Rebuttal Testimony
Robert J. Hollibaugh

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. EL14-026

January 15, 2015

TABLE OF CONTENTS

I. INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Robert J. Hollibaugh. My business address is 625 Ninth Street, Rapid City, South Dakota 57701.

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

A. I am employed by Black Hills Service Company ("BHSC"), a wholly-owned subsidiary of Black Hills Corporation ("BHC"), a public utility holding company. I am the Director of Tax.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

A. I am testifying on behalf of Black Hills Power, Inc. ("Black Hills Power" or "Company").

Q. DID YOU FILE DIRECT TESTIMONY IN THIS DOCKET?

A. No, I did not file direct testimony in this docket.

II. STATEMENT OF QUALIFICATIONS

Q. WHAT ARE YOUR DUTIES AND RESPONSIBILITIES IN YOUR CURRENT POSITION?

A. I am responsible for overseeing all tax-related matters pertaining to the consolidated group that comprises BHC including those that affect the Company. Additional responsibilities include providing regulatory support with respect to tax-related matters for all entities that comprise the regulated business segment of BHC.

Q. WOULD YOU PLEASE OUTLINE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND?

A. I have a Bachelor of Science degree in Business Administration with an accounting emphasis from University of Nebraska-Kearney. I am a Certified Public Accountant and a member of the American Institute of Certified Public Accountants, as well as the Taxation Committee of the Edison Electric Institute.

Prior to joining the Company in mid-2005, I was employed by KPMG LLP as a senior tax manager from 2002 to 2005 with clients that were primarily in the utility and energy related industries. Such client responsibilities included tax planning, mergers and acquisitions, restructurings, controversy matters (e.g., IRS audit), and tax compliance. From 1996 to 2002, I was employed as an experienced tax manager for Arthur Andersen LLP with clients that were primarily in the utility and energy related industries. Client responsibilities were identical to those for my position at KPMG LLP. Prior to joining Arthur Andersen LLP, I was employed by NorthWestern Energy Corporation (f/k/a Northwestern Public Service Company) from 1980 to 1996 with responsibilities that were primarily tax related, but also included managerial duties in accounting and finance. As part of my tax related responsibilities at Northwestern Public Service Company, I provided support for rate case filings that included the development of all income tax related schedules.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A. No.

III. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to address arguments made by the Black Hills Industrial Intervenors' witness, Mr. Kollen, at pages 10-25 of his direct testimony in support of his recommendation that the Commission: (1) not allow an adjustment to rate base for accumulated deferred income taxes ("ADIT") associated with net operating losses ("NOL ADIT") that have been generated for income tax purposes; and (2) correct certain ADIT adjustments related to plant decommissioning costs and the 69KV LIDAR Surveying Project.

Q. ARE YOU SPONSORING ANY EXHIBITS AS PART OF YOUR REBUTTAL TESTIMONY?

A. No.

IV. NOL ADIT INCLUSION IN RATE BASE

Q. HOW DOES MR. KOLLEN CHARACTERIZE THE ISSUE HE RAISES WITH RESPECT TO THE NOL ADIT IN HIS DIRECT TESTIMONY?

A. Mr. Kollen characterizes the inclusion of the NOL ADIT asset in rate base as a violation of the prohibition against retroactive ratemaking. In addition, he indicates that such ADIT is temporary and the Company has demonstrated it will have generated sufficient taxable income to fully utilize any remaining NOL carryforward. Thus, he recommends that the Commission should not allow the inclusion of any portion of the NOL ADIT asset in rate base whether conceptually as a violation of the prohibition against retroactive ratemaking or quantitatively on the basis there won't be any NOL carryforward left due the generation of sufficient taxable income to utilize such carryforward.

Q. MR. KOLLEN CHARACTERIZES THE NOL ADIT REFLECTED IN THE RATE CASE AS A THIRTEEN MONTH AVERAGE FOR THE HISTORIC TEST YEAR, AND AN ADJUSTMENT TO REFLECT CERTAIN PLANT ADDITIONS ON SCHEDULE M-2 THROUGH SEPTEMBER 30, 2014. IS THIS ACCURATE?

