

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

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In the Matter of the Application  
of Black Hills Power, Inc. for  
Authority to Increase its Electric  
Rates

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Docket No. EL14-026

**POST-HEARING BRIEF  
OF THE BLACK HILLS INDUSTRIAL INTERVENORS**

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## I. PROCEDURAL POSTURE

On March 31, 2014, Black Hills Power, Inc. (“BHP” or the “Company”) filed an application for authority to increase electric rates (the “Application”) with the South Dakota Public Utilities Commission (the “Commission”) in the above-referenced docket. The Application represents the fourth time since 2006 that the Company has filed to increase rates for South Dakota customers and during that time, overall rates have risen by 27%.<sup>1</sup> Now, just two years after its last overall increase of 6.4%, the Company is requesting a further increase of 9.3%.<sup>2</sup>

The Black Hills Industrial Intervenors (“BHII”)<sup>3</sup> is a group of large commercial and industrial customers that take retail service from BHP and have been subjected to the Company’s significant increases in electric rates over the past decade. It is because of these increases that BHII has been actively involved in this case since filing its Petition to Intervene on June 6, 2014. BHII participated in the discovery process throughout the pendency of the case and engaged in settlement negotiations with the Company, the South Dakota Public Utilities Commission staff (“Commission Staff” or “Staff”), and Dakota Rural Action (“DRA”) between late October and early December 2014. Following BHP and Staff’s joint filing of a proposed Settlement Stipulation on December 9, 2014 (the “Proposed Settlement”), BHII filed direct written testimony on December 30, 2014, and provided live testimony opposing the Company’s Application and the Proposed Settlement at the Commission’s hearing on January 27-28, 2015.

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<sup>1</sup> *Evidentiary Hearing Transcript*, 167:13-22. In 2006, BHP sought an increase of 9.5%, and received an increase of 7.9%. In 2009, the Company sought an increase 26.6% and received an increase of 12.7%. In 2012, the Company sought an increase of 9.9% and received an increase of 6.4%.

<sup>2</sup> *Id.*

<sup>3</sup> GCC Dacotah Inc., Pete Lien & Sons, Inc., Rushmore Forest Products, Inc., Spearfish Forest Products, Inc., Rapid City Regional Hospital, Inc., and Wharf Resources (U.S.A.), Inc.

On February 10, 2015, two weeks after the hearing, Staff and BHP submitted a revised proposed Settlement Stipulation (the “Revised Settlement”) to the Commission, BHII, and DRA.<sup>4</sup>

BHII submits this post-hearing brief to (1) clarify the record, (2) demonstrate that neither the Application nor the Proposed Settlement complies with governing South Dakota law, (3) request a ruling of the Commission that sets forth its interpretation of governing South Dakota law, and (4) advocate that the Commission reject the Proposed Settlement for failure to comply with the law of this State. Arguments in this post-hearing brief are directed to the Proposed Settlement because the Revised Settlement is not properly before the Commission. There has not been a hearing on the Revised Settlement and the parties have not been afforded the opportunity to offer testimony in response to the same. At best, the Revised Settlement represents modifications to the Proposed Settlement that BHP and Commission Staff may accept when the Commission issues its decision on March 2, 2015. In the event that the Commission disagrees with BHII’s interpretation of South Dakota law, there is ample support in the record for the Commission to further modify the Proposed Settlement as more further explained herein.

## **II. INTRODUCTION**

BHII had hoped to reach a settlement with BHP, Commission Staff, and DRA and avoid contested proceedings. But after reviewing the record and participating in settlement discussions with the parties prior to the hearing, BHII could not sign-on to the Proposed Settlement. While

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<sup>4</sup> BHII was not aware that discussions between Commission Staff and BHP were occurring after the January 27-28, 2015 hearing and was not provided any advance notice of the Revised Settlement. BHII objects to the Revised Settlement on the same grounds it objected to the Proposed Settlement. BHII notes that the Proposed Settlement contained an error in the revenue requirement calculation of certain O&M costs that all parties acknowledged, but did not agree to the resolution of. Because BHII opposes the proposed resolution of that error in the Revised Settlement and was never given an opportunity to address the treatment or handling of the error following the hearing, the Commission should disregard the Revised Settlement altogether and not give any credence to the after-the-fact and modified positions of Staff and BHP set forth therein when rendering its decision in this case. Simply put, the Revised Settlement was not part of the notice of hearing or the issues identified at the outset of the hearing and is therefore not properly before the Commission for consideration or approval.

BHII members and members of other rate classes may benefit from the Proposed Settlement,<sup>5</sup> a reduction to BHP's revenue requirement that is supported by only two of the four parties to this proceeding should not be approved simply because of the reduction. Each and every rate, even those rates arrived at via settlement, must be just and reasonable.<sup>6</sup> Unfortunately, rates under the Proposed Settlement would not be just or reasonable because the Proposed Settlement is not supported by the record before the Commission or by South Dakota law.

The Proposed Settlement is not supported by the record for two primary reasons. First, by admission of both Commission Staff and BHP, the Proposed Settlement includes a \$286,041 error in the underlying revenue requirement calculation. Second, the Proposed Settlement allows the Company to recover an unjust, unreasonable, and unjustified amount of incentive compensation.

The Proposed Settlement also is not legally justified. It provides for numerous adjustments to the Company's cost of service analysis that: (i) were not fully supported in the record; (ii) were not known with reasonable certainty and measurable with reasonable accuracy at the time the Company filed the Application; (iii) were not accompanied by expected changes in revenue in direct contravention of South Dakota law; and (iv) were not supported by a cost of service analysis conducted by the Company. By including these adjustments in the Proposed Settlement, BHP transforms the 12-month historical test year into a dynamic test period that will

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<sup>5</sup> *Evidentiary Hearing Transcript*, 30:5-8 (Company witness White retracts the statement from page 2, lines 19-20 of his rebuttal testimony and acknowledges that BHII members are not the "primary beneficiaries" of the Proposed Settlement). The rate mitigation proposed by the Company in its Application and that carries through the Proposed Settlement is greater for the Residential Class than for the General Service/Large Industrial Class. *Id.* at 33:3-12.

<sup>6</sup> "Every rate made, demanded or received by any public utility shall be just and reasonable. Every unjust or unreasonable rate shall be prohibited. The Public Utilities Commission is hereby authorized, empowered and directed to regulate all rates, fees and charges for the public utility service of all public utilities to the end that the public shall pay only just and reasonable rates for service rendered." South Dakota Codified Laws ("SDCL") § 49-34A-6.

end only after the Commission issues its final order and relies on Commission Staff to create and file the allegedly supporting analysis. On this record, the Company has not met its burden of proof either with respect to its cost of service or its proposed rates.

Importantly, this case is not about how much each customer class should contribute to the Company's revenue requirement. BHII supports the revenue allocation set forth in the Proposed Settlement and is not seeking to push costs from BHII members on to other customer classes. Rather, BHII's written and oral testimony in this case primarily focused on the revenue requirement included in the Company's Application and the revised revenue requirement described in the Proposed Settlement. BHII's testimony and its cross-examination of witnesses at the evidentiary hearing exposed important differences in how the parties interpret South Dakota law with respect to the 12-month historical test year and the Company's proposed adjustments to its filed cost of service analysis.

This brief is organized into two sections. Section II provides a review of governing South Dakota law, including an analysis of the parties' positions on its interpretation, and Section III applies BHII's analysis of the governing law to the factual record.

### **III. GOVERNING LAW**

The Company has not met either of its burdens of proof under SDCL § 49-34A-8.4 and § 49-34A-11 because it has not established that the costs underlying the rates set forth in the Application and the Proposed Settlement are prudent, efficient and economical, just and reasonable, and necessary to provide service to its customers in the State. Contrary to Staff's assertion, the Proposed Settlement does not "resolve[]" all of the issues in this proceeding based

on sound regulatory principles . . . consistent with South Dakota Law.”<sup>7</sup> Instead, the Proposed Settlement propagates two fundamental flaws in Staff’s interpretation of South Dakota Administrative Rule (“ARSD”) 20:10:13:44 that result in rates that would be unjust and unreasonable. BHII understands the gravity of its argument and the impact, both generally and in this particular case, that the proper interpretation of ARSD 20:10:13:44 will have. But Staff’s interpretation is simply not supported by the plain language of the rule and, based on BHP’s seemingly relentless effort to redefine the 12-month test year by continually and opportunistically revising its cost of service analysis after filing its Application, it would not be in the public interest for the Commission to adopt. Righting this wrong now, while undeniably additional work, would benefit South Dakota’s ratepayers in the long run.

When considering whether to accept or reject the Proposed Settlement, the Commission should be mindful that the proper interpretation of ARSD 20:10:13:44 is a matter of first impression and has never been litigated, either before the Commission or in any South Dakota state court.<sup>8</sup> To date, no party has challenged Staff’s interpretation of the rule and, as a result, the Commission has never been required to address the merits of it. Because BHII challenges Staff’s interpretation and has proffered an alternative interpretation in written and oral testimony and now by way of written argument, the interpretation of the rule is properly before the Commission, and the Commission must accept or reject BHII’s alternative interpretation and provide justification for doing so.

Both Staff and BHP agree that (1) settlements approved by the Commission are not legal precedent and (2) the treatment of issues in a settlement is not binding on future settlements or

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<sup>7</sup> *Evidentiary Hearing Transcript*, 263:14-17.

<sup>8</sup> *Id.* at 276:8-13.



Commission decisions in any way.<sup>9</sup> Nevertheless, Staff and BHP rely entirely on past settlements and the testimony of Staff witness Peterson in maintaining that the Commission should reject BHII's interpretation of ARSD 20:10:13:44. While Mr. Peterson agreed that the Commission has never been asked to interpret the rule, he contended that Staff's interpretation is correct because it is "[e]mbedded in virtually every settlement that the Commission has approved since the inception of [the] rule."<sup>10</sup> Stated differently, the argument offered by Staff and supported by BHP boils down to this: "the Commission should adopt Staff's interpretation of ARSD 20:10:13:44 because that's how we've always done it." Not only is such an argument legally insufficient (because Staff's interpretation has never been challenged and neither BHP nor Staff has cited any legal precedent to support it), but also the testimony of record underscores the lack of support for Staff's interpretation of the rule.

Regardless of whether prior settlements have incorporated Staff's interpretation of ARSD 20:10:13:44, the Commission should not give any weight whatsoever to the argument because the Commission's interpretation of the rule is unsettled as a matter of law. And even if prior settlements could be viewed as precedential – which all parties agree that they cannot – there is a difference between (1) relying on precedent where the relevant question was asked and definitively answered and (2) relying on precedent where no answer at all was given because the salient question was never asked. Staff and BHP's empty reliance on past settlements is an attempt to do the latter. No one has asked the Commission the proper question; namely, Is Staff's interpretation of the rule correct? While prior settlements may be useful to show that Staff's interpretation has not been previously contested, those settlements cannot support

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<sup>9</sup> *Id.* at 35:8-11 (BHP witness White acknowledges that settlements are not precedential); 276:16-20 (Staff witness Peterson concedes that settlements are not precedential).

<sup>10</sup> *Id.* at 276:13-15.

rejecting an alternative interpretation that the Commission has never considered or decided before in a contested case.

Sections II.A. and II.B., below, are intended to provide the Commission legal context for its decision whether to approve or reject the Proposed Settlement. Where the positions of the parties differ with respect to the interpretation of the law, those positions are presented with appropriate citations to the record.

**A. The Utility Filing for a Rate Increase Bears Two Burdens of Proof**

The utility filing for a rate increase bears two burdens of proof: (1) it must establish “that the underlying costs of any rates, charges, or automatic adjustment charges filed under [SDCL § 49-34A] are prudent, efficient, and economical and are reasonable and necessary to provide service” to its customers in South Dakota,<sup>11</sup> and (2) it must “show that any rate filed is just and reasonable.”<sup>12</sup> Although they are related, the two burdens are distinguishable and the utility must meet each of them separately. Ultimately, the Commission is not “clothed with unlimited discretion.”<sup>13</sup> Rather, it may only act in a reasonable, logical manner.<sup>14</sup> Accordingly, the Commission must take into account the plain language of the statutes and its own rules when evaluating each of BHP’s proposed adjustments to its cost of service.

**1. The Utility Must Establish That Its Proposed Cost of Service is Prudent, Efficient, and Economical and Reasonable and Necessary to Provide Service**

The first burden, under SDCL § 49-34A-8.4, focuses on the underlying costs. The utility must establish that those costs are “prudent, efficient, and economical and are reasonable and

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<sup>11</sup> SDCL § 49-34A-8.4.

<sup>12</sup> *Id.* at § 49-34A-11.

<sup>13</sup> *Illinois Cent. R. Co. v. Wisconsin Granite Co.*, 19 N.W.2d 753, 754 (S.D. 1945) (quoting *Application of Megan*, 5 N.W.2d 729, 735 (S.D. 1942)).

