

Direct Testimony  
Laura A. Patterson

Before the South Dakota Public Utilities Commission  
of the State of South Dakota

In the Matter of the Application of  
Black Hills Power, Inc., a South Dakota Corporation

For Authority to Increase Rates  
In South Dakota

Docket No. EL14-\_\_\_

March 31, 2014

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### Exhibits

None

1                    I.            **INTRODUCTION AND QUALIFICATIONS**

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

3    A.    My name is Laura A. Patterson and my business address is 625 9th Street (4th  
4        Floor), Rapid City, South Dakota 57701.

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

6    A.    I am employed by Black Hills Service Company, (“Service Company”), a wholly-  
7        owned subsidiary of Black Hills Corporation (“BHC”), as the Director of  
8        Compensation, Benefits and Human Resources Information Systems (“HRIS”). In  
9        my position, I am responsible for partnering with business leaders to design and  
10       execute compensation and benefits strategies and plans. I also provide input  
11       related to strategic planning, implementation and administration of compensation  
12       and benefits programs, executive plans, equity programs, non-qualified plans and  
13       other initiatives. My responsibilities also cover employees working for Black Hills  
14       Power, Inc. (“Black Hills Power” or the “Company”).

15   **Q.    PLEASE   BRIEFLY   SUMMARIZE   YOUR   ACADEMIC   AND**  
16   **PROFESSIONAL BACKGROUND?**

17   A.    I have more than 23 years of experience in compensation and benefits, with  
18        responsibilities including the development, management, administration and  
19        regulatory compliance of such plans. I began my current position as Director of  
20        Compensation, Benefits and HRIS for BHC in April 2009. Prior to this position, I  
21        spent 6 years as Director of Compensation, Benefits and HRIS and 2 years as  
22        Employee Benefits Manager, for PNM Resources, Inc. (PNMR), where I was

1 responsible for managing and administrating all compensation and benefit  
2 programs for PNMR, its subsidiaries and for its joint venture business with  
3 Cascade Investments, Optim Energy. Prior to working for PNMR, I was employed  
4 as a Tax Manager and Human Capital Consultant for four years at Arthur  
5 Andersen, a global tax and consulting firm. In this position, I worked with  
6 organizations to identify, analyze and apply regulatory rules that govern structure,  
7 compliance, and administration of employee benefit plans. Prior to Arthur  
8 Andersen, I was employed as a Trust Officer at Mercantile Trust Company from  
9 1995 to 1999 with responsibilities for managing and administration of profit  
10 sharing, 401(k), and pension purchase retirement plans sponsored by a wide range  
11 of clients. I have a Bachelor of Business Administration degree from the  
12 University of Iowa.

13 **Q. HAVE YOU PROVIDED TESTIMONY IN REGULATORY**  
14 **PROCEEDINGS PRIOR TO THIS CASE?**

15 A. Yes. I have previously testified in New Mexico PRC Case No. 06-00210-UT, a  
16 gas rate case, in New Mexico PRC Case No. 07-00077-UT, an electric rate case, in  
17 Texas PUC Case Docket No. 36025, an electric rate case, in Nebraska PUC Case  
18 Docket No. NG-0061, a gas rate case, and in Colorado PUC Case Docket No. 11-  
19 AL-382E, an electric rate case. I have also submitted testimony in Black Hills  
20 Power's last rate application with the South Dakota PUC, Docket No. EL 12-061.  
21 Finally, I testified on behalf of Cheyenne Light before the Commission in  
22 Cheyenne Light's 2009 and 2011 electric and natural gas rate proceedings.

1 **Q. DESCRIBE YOUR PROFESSIONAL ASSOCIATIONS.**

2 A. I served on the Corporate Board of Directors of the International Foundation of  
3 Employee Benefit Plans and currently serve on the Employee Benefits Committee  
4 for the U.S. Chamber of Commerce. I am also a Certified Retirement Services  
5 Professional.