A. No, it is not. Mr. Kollen does not accurately describe the NOL adjustment on Schedule M-2. The adjustment on Schedule M-2 was made to the thirteen month average NOL balance to reflect the estimated NOL as of October 1, 2014. The supporting work paper for the NOL adjustment on Schedule M-2 was provided in Response to SDPUC Request No. 3-99.

Mr. Kollen makes a reference to the taxable income on Schedule K page 2 and alleges that the Company did not reflect pretax income in the NOL recalculation and that proper reflection of the "taxable income will be more than sufficient to fully utilize the NOL carryforward either before rates are reset or within the twelve months after rates are reset." This is not correct. As can be seen on tab "B. TI Forecast BHP", line 7, column AL, of the work paper submitted to support the NOL adjustment on Schedule M-2, the Company reflected $49,105,020 of estimated pretax income for the pro forma time period of October 1, 2013, through September 30, 2014. This is equivalent to pretax income listed on Schedule K, page 2, line 5, column e.

Mr. Kollen failed to recognize the ADIT associated with the additional tax deductions of research and development and accelerated depreciation including bonus depreciation related to plant expenditures to be incurred during the same pro forma time period on Schedule M-2 in the NOL calculation. Mr. Kollen's description of the NOL and the associated ADIT deferred tax asset reflected in the revenue requirement is inaccurate.

The Company reflected the NOL balance as of October 1, 2014, in the Settlement Agreement, and included the revenue increase authorized in this Settlement Agreement as taxable income in computing the appropriate ADIT deferred tax asset amount.

Q. DOES THE INCLUSION OF NOL ADIT IN RATE BASE CONSTITUTE RETROACTIVE RATEMAKING?

A. No. Income tax expense in determining cost of service in prior rate cases filed by the Company where a NOL was involved has been appropriately calculated. As discussed in more detail below, the NOL generated was principally the result of accelerated depreciation including bonus depreciation. The impact on total income tax expense due to these temporary differences was zero since there was an increase in deferred tax expense due to accelerated depreciation including bonus depreciation and a similar decrease to deferred tax expense as a result of the NOL in recording the deferred tax asset (i.e., NOL ADIT). Similarly, the income tax effect of such losses generated in previous tax years that are being utilized by the Company as it produces taxable income has no effect on income tax expense because it is simply a monetization of the NOL ADIT deferred tax asset. Mr. Kollen's assertion that the inclusion of a NOL ADIT in rate base constitutes some form of a retroactive ratemaking adjustment is completely without merit. The inclusion of the appropriate amount of NOL ADIT in rate base, which the Settlement Agreement reflects, is in accordance with the normalization rules specifically prescribed in the Internal Revenue Code of 1986 ("Code") and the applicable regulations thereunder.

Q. PLEASE RESPOND TO MR. KOLLEN'S CONTENTION THAT THE COMPANY HAS GENERATED SUFFICIENT TAXABLE INCOME TO FULLY UTILIZE ANY NOL CARRYFORWARD.

A. The key fact that Mr. Kollen fails to consider is the effect on taxable income of the expected accelerated depreciation including bonus depreciation as provided on Schedule M-2. Mr. Kollen is incorrect when he indicates on lines 13 and 14 of page 14 of his direct testimony that bonus depreciation is not available for 2014. To the contrary, Schedule M-2 details the capital expenditures that the Company expected would be eligible for bonus depreciation namely in the form of certain costs incurred with respect to the Cheyenne Prairie Generating Station ("CPGS"). The Company estimated that a significant portion of the cost incurred to construct CPGS would qualify. The amount of additional tax deductions including bonus depreciation as indicated on Schedule M-2 is $43.431 million, which nearly offsets the federal taxable income of $44.678 million from Schedule K page 2 that includes the full effect of the rate increase requested. Thus, there is an amount of NOL carryforward and the associated ADIT deferred tax asset that remain.

