, as amended, between WRDC and the Company.

VI.

EXCESS DEFERRED TAXES

Notwithstanding the obligation to commence a flow through to earnings of excess deferred income taxes under FASB 96, the

Company agrees that for rate making purposes in the retail South Dakota jurisdiction, that the excess deferred income taxes on the Company's books shall not be considered as being flowed through to earnings until a decision is made by the Commission as to the treatment of those excess deferred income taxes.

GENERAL CONDITIONS

A. The making of this Settlement Agreement establishes no principles and shall not be deemed to foreclose the Company, Staff or any other person from making any contention in any proceeding or investigation except as provided in Paragraphs IV(C), V and VI above.

B. Approval of this Settlement Agreement by the Commission shall not in any respect constitute a determination by the Commission as to the merits of any allegations or contentions made in this proceeding.

C. The Settlement Agreement is expressly conditioned upon the Commission's acceptance of all the provisions thereof, without change or condition which is unacceptable to any party.

D. The discussions between Staff and Company which produced this Settlement Agreement have been conducted with the customary understanding that all offers of settlement and discussions relating thereto are not to be used in any manner in connection with this proceeding or otherwise except as required by law.

E. This Settlement Agreement includes all terms of settlement and is submitted on the condition that in the event the Commission imposes any change or condition which is unacceptable to any party, this settlement shall be deemed withdrawn and shall not constitute any part of the record in this proceeding or any other proceeding or be used for any other purpose.

F. This Settlement Agreement shall be binding upon the parties hereto, and upon their successors, assigns, agents and representatives.

G. It is understood that Staff enters into this Settlement Agreement for the benefit of the Company's electric customers which are located in the state of South Dakota.

H. This Settlement Agreement is entered into between Staff and Company by their respective agents who represent that they are fully authorized to do so on behalf of their principals.

STAFF OF THE SOUTH DAKOTA
PUBLIC UTILITIES COMMISSION

By: Diane M Patrick
Diane M. Patrick, Staff Counsel

Dated: 8-1-88

BLACK HILLS CORPORATION

By: David E. Morrill
David E. Morrill, Counsel for Company

Dated: July 29, 1988

FUEL AND PURCHASED POWER ADJUSTMENT

APPLICABLE

This Fuel and Purchased Power Adjustment as authorized by SDCL 49-34A-25 applies to all rate schedules for all classes of service authorized by the South Dakota Public Utilities Commission.

FUEL AND PURCHASED POWER ADJUSTMENT

For each month in which the cost of fuel and purchased power and energy per kWh of sales during the second calendar month preceding the billing month exceeds or is less than 2.555¢ per kWh, the energy charge shall be increased or decreased, respectively, by the following adjustment factor:

$$\text{Adjustment Factor} = \left[\frac{Fm}{Sm} - \frac{Fb}{Sb}\right] \times \left[\frac{Tm}{Tn}\right] = \_\_\_\_\_ ¢ \text{ per kWh}$$

Where: (F) is the expense of fuel and purchased power and energy in the base (b) and current (m) periods; (S) is the firm kWh sales in the base and current periods; and (T) is the South Dakota kWh sales for the current or expected (n) billing periods. The adjustment factor shall be rounded to the nearest 0.001¢ for billing purposes and applied to each kWh delivered.

Provided, for the fuel cost and purchased power and energy incurred in the months of July and August of 1988 which shall be billed in September and October of 1988, the base Adjustment Factor shall be 1.109¢ per kWh.

The cost of fuel and purchased power and energy as used herein shall be the cost of (a) fuel costs of the Company's net generation for items listed in Federal Energy Regulatory Commission's Account 151 as may be adjusted by the Affiliate Coal Adjustment below, (b) the costs of all power and energy purchases, and (c) less the incremental cost of intersystem sales.

Affiliate Coal Adjustment. The amount paid for coal purchased by the Company from its affiliate, Wyodak Resources Development Corp. (WRDC) (i) to fuel the Company's Neil Simpson, Osage, Kirk and Ben French electric generating plants (referred to as BH's Plants) to be included in (F) in the above formula shall be the amount as determined by the Coal Supply Agreement, dated September 1, 1977 between WRDC and the Company as amended by the First Amendment, dated May 1, 1980 and the Second Amendment, dated November 2, 1987; and (ii) to fuel the Company's 20 percent interest in the Wyodak electric generating plant (referred to as the "Wyodak Plant") to be included in (F) in the above formula shall be the amount as determined by the Further Restated and Amended Coal Supply Agreement, dated May 5, 1987 among Pacific Power & Light Company (PPL), the Company and WRDC, both (i) and (ii) subject, however, to the following adjustment. Each April 1 commencing with April 1, 1989, the Company shall cause WRDC to determine the return on equity earned by WRDC during the previous calendar year on sales of coal to the Company to fuel BH's Plants and to fuel the Company's 20 percent interest in the Wyodak Plant. In determining the rate of return on equity, the following methods shall be included in the calculation:

(a) The investment base is WRDC's actual cost for its land, coal reserves and mining and Processing Plant and plant held for coal mining and processing purposes as of the calendar year for which the calculations is being made.

(b) The investment base and costs related thereto include the WRDC obligations under the Coal Handling System Agreement, dated June 8, 1978, as amended by the First Amendment to Coal Supply System Agreement, dated as of April 8, 1983.

