

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

IN THE MATTER OF THE)	FINAL DECISION AND ORDER
APPLICATION OF BLACK HILLS)	GRANTING JOINT MOTION FOR
POWER, INC., FOR AUTHORITY TO)	APPROVAL OF SETTLEMENT
INCREASE ITS ELECTRIC RATES)	STIPULATION AND APPROVING
)	RATES AND TARIFFS; NOTICE OF
)	ENTRY
)	
)	
)	EL09-018

PROCEDURAL HISTORY

On September 30, 2009, Black Hills Power, Inc. ("BHP" or "Applicant") filed with the South Dakota Public Utilities Commission ("Commission") an application for approval to increase rates for electric service to customers in its South Dakota service territory ("Application").¹ The Application included an extensive, detailed set of schedules and pre-filed testimony in support of the proposed rates and supporting schedules. The Application stated that BHP proposed to increase base rates by approximately \$32 million annually or approximately 26.6% based on BHP's test year ending June 30, 2009. The Application stated that a typical residential electric customer using 600 kWh per month could expect to see a net increase of \$17.99 per month and that the proposed increase in rates would potentially affect approximately 64,100 customers in BHP's service territory.

On September 30, 2009, the Commission electronically transmitted notice of the filing and the intervention deadline of November 20, 2009, to interested individuals and entities. On November 3, 2009, the Commission issued an Order of Assessment of Filing Fee and Suspension of Imposition of Tariff assessing a filing fee against BHP up to the statutory maximum amount of \$100,000, suspending BHP's proposed schedule of rates for 180 days beyond September 30, 2009, and affirming an intervention deadline of November 20, 2009.

On November 5, 2009, the Commission received a Petition to Intervene from Countertops, Inc., d/b/a Dakota Panel South Dakota, GCC Dacotah, Inc., Rushmore Forest Products, Inc., Sanford Underground Laboratory and Spearfish Forest Products, Inc. (collectively, "Industrial Intervenors"). On November 19, 2009, the Commission received a Petition to Intervene from Liliias Jarding, Bobbie Handley, Carla Kock, and the South Dakota Peace and Justice Center (collectively, "Residential Consumers Coalition" or "RCC"). On November 20, 2009, the Commission received a Petition to Intervene and join with Industrial Intervenors from Rapid City Regional Hospital, Inc. ("Regional Hospital"). On December 3, 2009, the Commission issued an Order Granting Intervention to Industrial Intervenors, Regional Hospital (henceforth included in "Industrial Intervenors") and RCC.

On December 7, 2009, the Commission issued an Order for and Notice of Procedural Schedule and Hearing setting the matter for hearing to commence on February 23, 2010, and

¹ The Commission's Orders in the case and all other filings and documents in the record are available on the Commission's web page for Docket EL09-018 at: <http://puc.sd.gov/Dockets/Electric/2009/el09-018.aspx>

setting dates for the parties' filing of pre-filed testimony. On January 14, 2010, Staff requested, pursuant to SDCL 49-1A-8, the assessment of an additional filing fee up to the statutory maximum of \$25,000 for expenses related to the evaluation of an integrated resource plan filed by BHP with the Application. On January 28, 2010, the Commission issued an Order of Assessment of Additional Filing Fee assessing an additional filing fee of \$25,000 to defray the expenses incurred by the Commission's staff ("Staff") for evaluation of BHP's integrated resource plan. On February 4, 2010, the Commission issued an Order for Continuance of Procedural Schedule and Hearing, continuing the hearing to a date to be determined. On March 8, 2010, the Commission issued an Order for and Notice of Amended Procedural Schedule and Hearing setting the matter for hearing commencing on June 28, 2010, and setting revised dates for the parties' filing of pre-filed testimony.

On March 1, 2010, the Commission received from BHP a Request for Authority to Implement an Interim Rate Increase on April 1, 2010, pursuant to SDCL 49-34A-17, until Commission Makes Final Determination in this Matter ("Interim Rate Request"). On March 5, 2010, the Commission received Industrial Intervenors' Comment to Black Hills Power's Request to Implement Interim Rates. On March 8, 2010, the Commission received from RCC, Residential Consumers' Response to Black Hills Power's Request to Implement an Interim Rate Increase. At its regularly scheduled meeting on March 9, 2010, the Commission considered BHP's Interim Rate Request. All parties appeared. Following oral arguments by the parties and a lengthy discussion between the Commission and BHP and questioning by Commissioners, the Commission voted unanimously: (i) to approve BHP's request to implement a reduced interim rate increase on April 1, 2010, in lieu of the proposed rate increase in its rate filing as would otherwise occur under SDCL 49-34A-17; (ii) to require BHP to keep an accurate account in detail of all amounts received by reason of the increase, specifying by whom and on whose behalf the amounts were paid as provided under SDCL 49-34A-17; and (iii) to not allow the interim rate to go into effect until BHP had filed conforming tariff sheets with the Commission, with directions and authorization to Staff to review the revised tariff sheets for conformity with the Commission's decision. On March 17, 2010, BHP filed revised tariffs reflecting the Interim Rate Request. On March 23, 2010, the Commission issued its Order Granting Request for Authority to Implement an Interim Rate Increase on April 1, 2010, Pursuant to SDCL 49-34A-17 reflecting the decisions of the Commission on the Interim Rate Request and associated record keeping. On April 1, 2010, BHP filed a Certification Regarding In-Service Date of Wygen III certifying that construction of Wygen III was complete and that the plant went in service on April 1, 2010.

On April 1, 2010, BHP filed a letter advising the Commission that the parties had all agreed to a two week extension for the filing of testimony by Staff and Intervenors originally due on April 9, 2010, and that Staff and Intervenor testimony would therefore be due on April 23, 2010, with all other dates in the procedural schedule to remain intact. On April 22, 2010, BHP filed a letter advising the Commission that BHP had agreed to an additional one week extension for the filing of testimony by Staff and Intervenors and that Staff and Intervenor testimony would therefore be due on April 30, 2010, with all other dates in the procedural schedule to remain intact.