Secondly, the NOL ADIT deferred tax asset at December 31, 2013, referred to by Mr. Kollen in Exhibit LK-5 is comparing apples to oranges. The NOL ADIT disclosed by the Company in its public documents including FERC Form-1 filings represents the amount reported for financial reporting purposes in accordance with GAAP. The NOL carryforward and associated ADIT in the regulatory context is the amount that is attributable to Black Hills Power as a stand-alone entity whereby taxable income and any NOL are determined as if it filed its own separate income tax return. As a result, the NOL ADIT that is applicable for regulatory purposes has been determined in accordance with the methodology as prescribed by IRS. Thus, the adjustment to the NOL ADIT deferred tax asset that has been reflected in the Proposed Settlement is in compliance with the normalization rules mentioned above.

Q. PLEASE EXPLAIN THE NORMALIZATION REQUIREMENTS.

A. To understand the normalization requirements, it is helpful to begin with some background information. The background information presented by this testimony is not intended to represent a legal analysis, but instead reflects a general understanding of the legal holdings and legislative developments that have occurred and are relevant to application of such normalization requirements in this rate proceeding.

To that end, the Company's review of applicable tax code history leads it to understand that Congress enacted accelerated depreciation in 1954 as a means to promote and encourage economic expansion. Accelerated depreciation provides for the deferral of taxes that a company would otherwise be required to pay. Congress perceived this deferral of taxes as an interest-free loan, which was intended to be used by companies for capital investment and expansion in an effort to stimulate the post-World War II economy.

Q. HOW DID STATE AND FEDERAL REGULATORY AGENCIES TREAT ACCELERATED DEPRECIATION AFTER CONGRESS ENACTED IT IN 1954?

A. Initially, regulators had two choices. They could choose to treat income taxes for ratemaking purposes based on either the flow-through method or the normalization method.

Q. COULD YOU EXPLAIN THESE TWO METHODS OF HANDLING ACCELERATED DEPRECIATION?

A. Yes. The flow-through method allows customers to benefit immediately from the income tax savings associated with accelerated depreciation. In other words, the flow-through treatment of income tax expense allowed for ratemaking purposes essentially matched the income tax expense that resulted from the taxable income being reported on the utility's income tax return. In the early years of an asset's useful life, the benefit of lower income taxes resulting from accelerated depreciation was allowed to "flow-through" to the utility's customers. Under this method, future customers will bear a higher tax expense because the assets become depreciated more rapidly and less depreciation expense is available as a deduction claimed for income tax purposes.

Q. PLEASE EXPLAIN THE OTHER METHOD KNOWN AS "NORMALIZATION."

A. The normalization method spreads out, or normalizes, the tax benefit associated with depreciation expense to match the depreciation being used in setting rates. In other words, under the normalization convention, income tax expense reflected in the utility's cost of service is based on the amount of tax the utility would have paid had its taxes been calculated using the same method of depreciation and useful life adopted for ratemaking purposes. Under this method, the utility recovers in its rates more in income taxes than it actually incurs during the early years of an asset's useful life. If straight-line depreciation is used for ratemaking, the income tax benefits resulting from accelerated depreciation are effectively deferred evenly throughout the useful life of the asset. The income tax effect of the book/tax temporary difference is recorded in an ADIT account, as prescribed by the interperiod tax allocation method of accounting. This accounting is described in General Instruction No. 16 of the FERC Uniform System of Accounts, 18 C.F.R. Part 101, "Comprehensive Interperiod Income Tax Allocation." Deferred income taxes reverse in the later years of an asset's life when the utility will pay higher taxes than it is permitted to recover from its customers in rates.

Q. UNDER THE NORMALIZATION METHOD, IS IT CORRECT TO SAY THAT THE UTILITY RETAINS THE "INTEREST-FREE LOAN" CREATED BY THE INTERNAL REVENUE CODE?