6 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING?**

7 A. Black Hills Power.

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

9 A. I describe and support the general compensation program for BHC employees,  
10 and particularly the employees of Black Hills Power, including the variable  
11 compensation program and the equity compensation program. I explain why  
12 these programs and their associated costs are reasonable and necessary to attract,  
13 motivate and retain well qualified and competent employees to support utility  
14 operations. Black Hills Power employees, both non-union and union, participate  
15 in the compensation and benefit plans sponsored by BHC.

16 I also describe and support the general benefits programs and policies for BHC  
17 employees, particularly the employees of Black Hills Power, including the health,  
18 welfare and retirement benefits, and explain why those programs and their  
19 associated costs are reasonable and necessary.

20 My testimony specifically supports employee compensation related adjustments,  
21 including base salary, variable compensation, equity compensation, retiree  
22 healthcare, pension plan, pooled medical, and 401(k) plan, that are part of the

1 overall benefits adjustment. Finally, my testimony will explain the adjustments  
2 related to personnel due to the suspension of operations at certain facilities.

3 **II. COMPENSATION PHILOSOPHY AND PROGRAMS**

4 **Q. WHAT IS BHC'S GENERAL COMPENSATION PHILOSOPHY?**

5 A. BHC's long-term success depends on operational excellence, providing reliable  
6 products and services to our customers, and investing wisely to ensure present  
7 and future strength. BHC's strength allows us to invest in our utility infrastructure  
8 and systems to improve the safe, reliable and affordable service our customers  
9 and communities depend on. To consistently achieve these outcomes, BHC must  
10 attract, motivate and retain employees to achieve appropriate business results. For  
11 these reasons, BHC promotes a compensation program that supports the overall  
12 operational excellence and customer service objectives, based on principles  
13 designed to:

- 14 • attract, motivate, retain and encourage the development of highly qualified  
15 employees;
- 16 • provide compensation that is competitive;
- 17 • promote the relationship between pay and performance;
- 18 • promote overall performance that is linked to our customers and  
19 shareholders; and
- 20 • recognize and reward individual performance appropriately.

1 All compensation programs are designed to be strategically aligned, externally  
2 competitive, internally equitable, personally motivating, cost effective and legally  
3 compliant.

4 **Q. PLEASE DESCRIBE BHC'S COMPENSATION PROGRAMS.**

5 A. There are two primary components to the compensation program – Base Salary  
6 and Variable Pay programs.

7 • Base Salary: Base salary represents the fixed portion of an employee's total  
8 cash compensation opportunity. Base salary compensation is determined by  
9 the market value of the job, the experience level of the employee, and  
10 specific performance standards and competencies. Base salaries are  
11 reviewed on an annual basis and merit salary increases are based on  
12 individual performance and contributions. Base rates of pay for Black Hills  
13 Power's union employees are established under the terms of the collective  
14 bargaining agreement with the International Brotherhood of Electrical  
15 Workers ("IBEW") Local 1250.

16 • Variable Pay: Variable Pay is pay that is "at risk" and is not fixed or  
17 guaranteed. Variable Pay is only earned and awarded based on  
18 achievements against specific performance-based goals. All BHC  
19 employees (non-union and union) participate in the Annual Incentive Plan  
20 (AIP) which is described in detail later in this testimony.

1 **Q. PLEASE EXPLAIN BHC'S PHILOSOPHY ON BASE PAY**  
2 **COMPENSATION.**

3 A. Base pay is intended to reflect the median of the market for similar positions in  
4 similar companies. Overall, our goal is to target direct compensation (base salary  
5 and variable pay / annual incentives) at the median of the appropriate market when  
6 our operating results approximate average in relation to our peers.

7 There are twenty-three (23) pay grades which are used for all non-executive, non-  
8 union jobs. Each grade has a minimum, midpoint, and a maximum pay level. This  
9 means that the pay ranges within the grades are competitive with what other  
10 companies pay for similar positions. All jobs are compared to the market, where  
11 data exists, and placed in the grade where the midpoint of the range is closest to  
12 the average market rate for that job. In 2009, Towers Watson conducted an  
13 independent market review of the BHC's positions and benchmarked each  
14 position. Each position was placed in the appropriate salary grade, reflecting the  
15 market median values. Subsequent to the Towers Watson study, the BHC Human  
16 Resources Compensation Department periodically reviews each position in the  
17 company and compares it to credible market survey data to ensure that current  
18 compensation remains within the competitive range.