On April 14, 2010, BHP filed a letter advising the Commission that BHP had reached separate settlements of all issues with both Staff and Industrial Intervenors. On May 14, 2010, the Commission received a Joint Motion for Approval of Settlement Stipulation and Settlement Stipulation between BHP and Staff ("Joint Motion" and "Settlement Stipulation"), Staff Memorandum Supporting Settlement Stipulation, "Public Version," and supporting exhibits, and Staff Memorandum Supporting Settlement Stipulation, "Confidential Version," and supporting

exhibits ("Staff Memorandum"). On May 19, 2010, the Commission received a Brief in Opposition to Joint Motion for Approval of Settlement Stipulation from the Residential Consumers Coalition. On May 25, 2010, Chairman Johnson filed a letter requesting an Ad Hoc Commission meeting on May 27, 2010, to consider procedural matters related to the effect of the Joint Motion and Settlement Stipulation on the posture of the case, particularly with respect to what the focus of the hearing would be on June 28, 2010, in light of the filing of the Joint Motion and Settlement Stipulation. On May 25, 2010, BHP filed a Brief in Reply to Opposition to Joint Motion for Approval of Settlement Stipulation. On May 26, 2010, Staff filed a letter response to RCC's Brief in Opposition to Joint Motion for Approval of Settlement Stipulation and BHP's Brief in Reply to Opposition to Joint Motion for Approval of Settlement Stipulation. At its ad hoc meeting of May 27, 2010, the Commission considered the issues raised in Chairman Johnson's letter with respect to the Commission's consideration of the Joint Motion and its effect on the conduct of the case thenceforth, specifically with respect to the procedure for consideration of the Joint Motion and the nature of any hearing to be held to afford the non-settling party, RCC, the opportunity for hearing in light of the pendency of the Joint Motion and Settlement Stipulation. All parties appeared and presented argument. At the conclusion of argument and Commissioner questions, the Commission voted unanimously to take the matter under advisement until its regular meeting scheduled for June 1, 2010.

On May 27, 2010, following the ad hoc Commission meeting to address Chairman Johnson's letter regarding procedural matters, Commission Counsel and counsel for the parties held an informal pre-hearing conference to discuss procedural and scheduling issues in an effort to arrive at a procedural order to govern the schedule and procedures to be followed from that point forward to hearing in the matter. As a result of these discussions, the parties stipulated to a number of procedural steps and dates therefor to be followed prior to the hearing scheduled for June 28, 2010, to be reflected in a procedural order regarding pre-hearing matters. See Transcript, June 1, 2010.

At its regularly scheduled meeting on June 1, 2010, the Commission considered the matters raised by Chairman Johnson's letter regarding procedural matters and were advised by the parties concerning the procedural and scheduling stipulations arrived at among the parties at their informal conference on May 27, 2010. The Commission voted unanimously in favor of Chairman Johnson's motion that the appropriate issue for hearing in this case, in accordance with the prevailing case law as presented to the Commission in the briefs and arguments of the parties, is whether the rates, terms, and conditions set forth in the Settlement Stipulation are just and reasonable as demonstrated by the evidence and satisfy the standards for approval under South Dakota law, with BHP having the burden of proof as to such issue and with all parties having the right to a full hearing on the merits. On June 8, 2010, the Commission issued a Procedural Order Regarding Pre-Hearing Matters reflecting the decision of the Commission regarding the issue to be addressed at the hearing in the case to be held on June 28, 2010, and the stipulations of the parties regarding procedural matters and schedule preparatory to the hearing.

On May 28, 2010, the Commission received a Joint Motion for Approval of Settlement Stipulation ("Industrial Joint Motion") and Confidential Settlement Agreement between BHP and Industrial Intervenors ("Industrial Settlement"). At its ad hoc meeting of June 10, 2010, the Commission considered the Industrial Joint Motion and Industrial Settlement. All parties appeared. Counsel for RCC indicated that RCC did not object to granting the Industrial Joint Motion and approval of the Industrial Settlement provided that such non-objection not be construed as a waiver of any issues that RCC wished to raise at the hearing. TR June 10, p. 13. Based on its determination that the Industrial Settlement had no effect on the Settlement

Stipulation, Staff recommended granting the Industrial Joint Motion. TR June 10, pp. 32-33. Following extensive discussion between Commissioners, BHP and Industrial Intervenors regarding the Industrial Settlement, the Commission, finding that the Industrial Settlement and the rates, terms and conditions therein were just and reasonable and met the standards of SDCL 49-34A-8.3, voted unanimously to approve the Industrial Settlement subject to the condition that BHP file an affidavit of Kyle White, Vice President of Regulatory and Government Affairs of Black Hills Corporation, BHP's parent company, in support of the representations made by Mr. White before the Commission at the June 10, 2010, hearing on the Industrial Joint Motion. TR June 10, pp. 46, 48; Exs BHP 51, BHP 7 and BHP 8. On June 11, 2010, BHP filed the Affidavit of Kyle D. White in conformity with the Commission's directive, and on June 16, 2010, the Commission issued its Order Approving Joint Motion for Approval of Settlement Stipulation granting the Industrial Joint Motion and approving the Industrial Settlement.

In accordance with the Procedural Order Regarding Pre-Hearing Matters, on June 17, 2010: BHP filed and served Black Hills Power, Inc.'s Witness List, Exhibit List of Black Hills Power, Inc., Black Hills Power, Inc.'s Summary of Remaining Issues of Fact and Law, and Stipulated Summary of Uncontroverted Facts; Staff filed and served Staff's Response to Procedural Order Regarding Pre-Hearing Matters; and RCC filed and served its List of Witnesses and Summary of Testimony, Exhibit List, and Summary of Remaining Issues of Fact and Law. On June 21, 2010, a pre-hearing conference was held among Commission Counsel and counsel for BHP, Staff and RCC. Counsel for Industrial Intervenors did not participate since, following the Commission's grant of the Industrial Joint Motion, Industrial Intervenors advised the Commission and other parties that they deemed their portion of the case concluded and their further participation in the hearing and decision process on the general rate case unwarranted.

The hearing was held as scheduled commencing on June 28, 2010, at which BHP, RCC and Staff appeared and participated. The hearing was recessed following the taking of testimony on June 29, 2010, with the hearing to reconvene on July 7, 2010, to accommodate a scheduling conflict of RCC's witness, Christopher James. The hearing reconvened on July 7, 2010, as scheduled. Following the conclusion of the evidentiary portion of the hearing and the parties' oral arguments on July 7, 2010, the matter came on before the Commission for decision.