A. No. Under the normalization method, the utility does not keep the full "principal" of the "interest-free loan" because the amount of ADIT is deducted from rate base, resulting in a lower revenue requirement and, consequently, reduced rates for customers. The utility, however, still has the unrestricted use of the funds to allow it to reinvest in the form of additional plant facilities, as intended by Congress. The reduction in rate base resulting from the ADIT decreases in later years as previously deferred taxes are paid by the utility.

Q. WHICH METHOD DID REGULATORY AGENCIES TEND TO ADOPT, THE FLOW-THROUGH METHOD OR THE NORMALIZATION METHOD, FOR RATEMAKING PURPOSES?

A. After Congress approved accelerated depreciation, regulatory agencies were not consistent with respect to rate treatment. Different regulatory agencies handled accelerated depreciation differently, depending upon how they viewed accelerated depreciation and whether the benefits of this tax treatment should accrue to customers or to the utility. In addition, it depended upon the regulator's view of the need to match income tax expense reflected in cost of service to the amount of taxes paid by the utility.

Q. DID THE APPROACH OF ALLOWING REGULATORS TO CHOOSE CHANGE?

A. Yes. Ultimately, Congress became concerned that "flow-through" decisions by regulators resulted in a "doubling of the Government's loss of revenue, from the use of accelerated methods of depreciation for tax purposes." H.R. Rep. No. 91-413 (1986), reprinted in 1969 U.S.C.C.A.N. 1645, 1782. Congress reasoned that this was because the flow-through of the tax reduction reduces the rates charged to customers, which in turn reduces the utility's taxable income and therefore reduces its income tax. This second level of tax reduction is passed on to the utility's customers.

Q. HOW DID CONGRESS ADDRESS THE CONCERN RELATED TO FLOW- THROUGH TREATMENT BY REGULATORS?

A. In the Tax Reform Act of 1969 (Pub. L. No. 91-172), Congress added Section 167(l) to the Code, which was subsequently re-codified at Sections 168(f)(2) and 168(i)(9). This provision essentially provided that, in order for a taxpayer to be entitled to claim accelerated depreciation on public utility property, it must be permitted normalization treatment in the setting of rates. Otherwise, for tax purposes, it must use the straight-line method of depreciation and generally longer useful life (i.e., book method) when determining its depreciation expense for federal income tax purposes. At one point, Congress considered no longer permitting utilities to use accelerated depreciation. Congress, however, believed that precluding regulated utilities from using accelerated depreciation would place them at an unfair competitive disadvantage both in terms of pricing with respect to the sale of their products and services and their ability to attract capital from bondholders and equity investors. The legislative history reflects congressional intent to remove the regulatory agencies' ability to require flow-through of income taxes resulting from accelerate depreciation. As stated in the legislative history, regulatory agencies "will be permitted to, in effect, force the taxpayer to straight line depreciation by not permitting normalization. The regulatory agency will not, in such cases, be permitted to require flow through of deferred taxes." H.R. Rep 91-413, 91st Congress, 1st Sess 1969 at 133. Thus, Congress eliminated any customer benefit from a regulatory agency's decision to adopt the flow-through method by removing the utility's ability to use accelerated depreciation for tax purposes in the event the regulator mandated the flow-through method.

Q. ARE THERE ANY ADDITIONAL SIGNIFICANT LEGISLATIVE CHANGES RELATED TO INCOME TAX NORMALIZATION?

A. Yes. There are two other significant developments in the tax laws that affected tax normalization: 1) the Economic Recovery Tax Act of 1981 ("1981 Act"); and 2) the normalization regulations as originally issued by Treasury.

Q. WHAT IS THE COMPANY'S UNDERSTANDING OF THE 1981 ACT AND THE U.S. TREASURY REGULATIONS AS THEY RELATE TO NORMALIZATION?