19 Market rates are determined by utilizing compensation survey data where  
20 companies report actual compensation paid to employees by position. The survey  
21 most widely used by BHC is from Towers Watson, as they are recognized  
22 nationally as the leader in the energy services / utility market place.



1 **Q. IN ADDITION TO THE TOWERS SURVEY, ARE THERE ANY OTHER**  
2 **SURVEYS THAT BHC UTILIZES TO ENSURE THAT ITS OVERALL**  
3 **COMPENSATION IS COMPETITIVE IN COMPARISON WITH OTHER**  
4 **COMPANIES?**

5 A. Yes. BHC also utilizes surveys conducted by Aon Hewitt, Mercer, the Edison  
6 Electric Institute (EEI), ECI, the EAPDIS LLC, Ed Powell, and other surveys,  
7 including several specific to wages by state. The surveys provide compensation  
8 and other data for each position by company size, revenue, and number of  
9 employees so that BHC can match each of its positions to positions in the market  
10 that are most similar in duties and most similar for the company size/revenue.

11 **Q. HOW DO THE COMPANY'S COMPENSATION STRATEGIES**  
12 **COMPARE TO THE CURRENT MARKET?**

13 A. The BHC Compensation Department reviews the pay structure annually to see  
14 how the structure and pay practices reflect the market. As of October 21, 2013, the  
15 average base pay for non-union employees of Black Hills Power was 95% of the  
16 market median, indicating Black Hills Power employees' base pay rates were  
17 lower than the market median. Compensation is considered to be competitive to  
18 the market at a range of 95% to 105% of the market median, so compensation for  
19 Black Hills Power is at the lower end of this range.

20 **Q. DOES BHC HAVE A VARIABLE COMPENSATION COMPONENT OF**  
21 **ITS TOTAL COMPENSATION PHILOSOPHY?**

22 A. Yes. The Black Hills Corporation Annual Incentive Plan (the "AIP" or the "Plan")

1 is designed to motivate and reward employees for achieving and exceeding goals  
2 that benefit our customers and our shareholders. The AIP is designed to reward  
3 eligible employees, including both non-union and union employees of Black Hills  
4 Power, who contribute to the success of the BHC and/or their assigned Business  
5 Unit; reward employees who contribute to the quality of service provided to  
6 customers including, but not limited to, the provision of safe, reliable and  
7 affordable service; motivate work performance and behavior that supports the  
8 Corporation's financial and non-financial goals and increase the employee's  
9 understanding of the Corporation's business objectives and performance.

10 **III. COMPANY ANNUAL INCENTIVE PLAN**

11 **Q. PLEASE DESCRIBE BHC'S ANNUAL INCENTIVE PLAN.**

12 A. The purpose of BHC's AIP is to promote BHC's pay for performance philosophy,  
13 to provide competitive incentive opportunities that are consistent with other  
14 companies in the industry, and to focus employees on important performance  
15 objectives. The AIP is an important component of the total pay package necessary  
16 to ensure BHC is competitive with market practices for employees. In addition,  
17 the AIP directly links pay with performance, and therefore total compensation  
18 expense varies with BHC's performance on measures important to the customers,  
19 and provides a tool to align employees' interests with customer and community  
20 interests.

1 **Q. WHO IS ELIGIBLE TO PARTICIPATE IN THE AIP?**

2 A. All regular full-time and part-time employees, both union and non-union, who are  
3 hired and working by October 1 of the plan year are eligible to participate in the  
4 Plan for that plan year. Part-time employees who work a minimum of 20 hours  
5 per week are eligible for a pro-rata award based on their actual wages for hours  
6 worked. Pro-rata awards for the number of months actively employed at each  
7 eligibility level during the plan year will also be paid to Participants who are hired,  
8 promoted, retire or have other job changes during the year.