<sup>14</sup> *See id.*

necessary to provide service.” It is not incumbent on Commission Staff or any intervenor to establish that the utility’s proposed cost of service is imprudent, inefficient, uneconomical, or not reasonably necessary to provide service. Both the South Dakota Supreme Court and the Commission have disapproved of speculative cost estimates.<sup>15</sup> And while the Commission has suggested that the phrase “efficient, and economical” should mean that utilities have “a certain amount of flexibility to pick alternatives that are best for the overall system, not strictly the least-cost alternative,”<sup>16</sup> the Commission has concluded that imprudence on the part of the utility “such as failure to exercise due diligence in project management and oversight” could lead to a disallowance of certain costs.<sup>17</sup>

Importantly, neither SDCL § 49-34A-8.4 nor any other South Dakota statute establishes the criteria the Commission must use to determine whether a utility’s filed costs “are prudent, efficient, and economical and are reasonable and necessary to provide service.” The Commission is, however, required to analyze the completeness and accuracy of a utility’s filed cost of service pursuant to ARSD 20:10:13:44. In other words, the Commission can only find that a utility has met its burden of proof under SDCL § 49-34A-8.4 if the utility’s cost of service satisfies the provisions of ARSD 20:10:13:44.

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<sup>15</sup> *In the Matter of the Application of Northwestern Pub. Serv. Co. for a Proposed Increase in Rates for Electric Service*, 297 N.W.2d 462, 469 (S.D. 1980) (holding that the Commission’s reliance on plant manager’s “speculative” prediction of operation and maintenance costs rather than evidence of actual results was arbitrary and not supported by the evidence); *Re Northern States Power Co.*, EL92-016, 140 P.U.R.4th 235 (Jan. 26, 1993) (concluding that accrual of expenses for Post-Retirement Benefits Other Than Pension is not acceptable for inclusion in rates because they were not known and measurable).

<sup>16</sup> *In re Application of Northern States Power Co. dba Xcel Energy for Authority to Increase its Electric Rates*, EL11-019, Final Decision and Order; Notice of Entry, 9 (Jul. 2, 2012).

<sup>17</sup> *Id.* at 11.

## 2. The Utility Must Show That Its Rates Are Just and Reasonable

The second burden, under SDCL § 49-34A-11, requires the utility to “show that any rate filed is just and reasonable.”<sup>18</sup> Thus, even if the Commission finds “that the underlying costs are prudent, efficient, and economical and are reasonably necessary to provide service” because the utility’s cost of service meets the requirements of ARSD 20:10:13:44, the Commission must separately determine whether the utility has shown that the rate adjustments it proposes are just and reasonable. Commission Staff and intervenors are not charged with the obligation of coming forward with evidence that the rates proposed are unjust or unreasonable.<sup>19</sup> Instead, it is the utility’s burden to prove that its own proposed rates are just and reasonable. And this requires more than showing that it spent the money. The utility must prove that the amounts spent were reasonable and that doing so was a prudent decision.<sup>20</sup>

In determining whether a utility’s proposed rates are just and reasonable, the Commission “shall give due consideration to the public need for adequate, efficient, economical, and reasonable service and to the need of the public utility for revenues sufficient to enable it to meet its total current cost of furnishing such service.”<sup>21</sup> Per force, the Commission must reject any unjust or unreasonable rate the utility proposes.<sup>22</sup>

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<sup>18</sup> SDCL § 49-34A-11.

<sup>19</sup> South Dakota is not unique in this regard. For example, under Minnesota law, even if the utility presents a *prima facie* case and no party presents contrary evidence, “the utility does not necessarily meet its burden of demonstrating that it is just and reasonable that the ratepayers bear the costs of those expenses.” *In re Petition of N. States Power Co.*, 416 N.W.2d 719, 723 (Minn. 1987).

<sup>20</sup> *Evidentiary Hearing Transcript*, 171:3-8.

<sup>21</sup> SDCL § 49-34A-8.

<sup>22</sup> *Id.* at § 49-34A-6 (“Every rate made, demanded or received by any public utility shall be just and reasonable. Every unjust or unreasonable rate shall be prohibited.”).

**B. The Utility's Proposed Cost of Service Must Meet the Requirements Set Forth in ARSD 20:10:13:44**

As already discussed, the Commission can only find that a utility has met its burden of proof under SDCL § 49-34A-8.4 if the utility's cost of service meets the requirements of ARSD 20:10:13:44. The language of the rule, set forth below, has been diagrammed for purposes of the discussion that follows.

**20:10:13:44. Analysis of system costs for a 12-month historical test year.** The statement of the cost of service shall contain an analysis of system costs as reflected on the filing utility's books for a test period consisting of 12 months of actual experience ending no earlier than 6 months before the date of filing of the data required by §§ 20:10:13:40 and 20:10:13:43 unless good cause for extension is shown.

The analysis shall include the return, taxes, depreciation, and operating expenses and an allocation of such costs to the services rendered.

The information submitted with the statement shall show the data itemized in this section for the test period, as reflected on the books of the filing public utility.

Proposed adjustments to book costs shall be shown separately and shall be fully supported, including schedules showing their derivation, where appropriate.

However, **no adjustments shall be permitted**

**unless** they are based on changes in facilities, operations, or costs

which are known with reasonable certainty and measurable with reasonable accuracy at the time of the filing

and which will become effective within 24 months of the last month of the test period used for this section **and**

**unless** expected changes in revenue are also shown for the same period.

## **1. ARSD 20:10:13:44 Requires the Utility to Base Its Cost of Service on a 12-Month Historical Test Year**

A fundamental principle underlying ARSD 20:10:13:44 is that the utility is obligated to base its cost of service on a 12-month historical test year.<sup>23</sup> “The purpose of using a test year is to establish with a reasonable degree of accuracy the revenue and expenses that a utility will experience during the period when the new rates will be in effect.”<sup>24</sup> Importantly, the utility is in complete control of both (1) the 12-month period it chooses for its test year and (2) the date on which it applies for a rate increase.<sup>25</sup> Thus, a utility can pick the test period and the filing date to meet its business goals, but the utility is then required to base its cost of service on the 12-month period it chooses, with certain permitted adjustments.

Under ARSD 20:10:13:44, a utility may propose adjustments to book costs from the test year. These proposed adjustments must be “shown separately” and “fully supported.” However, the rule bars the Commission from permitting any adjustments (1) “unless they are based on changes in facilities operations or costs which are known with reasonable certainty and measurable with reasonable accuracy at the time of the filing and which will become effective within 24 months of the last month of the test period,” and (2) “unless expected changes in revenue are also shown for the same period.”

There are two key differences between BHII’s interpretation of ARSD 20:10:13:44 and the interpretation advanced by Commission Staff and supported by BHP. Both differences relate to the limitations on adjustments to book costs in the last sentence and implicate the 12-month

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<sup>23</sup> The first sentence of ARSD 20:10:13:44 clearly establishes a static, 12-month historical test period: “The statement of the cost of service shall contain an analysis of system costs as reflected on the filing utility’s books for a test period consisting of 12 months of actual experience.”

<sup>24</sup> *In the Matter of the Application of Northwestern Pub. Serv. Co. for a Proposed Increase in Rates for Electric Service*, 297 N.W.2d 462, 469 (S.D. 1980) (quoting *Northwestern Pub. Serv. v. Cities of Chamberlain, Huron, Mitchell et al.*, 265 N.W.2d 867, 879 (S.D. 1978)).

<sup>25</sup> Provided that the application is filed within six months after the end of the test year. ARSD 20:10:13:44.

historical test period set out in the rule. Specifically, the parties disagree about the proper interpretation of the phrases (1) “at the time of the filing” and (2) “unless expected changes in revenue are also shown for the same period.” The parties’ contradictory interpretations raise three important questions for the Commission to consider and address in its decision. These questions are set forth **in boldface type** in the sections that follow, along with BHII’s position with respect to each.

**2. ARSD 20:10:13:44 Requires Proposed Adjustments to be Known With Reasonable Certainty and Measurable with Reasonable Accuracy “At the Time of Filing”**

The Commission’s interpretation of the phrase “at the time of filing” in ARSD 20:10:13:44 is critical to determining what adjustments to book costs a utility should be permitted to make. BHII interprets that phrase to mean “at the time the utility files its Application.”<sup>26</sup> Commission Staff, on the other hand, believes that phrase means “at the time the utility proposes the adjustment.”<sup>27</sup> Thus, for purposes of this case, it is BHII’s position that “no adjustments shall be permitted unless they are based on changes in facilities, operations, or costs which are known with reasonable certainty and measurable with reasonable accuracy at the time the Company files its Application.” Staff and BHP’s position is that “no adjustments shall be permitted unless they are based on changes in facilities, operations, or costs which are known with reasonable certainty and measurable with reasonable accuracy at the time the Company proposes the adjustment.” The parties’ incongruent interpretations raise two important questions for the Commission to consider and address:

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<sup>26</sup> *Evidentiary Hearing Transcript*, 173:18-20 (“The utility must first demonstrate that [the proposed adjustments] are known and measurable at the time of the filing, which would be March 31, 2014”).

<sup>27</sup> *Evidentiary Hearing Transcript*, 279:11-14 (“[T]he Commission Staff has interpreted it that the adjustments have to be sufficiently known and measurable at the time of their review within the filings of the case”).

**QUESTION 1: Under ARSD 20:10:13:44, at what point in time must a proposed adjustment be known with reasonable certainty and measurable with reasonable accuracy in order to qualify for inclusion in the utility’s filed cost of service?**

BHII Response: ARSD 20:10:13:44 does not permit a utility to propose adjustments to its filed cost of service that were not known and measurable at the time the utility filed its application. In other words, a utility cannot adjust a cost that appears in its filed cost of service unless the utility can demonstrate that the adjustment was known with reasonable certainty and measurable with reasonable accuracy at the time the utility filed its application.

**QUESTION 2: Under ARSD 20:10:13:44, can a utility use the mechanism for proposing adjustments to add new costs to its filed cost of service that were not known with reasonable certainty and measurable with reasonable accuracy at the time the utility filed its application?**

BHII Response: ARSD 20:10:13:44 does not allow a utility to continually add costs to its overall cost of service that were not known with reasonable accuracy and measurable with reasonable certainty at the time the utility filed its application. Put differently, a utility cannot use the mechanism for proposing adjustments to retroactively add any new costs to its filed cost of service unless the utility can demonstrate that the new cost was known and measurable at the time the utility filed its application.

(a) “At the Time of Filing” Means “At the Time the Utility Files its Application”

“At the time of filing” can only mean “at the time the utility files its application” because that reading is supported by the plain language of the rule, as well as the principles of equity and due process in rate case proceedings. The plain language of the rule- indeed, the title of the rule- calls for a 12-month historical test year and not a forecast test year.<sup>28</sup> The beginning of that 12-month historical test year provides the starting point for determining a utility’s cost of service and the date the utility files its application represents the endpoint. The plain language of the

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<sup>28</sup> BHII acknowledges that ARSD 20:10:13:104 makes the following exception to the 12-month historical test year: “Although §§ 20:10:13:51 to 20:10:13:102, inclusive provide for a historical test period, the utility, in addition, may submit cost of service information for a nonhistorical test period beginning no later than the proposed effective date of the new rates. Statements A through R and the accompanying testimony shall include an explanation of these exhibits.” BHII notes, however, that the Statements A through R BHP filed did not include nonhistorical test-year data beginning on October 1, 2014 (the date the Company’s rates are proposed to be effective), and that the Company did not provide any testimony explaining any changes to Statements A through R that included such information. As a result, the exclusive 12-month historical test year, with permitted adjustments, controls the Company’s Application in this case.



rule allows for adjustments only in certain limited circumstances. To the extent that adjustments to test-year book costs become known and measurable before the utility files its case (*i.e.*, in the time between the end of the test year and the date of filing), the rule permits the utility to propose these adjustments as part of its application.<sup>29</sup> Absent those certain limited circumstances, which the utility bears the burden of demonstrating exist, the rule holds the utility to the cost of service as it is understood at the time the utility files its case. The Commission is required to look at a snapshot in time, as adjusted for known and measurable changes, when determining whether a utility's proposed revenue requirement and rates are reasonable and prudent. The plain language of the rule frames that time period so the snapshot is taken on the date the utility files its application, looking backward to the beginning of the 12-month historical test year.

The Commission may be concerned that not allowing adjustments after the date the utility files its application (e.g., true-ups for actual costs incurred) would be arbitrary.<sup>30</sup> While a 12-month historical test year is not a perfect predictor of future costs, it is nonetheless the law as it now stands. ARSD 20:10:13:44 takes into account the imperfect nature of the historical test year and includes two mechanisms to ensure that test-year data is representative of the utility's cost of service on the date it files for a rate increase. First, the rule requires the utility to file its

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<sup>29</sup> BHII admits there may be a very unlikely circumstance in which the utility discovers, after filing its application, that certain adjustments that were known and measurable at the time of the filing were erroneously excluded from the utility's application. ARSD 20:10:13:44 appears to provide the utility with an opportunity for correcting such an error. What the utility knew and when it knew it would likely be contested issues in a general rate case.