A. The Company's understanding of the 1981 Act is that it required normalization by regulators as a condition for accelerated depreciation by public utilities for qualified property placed in service after December 31, 1980. S. Rep. No. 97-144 (1981), <u>reprinted in</u> 1981 U.S.C.C.A.N. 105, 161. Similar to Congress' objective in 1954, Black Hills Power believes that the purpose of the 1981 amendment was to provide an investment stimulus that was viewed as essential for economic expansion. Congress considered accelerated depreciation as a way of spurring investment and encouraging businesses to replace old machinery and equipment with modern and more efficient assets that reflected improved technology. The legislative history explains that passage of the 1981 Act was an attempt by Congress to restructure the system of determining tax depreciation as a way to stimulate capital formation, increase productivity and improve the nation's competitiveness in international trade.

Congress was also trying to simplify the depreciation rules. For example, it is apparent to the Company from reading the legislative history of the 1981 Act that Congress viewed "deferred taxes" as an interest-free loan to the utility. That section of the legislative history notes that a utility is able to use funds that otherwise would have to be obtained by borrowing or raising equity capital. Thus, Congress did not want to allow accelerated depreciation for tax purposes unless the regulatory body used the normalization method to account for it. This explains the provision in the 1981 Act that states the amount of capital to be deducted from rate base must not exceed the amount of deferred taxes recorded on the books with respect to accelerated depreciation in order to be in compliance with tax normalization.

The Treasury Regulations, which were issued in Treasury Decision (T.D.) 7315 and released on June 7, 1974, provided additional guidance with respect to the law enacted in the Tax Reform Act of 1969 that defined the normalization method of accounting. For example, they provide that the reserve established for public utility property should reflect the total amount of tax deferral resulting from the use of different depreciation methods for tax and ratemaking purposes. The Treasury regulations also require that the ADIT balance be used as a reduction to the utility's rate base and must be determined by reference to the same historical period as used for determining ratemaking tax expense. The utility may use historical or projected data in calculating these two amounts, but they must be done consistently. Lastly, the Treasury regulations describe the consequences to the utility if found in violation of the normalization rules.

Q. WITH THAT BACKGROUND, PLEASE EXPLAIN HOW THE COMPANY UNDERSTANDS THE NORMALIZATION RULES AS THEY APPLY TO BLACK HILLS POWER.

A. The normalization method of accounting as presently prescribed under Treasury Regulations Section 1.167(l)-1(h) provides that the amount of federal income tax liability deferred as a result of the use of different depreciation methods for tax and ratemaking purposes is the excess (computed without regard to credits) of the amount the tax liability would have been had the depreciation method for ratemaking purposes been used over the actual tax liability. In other words, if the regulatory agency uses straight-line depreciation in setting rates, a utility that uses accelerated depreciation for tax purposes must use the straight-line method of depreciation (i.e., the straight-line method and estimated useful life used in calculating annual book depreciation expense) in computing its income tax expense for purposes of determining the cost of service for ratemaking purposes. The Treasury Regulations further require the utility to calculate the annual tax effect of this book/tax temporary difference and record the increase or decrease on its books and records in a deferred tax account (i.e., ADIT). Additionally, the regulations require that the ADIT balance be used as a reduction to the utility's rate base and must be determined by reference to the same historical period as used for determining ratemaking tax expense. The utility may use historical or projected data in calculating these two amounts, but they must be done consistently.

Q. WHAT ARE THE CONSEQUENCES IF THE UTILITY VIOLATES THE TAX NORMALIZATION RULES?

A. As stated above, the Company believes that Congress originally enacted the normalization rules to ensure that the capital formation benefits of accelerated depreciation be retained by the utility and for customers to benefit from lower rates through the reduction to rate base. The intent behind the normalization rules is to prevent regulators from assigning the tax benefits of accelerated depreciation to customers by reducing the income tax allowance used in developing cost of service. The normalization rules dictate that accelerated depreciation, determined under Code Section 168, does not apply to any utility property if the taxpayer does not use the normalization method of accounting. Violation of the normalization rules will preclude the utility from being able to claim accelerated depreciation in current and future years. Thus, the utility would not get the benefit of tax deferral from accelerated depreciation and the cost free capital associated with this book/tax temporary difference.