Commissioner Hanson moved to approve the Settlement Stipulation. TR 522-525. Commissioner Johnson moved to amend the motion to add that the next rate case filed by the Applicant must include, in addition to statutory requirements, a report detailing BHP's energy efficiency and DSM efforts and the impact of those efforts. TR 528. Finding (i) that the need for construction of Wygen III had been demonstrated by substantial evidence and that such evidence had not been convincingly refuted by RCC's witnesses and evidence, (ii) that the return on equity, cost of debt and capital structure contained in the Settlement Stipulation were supported by substantial evidence, were not convincingly refuted by RCC's witness, and were within or not materially outside the range of reasonable values put forth by RCC's witness, when adjusted for reasonable capital procurement flotation costs, and significantly less than the low end of the range supported by BHP's witness, (iii) that when both the surplus energy and power marketing income credits are factored in, the effective actual return on equity is reduced from the nominal rate and will fall within the range advocated by RCC's witness during the period these credits are in effect, (iv) that the other rate base and expense values, after adjustment as set forth in the Settlement Stipulation, were supported by substantial evidence, including particularly the Staff Memorandum and supporting exhibits and testimony, and (v) that the rates, terms and conditions of the Settlement Stipulation as amended by the Commission are just and

reasonable and meet the standards of SDCL 49-34A-6 and 49-34A-8 and applicable law, the Commission voted unanimously in favor of the motion as amended, approving the Settlement Stipulation as modified with respect to energy efficiency and DSM reporting in connection with a subsequent rate filing. TR 536, 522-535; Exs Joint 1 and Staff 1-6. Before the end of the proceeding, BHP stipulated on the record that it did not object to the amendment to the Settlement Stipulation involving BHP's reporting of its energy efficiency and DSM efforts and the impact of those efforts in connection with its next rate case filing. TR 558-559.

The Commission next considered the issue of refund or credit, pursuant to SDCL 49-34A-17 and 49-34A-22, of excess charges to customers from and after April 1, 2010, under the interim rates approved by the Commission in its Order Granting Request for Authority to Implement an Interim Rate Increase issued on March 23, 2010. Following extensive discussion among the Commissioners and the parties concerning an appropriate interest rate, mechanism for effecting the refunds or credits, and treatment of discontinued, non-creditable accounts with minimal refund balances, the Commission voted unanimously (i) to approve an interest rate of seven percent per annum on overcharges during the interim rate period as per ARSD 20:10:19:08, (ii) to require BHP to issue credits to the bills of existing customers in the amount of the overcharges during the interim period plus interest on the overcharges during such period, (iii) for those former customers with currently discontinued accounts who were overcharged during the interim period, to issue and mail refund checks or make direct deposits in the amount of the overcharges plus interest thereon, if the overcharge plus interest amount totals three dollars or more, and (iv) for any overcharge amounts plus interest not returnable through either bill credits, refund checks or direct deposits, including those where the overcharge plus interest balance is less than three dollars, to credit such amounts with interest to customers generally through the ECA account true-up process.

Following the Commission's action on refunds and credits, Staff requested that at such time as BHP determines that the refund and credit process has been completed in so far as practicable, BHP submit a compliance report to the Commission on the actions taken and the results of such actions to implement the refunds and credits ordered by the Commission. BHP stipulated on the record that it would provide such a report at such time as it deemed the process complete.

On July 20, 2010, BHP filed revised tariff sheets Section No. 3C, Revised Sheet Nos. 1-10 to BHP's South Dakota Electric Rate Book, Tariff Schedules Applicable to Electric Service of Black Hills Power, Inc. ("BHP Tariff") and additional tariff sheets Section No. 3C, Revised Sheet No. 11 and Original Sheets Nos. 16-19, which reflect the Settlement Stipulation provisions regarding ECA adjustment clause rate specifications that remain in effect through March 31, 2011, and the ensuing true-up period and which BHP discovered had been inadvertently omitted from the tariff sheet attachment to the Settlement Stipulation. Ex Joint 7. Both the revised and additional tariff sheets were filed to accurately reflect the terms of the Settlement Stipulation with respect to the ECA. The July 20, 2010, filing also includes revised tariff sheet Section No. 1, Table of Contents, Sixteenth Revised Sheet No. 3, Replaces Fifteenth Revised Sheet No. 3 to accurately reflect the inclusion in Section No. 3C of Original Sheet Nos. 16-19 and revised tariff sheet Section No. 4, Second Revised Sheet No. 4, Replaces First Revised Sheet No. 4 to correct a typographical error. On July 26, 2010, BHP filed replacement revised tariff sheets Section 3C, First Revised Sheet No. 2, Replaces Original Sheet No. 2, Fourth Revised Sheet No. 8, Replaces Third Revised Sheet No. 8 and Third Revised Sheet No. 11, Replaces Second Revised Sheet No. 11 to correct the effective date references. On July 27, 2010, BHP filed a revised cover sheet for the BHP Tariff to correct a misspelled word. On July 28, 2010, BHP filed a revised Section No. 3C, Sixth Revised Sheet No. 31, Replaces Fifth

Revised Sheet No. 31 and a revised Section No. 4, Second Revised Sheet No. 4, Replaces First Revised Sheet No. 4 to correct the Date Filed dates.

Having considered the evidence of record, applicable law and the arguments of the parties, the Commission makes the following Findings of Fact, Conclusions of Law and Decision:

FINDINGS OF FACT

Parties

1. The Applicant is Black Hills Power, Inc., a corporation organized under the laws of South Dakota. Ex BHP 1, p. 4. BHP is a wholly-owned subsidiary of Black Hills Corporation. Ex BHP 7, p. 4. BHP is a public utility as defined in SDCL 49-34A-1(12) that provides electric service to approximately 64,100 customers in South Dakota. TR 61; Ex BHP 7, p.8; BHP 10, pp. 3-4.

2. On December 3, 2009, the Commission issued an Order Granting Intervention to Industrial Intervenors, Regional Hospital and RCC. Following the Commission's decision on June 10, 2010, granting the Industrial Joint Motion and issuance on June 16, 2010, of the Order Approving Joint Motion for Approval of Settlement Stipulation, Industrial Intervenors, having determined that their issues in the case had been resolved, did not participate in subsequent proceedings in the case.

3. The Staff also participated in the case as a full party.

Procedural Findings

4. The Application was executed by BHP on September 28, 2009, and filed with the Commission on September 30, 2009. Ex BHP 1. The Application included all schedules and information required by ARSD 20:10:13.

5. The Procedural History set forth above is hereby incorporated by reference in its entirety in these Procedural Findings. The procedural findings set forth in the Procedural History and these Procedural Findings are a substantially complete and accurate description of the material documents filed in this docket and the proceedings conducted and decisions rendered by the Commission in this matter.