<sup>30</sup> To the extent that either Commission Staff or the Company relies on the South Dakota Supreme Court's decision in *Northwest Pub. Serv. Co. v. Cities of Chamberlain, Huron, Mitchell et al.*, 265 N.W.2d 867 (S.D. 1978), BHII notes that the court's decision in that case belies the fact that the court was analyzing a forecast test year and not a historical test year as is before the Commission in this case. The utility filed its rate increase in June 1973 and selected a test year of November 1973 – October 1974. Similarly, the cities analyzed a test year of July 1973 – June 1974.

application within six months after the end of the test year.<sup>31</sup> By mandating that a utility file within six months, the rule helps to protect the contemporaneousness of the historical test-year data. Second, as discussed above, the rule allows the utility to propose adjustments to test-year book costs that become known and measurable in the time between the end of the historical test year and the date the utility chooses to file its case. And the rule allows the utility to propose an adjustment for any cost that the utility will incur within 24 months after the end of the test year so long as it is known and measurable at the time the utility files its application. By permitting these adjustments, the rule helps ensure that the utility's cost of service is as accurate possible as of the date it files its application.

BHII is aware of only one instance where a utility was permitted to adjust the estimate of a known and measurable cost to account for actual post-test year expenses. However, that case, described below, involved a new cost (the Big Stone Power Plant) for which there was no historical data available at the time the utility filed its application and the data relied upon by the Commission were found to be "speculative" and "nothing more than a prediction."<sup>32</sup> In 1980, the South Dakota Supreme Court issued its decision in *In the Matter of the Application of Northwestern Pub. Serv. Co. for a Proposed Increase in Rates for Electric Service*, 297 N.W.2d 462 (S.D. 1980). At issue in that proceeding was how to account for the Big Stone Power Plant, which came online near the end of the utility's test year.<sup>33</sup> Although no one disagreed with the

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<sup>31</sup> BHII is only aware of one instance where a utility filed for and received an extension of the six month period for filing after the end of the 12-month test year. *In the Matter of the Petition of MidAmerican Energy Co. for Extension of Test Period*, EL14-030, Order Approving Extension of Filing Deadline Following Test Period (May 1, 2014) (approving August 2014 filing for a test year ending December 2013).

<sup>32</sup> *In the Matter of the Application of Northwestern Pub. Serv. Co. for a Proposed Increase in Rates for Electric Service*, 297 N.W.2d 462, 469 (S.D. 1980). The case was further complicated by the fact that Northwestern Public Service Company transitioned from being a purchasing utility to a generating utility when the Big Stone plant came online.

<sup>33</sup> The utility's test year was May 1, 1974 through April 30, 1975. The utility filed its notice and application for a rate increase on July 17, 1975.

notion that the plant be included in rate base, parties disagreed on the magnitude of the impact the plant would have on power supply costs in the post-test year period. A number of intervenors cited a letter, dated during the test year, that contained a prediction of the plant's operating and maintenance costs assuming the plant operated "for the full year in 1975 and at an unrestricted load."<sup>34</sup> By the time of the hearing, the plant had been operating for almost a full year, and the utility provided actual data of plant operation, which resulted in significant variance from the initial prediction of costs.<sup>35</sup> The Commission rejected the utility's actual performance and sales data and adopted the estimate in the letter cited by the intervenors, "ignoring [the] company's actual experience with the plant for nearly a year which had elapsed between the test year and the hearings." The Supreme Court of South Dakota subsequently reversed that decision, concluding "that the [Commission's] reliance . . . on the speculative data presented by cities and its refusal to consider company's evidence of actual results and the recommendation of its own staff was arbitrary and that the decision on this issue was not supported by the evidence."<sup>36</sup> While Commission Staff and BHP may read the court's decision as supporting their interpretation of ARSD 20:10:13:44, such a conclusion does not follow from the facts. The court's decision thus supports the proposition that a utility should be permitted to incorporate actual post-test year data if the only data available to estimate a new cost at the time the utility filed its application was "speculative" or "nothing more than a prediction." Such a narrow exception does not support Commission Staff's interpretation of the rule and it has absolutely no impact on BHII's argument in this proceeding.

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<sup>34</sup> *Id.* at 465.

<sup>35</sup> *Id.* at 469.

<sup>36</sup> *Id.* at 469-470.

Other references within the rule provide further support for BHII’s interpretation. The first sentence of ARSD 20:10:13:44 states that the utility must include in its application the data required by §§ 20:10:13:41 through 20:10:13:107. That data includes the information in Statements A through R and the associated schedules<sup>37</sup> and any other supporting data the utility has relied on in determining its cost of service.<sup>38</sup> With respect to the latter, ARSD 20:10:13:46 clearly provides that the additional supporting data “shall be limited to the test period prescribed in § 20:10:13:44” – i.e., the 12-month historic test year. That language reinforces the fundamental principle that the utility’s cost of service must be based on the 12-month historical test year and should not be a moving target subject to continuous updates throughout the pendency of a rate case.

Finally, and contrary to Staff witness Peterson’s testimony at the hearing, the language of the rule itself plainly references the utility’s application as the “filing” in question. At the hearing, Mr. Peterson stated that “[i]f the drafters of this rule intended it to be at the time of the application, the word would be application, not filing.”<sup>39</sup> That statement is pure supposition and cannot be relied upon by the Commission. In point of fact, the first sentence of the rule refers to a utility’s application as the “filing of the data required by §§ 20:10:13:40 and 20:10:13:43.” Hence, the only other reference to a utility’s application in the rule uses the word “filing.”

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<sup>37</sup> Statements A through R and associated schedules are required under §§ 20:10:13:51 through 20:10:13:102.

<sup>38</sup> ARSD 20:10:13:46 (“If the public utility has relied on supporting data other than that in statements A through R, such other data, appropriately identified and separately stated, shall be submitted in addition to the data required by statements A through R. *Such data shall be limited to the test period prescribed in § 20:10:13:44*”) (emphasis added).

<sup>39</sup> *Evidentiary Hearing Transcript*, 279:3-5.

(b) “At the Time of Filing” Does Not Mean “At the Time the Utility Submits its Adjustment”

Commission Staff interprets the phrase “at the time of filing” in ARSD 20:10:13:44 to mean “at the time the utility submits its adjustment.”<sup>40</sup> The Commission should reject Staff’s reading of the rule as unsupported by its plain language or the principles of equity and due process in rate case proceedings. To the extent that Staff believes its interpretation is correct because it is “[e]mbedded in virtually every settlement that the Commission has approved since the inception of [the] rule,”<sup>41</sup> that interpretation, as previously demonstrated, in the opening paragraphs of Section II, above, is inapposite. When pressed for evidence to back up Staff’s interpretation at the hearing, Mr. Peterson could not point to any language in the rule that supported it. Instead, he rested his case on opinions. First, that “the rule was written by legislators or legislative research assistants, not by rate consultants or utility analysts.”<sup>42</sup> And second, that “[i]f the drafters of this rule intended it to be at the time of the application, the word would be application, not filing.”<sup>43</sup> The first has no bearing on the legality or binding nature of the rule’s language as written and the second was disposed of at the end of subpart (a), above. These opinions provide absolutely no legal foundation for Commission Staff’s interpretation.

If taken to its ultimate conclusion, Staff’s interpretation would permit a utility to propose adjustments to its cost of service analysis up until the Commission issued its decision in the case, even those that were not known and measurable at the time the utility filed its application. Stated otherwise, Staff’s interpretation would violate the rule by transforming the static 12-month historic test year with limited adjustments into a dynamic, forward-looking test period with an

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<sup>40</sup> *Id.* at 279:11-14 (“[T]he Commission Staff has interpreted it that the adjustments have to be sufficiently known and measurable at the time of their review within the filings of the case”).

<sup>41</sup> *Id.* at 276:13-15.

<sup>42</sup> *Id.* at 278: 21-23.

<sup>43</sup> *Id.* at 279:3-5.

unlimited opportunity to make adjustments for up to 30 months.<sup>44</sup> To permit a utility to continually update its cost of service in this manner, and then only for selected cost increases, would undermine due process because ratepayers would never know exactly what revenue requirement the utility was proposing. The utility's application, and the Commission's analysis of that application, should be based on the 12-month test year, as adjusted for changes that become known and measurable between the end of the test year and the date the utility files its application. To conclude otherwise would be arbitrary and fundamentally unfair to ratepayers.

Perhaps one reason Staff and BHP contend the rule allows for cost adjustments that are not known and measurable at the time the utility files its application is their mutual misunderstanding of the 24-month post-test year period described in the rule. During the evidentiary hearing, Mr. Peterson stated that "We have to recognize changes that are known and measurable up to 24 months beyond the end of the test year."<sup>45</sup> Staff and the Company evidently believe that ARSD 20:10:13:44 obligates the Commission to accept a utility's proposed adjustments so long as the adjustment is known and measurable at some time within 24 months after the end of the test year. That is a clear misreading of the rule.

The rule states that no adjustments may be permitted to test-year book costs unless they meet specified criteria.<sup>46</sup> Adjustments must be based on changes in facilities, operations, or

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<sup>44</sup> The 12-month test year, followed by a 6-month window for filing, followed by a 12-month period in which the Commission must issue an order on the utility's application pursuant to SDCL 49-34A-17.

<sup>45</sup> *Evidentiary Hearing Transcript*, 278:1-3; *see also id.* at 274:13-16 ("the company has an opportunity to come forward with any number of adjustments as long as they meet the specific criteria that they're known and measurable and that they fall within the 24-month period"). In his rebuttal testimony, BHP witness Thurber similarly stated that the Company "made adjustments to its book costs that were based on changes in facilities, operations, and costs that were known with reasonable certainty and measurable with reasonable accuracy and either have been or will become effective within the 24 months following the last month of the test year." Thurber Rebuttal, 2:22-3:3.

<sup>46</sup> "However, no adjustments shall be permitted unless . . ." ARSD 20:10:13:44; *see also Evidentiary Hearing Transcript*, 173:10-12 ("[T]he initial presumption is that no changes to the test year are allowed. In other words, you start with the historic cost. The presumption is no changes are allowed.").

costs (1) which are known and measurable at the time of filing and (2) which will become effective within 24 months after the end of the test year. While Mr. Peterson may think that the Commission is obligated to accept adjustments that are known and measurable within 24 months after the end of the test year, that is not what the rule says. The diagrammed rule presented above makes it clear that the changes in facilities, operations, or costs must be known and measurable at the time of filing, and must become effective within 24 months after the end of the test year. Nowhere in the rule does it say that the proposed adjustments are valid so long as they are known and measurable at some point in time within 24 months after the end of the test year. Indeed, the plain language of the rule says otherwise. The requirement that changes in facilities, operations, or costs must become effective within 24 months after the end of the test year does nothing more than put an outside boundary on the scope of costs that can be included in the current rate case protects ratepayers from pre-paying for costs that will not be incurred until well into the future. The Commission should reject Staff's interpretation because it is not supported by the language set forth in the rule.

(c) ARSD 20:10:13:44 Does Not Permit a Utility to Propose New Costs as Adjustments to Its Filed Cost of Service

Commission Staff's interpretation of the phrase "at the time of filing," raises a separate question with respect to the character of the adjustments a utility is permitted to request. The rule allows "[p]roposed adjustments to book costs." It does not permit line-item increases to the utility's overall cost of service by adding costs that were not included in the utility's filed cost of service.

As discussed above, BHII's interpretation of "at the time of filing" would foreclose the utility from proposing any adjustments to its filed cost of service analysis that are not known and

measurable at the time the utility files its application. By extension, the rule does not permit a utility to use the mechanism for proposing adjustments as a tool to introduce new costs to its filed cost of service that were not known with reasonable certainty or measurable with reasonable accuracy at the time the utility filed its application. Therefore, the Commission should reject any proposed “adjustments” that actually propose new costs. Such “adjustments” are actually line-item additions to the cost of service analysis. To decide otherwise would magnify the transformation of the static 12-month test year into a dynamic test period of up to 30 months.

### **3. ARSD 20:10:13:44 Requires Proposed Adjustments to be Accompanied by Expected Changes in Revenue**

Similar to its interpretation of “at the time of filing,” the Commission’s interpretation of the phrase “unless expected changes in revenue are also shown for the same period” in ARSD 20:10:13:44 is critical to determining whether, and to what extent, a utility is required to include expected revenue increases that may offset its proposed upward adjustments to book costs. The language of the rule is intended to require utilities to include any expected changes in revenue when submitting proposed adjustments to test-year book costs.<sup>47</sup> Commission Staff and BHP contend that the rule only requires utilities to submit expected changes in revenue that are directly tied to expenses or investments made to increase sales and/or to serve new customers.<sup>48</sup> In other words, BHII suggests the rule provides that “no adjustments shall be permitted . . . unless any expected changes in revenue are also shown for the same period,” while Staff and BHP insert a qualification into the rule that would provide “no adjustments shall be permitted . . .