Q. DOES ACCELERATED DEPRECIATION INCLUDE BONUS DEPRECIATION?

A. Yes, it does.

Q. PLEASE DESCRIBE THE NATURE OF BONUS DEPRECIATION.

A. Bonus depreciation is the expensing, for income tax purposes, of either 50% or 100% of the cost of the asset in the year it is placed in service. For assets subject to the 50% bonus depreciation, the remaining balance is depreciated in accordance with the existing modified accelerated cost recovery system ("MACRS") tables starting with the current year. For assets subject to 100% bonus depreciation, there is no remaining balance to be depreciated. It does not mean that the asset receives more depreciation than any other assets; it simply means that tax depreciation is accelerated into the first year.

Bonus depreciation was originally enacted under the Job Creation and Worker Assistance Act of 2002 in an attempt to spur an economy that was significantly impacted by the events of September 11, 2001. Qualified assets placed in service after September 10, 2001, were eligible for 30% bonus depreciation. It was subsequently reinstated under the Economic Stabilization Act of 2008, whereby certain assets placed in service between December 31, 2007 and January 1, 2009 qualified for 50% bonus depreciation. Through enactment of the American

Recovery and Reinvestment Act of 2009, Congress extended this bonus depreciation to cover qualifying assets placed in service between December 31, 2008 and January 1, 2010. The Small Business Jobs Act of 2010 was enacted in September 2010, which allowed companies to use bonus depreciation for qualified capital additions placed in service after December 31, 2009 and before January 1, 2011. In December 2010, Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act ("2010 Act") was passed into law. The 2010 Act contained a provision extending bonus depreciation to certain assets placed in service after September 8, 2010 and before January 1, 2013. It also increased the amount of bonus depreciation for assets placed in service from September 9, 2010 through December 31, 2011, from a 50% deduction to a 100% deduction. Bonus depreciation reverted back to 50% for assets placed in service in 2012 and for certain assets with a long production period that were placed in service in 2013. Subsequently, with the passage of the American Taxpayer Relief Act of 2012 in early January 2013, 50% bonus depreciation was extended another year and made available to qualified assets placed in service in 2013 and for certain qualified assets with a long production period that are placed in service in 2014. Recent passage of the Tax Increase Prevention Act of 2014 ("2014 Act") once again extended 50% bonus depreciation for another year and is made available to qualified assets placed in service in 2014 and for certain qualified assets with a long production period that are placed in service in 2015. The effect of the 2014 Act was not reflected in this rate case, however, the one year extension of 50%

bonus depreciation is expected to result in the generation of a NOL for 2014 for the Company.

Q. DO THE NORMALIZATION RULES ALSO APPLY TO BONUS DEPRECIATION?

A. Yes, they do. As mentioned above, the normalization rules were originally codified in Code Section 167 and the regulations thereunder. Presently, such rules reside in Code Section 168 including a provision specific to bonus depreciation.

Q. WHAT IMPACT HAS ACCELERATED DEPRECIATION INCLUDING BONUS DEPRECIATION HAD IN DETERMINING THE COMPANY'S NET INCOME FOR TAX PURPOSES?

A. If a utility has more tax deductions than taxable income in a given tax year, it results in a NOL. For Black Hills Power, the effect of accelerated depreciation including bonus depreciation has resulted in tax deductions in excess of taxable income for certain years. The Company generated a NOL for each of the tax years 2008 through 2011and expects such NOLs to completely unwind during the 20-year carry-forward period, as prescribed under the Code. It is appropriate under generally accepted accounting principles ("GAAP") to record a deferred tax asset associated with a NOL if the company can demonstrate the ability to timely unwind the NOL by offsetting future taxable income. The deferred tax asset attributable to the NOL resulting from accelerated tax depreciation, including bonus depreciation, is added to rate base to the extent that it offsets the ADIT, or some portion thereof, related to the book/tax depreciation temporary difference resulting in a NOL ADIT. Specific guidance previously issued by the IRS in the form of Private Letter Ruling ("PLR") 8818040 prescribed this approach as acceptable with respect to determining the NOL ADIT. This approach has been recently reiterated by the IRS in PLRs 201436037, 201436038, and 201438003. Such treatment is consistent with the underlying premise of ADIT as a source of an interest free loan being offered by the United States government. To the extent that temporary differences such as accelerated tax depreciation deductions including bonus depreciation give rise to a NOL, the interest free loan has not yet been funded or realized. The amount of the increase in ADIT liability is then partially offset by the NOL ADIT deferred tax asset.