6. On March 30, 2010, the 180 day suspension of BHP's proposed rates imposed by the Commission pursuant to SDCL 49-34A-14 expired. As of April 1, 2010, BHP's proposed rates were no longer subject to suspension, the Commission had not issued a final decision and more than 30 days had passed from the date of the filing. On March 1, 2010, BHP filed a request to implement a reduced interim rate increase on April 1, 2010, in lieu of the proposed rate increase in its rate filing as would otherwise occur under SDCL 49-34A-17. On March 23, 2010, the Commission issued its Order Granting Request for Authority to Implement an Interim Rate Increase on April 1, 2010, Pursuant to SDCL 49-34A-17 authorizing BHP to implement a reduced interim rate increase on April 1, 2010, in lieu of the proposed rate increase in its rate filing as would otherwise occur under SDCL 49-34A-17; (ii) to require BHP to keep an accurate account in detail of all amounts received by reason of the increase, specifying by whom and on whose behalf the amounts were paid as provided under SDCL 49-34A-17; and (iii) to not allow the interim rate to go into effect until BHP had filed conforming tariff sheets with the

Commission, with directions and authorization to Staff to review the revised tariff sheets for conformity with the Commission's decision. The conforming tariff sheets were duly filed by BHP and on April 1, 2010, the interim rates went into effect.

7. The Commission issued the following notices and orders in the case as described in greater detail in the Procedural History:

- Electronic transmission of notice of the filing and intervention deadline of November 20, 2009, to interested individuals and entities.
- Order of Assessment of Filing Fee and Suspension of Imposition of Tariff
- Order Granting Intervention
- Order for And Notice of Procedural Schedule and Hearing
- Order of Assessment of Additional Filing Fee
- Order for Continuance of Procedural Schedule and Hearing
- Order for and Notice of Amended Procedural Schedule and Hearing
- Order Granting Request for Authority to Implement an Interim Rate Increase on April 1, 2010, Pursuant to SDCL 49-34A-17
- Procedural Order Regarding Pre-Hearing Matters
- Order Approving Joint Motion for Approval of Settlement Stipulation

8. The Commission held a public informational and input hearing on BHP's Application on November 24, 2009, at 7:00 p.m. MST at the Journey Museum, Rapid City, SD. Approximately forty members of the public signed the Commission's sign-in sheets at the hearing.

9. The purpose of the public informational and input hearing was to afford an opportunity for interested persons to present their views and comments to the Commission concerning the Application. At the hearing, Chairman Johnson presented a brief overview of the Commission's process in considering a request for a rate increase, following which BHP presented an explanation of the proposed rate increase and the reasons for it. After these introductory presentations, interested persons presented their views, comments and questions regarding the Application. Recording of Public Input Meeting.

10. In addition to informal comments received by the Commission at the public informational and input hearing, informal comments were received by individual Commissioners at three informational meetings conducted by each of the three Commissioners individually on March 29, 2010, at 7 p.m. MDT at the Journey Museum in Rapid City, on April 14, 2010, at 2 to 4 p.m. MDT at the Colonial House Restaurant in Rapid City, and on April 23, 2010, 10 a.m. to noon, MDT at the Dunn Brothers Coffee shop in Rapid City. The Commission also accepted informal comments by phone, mail and electronically throughout the pendency of the proceeding, with hundreds of written and verbal comments received from interested persons.

11. The following testimony was pre-filed in advance of the formal evidentiary hearing held as noticed on June 28-29 and July 7, 2010, in Room 414, State Capitol, Pierre, South Dakota:

- A. Applicant's September 30, 2009, Direct Testimony.
 - Stuart A. Wevik
 - Richard C. Loomis
 - Thomas M. Ohlmacher

- Jill S. Tietjen
 - Jacqueline A. Sargent
 - Mark Lux
 - Christopher J. Kilpatrick
 - William E. Avera
 - Anthony S. Cleberg
 - Larry W. Loos
 - Michael J. McFadden
 - Kyle D. White
- B. RCC's Direct Testimony of April 29, 2010.
- Christopher A. James
 - David A. Schlissel
 - Don Frankenfeld
- C. Applicant's Rebuttal Testimony of June 4, 2010.
- William E. Avera
 - Doug Buresh
 - Jill S. Tietjen
- D. Staff's Rebuttal Testimony of June 4, 2010.
- George W. Evans

Settlement Stipulation

12. The Application as filed sought an increase in annual revenues of approximately \$32,000,000 or 26.6% for electric service to retail customers in its South Dakota service territory. BHP's proposed increase was based on a historic test year ending June 30, 2009, as adjusted for what BHP believed to be known and measurable changes, a capital structure of 52% common equity and 48% debt, a cost of debt of 6.85%, an 11.5% return on common equity, and a 9.27% rate of return on rate base. The Application also proposed rolling the test year fuel and purchased power costs currently collected through the Energy Cost Adjustment ("ECA") into base rates. Under the request in the Application, BHP's rates, including the lagging ECA balancing account recovery of approximately \$6,800,000, would increase annual revenues by approximately \$38,800,000 or 34.2%, and customers' bills would increase by approximately 34.2% on average for service on and after April 1, 2010. Ex BHP 38, pp. 17-18; Ex Staff 1 and 2, p. 1.

13. On May 14, 2010, the Commission received the Joint Motion and the Settlement Stipulation between BHP and Staff. Staff based its determination of the settlement revenue requirement on a comprehensive analysis of the as-filed June 30, 2009, total Company test year costs and BHP's proposed adjustments and on additional information obtained through discovery. Staff first allocated total Company amounts to the South Dakota retail jurisdiction. Staff then adjusted the June 30, 2009, test year results for known and measurable post-test year changes. Exs Staff 1 and 2, pp. 2-3. The Settlement Stipulation incorporates some 62 or more adjustments. The adjustments and other agreements cover a wide gamut of subjects with the most significant from a rate standpoint including:

- Surplus energy credit to ECA
- Power marketing income credit to ECA

- Workers compensation expense adjustment
- Flow through tax treatment for repair allowance
- Additional employee adjustment
- Incentive compensation adjustment
- Coal price adjustment
- Depreciation life and corresponding annual depreciation rate adjustments
- Return on equity, capital structure and corresponding rate of return adjustments
- Three year moratorium on subsequent rate filing absent extraordinary circumstances

Exs Staff 1-6.