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<sup>47</sup> *Evidentiary Hearing Transcript*, 173:20-22; Kollen Direct, 8:8-11 (“any proposed adjustments based on projected costs beyond the twelve month post-test year period must be accompanied by projected changes in revenue for the same period”); 17:13-19.

<sup>48</sup> Peterson Direct, 9:3-6 (“for any post-test year change in expense or investment that has an incremental revenue component (i.e., expenses or investments made to increase sales and/or to serve new customers) a corresponding revenue adjustment must also be recognized”); *Evidentiary Hearing Transcript*, 273:4-10.



unless expected changes in revenue that are directly tied to expenses or investments made to increase sales and/or to serve new customers are also shown for the same period.” The parties’ variant interpretations of the rule raise the following important question for the Commission to consider and address:

**QUESTION 3: Under ARSD 20:10:13:44, when a utility proposes an adjustment to book costs, what expected changes in revenue must be included?**

BHII Response: When a utility takes advantage of the mechanism for proposing adjustments to book costs, ARSD 20:10:13:44 requires the utility to include any expected changes in revenue that would occur during the time the cost adjustment would be in effect. In other words, any time a utility wants to lift the hood of the 12-month historic test year to adjust costs, it must also adjust revenues.

The Commission should adopt BHII’s interpretation because it is supported by the plain language of the rule and the principles of equity and due process in rate case proceedings.

Under ARSD 20:10:13:44, the Commission can only permit an adjustment to test-year costs if it meets two conditions: (1) the adjustment must be based on changes in facilities, operations, or costs that meet certain criteria and (2) “expected changes in revenue” must be shown for the same period. The diagrammed rule presented above shows that each of these conditions begins with the word “unless.” The conditions should be read independently and the latter is designed to safeguard ratepayers from a utility including a mismatch of expenses and revenues in, and as part of, its cost of service.

The fundamental ratemaking principle underlying BHII’s interpretation is often referred to as “matching.” In 1979, the Commission wrote extensively on the matching principle in *In re Minnesota Gas Co.*, when it rejected, among other things, certain proposed adjustments to the

utility's cost of service.<sup>49</sup> In that decision, the Commission reiterated Staff's position at the time, which was that "each . . . adjustment for a known and measurable change must be accompanied by corresponding adjustments to assure that costs and revenues continue to match."<sup>50</sup> Indeed, Staff pointed out in that case "that the matching requirement is a basic principle in proper rate making and should not be violated."<sup>51</sup> In 1980, the South Dakota Supreme Court followed suit, upholding an adjustment to revenue proposed by Commission Staff that "was attributable in part to the higher costs of the Big Stone Plant."<sup>52</sup> The court held that Staff "was justified in considering that it would be inequitable for the retail customers to bear the higher costs of Big Stone without taking into account the fact that future sales would be made at a higher rate specifically designed to take into account the higher costs of the newer fossil units such as Big Stone."<sup>53</sup>

The simple fact is that the Commission and ratepayers will only be able to avoid a mismatch of expenses and revenues if the filing utility is required to include expected changes in revenue each time it submits a proposed adjustment to costs. While the 12-month historical test year presents an accurate picture of expenses and revenues for that period, any change to one side of the ledger (e.g., expenses) would pervert the other side of the ledger (e.g., revenues) unless corresponding changes to the latter were made. If, as Commission Staff claims, a utility is allowed to adjust costs using post-test-year data without making corresponding adjustments to revenue, then the 12-month historical test year would be skewed.

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<sup>49</sup> *In re Minnesota Gas Co.*, F-3302, 32 P.U.R.4th 1, 1979 WL461903, \*4 (S.D.P.U.C. 1979).

<sup>50</sup> *Id.* at \*3.

<sup>51</sup> *Id.*

<sup>52</sup> *Public Util. Comm'n v. Otter Tail Power Company*, 291 N.W.2d 291, 296 (S.D. 1980) (emphasis added).

<sup>53</sup> *Id.*

Commission Staff's interpretation promotes a gross inequity between the filing utility and ratepayers. Specifically, permitting a utility to cherry-pick adjustments to its filed cost of service based on whether each cost has an incremental revenue component would enable the utility to propose cost increases and ignore expected revenue increases in other areas that were also known and measurable at the time of filing. The ratepayers would be stuck in a situation where the utility's revenues were fixed in the 12-month historical test year, but its costs were not. A utility does not meet the requirements of ARSD 20:10:13:44 and satisfy its burden of proof under SDCL 49-34A-8.4 if the utility omits expected changes in revenue from its proposed cost-of-service adjustments.

#### **IV. ANALYSIS**

This section applies BHII's interpretation of South Dakota law set forth above to those proposed adjustments to BHP's cost of service analysis that remain in dispute between the parties. The analysis demonstrates that the Company has not met its burden of proof with respect to the adjustments and that the Commission should reject each as either not fully supported by the record, not known and measurable at the time the Company filed its Application, or both. In the event the Commission disagrees with BHII's legal interpretation, the analysis also demonstrates that certain adjustments included in the Proposed Settlement should be rejected because they are not in the public interest. To assist the Commission in its review, BHII Exhibit 9, the table admitted at the hearing to replace the table on page 6 of BHII witness Kollen's direct testimony, is attached hereto as Exhibit A. As described at the hearing,<sup>54</sup> column 1 of the revised table describes BHII's recommendations based on the Company's Application, column 2 describes BHII's recommendations from column 1, as applied to the Proposed

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<sup>54</sup> *Evidentiary Hearing Transcript*, 162:16-164:23.

Settlement, and column 3 describes BHII's recommendations starting with the Proposed Settlement.

**A. The Company's Proposed Adjustments to Its Filed Cost of Service Analysis Do Not Comply with South Dakota Law**

**1. Failure to Meet Burden of Proof**

In this case, BHP has abandoned the cost of service analysis proposed in its Application in favor of a settlement that includes a cost of service analysis prepared by Commission Staff and not BHP. Without the Company's cost of service analysis to review, the Commission is put on tenuous ground. As discussed in Section II.A.1., above, SDCL § 49-34A-8.4 requires the Company to demonstrate that the costs it proposes to recover are "prudent, efficient, and economical and are reasonable and necessary to provide service." The Proposed Settlement does not include any breakdown of the revenue requirement by BHP. The Company, instead, relies on Commission Staff's memorandum to carry the water on its behalf. This is exactly what BHII means when it refers to a "black box" settlement, and it poses two major problems that the Commission must resolve.

First, without a cost of service analysis prepared by the Company, BHP has failed to meet its burden of proof under SDCL § 49-34A-8.4. The public has a right to know how the Company will spend the revenue it receives from ratepayers in fulfilling its obligation to provide service. By trading the analysis of specific costs in its Application for an overall revenue number, the Company is asking the Commission and its customers to "trust us and let us handle how we spend the money." Such a proposal does not satisfy the Company's burden.

Second, by relying on Commission Staff's memorandum, BHP is abdicating its obligation to meet the burden of proof under SDCL §49-34A-8.4 and relying on Staff to carry

that burden for it. The Commission is being asked to analyze and approve the revenue requirement in the Proposed Settlement based on the justification of underlying costs set out in Commission Staff’s memorandum. However, Staff does not bear the burden of proving that those costs are “prudent, efficient, and economical and are reasonable and necessary to provide service.” That is the Company’s burden to bear.

Both BHP and Staff stated that they came to agreement on the revenue requirement using different analyses. During the evidentiary hearing, BHP witness Thurber declared that “we agreed to an overall revenue requirement figure. And we came to that figure, each party, with our own unique analysis.”<sup>55</sup> Similarly, Staff witness Peterson testified that “Staff’s resolution of those issues are stated in the Settlement Memorandum, but the Company had its own basis for settling certain issues . . . . We did not – we don’t see the Company’s analysis of that.”<sup>56</sup> Regardless of whether BHP and Staff agree on an overall revenue requirement, BHP’s customers have a right to see and understand how the Company intends to spend their ratepayer dollars. Because the Proposed Settlement does not demonstrate, from the Company’s standpoint, that the revenue requirement is “prudent, efficient, and economical” and the underlying costs are “reasonable and necessary to provide service,” the Company has impermissibly abdicated its burden of proof and placed it squarely on the shoulders of Commission Staff. For these reasons, the Commission should reject the Proposed Settlement in its entirety.

## **2. Failure to Include Revenue**

Furthermore, the Company has not met its burdens of proof under either SDCL § 49-34A-8.4 or § 49-34A-11 because the Company failed to include expected changes in revenue in

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<sup>55</sup> *Evidentiary Hearing Transcript*, 131:1-7 (emphasis added).

<sup>56</sup> *Id.* at 280:16-22 (emphasis added).

any of its proposed adjustments to test-year book costs. This is another fundamental flaw in the Application and in the Proposed Settlement.<sup>57</sup> As discussed in Section II.B.3., above, ARSD 20:10:13:44 requires each utility to include any expected changes in revenue in its proposed adjustments. By not including expected changes in revenue, the Company has failed to establish that the costs underlying its proposed rate increase are “prudent, efficient, and economical and are reasonable and necessary to provide service” under SDCL §49-34A-8.4. And because it has not established that the underlying costs are reasonable and necessary, the Company has not shown that the rates it filed are “just and reasonable” under SDCL § 49-34A-11.

BHP did not include any expected changes in revenue that would offset its proposed increases in costs.<sup>58</sup> By failing to make known such revenue increases and cost reductions in its Application or in the Proposed Settlement, the Company unjustly and unreasonably distorted the proposed base rate increase upward.<sup>59</sup> In the following exchange during the evidentiary hearing, Staff witness Peterson confirmed that the Company and Commission Staff excluded any adjustments from the Proposed Settlement that they believed would trigger an increase in revenue:

Q. . . . I understand that your testimony is that although the rule requires expected changes in revenue to be incorporated into . . . any adjustment, that your interpretation of that language is that the adjustment has to be one that produces revenue. Is my understanding correct?

A. Almost correct. The adjustments that are revenue producing or income producing would have to reflect either the additional revenue or the additional income that results from that change in operation before it would be recognized as a known and

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<sup>57</sup> This flaw also carries through to the Revised Settlement, which did not include expected revenue increases to offset the cost adjustments agreed to by BHP and Commission Staff.

<sup>58</sup> Kollen Direct, 8:3-5.

<sup>59</sup> *Id.* at 8-3-8.

measurable adjustment. And those types of changes are not included in the Settlement between the company and the Staff.

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Q. But, Mr. Peterson, I wonder, wouldn't that interpretation allow the company to cherry pick cost adjustments that don't have a revenue component?<sup>60</sup>

That exchange highlights a key issue underlying all of BHP's proposed adjustments in this case. The Company has interpreted ARSD 20:10:13:44 in a manner that would permit it to opportunistically select adjustments to the cost of service that, by themselves, are not directly tied to expenses or investments made to increase sales or serve new customers. In doing so, the Company has twisted the 12-month historical test year in a way that leaves ratepayers tied to 2012-2013 revenues. That result is unjust and unreasonable and the Commission should reject all of the Company's proposed adjustments on that basis alone.

### **3. FutureTrack and Inclusion of Associated O&M Costs in Proposed Settlement**

The FutureTrack Workforce program BHP proposed does not meet the burden of proof under SDCL § 49-34A-8.4 because the Company has not satisfied the requirement set forth in ARSD 20:10:13:44 that any adjustment to test-year book costs be "fully supported." In its Application, the Company proposed an increase in payroll and related expenses of \$0.676 million for the FutureTrack program.<sup>61</sup> The Company's proposal incorporated a deferral mechanism so that any costs incurred in excess of the authorized annual amount would be deferred as a regulatory asset.<sup>62</sup> The Company has experienced retirements throughout its history and has historically trained and promoted employees or retained new employees to

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<sup>60</sup> *Evidentiary Hearing Transcript*, 272:22-273:20 (emphasis added). After objections from counsel for Commission Staff, Mr. Peterson appeared to rely on the *Northwestern Pub. Serv. Co.* decision discussed above to support Commission Staff's permission of BHP's cherry picking.

<sup>61</sup> Kollen Direct, 25:1-17.

<sup>62</sup> *Id.* at 25:17-19.

replace retired employees on a recurring basis.<sup>63</sup> No evidence was provided that the FutureTrack program and the associated expenses are necessary for the Company's operations or that it cannot or will not be able to hire qualified employees when needed.<sup>64</sup> Therefore, the Commission should limit the Company's recovery for at least three reasons: (1) its request is open-ended, (2) it has not presented a measurement baseline that defines how the payroll and related expenses would be differentiated from other payroll and related expenses, and (3) it is not incentivized to operate efficiently because it would be permitted to defer any amount in excess of the annual amount allowed by the Commission.<sup>65</sup>

The FutureTrack proposal is open-ended because BHP did not ask the Commission to approve a specific dollar figure that the Company would be required to manage its budget around.<sup>66</sup> If the Company was to exceed the fixed amount proposed by the Commission, then it could defer the overage for recovery in subsequent years. Thus, no matter how strenuously BHP asserts that the FutureTrack program is "well-defined,"<sup>67</sup> the simple fact is that the Company asked for a blank check and the Commission would only have the opportunity to review its decision after 5 years.<sup>68</sup> With respect to BHP's measurement baseline, the Company's proposal to track the cost in a regulatory asset does not address or cure the lack of a measurement baseline

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<sup>63</sup> *Id.* at 25:21-23.