9 **Q. WHAT PERFORMANCE GOALS ARE MEASURED UNDER THE AIP?**

10 A. An eligible employee can earn an incentive award based on that employee's  
11 performance toward goals designed to achieve business unit operational  
12 performance targets. The components of the incentive award for the test year were  
13 as follows:

- 14 • An employee could qualify for up to 50% of the maximum possible award  
15 for goals tied to customer satisfaction, cost control, safety, reliability,  
16 operations efficiency, expense reductions and other operational measures;
- 17 • An employee could qualify for up to 25% of the maximum possible award  
18 for the achievement of direct business unit operating income goals,  
19 including initiatives on cost control, continuous improvement and  
20 improvements in operations efficiencies; and
- 21 • An employee could qualify for up to 25% of the maximum possible award  
22 if BHC realizes established earnings per share ("EPS") targets.

1 Each goal is measured independently. Goal performance that meets or exceeds the  
2 threshold level will be used to calculate the incentive award. Achievement of  
3 financial results is not a condition to award incentive for achievement of other  
4 goals. An employee can earn from 0 to 1.50 times the target percentage incentive  
5 based on achievement against each of the AIP goals. Performance below  
6 threshold results in a zero payout for the associated goal. Achievement of a goal's  
7 "target" performance results in a payout of 100% of the payment relative to that  
8 goal. There is also a Maximum payout, which means that if performance exceeds  
9 target, no more than 1.50 times the target payment will be made relative to that  
10 goal.

11 **Q. HOW DOES THE AIP PROVIDE VALUE TO CUSTOMERS?**

12 A. The AIP provides direct and indirect value to customers in a number of different  
13 ways. For example, AIP goals are aligned with BHC's high-level objectives and  
14 strategic framework. Business unit goals are primarily designed to improve the  
15 performance of utility operations by focusing on improvements to operational  
16 excellence, safety, reliability, and customer satisfaction. Examples of Black Hills  
17 Power's business unit goals include:

- 18 • Continuous improvement in results from customer satisfaction surveys.  
19 These results are measured each quarter.
- 20 • Service reliability metrics.
- 21 • Increase in number of completed service orders per day.
- 22 • Reduction in labor cost per service order.

- 1 • Reductions in O&M expense resulting from Continuous (Process)  
2 Improvement projects.
- 3 • Reduction in number of lost time accidents, preventable vehicle accidents,  
4 and OSHA recordable accidents.

5 BHC must maintain a skilled and motivated workforce in order to provide safe,  
6 reliable and affordable service and products. To do so, it is important to pay our  
7 employees at rates competitive to rates paid by similar utilities and other  
8 companies with which we compete for employees. Because the actual base  
9 salaries for Black Hills Power's employees fall somewhat below the market  
10 median levels, total compensation would be significantly less competitive without  
11 the incentive plan component. An employee's total cash earnings potential (base  
12 salary *plus* AIP incentive award) depends on both competitive base salary and on a  
13 competitive AIP incentive compensation opportunity awarded for the achievement  
14 of key operating and strategic goals.

15 **Q. HOW WOULD AVERAGE BASE SALARIES BE AFFECTED IF AIP**  
16 **INCENTIVES WERE ELIMINATED?**

17 A. If BHC did not offer employees the opportunity to earn AIP incentive  
18 compensation, BHC would need to make-up the difference by increasing base  
19 salaries in at least an equivalent amount, which would result in higher fixed costs  
20 for salaries and benefits. An alternative to variable compensation would be for  
21 BHC to raise all employees base pay to reflect the median variable compensation  
22 earnings provided by other utilities. While this would provide a competitive total

1 compensation rate that is “fixed and measurable”, it would de-link those costs with  
2 customer performance measures and increase overall costs as many of our benefits  
3 are also tied to base pay rates.

4 **Q. DO YOU BELIEVE THAT THE AIP IS AN IMPORTANT ELEMENT OF**  
5 **EMPLOYEE RETENTION?**

6 A. Yes. If BHC were to eliminate its variable pay program and did not replace that  
7 compensation with base pay, employees would be much less likely to stay with  
8 BHC because their total compensation would significantly lag what other utilities  
9 were paying for the same positions. Coupling this risk with the loss of experience  
10 that Black Hills Power will realize over the next eight years due to retirements,  
11 results in a significant and immediate business risk.