(c) Processing Plant and related costs shall not be allocated to the coal to fuel the Wyodak Plant. The Processing Plant is divided into three categories, (1) truck loadout facilities; (2) facilities for delivering coal to railcars and the Neil Simpson Plant; and (3) facilities needed to serve (1) and (2). Allocations of the Processing Plant and related costs are to be allocated among the sales for which the categories of plant are used.

(d) New investment base acquired by WRDC after July 1, 1988 to mine and process coal to fulfill new WRDC coal sale contracts of 100,000 tons or more per year entered into after July 1, 1988 and the costs connected therewith of such new investment base shall be allocated to the sales under the said new coal sale contracts.

(e) The capitalization of WRDC shall consist of (1) long term debt devoted to mining operations and (2) common equity defined as being the total proprietary capital of WRDC less such investment as WRDC may have in subsidiary companies.

(f) For each of the five years of 1988 through 1992, the investment base and costs related thereto shall be adjusted for canceled contracts by deleting portions of the investment base and costs by the methodology as illustrated by column (3) of pages 1 and 2 of attached Addendum A. For such purposes, the percentage allocated to canceled contracts at lines 3, 4, 6 and 7 of page 7 shall remain constant for the calculation for all five years, except that, if actual sales are made to Hastings or Grand Island, the actual sales shall be reflected in the normal allocation of WRDC's costs, and the actual tonnages shall be subtracted from the tonnages used on page 7 to derive the otherwise constant allocation factors.

(g) Addendum A attached hereto is an illustration of the forecast calculation of the rate of return for 1988. For years after 1992 allocations of plant and costs are the same under columns (2) and (3) of pages 1 and 2.

If for any calendar year the return on equity earned by WRDC from sales to the Company for BH's Plants and the Company's 20 percent interest in the Wyodak Plant, as calculated by the above methodology, is higher than the Cap Rate as of the April 1 for which the calculation is being determined, (F) shall be reduced for each of the 12 months following the said April 1 in an amount equal to one-twelth of the reduction in revenue WRDC would have received from sales of coal to the Company for BH's Plants and the Company's 20 percent interest in the Wyodak Plant during the previous calendar year if WRDC had earned a return on equity equal to the Cap Rate.

For the purposes of the Affiliate Coal Adjustment the Cap Rate shall be the total of (i) the average interest rate for fixed rate new long term bonds (20 years average life or longer) issued by utilities during the calendar year previous to the April 1 for which the calculation is being made rated "A" by Moody's, and (ii) 400 basis points (4%).

For the purposes of the Affiliate Coal Adjustment "Processing Plant" is that plant which is owned by WRDC at the time of the calculation for the purpose of crushing coal to 0 inches to approximately 2 inches, delivery through the crushing process and to storage, storage and delivery to rail car, highway licensed motor carrier or mine mouth generating plants.

<u>Balancing Account</u>. A balancing adjustment to offset any accumulated difference between fuel and purchased power cost adjustments actually billed and the actual cost variable from Fb/Sb during prior months of operation shall be used in determining the fuel and purchased power adjustment factor.

ADDENDUM A
to
Fuel and Purchased
Power Adjustment

ILLUSTRATION OF AFFILIATE COAL ADJUSTMENT BASED ON 1988 FORECAST

Total Company Adjustment is $7,838,322 less $7,107,516, or $730,806.

Allocation to South Dakota:

1988 Estimated MWH Sales - South Dakota	-	1,080,000	equals 73.072%
1988 Estimated MWH Sales - Total Company	-	1,478,000	

73.072% of $730,806 equals $534,012 the affiliated coal adjustment based on the 1988 forecast

(1) Column (1) on pages 2 and 3 are plant and costs of entire WRDC.

(2) Column (2) on pages 2 and 3 are allocations of plant and costs to BHPL sales to determine actual return on equity.

(3) Column (3) on pages 2 and 3 are allocations of plant and costs on method to be applied for 5 years, 1988 - 1992 to reflect excess base resulting from canceled coal contracts and to determine income allowed by Rate Caps to determine any over-charge adjustment. After five years, the allocations of plant and costs in columns (2) and (3) will be identical and column (3) will determine income allowed by Rate Cap to determine any overcharge.

This Addendum A, based on estimates for 1988, was prepared to illustrate the calculation of the Affiliate Coal Adjustment as set forth in the Fuel and Purchased Power Adjustment attached hereto.

ALLOCATION METHOD FOR PROCESSING PLANT

The total Processing Plant at year end 1987 had an investment cost of $11,646,556 with reserve for depreciation of $3,589,663.

The Processing Plant falls into three categories - (1) truck loadout facility; (2) facilities for delivering coal to Hastings and Grand Island and the Neil Simpson Plant; and (3) facilities, namely-the crushers and conveyors, etc. needed to serve (1) and (2). Facilities in (3) were allocated to (1) and (2) on the basis of coal thru the respective facility to the sum of coal thru (1) and (2). Coal delivered thru the truck loadout facility in 1987 was 625,708 tons of which 397,864 tons was for Black Hills Power and Light Company. Coal delivered to Hastings and Grand Island (388,265 tons) and to Black Hills Power and Light Company (Neil Simpson Plant) (128,659 tons) totaled 516,924 tons. Thus facilities in (3) were allocated to (1) by 54.760% (625,708 ÷ (625,708 + 516,924)) facilities in (3) were allocated to (2) by 45.240% (100% - 54.760%).

Gross Processing Plant plus its reserve in 1987 breaks down as follows:

Processing Plant-Truck Loadout related	$6,096,354
Reserve for Depreciation	$1,519,863
Processing Plant-Other	5,550,202
Reserve for Depreciation	2,069,800