<sup>64</sup> *Id.* at 27:16-18.

<sup>65</sup> Kollen Direct, 29:2-15.

<sup>66</sup> *Evidentiary Hearing Transcript*, 40:4-8; Kyle White testified "I would agree that there is not a dollar baseline." *Id.* at 42:9-10

<sup>67</sup> *Id.* at 39:10-11; 40:13.

<sup>68</sup> *Id.* at 39:7-8. BHII notes that BHP witness White disagrees with the characterization of the proposal as a request for a "blank check." *Id.* at 38:5-10. Rather, Mr. White characterizes it as "an indicative amount" based on program costs that "have been defined as to what might be available." *Id.* at 38:7-12.



because the costs that will be identified and tracked will not be measured against any objective benchmark.<sup>69</sup>

The Company asserts that the FutureTrack program was not included in the Proposed Settlement.<sup>70</sup> However, the Proposed Settlement contains an adjustment that would permit BHP to recover \$0.344 million in FutureTrack Workforce program expense.<sup>71</sup> BHP witness White admits as much when he said that the Proposed Settlement “provides for rate recovery of employees hired in 2014.”<sup>72</sup> Even Commission Staff’s memorandum in support of the Proposed Settlement states “The Parties agreed to reflect in rates BHP’s actual costs for newly hired employees under the FutureTrack Program, without deferrals.”<sup>73</sup> While the Proposed Settlement would remove the regulatory asset and BHP’s ability to defer costs incurred in excess of the \$0.344 million,<sup>74</sup> the adjustment for employees hired that “would have been eligible” for FutureTrack does not meet the burden of proof under SDCL § 49-34A-8.4 because the costs are not “fully supported” in the record and they were not “known with reasonable certainty and measurable with reasonable accuracy” at the time the Company filed its Application. In this regard, the Proposed Settlement is nothing more than a back door for permitting recovery for a portion of the FutureTrack program that would not have otherwise passed muster.

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<sup>69</sup> Kollen Direct, 29:8-12.

<sup>70</sup> “The Settlement does not provide for recovery of [FutureTrack].” *Testimony of Kyle White, Evidentiary Hearing Transcript*, 38:18-19.

<sup>71</sup> Kollen Direct, 30:4-9; 31:4-5, n.9.

<sup>72</sup> White Rebuttal, 5:2.

<sup>73</sup> *Commission Staff Memorandum in Support of Proposed Settlement*, at 9.

<sup>74</sup> *Id.*; White Rebuttal, 5:2-4 (“It does not include future expenses, the tracking of expenses, or reporting requirements as contemplated by the program.”).

Furthermore, there is no evidence in the record to support the claim that BHP has hired new employees under the FutureTrack program.<sup>75</sup> Without having made the hires, or at least having received signed commitments, these employees were nothing more than a budget item at the time the Company filed its Application. It is counter-intuitive to remove the adjustment for a program like FutureTrack but retain an adjustment for O&M expenses associated with employees that “would have been eligible” for it. Because BHP failed to introduce evidence into the record that the employees have been hired, has not established that the O&M costs are fully supported by the record in light of removing the FutureTrack program, and has not shown that the O&M costs were known and measurable at the time the Company filed its case, the Commission should disallow the \$0.344 million adjustment.

#### **4. Employee Additions and Eliminations**

The proposed adjustment for employee position additions and eliminations does not meet the burden of proof under SDCL § 49:34A-8.4 because BHP has not met the requirements under ARSD 20:10:13:44 and shown that the costs are “fully supported” in the record or that they were “known with reasonable certainty and measurable with reasonable accuracy” when the Company filed its Application. In the Proposed Settlement, the Company seeks recovery of \$1.266 million in payroll and related expenses for additional employee positions over and above the amount requested for employees hired that “would have been eligible” for FutureTrack.<sup>76</sup> BHP’s actual history for the last several years, however, indicates that it is not likely to fill all the open positions or actually incur the requested expense.<sup>77</sup> Since January 2011, the Company has had between 5 and 42 open positions in any one month and averaged 19 open positions. During the

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<sup>75</sup> On January 6, 2015, BHP issued a Supplemental Response to Staff Request No. 5-25, which arguably bears on this adjustment. But BHP did not offer this response into the record to support the adjustment in the Proposed Settlement.

<sup>76</sup> Kollen Direct, 31:1-5.

<sup>77</sup> *Id.* at 31:18-19.

test year, the Company had between 18 and 42 open positions in any single month and averaged 26 open positions.<sup>78</sup> And the Company's request represents an 11% increase in labor and related expense compared to the expense without the proposed adjustment.<sup>79</sup>

BHP has provided no evidence that it requires additional employees to do the same work that it was doing in the historical test year.<sup>80</sup> Moreover, Staff witness Peterson admits that the adjustment for employee additions and eliminations in the Proposed Settlement covers positions "hired at the time of the settlement negotiations."<sup>81</sup> Thus, BHP's proposed adjustment is not only unsupported in the record and not consistent with the Company's actual experience, but the amounts included in the Proposed Settlement could not have been known and measurable at the time the Company filed its Application. For those reasons, the Commission should reject the Company's proposed \$1.266 million adjustment for payroll and related expenses.<sup>82</sup>

## 5. NOL ADIT

BHP did not satisfy its burden of proof under SDCL § 49-34A-11 with respect to its proposal to include the asset Net Operating Loss ("NOL") Accumulated Deferred Income Taxes ("ADIT") in rates because Company has not shown that including it would be "just and reasonable." Substantial oral and written testimony has been provided to the Commission on whether the asset NOL ADIT should be included in, or removed from, the Company's rate base.<sup>83</sup> The Commission should remove the asset NOL ADIT from rate base entirely because (1) it violates the prohibition against retroactive ratemaking and (2) it is only temporary and will be

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<sup>78</sup> *Id.* at 31:18-32:4.

<sup>79</sup> *Id.* at 32:14-15.

<sup>80</sup> *Evidentiary Hearing Transcript*, 183:6-9.

<sup>81</sup> Peterson Direct, 15:9-12

<sup>82</sup> Kollen Direct, 32:7-9.

<sup>83</sup> *Id.* at 10:14-15:14; Hollibaugh Direct, 3:13-20:7; *Evidentiary Hearing Transcript*, 148:22-155:8, 178:6-181:19, 198:9-202:25.

utilized as the Company generates taxable income.<sup>84</sup> In fact, Schedule K, page 2, of the Company's Application indicates that the NOL carry-forward that gave rise to the NOL ADIT will be fully utilized *prior to or during the first year that rates are effective*.<sup>85</sup> The NOL ADIT has steadily declined since October 1, 2012 (the beginning of the historical test year) toward a \$0 balance at October 1, 2014 (the date rates are assumed to be reset in this case).<sup>86</sup> Therefore, even with zero base rate increase, the Company's Application indicates that taxable income will be more than sufficient to utilize the NOL carry-forward either before rates are reset or within the twelve months after rates are reset.<sup>87</sup> Removing the NOL ADIT from rate base would reduce the Company's revenue requirement by \$1.414 million.<sup>88</sup>

The Proposed Settlement decreases the NOL ADIT amount by \$0.226 million but retains it in BHP's rate base. This adjustment reduced the Company's revenue requirement by a mere \$0.026 million.<sup>89</sup>

In rebuttal testimony and at the evidentiary hearing, BHP witness Hollibaugh attempted to scare the Commission into including the NOL ADIT in rate base by suggesting that excluding it would result in a violation of the rules regarding the normalization method of accounting prescribed by the U.S. Department of the Treasury (the "Treasury") in the Internal Revenue Code.<sup>90</sup> In particular, Mr. Hollibaugh directed the Commission to three private letter rulings from the Internal Revenue Service ("IRS") that he argues support his position.<sup>91</sup> However, Mr. Hollibaugh conceded at the hearing that (1) he knowingly omitted reference to a private letter

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<sup>84</sup> Kollen Direct, 11:4-5:8.

<sup>85</sup> *Id.* at 11:22-12:1.

<sup>86</sup> *Id.* at 13:13-15; 14:8-20.

<sup>87</sup> *Id.* at 12:5-8.

<sup>88</sup> *Id.* at 12:12.

<sup>89</sup> Kollen Direct, 15:7-10.

<sup>90</sup> Hollibaugh Rebuttal, 14:11-16:3; 19:11-20:7; *Evidentiary Hearing Transcript*, 149:23-150:14.

<sup>91</sup> Hollibaugh Rebuttal, 19:3-4 (citing private letter rulings 201436037, 201436038, and 201438003).

ruling from the IRS that stated an alternative position to the one he advocated, (2) private letter rulings are not precedential on any taxpayer other than the one filing the request for an opinion from the IRS, (3) the IRS, to his knowledge, has never issued a notice of violation to a utility for violating the normalization rules related to the NOL ADIT issue before the Commission in this case, and (4) even if the IRS was to issue a notice of violation, the Company would have an opportunity to cure the violation.<sup>92</sup>

BHII witness Kollen also addressed the potential for a normalization violation in his oral testimony at the hearing.<sup>93</sup> In his testimony, Mr. Kollen made the very points that Mr. Hollibaugh conceded to,<sup>94</sup> expressed his expert opinion that excluding the NOL ADIT from rate base would not be a normalization violation,<sup>95</sup> and provided the following reasons why it would not: (1) there is no definitive guidance from the Treasury or from the IRS that is applicable to all taxpayers, (2) the private letter rulings cited by Mr. Hollibaugh are fact-specific to individual taxpayers, (3) a private letter ruling that Mr. Hollibaugh failed to cite found no normalization violation when NOL ADIT was excluded from rate base, and (4) the NOL ADIT is temporary and will eventually be used up and no party has argued that there would be a flow through of tax benefits that are inappropriate from an income tax standpoint.<sup>96</sup> Because the NOL ADIT would be fully utilized prior to or during the first year rates are effective, and given the facts that the IRS has never issued a normalization violation for excluding NOL ADIT from rate base and BHP would have the opportunity to cure the violation even if one was found, the Company has

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<sup>92</sup> *Evidentiary Hearing Transcript*, 151:17-152:17.

<sup>93</sup> *Id.* at 178:3-181:19.

<sup>94</sup> *Id.* at 179:6-180:20; 201:19-21.

<sup>95</sup> *Id.* at 179:21-22.

<sup>96</sup> *Id.* at 180:10-181:2. BHII acknowledges that a citation to the private letter ruling referenced by Mr. Kollen and Mr. Hollibaugh during the evidentiary hearing was not provided at the hearing. In the event the Commission chooses to take judicial notice of it, the private letter ruling was issued on Jan. 27, 2014 and is numbered 201418024.

not shown that including the asset NOL ADIT in rate base would be “just and reasonable” and the Commission should remove it from rate base entirely.

## **6. Incentive Compensation**

The proposed adjustment for incentive compensation included in BHP’s Application, and carried over in part to the Proposed Settlement, does not meet the burden of proof under SDCL § 49:34A-8.4 because the Company has not satisfied ARSD 20:10:13:44’s requirements and shown that the costs are “fully supported” in the record. In response to discovery allegedly supporting the Application, the Company claimed that of the total \$3,789,297 included in its cost of service analysis, \$666,068 related to financial goals.<sup>97</sup> As can be seen from the discovery response, the Company is asserting that the \$0.666 million, including a portion of the performance plan expense, met its operating and financial criteria for performance-based incentive compensation but \$0.149 million in performance plan expenses and \$0.739 million in incentive restricted stock expense did not.<sup>98</sup> The Commission should disallow \$1.554 million in performance plan and incentive restricted stock expenses (or \$0.888 million more than provided in the Proposed Settlement) for three reasons: (1) the inherent conflict between lower rates and greater financial performance means that the Company could be incentivized to seek greater rate increases and act against its customers’ interest; (2) the revenue requirement should not embed recovery of expenses that are based on performance because the Company would be ensured recovery regardless of performance; and (3) this form of incentive compensation is primarily directed toward shareholder, not customer goals.<sup>99</sup>

The Proposed Settlement removes only the \$0.666 million BHP identified as relating

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<sup>97</sup> BHII Ex. No. 6.

<sup>98</sup> Kollen Direct, 35:14-18.

<sup>99</sup> *Id.* at 35:22-36:14.

directly to operational and financial criteria.<sup>100</sup> Commission Staff would allow the Company to recover \$0.149 million in performance plan expenses and the \$0.739 million in incentive restricted stock expense. The Commission should reject the \$0.888 million (\$0.149 million plus \$0.739 million) adjustment for performance plan and incentive restricted stock expenses because they are not fully supported by the record and BHP's customers should not be required to fund incentives that meet shareholder goals.