Q. WHAT DOES THIS MEAN FOR BLACK HILLS POWER IN THIS RATE CASE?

A. The Settlement Agreement reflects the necessary adjustment to ADIT as a result of accelerated depreciation including bonus depreciation, where applicable, and the NOL ADIT deferred tax asset. Schedule M-2 details the capital expenditures that will be eligible for bonus depreciation namely in the form of certain costs incurred with respect to the Cheyenne Prairie Generating Station ("CPGS"). The Company estimates that a significant portion of the cost incurred to construct CPGS should qualify, which resulted in a sizeable ADIT adjustment in reducing rate base. As discussed above, an increase in accelerated depreciation including bonus depreciation had an effect on the NOL ADIT as well. The NOL carryforward and associated ADIT in the regulatory context is the amount that is attributable to

Black Hills Power as a stand-alone entity whereby taxable income and any NOL are determined as if it filed its own separate income tax return. As a result, the NOL ADIT that is applicable for regulatory purposes is determined in accordance with the methodology as prescribed by IRS. Thus, the adjustment to ADIT and ADIT NOL deferred tax asset that have been reflected in the Settlement Agreement are in compliance with the normalization rules as described above including the guidance previously issued by IRS specific to NOLs.

V. ADIT ADJUSTMENT RELATED TO PLANT DECOMMISSIONING COSTS

Q. IS MR. KOLLEN CORRECT IN HIS ASSERTION THAT THERE IS AN ERROR IN THE CALCULATION OF ADIT?

A. No. However, Mr. Kollen is correct in that the Company will not be entitled to a deduction for income tax purposes until the decommissioning costs have been incurred. Such costs are expected to be incurred by September 2015. The timing of the deductibility should determine the ADIT consequence when the temporary difference between book and tax is created, which is consistent with the approach that has been applied to the losses for income tax purposes that will be realized and recognized related to the retirement of the plant facilities and disposition of applicable obsolete inventory. Alternatively, should the Commission agree with Mr. Kollen's recommendation of reflecting the deferred tax liability as a reduction to rate base, the additional tax deduction would result in less utilization of the NOL carryforward. Restoration of the NOL carryforward results in a corresponding adjustment in the NOL ADIT. As discussed above in connection with the impact to taxable income of the additional tax deductions identified on Schedule M-2, an imputed tax deduction of approximately $10 million related to decommissioning costs would certainly result in less NOL carryforward being utilized. Thus, to be consistent with Mr. Kollen's reasoning of matching the ADIT with the inclusion in rate base of the regulatory asset, an associated NOL ADIT deferred tax asset should likewise be included providing effectively an offset to the increased ADIT liability.

VI. ADIT ADJUSTMENT RELATED TO 69KV LIDAR SURVEYING PROJECT

Q. IS MR. KOLLEN CORRECT IN HIS ASSERTION THERE IS AN ERROR IN THE CALCULATION OF ADIT?

A. No. There seems to be a disconnect in the cost information that Mr. Kollen used in the development of his Exhibit LK-13. Updated cost information provided by Black Hills Power to Commission Staff as reflected on Staff Exhibit PJS -1 Schedule 5 indicates allocable costs of $337,919 as opposed to the $685,000 shown in Exhibit LK-13. Based on the revised cost information, Schedule M-2 appropriately reflects the ADIT adjustment that has been incorporated into the Settlement Agreement.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.