14. The Settlement Stipulation concludes that BHP's revenue deficiency at this time is \$22,002,926 or approximately 12.7%, justifying an approximate 19.36% increase in present rates (~12.7% revenue increase plus ~6.7% lagging recovery of BHP's accrued costs under the ECA). Ex Staff 1, p. 2-3. The Settlement Stipulation represents a comprehensive resolution between BHP and Staff of the overall revenue deficiency and other issues presented in the case including, but not limited to, class revenue responsibilities, rate design, and tariff concerns. Ex Joint 2, pp. 1-2; Ex Staff 1, pp. 2-3. The Joint Motion requests that the Commission (i) adopt the Settlement Stipulation without modification for the purposes of resolving all issues in this rate proceeding, and (ii) enter an order finding that the Settlement Stipulation results in just and reasonable rates for customers of BHP. Ex Joint 1.

15. Following briefing and oral argument from the parties at its hearing on June 1, 2010, regarding the posture of the case and the nature of the hearing to be held on the merits in the context of the pendency of the Joint Motion and Settlement Stipulation in the absence of joinder in the settlement by all parties, the Commission ruled that the appropriate issue remaining for hearing, in accordance with the prevailing case law, was whether the rates, terms, and conditions set forth in the Settlement Stipulation are just and reasonable as demonstrated by the evidence and satisfy the standards for approval under South Dakota law, with BHP having the burden of proof as to such issue and with all parties having the right to a full hearing on the merits. Transcript, June 1, 2010; Procedural Order Regarding Pre-Hearing Matters.

16. At the evidentiary hearing in the case, as parties to the Settlement Stipulation, BHP and Staff offered evidence in support of the Settlement Stipulation as an outcome, achieved after a lengthy and penetrating investigative, analytical and negotiating process, that results in rates that are just and reasonable to ratepayers for the services rendered by BHP, with due consideration having been given 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, including taxes and interest, and including adequate provision for depreciation of its utility property used and necessary in rendering service to the public, and to earn a fair and reasonable return upon the value of its property. TR testimony of Staff and BHP witnesses; Staff 1-7; Exs BHP 1-58.

17. RCC offered evidence contesting essentially two components of the Settlement Stipulation: (i) the inclusion of Wygen III costs in rate base, even with the adjustments included in the Settlement Stipulation; and (ii) the return on equity and, to a lesser extent, the capital structure components of the rate of return. RCC offered no evidence or argument contesting any of the accounting adjustments offered by Staff and included in the Settlement Stipulation except to the extent attributable to inclusion of Wygen III and/or rate of return. TR 402-403; Exs RCC 1, 9, 9A, 17.

Inclusion of Wygen III in Rate Base

18. A key driver in BHP's decision to seek an increase in its rates was the construction of Wygen III, a coal-fired power plant with a 100 megawatt ("MW") net generating capacity constructed at the Neal Simpson Energy Complex approximately eight miles east of the city of Gillette, Wyoming. TR 61; Ex BHP 7, p. 9. BHP filed an application for a certificate of public convenience and necessity ("CPCN") to construct Wygen III with the Public Service Commission of Wyoming ("WY PSC"). TR 96. In March, 2008, the WY PSC issued a CPCN for construction of Wygen III at a total approved cost of \$255 Million. TR 62, 69-70.

19. Wygen III was constructed ahead of schedule and under budget, with the total plant cost coming in at just under \$245 Million in contrast to the \$255 Million budgeted cost approved in the CPCN. TR 63; Ex BHP 58. Additionally, BHP was able, due to the timing of construction, to take advantage of a one-time federal tax bonus depreciation offered by the American Recovery and Reinvestment Act of 2009. TR 96; Ex BHP 58. The combination of under-budget construction plus the bonus depreciation resulted in rate base savings to BHP's customers receiving service from Wygen III of approximately \$27 Million annually. TR 93-98. Of the total plant capacity, 52 percent, or 52 MW, is owned by BHP, 25 percent is owned by Montana-Dakota Utilities, Co. ("MDU"), and 23 percent is the subject of sale/purchase negotiations between BHP and the city of Gillette, with the sale of such interest expected to occur in the immediate future. TR 229; Ex BHP 7, p. 8; EX BHP 21; Ex BHP 11, pp. 14-3-14. The capital costs and expenses attributable to this 52 percent ownership stake are then further allocated to the three state jurisdictions in which BHP will provide retail service from Wygen III. TR 95; Exs Staff 1 and 2, p. 6.

20. On April 1, 2010, BHP filed a Certification Regarding In-Service Date of Wygen III executed by Linden R. Evans, President and Chief Operating Officer for Utilities, Black Hills Corporation, certifying on behalf of BHP that construction of the Wygen III power plant was complete and that Wygen III was in-service and was placed in commercial operation on April 1, 2010. Ex BHP 53. Wygen III was placed in service on April 1, 2010, and has been supplying generation to BHP's customers in South Dakota and elsewhere since then. TR 63. Wygen III has been used and useful since April 1, 2010. TR 63. Wygen III is expected to immediately provide operating efficiencies that will accrue to BHP's retail customers. Exs Staff 1 and Staff 2, p. 14

21. In addition to this rate proceeding, BHP also made application to the WY PSC for a rate increase for service to its Wyoming customers. The WY PSC recently issued a bench decision approving a settlement agreement between the Wyoming Office of Consumer Advocate and BHP resulting in an approximate 30 percent increase in rates for BHP's Wyoming customers served by Wygen III. TR 63.

22. BHP presented substantial evidence in support of (i) the necessity for additional baseload generation capacity to meet expected growth in load, to offset the expiration of a wholesale power purchase agreement, to replace generating capacity from aging units planned for retirement, and to maintain capacity reserve requirements sufficient to comply with NERC reliability standards and (ii) the reasonableness of BHP's selection of Wygen III as its preferred option to meet this deficiency. TR 141-142; Exs BHP 11-26, 51, 53, 55, 56, 58; Ex Staff 7-7A.

23. Staff also presented evidence in support of the need for additional generation and the reasonableness of Wygen III as the selected option to address this need. Despite

agreeing that BHP should evaluate additional DSM measures and consider implementing those that appear cost effective and should include demonstrated DSM contributions in its resource planning, Staff's consultant and expert witness, after examining BHP's underlying 2007 Integrated Resource Plan ("IRP"), later forecasts and the pre-filed testimony of RCC's witness James, concluded that the introduction of Wygen III: (a) will provide the additional capacity (including reserve margin) needed by BHP to serve the projected combined requirements of its wholesale and South Dakota retail customers in 2010; and (b) will provide the additional capacity (including reserves) needed by BHP to serve the projected requirements of South Dakota retail customers alone in mid-2013. TR 263; Exs Staff 1 and Staff 2, p. 14; Ex Staff 7, pp. 5-6.