The performance plan and incentive restricted stock expenses represent awards of stock, units, or cash based on the performance measures listed in Section 12.1 of the Company's Confidential 2005 Incentive Compensation Plan.<sup>101</sup> In light of the lengthy discussion on this point at the hearing,<sup>102</sup> BHII presents the following definitions and provisions from the plan for ease of reference: **[BEGIN CONFIDENTIAL:**

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<sup>100</sup> *Id.* at 37:9-11.

<sup>101</sup> Kollen Direct, 36:18-21; Ex. BHII 7 (Confidential).

<sup>102</sup> *Evidentiary Hearing Transcript*, 45:19-67:14; 76:12-80:4; 95:4-22





**END CONFIDENTIAL]** The record does not contain a copy of a Restricted Stock Agreement;<sup>103</sup> nor does it contain evidence indicating the reasons that the Committee makes awards of restricted stock. In fact, the sum-total of BHP's evidence with respect to incentive compensation is the table attached to BHII Exhibit 6 labeled 211-G, which was presented with no underlying work papers or other references to other documents.<sup>104</sup> When questioned about the sufficiency of the 211-G attachment and the lack of supporting documents, BHP witness White simply shrugged it off:

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<sup>103</sup> *Evidentiary Hearing Transcript*, 65:13-16.

<sup>104</sup> *Id.* at 11-18.

**[BEGIN CONFIDENTIAL**

**END CONFIDENTIAL]**

In Mr. White's view, BHP's testimony alone, without *any* supporting documentation, should be sufficient for the Commission to conclude that the adjustment is just and reasonable. It is not. The record is devoid of any documentary evidence to support the Company's assertion that awards of restricted stock are not performance-based compensation,<sup>105</sup> and the Commission should conclude that the Company's proposed \$0.666 million adjustment for performance plan and incentive restricted stock expenses is not "fully supported" by the record and should be rejected.

Importantly, while prior settlements approved by the Commission may have included various levels of incentive compensation, BHP agreed that these settlements do not represent binding precedent on the Commission.<sup>106</sup> And while BHP alleges that the Wyoming Public Service Commission and the Colorado Public Service Commission have recently accepted proposed incentive compensation proposals from two of the Company's affiliates, the record before the Commission in this case contains no evidence and provides no explanation as to why those Commissions ruled the way they did.<sup>107</sup>

Finally, it is important to note that BHII is not recommending that all of BHP's incentive compensation expenses be disallowed.<sup>108</sup> If the Commission disallowed the \$1.554 million in

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<sup>105</sup> *Id.* at 79: 8-10.

<sup>106</sup> *Evidentiary Hearing Transcript*, 35:8-11.

<sup>107</sup> *Id.* at 35:12-36:19.

<sup>108</sup> *Id.* at 55:24-56:2.

performance plan and incentive restricted stock expense (including both the \$0.666 million that was removed in the Proposed Settlement and the \$0.888 million that BHII recommends removing because it is not fully supported in the record), the Company would still be permitted to recover approximately \$2.2 million in incentive compensation expenses.<sup>109</sup>

## **7. Pension Expense Normalization**

The adjustment for pension expense included in BHP's Application, which in turn is carried over in the Proposed Settlement, does not meet the burden of proof under SDCL § 49:34A-8.4 because, once again, the Company has not met the requirements in ARSD 20:10:13:44 and shown that the costs are "fully supported" in the record. The Proposed Settlement includes an adjustment for pension expense that is calculated using a new five-year average methodology and results in a request that exceeds the actual known and measurable 2014 pension expense by \$1.247 million without justification.<sup>110</sup> This is an opportunistic response to the reduction in 2014 expense. BHP has presented no evidence that the pension expense will swing upward to meet the five year average it seeks in the future.<sup>111</sup> The Company has already received the benefit of the lower pension expense this year and it has not offered to defer the difference between the pension expense reflected in its rates and the actual pension expense this year to share the savings with its customers.<sup>112</sup>

The Commission has wrestled with normalizations in the past, and for good reason. In 1979, it determined that normalization should not be adopted for deferred income taxes related to capitalized payroll taxes.<sup>113</sup> While admittedly, taxes and pension expenses are different, the

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<sup>109</sup> *Id.* at 66:12-17.

<sup>110</sup> Kollen Direct, 33:8-17.

<sup>111</sup> *Id.* at 33:21-24.

<sup>112</sup> *Id.* at 34:7-13.

<sup>113</sup> *Re Minnesota Gas Co.*, F-3302, 32 P.U.R.4th 1, 1979 WL 461903 at \*18 (S.D.P.U.C. 1979).

Commission's rationale in that case is equally applicable here. In concluding that tax normalization was not appropriate, the Commission observed that such normalization "assumes that tax circumstances will remain constant and presupposes that the costs of ongoing operations and the cost of construction can be completely separated."<sup>114</sup> The Commission found both contentions to be erroneous.<sup>115</sup> With respect to pension expenses, BHP witness Thurber acknowledged that "[n]ew employees are no longer eligible for the pension plan."<sup>116</sup> And, by their very nature, the pension plan and its expenses are subject to market conditions. Because new employees are not eligible for the pension plan and the pension expense obligation is tied to the market, the circumstances surrounding the pension plan, like the tax circumstances the Commission addressed in 1979, will not remain constant.

Furthermore, BHII witness Kollen testified in response to questions from Chairman Nelson that normalization is typically used for "abnormal and nonrecurring types of expenses" that are not removed and treated separately such as "pay raises at the end of a historic test year that weren't fully reflected in that test year."<sup>117</sup> Pension expense, on the other hand, "is a recurring expense. And the question is what is the appropriate level."<sup>118</sup> In Mr. Kollen's opinion, BHP knew its pension expense based on the actuarial report and the savings during the test year should be for the benefit of ratepayers.<sup>119</sup> The Commission should accordingly remove BHP's adjustment to increase pension expenses based on a five-year average and require the Company to apply the benefit of the lower pension expenses in 2014 as a reduction to its revenue requirement.

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<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> *Evidentiary Hearing Transcript*, 132:16-25.

<sup>117</sup> *Id.* at 215:17-216:5.

<sup>118</sup> *Id.* at 216:6-9.

<sup>119</sup> Kollen Direct, 34:7-19; *Evidentiary Hearing Transcript*, 216:6-9.

## 8. Retired Steam Plants Decommissioning Expense

BHP did not carry its burden of proof under SDCL § 49-34A-11 as part of its proposal to include in rate base the estimated costs to decommission the retired Osage, Neil Simpson I, and Ben French power plants because Company has not shown that including these costs would be “just and reasonable.” BHP should be required to defer these decommissioning costs as regulatory assets and address the recovery of the costs in the Company’s next base rate proceeding.<sup>120</sup> BHP witness Thurber agreed that if a carrying charge was added to BHII’s recommendation to defer the costs, then the Company would be kept financially whole.<sup>121</sup>

BHP’s Application included \$7.824 million in rate base for its estimated costs to decommission the retired Osage, Neil Simpson I, and Ben French power plants, net of accumulated depreciation and an incorrectly calculated adjustment to reduce ADIT.<sup>122</sup> The Company also included \$1.965 million in amortization expense on a proposed five-year amortization period.<sup>123</sup> The Company intends to complete decommissioning activities at the Ben French plant in early- to mid-September 2015, and will make payments on that work between January 2015 and September 2015.<sup>124</sup> It plans to complete decommissioning activities at the Neil Simpson I plant in mid- to late-June 2015, and will make payments on that work between November 2014 and June 2015.<sup>125</sup> And the Company expects to complete decommissioning

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<sup>120</sup> Kollen Direct, 17:3-5; *Evidentiary Hearing Transcript*, 182:3-12.

<sup>121</sup> *Evidentiary Hearing Transcript*, 118:2-6.

<sup>122</sup> Kollen Direct, 15:21-24.

<sup>123</sup> *Id.* at 15:24-16:3; Ex.\_\_(LK-7).

<sup>124</sup> *Evidentiary Hearing Transcript*, 115:21-24; 116:12-16; BHII Exhibit 8.

<sup>125</sup> *Id.* at 115:17-20; 116:4-7; BHII Exhibit 8.

activities at the Osage plant by mid-April 2015, and will make payments on that work between August 2014 and March 2015.<sup>126</sup>

In response to cross-examination questions, BHP witness Thurber attempted to confuse the issues of unrecovered plant, obsolete inventory, and decommissioning expense by discussing them together as parts of the same regulatory asset.<sup>127</sup> Nevertheless, Mr. Thurber acknowledged that BHII has not taken issue with either obsolete inventory or unrecovered plant.<sup>128</sup> BHII is exclusively concerned with the inclusion of decommissioning expenses for the three retired plants in rate base. Mr. Thurber argues that it would be improper to defer the costs because the customers that received a benefit from the plants may not be required to pay the costs of decommissioning.<sup>129</sup> However, the record contains no demographic evidence to support Mr. Thurber's argument. Furthermore, his argument does not change the simple fact that the Company is asking for its customers to pay now for costs that the Company will incur later. Including the decommissioning expenses in rate base would amount to the Company recovering prematurely for expenses it has not provided evidence of incurring at the time the new rates would be implemented. BHP agrees that if the costs were deferred with a carrying charge then the Company would be made financially whole. Therefore, the Commission should reject BHP's request to include the estimated costs for decommissioning of the retired Osage, Neil Simpson I, and Ben French power plants in rate base because the Company has not shown that including these costs would be just and reasonable at this time.

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<sup>126</sup> *Id.* at 115:13-16; 116:8-11; BHII Exhibit 8. BHII admits that Mr. Thurber testified at the hearing that the decommissioning of the Osage plant was "90 percent complete" at the time of the hearing. However, he was "not aware of how much [cost has been] incurred related to that specific decommissioning project." *Id.* at 137:15-20; 137:25-138:2.

<sup>127</sup> *Id.* at 181:21-182:5.

<sup>128</sup> *Id.* at 120:8-12.

<sup>129</sup> *Evidentiary Hearing Transcript*, 118:7-13.

## 9. Affiliate Allocations

### (a) Adjustment to Affiliate Allocations from Black Hills Utility Holdings (“BHUH”)

The proposed adjustment to increase affiliate allocations from BHUH included in the Company’s Application, which actually increased in the Proposed Settlement, does not meet the burden of proof under SDCL § 49-34A-8.4 because the Company has not established, as ARSD 20:10:13:44 requires, that the costs are “fully supported” in the record or that they were “known with reasonable certainty and measurable with reasonable accuracy” at the time the Company filed its Application. BHP’s Application proposed a \$1.846 million increase in affiliate allocations from BHUH when compared to the 12-month historical test year.<sup>130</sup> That increase represents a 19% increase over the historic test year expense, including a 21% increase to account 920 “administrative salaries” and a 53% increase to account 923 “outside services.”<sup>131</sup> The Company did not provide any evidence of known and measurable changes to the historical test year in its Application or in response to BHII discovery.<sup>132</sup>

Not only does the Proposed Settlement incorporate the full proposed adjustment for BHUH allocations that BHP included in its Application, but it also inexplicably increases the adjustment by an additional \$0.527 million, to \$2.373 million.<sup>133</sup> Of that additional \$0.527 million, the parties acknowledge that \$0.286 million was included in account 561 in error.<sup>134</sup> Despite the fact that the amount did not appear in the Company’s Application, both Staff witness Peterson and BHP witness Thurber claim they did not have the necessary information during

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<sup>130</sup> Kollen Direct, 37:24-38:1.

<sup>131</sup> *Id.* at 38:12-14.

<sup>132</sup> *Id.* at 38:22-39:1.

<sup>133</sup> Kollen Direct, 39:5-6.

<sup>134</sup> Thurber Rebuttal, 16:7-12; Peterson Direct, 19:3-5; *Evidentiary Hearing Transcript*, 279:24-280:5.

settlement discussions to make sure it was excluded from the Proposed Settlement.<sup>135</sup> That allegation is beyond the pale and the Commission should acknowledge the error by reducing the revenue requirement set forth in the Proposed Settlement by \$0.286 million.

As noted in the opening paragraphs of this brief, Staff and BHP filed a Revised Settlement with the Commission on February 10, 2015, two weeks after the hearing. Again, there has not been a hearing on the Revised Settlement and parties have not been afforded the opportunity to offer testimony on it. At best, the Revised Settlement represents modifications to the Proposed Settlement that BHP and Commission Staff have offered and which the Commission is free to accept or reject when it issues its decision on March 2, 2015. Notwithstanding this objection, BHII offers the following brief rebuttal to the proposals contained in the Revised Settlement.

In the Revised Settlement, Staff and BHP proposed to resolve the \$0.286 million error acknowledged by all parties by (1) removing the \$0.286 million, (2) adding a new adjustment for Wyodak O&M expenses incurred from October 2013 through September 2014, in the amount of approximately \$0.413 million, and (3) retaining the overall revenue requirement set forth in the original Proposed Settlement. BHII opposes the Revised Settlement for several non-procedural reasons: First, as set forth above, the \$0.286 million should be removed and the revenue requirement should be reduced accordingly. Errors in a calculation or schedule are entirely different than proposed adjustments and can and should be corrected at any time during a proceeding. Second, Wyodak O&M expenses should not be included because they were not known with reasonable certainty and measurable with reasonable accuracy at the time the

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<sup>135</sup> *Evidentiary Hearing Transcript*, 284:14-15 (Peterson stating that “had the Staff been aware of this error during settlement negotiations, it would have been corrected”); 133:17-19 (Thurber stating that “This information was not available to us during the settlement discussions. We first found out on December 30.”).