12 **Q. ONE OF THE INCENTIVE GOALS UNDER THE AIP RELATES TO THE**  
13 **COMPANY’S OPERATING INCOME OR EARNINGS PER SHARE**  
14 **(“EPS”) PERFORMANCE. DO CUSTOMERS BENEFIT FROM**  
15 **COMPANY EPS PERFORMANCE IN LINE WITH INCENTIVE PLAN**  
16 **TARGETS?**

17 A. Yes. Earnings Per Share is an easily recognized benchmark for successful and  
18 productive companies that are meeting their customers’ needs. They provide  
19 company-wide objective measures of performance that cannot reasonably be  
20 separated from customer interest. Both shareholders and customers benefit from  
21 strong EPS performance - - they are not mutually exclusive. Two primary drivers  
22 of EPS are expense management and debt costs. Customers benefit from receiving

1 service from a company that is able to effectively manage its costs. When the  
2 Company is managing its costs, rate cases are less frequent. When a rate case is  
3 required, the requested increase is less than would otherwise be required.

4 **Q. DO INDIVIDUAL EMPLOYEES CONTRIBUTE TO THE COMPANY'S**  
5 **EPS PERFORMANCE?**

6 A. Yes. Each employee primarily contributes to the financial success of the Company  
7 through the prudent actions he or she takes to control costs, work efficiently, and  
8 drive operational excellence. By setting an EPS target, and monitoring company  
9 performance against the target throughout the year, employees receive immediate  
10 feedback regarding performance. Providing incentive compensation related to  
11 meeting financial performance drives employees to cost-conscious behavior that is  
12 beneficial to customers.

13 **Q. HOW ELSE DO CUSTOMERS BENEFIT FROM A STRONG EPS**  
14 **RECORD?**

15 A. As described in the Direct Testimony of Brian G. Iverson, Black Hills Power must  
16 maintain financial integrity to access capital at reasonable costs. A strong  
17 financial position provides the financial flexibility necessary to meet the ongoing  
18 demand for utility services. Credit ratings agencies compare quantitative  
19 measures of a company's financial performance, including EPS, to determine a  
20 company's credit ratings. These ratings have a direct impact on the cost of  
21 Company's debt, both for acquiring debt and refinancing higher cost debt, which  
22 directly impact customer rates. Through strong EPS performance, the Company is

1 able to maintain or even improve its credit ratings, resulting in a lower cost of debt  
2 for customers. Because Company earnings are such an important consideration in  
3 rating agency evaluations of the Company, it is critical that employees receive  
4 incentives to maintain strong financial performance, which ultimately results in  
5 lower costs for customers.

6 **IV. COMPANY LONG-TERM INCENTIVE PROGRAM**

7 **Q. PLEASE DESCRIBE BHC'S LONG-TERM INCENTIVE PROGRAM.**

8 A. The Company provides a long-term incentive program on a limited basis to key  
9 employees who are responsible for various aspects of management and business  
10 results. These long-term incentives include restricted stock and performance share  
11 awards. Restricted stock is granted to key employees and vests ratably over a 3-  
12 year period. The purpose of the 3-year vesting period for both the restricted stock  
13 and the performance shares is to get retention of key employees.

14 Performance shares, if any, are based on achievement against established criteria  
15 measured over a 3-year period and are made at the conclusion of that 3-year  
16 period. The performance share component measures relative performance of  
17 BHC against other utilities - - it is about operational performance and metrics.  
18 BHC focuses on top quartile performance in all areas and performs at this level on  
19 a sustained basis. This operational excellence is recognized by the market and  
20 using performance measures to compare BHC to its peers provides focus for key  
21 employees in these areas. This operational excellence also results in lower costs to  
22 customers in very direct ways. For example, BHC's continued high performance



1 for power plant availability is recognized by the market with higher stock  
2 performance, but impacts the customers directly through lower cost of service,  
3 high reliability, and high customer satisfaction.