24. RCC offered evidence in support of the assertion that the resource planning process conducted by BHP that led to the decision to construct Wygen III was deficient in its showing as to the necessity for additional baseload generation to serve load and its support for Wygen III as a prudent alternative for the provision of needed additional generation. RCC's expert witnesses, Christopher James and David Schlissel, asserted several deficiencies in BHP's capacity deficiency analysis and selection of Wygen III. Essentially, these issues devolve down to two principal categories: (i) the underestimation of the magnitude and cost effectiveness of the potential resource contribution from load reduction, both energy and capacity, achievable from demand side measures ("DSM") and the inadequate consideration given by BHP's process to DSM, either alone or in combination with renewable generation and combined heat and power facilities ("CHP"), as resource alternatives to Wygen III; and (ii) the underestimation of the potential costs and risks associated with operation of Wygen III, in particular those associated with carbon dioxide regulation or taxation, other pollution regulation, and future coal costs. Exs RCC 1-16; Ex RCC 1, pp. 5-16.

25. In support of its conclusion that additional generation was necessary to meet projected load and that Wygen III was a prudent choice for meeting this need, BHP introduced its 2007 IRP, the supporting direct and rebuttal testimony of expert witness Jill Tietjen, the rebuttal testimony of Douglas Buresch, and the direct and rebuttal testimony of Kyle White. TR 60-86, 101-146, 148-178; Ex BHP 14, pp. 6; Ex BHP 16; Ex BHP 51; Ex BHP 55; and Ex BHP 56, pp. 3-5. RCC did not challenge BHP's basic capacity deficit forecast, but rather produced evidence that such deficits could have been supplied by DSM and potentially other resources than Wygen III. TR 262.

26. RCC's expert witness James offered evidence that very significant reduction in capacity requirements could potentially be achieved by BHP by the year 2020 with an aggressive energy efficiency program. Mr. James offered the opinion that BHP's capacity reduction by 2020 could be on the order of 128 MW, or two and one-half times the capacity of Wygen III for which recovery is sought in this proceeding. Ex RCC 1, p. 24-27.

27. BHP's expert Tietjen and Staff expert Evans rebutted this assertion and offered opinions that the capacity savings asserted by Mr. James were unrealistic. Ms. Tietjen testified that even had BHP implemented DSM that resulted in such annual capacity reductions, the capacity requirements by 2012 would still have required the construction of Wygen III. TR 128-129. Ms. Tietjen also testified that energy efficiency program results are affected significantly by the geographic, climatic, economic and demographic characteristics of the particular service area. TR 132. Evans pointed out that Mr. James did not dispute BHP's claimed capacity need in 2010 and offered no evidence at all to show that BHP would have been able to reduce its peak demand in 2010 by the 77 MW demonstrated deficiency. TR 261-262. Evans further questioned Mr. James's assertion of the ability of DSM to reduce peak demand by 128 MW or 17 percent

by 2020 as not realistic and contradicted by the U.S. Department of Energy, Energy Information Administration's statistics showing that the national average of demand reduction programs had achieved only around four percent. TR 262-264; Ex Staff 7A. Mr. Evans pointed out that other utilities serving South Dakota who had engaged in structured, Commission-approved DSM programs had been able to achieve capacity reductions of .4 MW, .6 MW and 2.9 MW. TR 262; Ex Staff 7, p 5. Mr. Evans further testified that although Mr. James had not presented any calculations or supporting data to analyze, his assertion of a 17 percent capacity reduction appeared to be incorrectly utilizing accumulated energy savings over a period of years to demonstrate a capacity savings at a point in time at the end of such period. TR 268-271. Mr. Evans asserted that energy efficiency programs could not replace the need for Wygen III under any circumstance. TR 274.

28. On the question of whether Wygen III was a reasonable generation alternative selection, the IRP conducted by BHP identified the Wygen III as the least costly option in at least 70 percent of the carbon tax and other cost scenarios against which it ran stochastic statistical analyses. TR 125-126, 134-136; Ex 16, p. 44-51. These analyses accounted for the potential impact of DSM programs by including reduced demand scenarios in the stochastic sensitivity runs. TR 137-138. BHP's witness Doug Buresch testified that his statistical analysis had evaluated a wide range of scenarios, including scenarios with significant carbon tax costs, and that Wygen III remained the option of choice in 70 percent of such cases. TR 166-177; Ex BHP 56, pp. 3-10, 7 and 10. BHP witnesses Thomas Ohlmacher and Staff witness Evans backed this up with testimony concerning both the favorable energy costs associated with Wygen III as a mine-mouth facility and its low construction costs. TR 272; Ex BHP 11.

29 As to meeting the "economical" standard, BHP presented evidence that Wygen III was able to be constructed at a reduced cost as a result of the company's prior construction of Wygen II with a similar design. BHP also presented evidence that the plant was constructed employing competitively bid procurement with a third party firm evaluating the competing bids and was completed ahead of schedule and under budget and would realize facility life fuel savings as a mine-mouth facility. Exs BHP 11 and 18.

30. The Commission finds that the capacity savings to be achieved by BHP by 2020 as proposed by James are not sufficiently persuasive, from an analytical standpoint, from a demonstrated national experience standpoint, or from the Commission's own regulatory experience standpoint, TR 262; Ex Staff 7, p 5. to warrant the rejection of recovery by BHP of its costs incurred in Wygen III. First of all, Evans raised concerns that there is no data or computational support or explanation of James's derivation of his 2020 energy savings to capacity reduction values. TR 267-268.

31. Second, on the simplest level, 2020 is ten years from now and more than twelve years after BHP made its decision to construct Wygen III to meet projected demand in 2010 and beyond, with the subsequent endorsement of the WY PSC through its CPCN for the project. Savings potentially achievable by 2020, even if ultimately realized, do not provide supply for customers requiring power now and over the next few years. As Mr. White testified, despite having experienced the loss of large loads totaling 40 to 50 MW through business customer shut-downs or moves, BHP's load has continued to grow at 1 to 2 percent per year. TR 479. Third, certain of BHP's generating units have been in service for over fifty years and are nearing the probable end of their reliable useful lives. TR 141-142.

32. Fourth, the Commission finds Evans's critique of James analysis to cast significant doubt on the computational logic of James's analysis. Cumulative energy savings

over a multi-year period, even if achievable at the levels advanced by James do not necessarily equate to proportional capacity reductions. TR 263, 267-270, 271. Furthermore, as BHP's witness White testified, BHP has actively pursued capacity shaving arrangements with its major high demand customers for a number of years. TR 478.