Company filed its Application. And third, the Revised Settlement provides further support for BHII's argument in Section III.A.1., above, that the Company engaged in a "black box" settlement process by abdicating its burden of proof under SDCL § 49-34A-8.4 and relying on Staff to shoulder the burden on its behalf. For these reasons, the Commission should reject the Revised Settlement in its entirety, and with it the positions of Staff and the positions of the Company set forth therein.

(b) Adjustment to Affiliate Allocations from Black Hills Service Company ("BHSC")

The proposed adjustment to increase affiliate allocations from BHSC included in the Proposed Settlement does not satisfy the burden of proof found in SDCL § 49-34A-8.4 because BHP has not proven, in accordance with ARSD 20:10:13:44, that the cost is "fully supported" in the record or that it was "known with reasonable certainty and measurable with reasonable accuracy" at the time the Company filed its Application. The Company did not propose an adjustment to affiliate allocations from BHSC in its initial Application.<sup>136</sup> BHP first proposed the new adjustment of approximately \$1.1 million some seven months after the Company filed its case.<sup>137</sup> It has provided no evidence to demonstrate that the adjustment was known and measurable at the time it filed its Application. And even if the amount *was* known and measurable, the only evidence that BHP provided to support the adjustment was a table attached to its Supplemental Response to Staff Data Request 3-96 showing that the amounts were allocated from BHSC.<sup>138</sup> For the Commission to simply rubber-stamp amounts spent and allow BHP to include these costs in rate base would be to relieve the Company of its burden to

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<sup>136</sup> Kollen Direct, 40:10; *Evidentiary Hearing Transcript*, 183:20-24; Kilpatrick Rebuttal, 7:20-8:2.

<sup>137</sup> Kilpatrick Rebuttal, 8:3-12; Kollen Direct, 40:17-18; *Evidentiary Hearing Transcript*, 183:20-24.

<sup>138</sup> BHII notes that Mr. Kilpatrick's rebuttal testimony states that "In the Supplemental Response to SDPUC Request 3-96, the Company provided the actual costs from September 2013 through August 2014 *with supporting work papers*." Kilpatrick Rebuttal, 9:18-20. However, the response did not include any work papers apart from the table comparing the per books costs filed with the Company's Application and the proposed adjusted amounts.

establish that the costs were just and reasonable. Given these proof problems, the Commission should reject the Company's proposed \$1.1 million adjustment to affiliate allocations for BHSC.

### **10. Steam and Other Production Plant Net Salvage**

The proposed adjustment to net negative salvage rates included in the Company's Application does not meet the burden of proof under SDCL § 49-34A-8.4 because the Company has not demonstrated that adjustment is "fully supported" in the record under ARSD 20:10:13:44. Net negative salvage refers to the net of estimated salvage income and cost of removal.<sup>139</sup> The Company proposes significant increases in net salvage rates from -5% to between -13% and -22% depending on the plant.<sup>140</sup> This significant increase in negative salvage for the production plant accounts is not appropriate for several reasons: (1) the basis for the calculation of the terminal net salvage is flawed and unreliable, (2) the increase in net negative salvage is not necessary at this time because the Commission is not required to provide recovery of unknown future costs in present rates, and (3) the adjustment appears to be a proposal to change the Commission's policy on decommissioning cost recovery from recovery *after* the retirement of plants to recovery *before* their retirement.<sup>141</sup> As to the first of these reasons, BHP witness Spanos spent the majority of his rebuttal testimony mischaracterizing (or demonstrating his misunderstanding of) BHII witness Kollen's testimony regarding terminal net salvage.<sup>142</sup> The net negative salvage included in present depreciation rates is applied to the entire gross plant amount, not only the interim retirement portion.<sup>143</sup> By applying the same rate to the entire gross

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<sup>139</sup> Kollen Direct, 40:22-23.

<sup>140</sup> *Id.* at 47:6-7; Ex. \_\_ (LK-18).

<sup>141</sup> Kollen Direct, 47:14-48:3.

<sup>142</sup> Spanos Rebuttal, 6:2-13:22.

<sup>143</sup> The gross plant can be considered in two parts: one part that will be retired and refreshed periodically over the life of the plant (e.g., equipment that wears out and is replaced in its entirety) and another part that remains until the plant is retired (e.g., buildings, stacks, valves, some equipment).

plant, as Mr. Kollen proposed,<sup>144</sup> and as is reflected in current depreciation rates, then the assumption is that the net negative salvage includes both interim and terminal amounts. Thus, Mr. Spanos's allegation that Mr. Kollen recommended not providing terminal net salvage in depreciation rates is incorrect.<sup>145</sup> As to the last reason, waiting to determine the appropriate manner of decommissioning until after a plant is retired is the most prudent policy for ratepayers while ensuring that the Company recovers its costs.<sup>146</sup> Because BHP has not justified the significant increases or proposed any valid rationale to change its current policy,<sup>147</sup> the Commission should reject the Company's proposed adjustment and require the Company to use the same -5% net salvage rate that is reflected in current depreciation rates<sup>148</sup>. Doing so would reduce the Company's depreciation expense and the revenue requirement by \$1.132 million.<sup>149</sup>

## 11. LIDAR

The proposed adjustment to include costs associated with a Light Detection and Ranging (“LIDAR”) survey on the Company's 69-kV system likewise does not satisfy BHP's burden of proof under SDCL § 49-34A-8.4 because the Company has not met the requirements ARSD 20:10:13:44 imposes and shown that the cost was “known with reasonable certainty and measurable with reasonable accuracy” when the Company filed its Application. Specifically, the amount included in the Company's Application is comparable to a budget for a LIDAR survey and was not tied to actual costs. BHP had not incurred any expenses for the LIDAR survey at

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<sup>144</sup> *Evidentiary Hearing Transcript*, 185:4-15.

<sup>145</sup> *Id.*

<sup>146</sup> At the evidentiary hearing, and in response to Mr. Kollen's direct testimony, BHP witness Spanos stated that he believes “to wait until the facilities are actually retired causes an intergenerational inequity circumstance where customers are paying for costs that they do not get the benefit of.” *Evidentiary Hearing Transcript*, 144:16-19.

<sup>147</sup> Kollen Direct, 48:8-10.

<sup>148</sup> *Id.* at 48:7-8.

<sup>149</sup> *Id.* at 48:17-18.

the time its Application was filed. In fact, at that time the Company had not even signed a contract obligating it to the expenses.<sup>150</sup>

BHP included \$0.502 million in rate base for its estimated LIDAR costs, net of accumulated depreciation.<sup>151</sup> The Company did not provide for any ADIT offset to the requested regulatory asset even though it represents a book/tax temporary difference.<sup>152</sup> The Company also included \$0.137 million in amortization expense based on a five year amortization period.<sup>153</sup> According to the Company's response to BHII's discovery request, the Company planned to begin the survey and incur the costs "by the end of 3Q 2014."<sup>154</sup> However, the Company did not submit any evidence to support the proposed adjustment in its Application. Only in response to BHII discovery did the Company produce the LIDAR services agreement between BHP and GeoDigital International Corporation. That contract was not signed until September 26, 2014, almost six months after the date the Company submitted its Application, as confirmed by BHP witness Thurber.<sup>155</sup> Mr. Thurber nonetheless testified that a "fixed price contract with costs incurred within 24 months of the last month of the test period [should] qualify as an appropriate adjustment under ARSD 20:10:13:44."<sup>156</sup> As set forth in detail above, Mr. Thurber's interpretation of the law is flawed and erroneous.

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<sup>150</sup> *Evidentiary Hearing Transcript*, 122:9-123:11 (BHP witness Thurber identifies BHII Ex. 8 as the LIDAR contract with GeoDigital International Corporation and confirms that the date of the contract is Sept. 26, 2014); BHII Ex. 8.

<sup>151</sup> Kollen Direct, 22:11-12; Ex.\_\_(LK-11).

<sup>152</sup> Kollen Direct, 22:13-14.

<sup>153</sup> *Id.* at 22:14-16.

<sup>154</sup> *Id.* at 22:21-22; Ex.\_\_(LK-12).

<sup>155</sup> *Evidentiary Hearing Transcript*, 122:9-123:11 (BHP witness Thurber identifies BHII Ex. 8 as the LIDAR contract with GeoDigital International Corporation and confirms that the date of the contract is Sept. 26, 2014); BHII Ex. 8.

<sup>156</sup> Thurber Rebuttal, 14:1-2.

The Commission itself has held that a “budget is an unreliable basis for establishing rates,”<sup>157</sup> and that to allow such estimates to influence ratemaking would be tantamount to adopting a projected test year “in total contravention of the rational and sound rate-making principle of utilizing a test year adjusted for known and measurable changes.”<sup>158</sup> BHP’s attempt to include LIDAR cost estimates in rate base when it had not signed a contract for the services is exactly the same as using budget estimates to establish rates. Because BHP’s proposed adjustment for LIDAR survey costs was not fully supported in the record and not known with reasonable certainty or measurable with reasonable accuracy at the time the Company filed its Application, the Commission should exclude the costs from rate base and authorize the Company to defer the survey costs as a regulatory asset and address the recovery of the costs in the Company’s next base rate proceeding.

**B. Notwithstanding the Company’s Failure to Comply with South Dakota Law, Commission Approval of the Proposed Settlement is not in the Public Interest**

Even if the Commission disagrees with BHII’s interpretation of South Dakota law, accepts BHP’s filings as satisfying the burden of proof, and believes there is sufficient evidence to support the Proposed Settlement, there is ample support in the record for the Commission to modify the Proposed Settlement. BHII’s proposed modifications fall into two categories. First, there are policy choices the Commission should make to further reduce the claimed revenue requirement under the Proposed Settlement. Second, there are errors in the Proposed Settlement that the Commission should correct to reduce the claimed revenue requirement under the Proposed Settlement. These categories of adjustments are addressed below.

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<sup>157</sup> *Re Minnesota Gas Co.*, F-3302, 32 P.U.R.4th 1 (S.D.P.U.C. 1979) (holding “that Minnegasco’s construction budget is an unreliable basis for establishing rates”).

<sup>158</sup> *Id.* (finding that projected plant in service expenses caused Minnegasco’s filing to represent a “projected test year” and stating that “not only is a projected test year impossible to fully evaluate and scrutinize, but moreover, a projected test year based upon estimates is in total contravention of the ration and sound rate-making principle of utilizing a test year adjusted for known and measurable changes”).

## 1. Policy Choices

### (a) Defer Decommissioning Expense

As previously discussed, BHP included approximately \$7.824 million in rate base for its estimated costs to decommission the retired Osage, Neil Simpson I and Ben French Power plants.<sup>159</sup> The Company also included approximately \$1.956 million in amortization costs, assuming a five-year amortization period.<sup>160</sup> BHII has not objected to these amounts.<sup>161</sup> But the overarching question is whether ratepayers should be forced to pay the Company now for these costs when they will not be incurred until up to 2 years after the end of the test year.

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It would be better, from a policy perspective, to postpone recovery of these costs. Assuming BHP were allowed to include a just and reasonable carrying charge, Company witness Mr. Thurber agreed the Company would be made whole.<sup>162</sup> During his cross-examination, Mr.

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<sup>159</sup> Kollen Direct, 15:21-22.

<sup>160</sup> *Id.* at 15:24-16:1.

<sup>161</sup> As explained below in the errors section, if the Proposed Settlement is accepted, BHII requests the Commission to correct the error in the ADIT.

<sup>162</sup> *Evidentiary Hearing Transcript*, 118:2-6.

Thurber appeared to assert that intergenerational equity supports current cost recovery.<sup>163</sup> He did not point to any evidence in the record to support this assertion. Nor could he. There is no record evidence that would support a claim that forcing ratepayers to pre-pay an expense of this magnitude - an expense based upon a contract executed nearly one-year after the test year that has already been subject to multiple change orders<sup>164</sup> - is fair. Instead, as Mr. Kollen testified, “the Commission should authorize BHP to defer these decommissioning costs as regulatory assets and address the recovery of the costs in the Company’s next base rate proceeding.”<sup>165</sup> The Commission should adopt Mr. Kollen’s recommendation.

(b) Defer LIDAR Surveying Costs

As noted above, BHP included approximately \$502,000 in rate base for estimated costs to perform a LIDAR survey of its 69 kV distribution system, net of depreciation.<sup>166</sup> For the same policy reasons set forth above, the Commission should authorize the Company to defer the LIDAR survey costs as a regulatory asset and address cost recovery in a subsequent rate proceeding.<sup>167</sup>

(c) Adjustments Consistent with Alternative Reading of ARSD 20:10:13:44

Should the Commission reject BHII’s interpretation of ARSD 10:20:13:44 and allow post-filing adjustments to costs included in the test-year, the Commission should require BHP to incorporate two additional changes. First, the Commission should incorporate 2015 into the five-year average for pension expense. Second, the Commission should adjust the 13 month average to October 1, 2014, for NOL ADIT.