4 Both forms of equity grants under the long-term incentive program are intended to  
5 provide participants with incentives for excellent performance, to promote  
6 teamwork and to motivate, retain and attract the services of participants who make  
7 significant contributions to the success of the company and its operational goals.

8 **V. INDUSTRY COMPENSATION COMPARISONS**

9 **Q. DO OTHER COMPANIES IN THE UTILITY INDUSTRY USE**  
10 **COMPARABLE VARIABLE AND LONG-TERM COMPENSATION**  
11 **MECHANISMS?**

12 A. Yes. Other utilities do provide incentive or variable compensation as part of their  
13 compensation packages, as do companies in other industries. Other utilities also  
14 provide key employees with long-term incentives designed to retain these key  
15 employees and to motivate them to achieve operational and strategic goals.  
16 Without similar annual and long-term plans, BHC's total compensation package  
17 would not be competitive with other utilities and BHC would be at risk for  
18 retention of its key employees.

19 **Q. ARE YOU AWARE OF ANY STUDIES THAT SUPPORT THIS**  
20 **CONCLUSION?**

21 A. Yes. Aon Hewitt Associates, an international business consulting firm that  
22 specializes in compensation issues, conducted a survey of broad-based variable

1 pay plans in 2013 titled "Variable Compensation Measurement (VCM) Report –  
2 U.S. Edition," which includes 125 companies, including 25 energy / utility  
3 companies. Results from the survey indicate the following:

- 4 • 90% of participating companies offered at least one broad-based variable  
5 compensation plan covering 99% of total U.S. employees, an increase from  
6 89% in 2007 and from 80% in 2002 as companies continue to turn to  
7 variable pay as a means to attract, retain and award performance. All  
8 energy / utility companies offer at least one broad-based variable incentive  
9 plan and all cover 100% of their employees.
- 10 • 74% of the participating companies in the survey have an annual incentive  
11 program with a plan design similar to BHC's AIP, where awards are based  
12 on the combined achievement of Company financial and business unit  
13 operating performance.
- 14 • 88% of the participating companies reported the benefits realized from their  
15 variable pay plan and the improved business results outweighed the cost.
- 16 • Notable outcomes reported by companies with a variable pay plan similar  
17 to the AIP include reduced costs, increased productivity, increased quality,  
18 increased customer satisfaction, and increased employee morale.

19 Other surveys published in 2012-2013 include:

- 20 • Mercer: 93% of employers provide short-term incentive or variable pay  
21 plans, an increase from 78% in 2004.

- 1 • World at Work: 84% of employers provide short-term incentive or variable  
2 pay plans, an increase from 77% in 2004. Of those providing a short-term  
3 incentive plan, 98% of hourly employees (average payout was 5%) and  
4 100% of salaried employees (average payout was 12%) are eligible under  
5 the plan.
- 6 • Buck Consulting: 87% of utilities in the survey provide a short-term  
7 incentive plan to all employees.
- 8 • Kenexa: 88.5% of energy and utility companies in the survey provide a  
9 short-term incentive plan to all employees.

10 **Q. HOW DOES BHC MAKE IMPROVEMENTS TO ITS AIP?**

11 A. Through its annual strategic and operational planning process, BHC routinely  
12 evaluates the effectiveness of the plan in meeting its goals. These goals are  
13 modified and continually refined to drive continued operational excellence and  
14 performance improvements. BHC also continuously evaluates the AIP design to  
15 ensure that it remains competitive and comparable to other utilities.

16 **VI. COMPANY RECOVERY OF EMPLOYEE**

17 **COMPENSATION EXPENSES**

18 **Q. SHOULD THE COMPENSATION MERIT INCREASE BE APPROVED?**

19 A. Yes. Recovering the actual amount of employee compensation expense is  
20 necessary to attract and retain the high quality of employees that are needed to  
21 serve the customers of Black Hills Power. Under existing economic conditions,  
22 independent surveys reflected that more than 97% of US-based companies will

1 award merit pay increases during 2014, with an average budget of 3% to 4%.  
2 Non-union employee pay changes are effective each March, with the most recent  
3 increase effective March 4, 2013 and the next scheduled merit increase to be  
4 effective March 3, 2014. The company has a non-union merit increase budget for  
5 2014 of 3.50%. The union salary increases for the period April 1, 2013 through  
6 March 30, 2014 range from 3.0% to 3.5% by position and the wage increase will  
7 be 3.25% effective April 1, 2014. Increases in employee compensation are known  
8 and measurable, and these increases in employee compensation are supported by  
9 extensive reviews of competitive market data.