33. Finally, energy efficiency measures are not solely, or in many respects primarily, within the control of the utility, since the decisions to make equipment replacements and to implement and continue other measures to achieve efficiency are within the control of the customer. DSM comes at a cost not only to the utility, but also to ratepayers. TR 477. Mr. White offered a real-world example of this involving one of its largest load customers, the GCC Dacotah cement plant, which despite having been offered and having availed itself of a peak-shaving cost savings program, felt the need to resume all-hours production when economic circumstances dictated production ramp-up. TR 478-479.

34. RCC also offered evidence that BHP could achieve significant capacity savings or additions through aggressive solicitation of combined heat and power ("CHP") opportunities, commonly referred to as co-generation facilities. Ex RCC 1, pp. 10-11, 14. RCC, however, produced no evidence to demonstrate that CHP opportunities are actually present within BHP's South Dakota service area. BHP's witness Kyle White testified that no cost effective opportunities for such facilities have been presented to BHP by customers or discovered by BHP in its South Dakota service area. BHP was recently approached by a customer about such an arrangement, but the economic analysis of the proposal demonstrated a cost fifty percent in excess of the cost of generation from Wygen III. TR 480. The Commission finds that there is insufficient evidence in the record on which the Commission could base a finding that Wygen III could have been displaced by CHP facilities.

35. RCC criticized BHP for not having performed, in connection with its IRP process, a more formal structured, quantitative analysis of the achievements of its DSM efforts to date and a cost benefit analysis of measures to achieve cost effective energy and capacity savings in the future. BHP pointed out that there has been no formal requirement or structured program in South Dakota, either statutory or at the Commission level, that provides utilities a program objective and cost recovery framework for such analysis or cost incurrence. BHP testified that it had in fact delayed completion of its previously initiated DSM study pending the results of the Commission's DSM initiative to ensure that what is developed and proposed by BHP conforms to the framework adopted by the Commission. TR 488.

36. Despite accepting the need for Wygen III to provide needed generating capacity in the immediate and near future, the Settlement Stipulation also recognizes, consistent with the Commission's recently launched DSM/energy efficiency initiative, the prudence of placing more emphasis on DSM going forward as a central component of resource planning and provision, and the Settlement Stipulation accordingly both (i) incorporates an adjustment that removes BHP's proposed DSM expense allowance based upon a determination that such costs should be dealt with through a separate cost recovery rider consistent with the program ultimately developed through the Commission's DSM initiative and (ii) includes the requirement that additional DSM programs, including conservation programs, be included in BHP's future integrated resource planning. Exs Staff 1 and 2, p. 11; Ex Joint 2, pp. 5-6.

37. In support of the reasonableness of Wygen III as a resource to meet its expected demand, the Settlement Stipulation additionally provides for a 50 year depreciation period. This was agreed to by BHP and not contested by RCC. Although generating resource addition is an inherently "lumpy" process, the customers of BHP will benefit from the reduced costs of the

extended depreciation period and the availability and reliability addition of Wygen III for a projected 50 year life.

38. The Settlement Stipulation addresses the issue of plant capacity phase-in to serve BHP's South Dakota customer load and "lumpiness" through three very significant ECA credit mechanisms. The first is a change to the Power Marketing Income ("PMI") credit under the ECA to credit back to ratepayers 65% of the PMI achieved by BHP. The second is an additional change to the PMI to require a minimum ratepayer credit of \$2,000,000 per year. The third is the Surplus Energy Credit, which will credit back to ratepayers through the ECA adjustment a total of \$6.75 Million over three years, with credits of \$2.5 Million in year one, \$2.25 Million in year two, and \$2 Million in year three. Finally, the Settlement Stipulation also imposes a three year moratorium on BHP's filing for an additional rate increase absent an Extraordinary Event. Exs Staff 1 and 2, p. 15.

39. The standard that a public utility must meet for approval of inclusion of any "underlying costs of any rates" is that they are "prudent, efficient, and economical and are reasonable and necessary to provide service to the public utility's customers in this state." SDCL 49-34A-8.4. The Commission finds that as of April 1, 2010, Wygen III was in service providing service to BHP's South Dakota retail customers and used and useful and that BHP has met this burden with respect to the costs and expenses attributable to the inclusion of Wygen III as a resource in accordance with the terms and conditions of the Settlement Stipulation as delineated in detail in the Staff Memorandum.

Rate of Return; Return on Equity

40. The Settlement Agreement proposes an overall rate of return ("ROR") for BHP of 8.26% versus BHP's requested 9.27%. Exs Staff 1 and 2, p. 14. This Settlement Stipulation rate of return reflects BHP's and Staff's agreed capital structure, including equity ratio, and cost of debt and ROE values. As agreed to by the parties to the Settlement Stipulation, those portions of the Staff Memorandum and supporting Exhibit___BLC-1that reference the capital structure, including equity ratio, and the cost of debt and ROE values were filed "Confidential." Exs Staff 1 and 2, p. 14 and Staff 3 and 4, Exhibit___BLC-1. See Appendix A – Confidential.

41. In addition to the requested increases in rate base and expenses based upon the test year, including those attributable to Wygen III, the revenue requirement and resulting rate increase proposed in the Application and supported by BHP's pre-filed exhibits and testimony were based on a proposed capital structure for BHP of 52% common equity and 48% debt, a 6.85% projected cost of debt, an 11.5% return on common equity ("ROE") and a resulting 9.27% ROR on a weighted cost of capital basis. Ex BHP 4G; Ex BHP 28, pp. 5-7, 58-59; Ex BHP 38, pp. 12-16; Exs Staff 1 and 2, pp. 13-14.

42. BHP's capital cost and structure expert witness, Dr. William Avera, testified that he applied three accepted analytical methods used throughout the country to estimate the cost of equity to utilities - discounted cash flow ("DCF"), the capital asset pricing model ("CAPM"), and expected earnings. Mr. Avera applied these to a utility proxy group of 16 utilities that he selected based on financial industry benchmarks of risk, including their bond ratings, their Value Line ratings, and their Standard & Poor stock valuations. Mr. Avera also performed a similar analysis on a non-utility proxy group of companies selected because of their similar risk profiles. He stated that also looking at non-utility companies is important to ensure that results are not "circular," that is, to avoid the potential feed-back loop effect of regulatory decisions considered in isolation from nonregulated enterprises. TR 24-25, 43-44; Ex BHP 28; Ex BHP 54, p. 11.