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<sup>163</sup> *Evidentiary Hearing Transcript*, 118:7-13.

<sup>164</sup> BHII Ex. No. 8.

<sup>165</sup> Kollen Direct, 17:3-5.

<sup>166</sup> *Id.* at 22:11-13.

<sup>167</sup> *Id.* at 23:16-18.

According to Mr. Thurber, BHP’s five-year average (years 2010 through 2015) for pension expense cost is \$2,336,305.<sup>168</sup> As support for beginning to use a five-year average, Mr. Thurber points to the fact that the Company now knows the pension expense for 2015. He testified that “Black Hills Power’s actual total company 2015 pension expense is \$2,056,581.”<sup>169</sup> If the Commission is inclined to use the most current information, Mr. Thurber’s table on page 21 of his rebuttal testimony should be revised to delete the year 2010 and add the year 2015 for purposes of calculating the five year average. The revised five year average would be \$2,162,451, which calculation is detailed below:

<u>Year</u>	<u>Total Company Cost</u>
2011	\$1,819,156
2012	\$3,251,072
2013	\$2,709,322
2014	\$976,122
2015	\$2,056,581
Average	\$2,162,451

For the reasons already expressed, it is wholly inappropriate to allow BHP to include NOL ADIT in rate base in this proceeding. If the Commission disagrees, and disagrees with BHII’s analysis with respect to ARSD 20:10:13:44, then the Commission should adjust the 13 month average for the historic test year to October 1, 2014.<sup>170</sup> As Mr. Kollen testified “If the Commission allows the Company to selectively adjust other rate base components to October 1, 2014, then it should ensure that the NOL ADIT is adjusted to the same date, and should do so based on the information in the Application.”<sup>171</sup>

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<sup>168</sup> Thurber Rebuttal, 21.

<sup>169</sup> *Id.* at 22:13-14.

<sup>170</sup> Kollen Direct, 12:19-13:3.

<sup>171</sup> *Id.* at 13:6-9.



## 2. Treatment of Errors in Proposed Settlement

### (a) Correct ADIT in Decommissioning Costs

Even if it is unwilling to defer decommissioning costs for review and potential recovery to a subsequent rate proceeding, the Commission should direct BHP to correct an error in ADIT. As Mr. Kollen observed, “the Company failed to include the deduction for the entire decommissioning cost under the column titled ‘tax depreciation’ on line 35 of Schedule M-2. If this deduction is properly reflected, the ADIT related to the regulatory asset should be \$3.423” on a South Dakota jurisdictional basis.<sup>172</sup> The impact of this correction is a reduction of \$0.391 million to BHP’s revenue requirement.<sup>173</sup> This adjustment should be incorporated into any approval of the Proposed Settlement.

### (b) Correct ADIT for LIDAR Surveying Costs

As discussed earlier, allowing the Company to recover costs associated with the LIDAR surveying project costs would violate South Dakota law. But if the Commission disagrees and rejects the proposal to defer the costs for review and potential recovery in a subsequent rate proceeding, the Commission should at least correct the ADIT error in the Company’s filing. As Mr. Kollen testified:

The Company failed to include the related ADIT on Schedule M-1, which it acknowledged in response to BHII Request No. 20. The ADIT should be \$0.176 million (\$0.502 million times 35%), which will reduce the Company’s claimed revenue deficiency by \$0.020 million (\$0.176 million times 11.43%).<sup>174</sup>

Based on this testimony, the Commission should direct BHP to correct its error.

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<sup>172</sup> Kollen Direct, 18:3-7.

<sup>173</sup> *Id.* at 18:21-23 (explaining the calculation using the Company’s requested grossed up rate of return).

<sup>174</sup> *Id.* at 24:1-5.

(c) Correct ADIT for Storm Atlas Costs

A close study of the Proposed Settlement reveals that BHP and Commission Staff erroneously calculated the effects of reducing the regulatory asset amount before computing the effects of including the ADIT as a reduction in rate base.<sup>175</sup> The Company should have treated the entirety of the regulatory asset as a temporary difference.<sup>176</sup> The impact of correcting this calculation is a slightly smaller reduction to rate base and operating income. To be clear, BHII recommends a \$.102 million reduction to rate base and \$.414 million reduction to operating income versus the Proposed Settlement, which recommends a \$.179 million reduction to rate base and \$.512 million reduction to operating income.<sup>177</sup>

**C. The Commission Should Accept the Revenue Allocation Proposal Under the Proposed Settlement, or a Pro-Rata Share Thereof Should the Commission Modify the Revenue Requirement**

As Mr. Baron explained in his direct testimony and testimony at the hearing, the parties are largely in agreement<sup>178</sup> on revenue allocation. Nonetheless, there are a number of valid concerns regarding BHP's class cost of service study, which should be incorporated into the Company's next rate filing. These proposed adjustments fall within the following three categories: (1) the allocation of demand-related production costs, (2) curtailable/interruptible load, (3) the classification and allocation of distribution-related costs, and (4) the energy-related costs associated with voltage loss factors.<sup>179</sup> Each is described below.

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<sup>175</sup> *Id.* at 21:22-22:1

<sup>176</sup> *Id.* at 20:24-21:1.

<sup>177</sup> Kollen Direct, 21:8-10, Exhibit \_\_ (LK-10).

<sup>178</sup> Except for BHP, which, although it has signed on to the Proposed Settlement, is the lone objector to the revenue allocation under the Proposed Settlement. *Evidentiary Hearing Transcript*, 245:18-23. BHII urges the Commission to reject such an unfounded and outlandish position.

<sup>179</sup> Baron Direct, 9:4-6.

Two changes are necessary in connection with the allocation of demand-related production costs. First, BHP's average and excess demand ("A&E") methodology contains an error. Specifically, the Company's A&E calculation fails to account for excess demand for the residential and general service classes.<sup>180</sup> Second, the Company fails to appropriately gauge the average demand component of the A&E analysis. To calculate the annual system load factor, the Company should have compared the ratio of average demand to the annual system peak (or 1 CP).<sup>181</sup> Instead, the Company used a 3 CP to weight the average demand component, which is inconsistent with the requirement that it meet its annual system peak.<sup>182</sup>

Furthermore, BHP's cost of service analysis fails to reflect known and measurable interruptible load at the time of its filing.<sup>183</sup> The impact of this failure is that the reported rates of return for interruptible customers are biased and understate the Company's actual return from those customers, which is particularly acute for the general service large/industrial contract rate class because of its significant amount of interruptible load.<sup>184</sup> Any decision based on the Company's analysis would therefore be incorrect, including a decision to rely exclusively on the class cost of service study to assign the proposed revenue increase to the general service large/industrial contract class.<sup>185</sup> To properly account for this interruptible load, BHP should have utilized an imputed avoided capacity cost approach.<sup>186</sup>

With respect to distribution-related costs, BHP's analysis contains a number of errors that need correction. The most significant correction is to require the Company's study to reflect a

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<sup>180</sup> *Id.* at 11:4-7.

<sup>181</sup> *Id.* at 11:10-13.

<sup>182</sup> *Id.* at 12:1-2.

<sup>183</sup> *Id.* at 12:18-13:3.

<sup>184</sup> Baron Direct, 13:5-13.

<sup>185</sup> *Id.* at 13:13-14.

<sup>186</sup> *Id.* at 13:16-14:4.

minimum distribution system methodology, as set forth in the NARUC Cost Allocation manual. It is wholly inappropriate for the Company to classify 100% of distribution costs in FERC accounts 364 to 369 as demand-related, with no amounts classified as customer-related.<sup>187</sup> As stated on page 90 of the NARUC cost allocation manual:

When the utility installs distribution plant to provide service to a customer and to meet the individual customer's peak demand requirements, the utility must classify distribution plant data separately into demand- and customer-related costs...[T]he number of poles, conductors, transformers, services, and meters are directly related to the number of customers on the utility's system.<sup>188</sup>

Although the Company failed to provide the necessary information for BHII to develop a BHP-specific minimum distribution methodology, Mr. Baron was able to rely on a minimum distribution analysis developed by Company affiliate Black Hills Colorado.<sup>189</sup> Mr. Baron's reliance is consistent with BHP's decision to rely on the Black Hills Colorado primary/secondary classification analysis.<sup>190</sup> Neither the Company nor Commission Staff offered any basis to refute Mr. Baron's use of Black Hills Colorado's analysis or incorporation of a minimum distribution system analysis into a class cost of service study.

Mr. Baron made three other corrections that pertain to distribution-related costs. First, and consistent with the NARUC cost allocation manual, he classified FERC Account 369-Services as customer-related.<sup>191</sup> Second, he functionalized FERC Accounts 360-362 into two

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<sup>187</sup> *Id.* at 15:6-12.

<sup>188</sup> *Id.* at 16:4-11.

<sup>189</sup> Baron Direct, 19:6-7.

<sup>190</sup> *Id.* at 19:9-11.

<sup>191</sup> Baron Direct, 23:1-10.

subfunctions, 69 kV and below 69 kV.<sup>192</sup> Third, and similar to the second adjustment, he subfunctionalized costs in FERC Accounts 364 to 367 as 69 kV and above and below 69 kV.<sup>193</sup>

Finally, with respect to loss factors, BHP erroneously failed to loss-adjust fuel and purchased energy costs. As a result, there is no reflection in BHP's class cost of service study of the varying impact on customer classes of fuel cost associated with losses, which is an important oversight now that the Company is recovering 100% of fuel and purchased energy costs in the Energy Cost Adjustment ("ECA").<sup>194</sup> Mr. Baron corrected this error by developing an adjustment to each rate class's O&M expenses.<sup>195</sup>

Make no mistake, BHII does not object to the Company's proposed revenue allocation at the original increase or the Proposed Settlement. Mr. Baron testified:

Effectively, the Proposed Settlement rate class increases shown in Exhibit No. 2 are consistent with the results of my corrected class cost of service study. If the Commission approves the overall base rate increase of \$6,890,746, in the Proposed Settlement, then the rate class increases shown in Exhibit No. 2 should be accepted. However, if the Commission approves an overall base rate increase that is lower than \$6,890,746, as BHII witness Lane Kollen recommends, then the increases shown in Exhibit No. 2 should be reduced proportionately.<sup>196</sup>

Even so, it is appropriate, going forward, for the Commission to direct BHP to either file a class cost of service study reflecting the above corrections or an alternative class cost of service study incorporating the corrections.<sup>197</sup> Although the latter may be marginally more work for the

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<sup>192</sup> *Id.* at 23:18-22 ("Because 69 kV customers are not served by lower voltage facilities, they should only be allocated an NCP demand share of the 69 kV facilities and none of the other lower voltage costs.")

<sup>193</sup> *Id.* at 24:4-8.

<sup>194</sup> *Id.* at 24:19-25:11.

<sup>195</sup> *Id.* at 14-17.

<sup>196</sup> Baron Direct, 6:1-8.

<sup>197</sup> *Id.* at 6-10:13.

Company, it is more palatable for the Commission to review two different class cost of service studies.

## V. CONCLUSION

The Commission should reject the Proposed Settlement in its entirety. Through the Proposed Settlement, the Company is attempting to convert the 12-month test-year into a dynamic test year period, under which it controls the timing and information to support proposed adjustments. As part of this process, Staff has been used as a pawn to support proposed adjustments and submit the Company's cost of service analysis. The Commission should end this practice now. The Company has not, and indeed cannot, satisfy its burdens of proof with respect to either its underlying costs of service or its overall rates, by relying on Staff's analysis. BHII understands and appreciates the difficult task presently before the Commission. Denying the Joint Motion to Approve the Proposed Settlement will require more work and could require additional hearings. This impact of denial should not, however, influence the Commission's decision. Although undoubtedly in good faith, Staff has erroneously professed its support for an interpretation of the law that has no foundation in its plain language. It is that interpretation that Staff proffers as justification for proposed adjustments to test-year costs that are drastically disproportionate to the Company's actual cost of serving its customers in South Dakota.<sup>198</sup> Approving the Proposed Settlement would perpetuate this misinterpretation and incentivize future manipulations of the test year and Staff by all utilities, not just BHP, to the detriment of all ratepayers. For all the reasons detailed herein, the Commission should reject the Proposed

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<sup>198</sup> Where the Commission makes a judgment on a question of fact, a South Dakota court may properly substitute its judgment where the decision is arbitrary, capricious, or constitutes an abuse of discretion. *Matter of N. States Power Co.*, 489 N.W.2d 365, 368, (S.D. 1992).

Settlement in its entirety. And if the Commission disagrees with BHII's interpretation of the law, there are good reasons to revise the Proposed Settlement rather than accept it as proposed.

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Respectfully submitted,

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