10 Without merit increases, BHC would further lag the median pay for these  
11 positions, significantly increasing retention and performance risk, and the  
12 company will incur higher costs for turnover and related issues. A summary of  
13 independent surveys regarding merit pay follows:

- 14 • Mercer: The survey of 634 employers reflects that energy and utility  
15 employers plan to provide merit increases to employees in 2014, with an  
16 average budgeted increase ranging from 3.0% to 4.0%.
- 17 • Aon Hewitt: The 2013-2014 survey of 1,096 employers reflects planned  
18 2014 merit increases, with an average budget of 3.1%. The energy and  
19 utility employers in the survey reflect a merit budget average of 3.7%.
- 20 • Towers Watson: The 2013-2014 survey of 633 employers reflects planned  
21 2014 merit increases, with an average budget of 3.1%. This survey does  
22 not reflect utility specific information.

- 1           •       World at Work: The 2013-2014 survey of 1,834 employers reflects a 3.1%  
2                   merit increase budget average for 2014 across all industries. The average  
3                   merit increase budgets for energy and utility companies average up to  
4                   4.1%.

5           Simply put, the merit increases and the union wage increases will be incurred, and  
6           the overall compensation to Black Hills Power employees is fair and competitive  
7           as tested against prevailing market comparisons.

8   **Q.   SHOULD THE COMPENSATION INCREASE BE APPROVED FOR**  
9   **UNION EMPLOYEES?**

10   **A.**   Recovering the actual amount of employee compensation expense is necessary –  
11           as described above – to attract and retain the high quality of employees that are  
12           needed to serve the customers of Black Hills Power.

13           The ratified contract between Black Hills Power and the IBEW Local 1250 Local  
14           Bargaining Unit requires an increase in union employee compensation of 3.0% to  
15           3.5% depending on job classification effective April 1, 2013; and an increase of  
16           3.25% effective April 1, 2014. Black Hills Power's union employees also  
17           participate in the AIP under the terms of the contract. Accordingly, the April 1,  
18           2014 rate increase of 3.25% and AIP compensation for union employees is  
19           representative of the amount that Black Hills Power will be obligated to pay while  
20           its rates will be in effect. Black Hills Power's union employee compensation  
21           adjustment qualifies as a known and measurable change over the four-year  
22           contract.

1           **VII.       COMPANY BENEFITS AND PERIODIC REVIEW**

2   **Q.    PLEASE DESCRIBE THE BENEFIT PLANS THAT BHC PROVIDES TO**  
3   **ITS BLACK HILLS POWER EMPLOYEES?**

4   A.   BHC offers a combination of company-provided and voluntary benefits.  
5       Employees are enrolled in certain company-provided benefits automatically and  
6       BHC pays the costs (for example, short-term and long-term disability benefits).  
7       Employees choose whether or not to participate in the voluntary benefits and they  
8       pay a portion or all of the costs. These company-provided and voluntary benefit  
9       programs consist of: (1) medical, dental and vision plans, (2) flexible spending  
10      accounts, (3) life insurance and accidental death and dismemberment insurance,  
11      (4) paid time off, (5) retirement, and (6) other benefits including educational  
12      assistance, holidays and other time away from work, business travel accident  
13      insurance, rewards & recognition and wellness programs.

14 **Q.    WHAT BENCHMARKING HAS BEEN CONDUCTED TO EVALUATE**  
15 **COST/PERFORMANCE LEVELS?**

16 A.   BHC solicits a number of independent reviews from external organizations and  
17      consulting firms such as Towers Watson, Aon Hewitt, Mercer, etc. These reviews  
18      cover a wide range of compensation and benefit program designs and costs  
19      including compensation and benefit programs, HR function administrative  
20      expenses, and market data for positions. BHC compares its benefit programs and  
21      costs with companies from the utility sector and from general industry to ensure  
22      the company can attract and retain employees with the necessary skills. BHC

1 utilizes multiple nationally recognized third-party surveys and also conducts  
2 customized surveys where appropriate and necessary. These benchmarking  
3 surveys allow BHC to evaluate the competitiveness and efficiencies of its benefit  
4 programs and costs compared to other companies in the market. If a program does  
5 not meet performance, cost or efficiency expectations, it is reviewed to determine  
6 the root cause and the options or alternatives available. BHC closely monitors  
7 market practices and benchmark data for costs to maintain competitive and cost  
8 effective programs.

9 **Q. WHAT TYPE OF OVERSIGHT IS IN PLACE TO ENSURE THAT BHC'S**  
10 **COMPENSATION AND BENEFIT PROGRAMS ARE THOSE THAT ARE**  
11 **MOST BENEFICIAL FOR THE SUPPORT OF THE OPERATING**  
12 **COMPANIES' UTILITY SERVICE?**

13 A. The BHC Human Resources Department, in partnership with the business unit  
14 leaders and company management, develop annual budgets and long-range plans  
15 (5 years), including compensation, benefit and other programs supporting the  
16 business' goals and objectives. HR and key operating personnel manage these  
17 budgets and review all programs for effectiveness, cost and any proposed  
18 modifications. All costs are modeled to determine impacts to cost and are  
19 benchmarked against the market parameters to ensure competitiveness, cost  
20 effectiveness, and reasonableness.

1 **Q. ARE YOU AWARE OF OTHER STATE COMMISSIONS THAT HAVE**  
2 **APPROVED THE EMPLOYEE COMPENSATION AND BENEFIT**  
3 **STRUCTURE PROPOSED IN THIS PROCEEDING?**

4 A. Yes. Through rate case settlements and contested proceedings, commissions in  
5 Nebraska, Iowa, Wyoming and Colorado in both gas and electric rate cases have  
6 approved this employee compensation and benefit structure. BHC places emphasis  
7 on maintaining a common employee compensation structure and program. The  
8 same is true for its proposal related to its employees living in or supporting our  
9 Black Hills Power customers.

10 **VIII. ADJUSTMENTS DUE TO SUSPENSION OF**  
11 **CERTAIN OPERATIONS**

12 **Q. HAS BLACK HILLS POWER SUSPENDED OPERATIONS AT ANY OF**  
13 **ITS FACILITIES?**

14 A. Yes, Black Hills Power placed its Osage and Ben French facilities into economic  
15 shutdown. Black Hills Power has suspended operations at its Neil Simpson I  
16 facility. As indicated in the testimony of both Vance Crocker and Mark Lux, these  
17 three facilities will be decommissioned as a result of the EPA's National Emission  
18 Standards for Hazardous Air Pollutants for Area Sources: Industrial, Commercial  
19 and Institutional Boilers.



1 **Q. WHAT ADJUSTMENTS WERE MADE RELATED TO PERSONNEL DUE**  
2 **TO THE SUSPENSION OF OPERATIONS AT THESE FACILITIES?**

3 A. Adjustments have not been made for the employees that were employed at Osage  
4 and Ben French when those facilities were placed into economic shutdown. The  
5 affected employees retired, took alternate positions with the Company, or left the  
6 Company. Black Hills Power has had a labor reduction due to the suspension of  
7 operations at Neil Simpson I. However, these employees were retained by Black  
8 Hills Power as part of its strategic workforce planning.

9 More specifically the Neil Simpson I employees have been retained and are  
10 assigning part of their time to the common Neil Simpson complex facilities.  
11 These employees also direct charge other specific units, such as Cheyenne Light  
12 and Black Hills Wyoming, and common facilities for work performed at those  
13 facilities. Retention of these critical skills is necessary to ensure the continued  
14 provision of safe, reliable and cost-effective service to customers.

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

16 A. Yes.

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