According to Mr. Avera, the results of the proxy group analyses, coupled with considerations including regulatory uncertainty, BHP's small size, and the need to provide an ROE that supports BHP's credit standing while funding necessary system investments, indicated that an ROE in the range of 11.5 to 12.5 percent is reasonable. Ex BHP 28, p. 59.

43. Based upon his review of reports of bond rating agencies and security analyst reports on Black Hills Corporation and BHP and the absence therein of any discussion of the BHP IRP, Mr. Avera offered his opinion that the BHP IRP did not appear to be regarded by the investment advisory community as a material concern for the company. TR 49.

44. With respect to the reasonableness of the ROR and ROE proposed in the Settlement Stipulation, Dr. Avera stated that in a litigated case the returns should be higher, but that when considered in the context of a settlement and its many advantages for all parties, a return that is on the low side, such as the rate proposed in the Settlement Stipulation, is acceptable. TR 32.

45. Due to the filing of the Settlement Stipulation, Staff's rate of return expert witness did not file pre-filed testimony or testify in the case. As stated in Staff Memorandum, Confidential, however, the agreed ROE proposed in the Settlement Stipulation was within the range of ROE rates determined to be reasonable by Staff's ROE expert, Basil Copeland. Ex Staff 2, p. 14.

46. In his pre-filed testimony, filed prior to the filing of the Settlement Stipulation, RCC's ROE expert, Mr. Frankenfeld, offered the opinion that the standard for a just and reasonable ROE is appropriately characterized as the minimum rate sufficient to attract capital. Mr. Frankenfeld offered the further opinion that this could arguably be the actual rate of the least cost utility, which Mr. Frankenfeld identified as a 4.7% return on equity rate of Great Plains Energy. Mr. Frankenfeld offered no evidence that Great Plains Energy had actually been able to attract equity capital at such rate. Mr. Frankenfeld then offered what he characterized as a more reasonable method for selecting a range of reasonable rates to be the average equity cost of the five least-cost utilities. By this logic, the fair ROE would lie somewhere between the 7.38% rate of Great Plains Energy, the least expensive based on the composite of Mr. Avera's sources, and the 9.78% of Westar Energy, the fifth least expensive by the same measure. Ex RCC 17, p. 6. Mr. Frankenfeld accordingly offered the opinion that a reasonable range of ROE values for BHP was from 7.38% to 9.78%.

47. Mr. Frankenfeld argued that determinations of an appropriate proxy group and of the cost of equity itself are inherently subjective. He advocated that the best method for selecting a return on equity rate for BHP was to look solely to BHP itself. Ex RCC 17, p. 9. Mr. Frankenfeld further argued that the only true value that investors receive from equity investment is dividend yield over time, which consists of current yield plus growth. Mr. Frankenfeld calculated BHP's actual dividend yield at 5.93% as of the end of 2009. To this, Mr. Frankenfeld added a calculated growth rate of 2.42% determined by multiplying BHP's normalized return on equity over the period 2004 through 2007 of 8.28% by BHP's retained earnings percentage over such period of 29.27%. Mr. Frankenfeld stated that the theoretical return on equity investment to an investor, and thus the cost of equity to BHP, is equal to the dividend yield of 5.93% plus the growth rate of 2.42%, or 8.35%, and that this was his recommended fair rate of return on equity, within a recommended range of 7.38% to 9.78%. Ex RCC 17, p. 11.

48. Mr. Frankenfeld offered several criticisms of Dr. Avera's analysis, among them the opinions that Dr. Avera's selection of both the utility proxy group and the non-utility

comparative risk proxy group were subjective, that the use of a nonutility proxy group is not appropriate as a comparison group because it is not representative of the risk profile of regulated utilities and that utility investment tends to be a class of investment decision unique unto itself, that other similarly situated utilities are the only appropriate comparison group, that certain of the companies included in Dr. Avera's nonregulated proxy group were not sufficiently similar from a potential investor's standpoint to justify their use as comparatives, and that Dr. Avera had improperly excluded outliers from his utility proxy group. Ex RCC 17. Mr. Frankenfeld, however, admitted on cross-examination that he himself had not performed any investigation as to the returns on equity approved by regulatory agencies for utilities over the recent past and had made inquiry neither into the analytical methodologies approved in *Bluefield* and *Hope*² nor other, more recent decisions of FERC or state regulatory agencies³. TR 307-308, 315-316, 343-344.

49. In his rebuttal testimony, Dr. Avera offered several criticisms of Mr. Frankenfeld's analysis, including Frankenfeld's use of a single company, Black Hills Corporation itself, for his DCF-based ROE calculations, which Avera asserted reduced the statistical confidence of his result compared to using a comparable risk sample, as Dr. Avera himself had done in his analysis. Citing the *Bluefield* and *Hope* decisions of the U.S. Supreme Court and several recent FERC cases, Dr. Avera stated that in his experience, almost all cost of equity witnesses, regardless of whom they represent, employ proxy groups and that he knew of no regulatory agency in the U.S. or Canada that does not reference a proxy group when applying the DCF model. Ex BHP 54, p. 14. Additional deficiencies cited by Dr. Avera included Mr. Frankenfeld's failure to include any adjustment for capital procurement flotation costs and a failure to account for the fact that the tax effects of debt issuance are dealt with in utility rate setting through revenue requirement adjustment. TR 54; Ex BHP 54, pp. 2, 16.

50. With respect to the use of the non-utility proxy group, Dr. Avera elaborated that to presume that an estimate of the required return for firms in the competitive sector of the economy is not useful in determining the appropriate return to be allowed for rate-setting purposes is inconsistent with reality and that returns in the competitive sector of the economy are the theoretical underpinning for utility ROEs because regulation purports to serve as a substitute for the actions of competitive markets. While nonregulated companies do not have the regulatory protections that utilities have, neither do they bear the burdens of losing control over their prices, undertaking the obligation to serve, and having to invest in infrastructure even in unfavorable market conditions. He pointed out that BHP can not relocate its service territory to an area with greater customer density or higher prospects for economic growth, postpone capital spending necessary to maintain reliability and accommodate growth, or abandon customers when turmoil roils energy or capital markets. Because the non-utility proxy group includes low risk companies from many industries, it also tends to diversify away distortion caused by the ebb and flow of enthusiasm for a particular sector. Ex BHP 54, p. 10-12.

51. In his hearing testimony, Mr. Frankenfeld acknowledged the propriety of including some amount of capital procurement flotation costs as advocated by Dr. Avera. Adding the lowest end of the flotation cost range presented by Mr. Avera of 21 basis points to Mr. Frankenfeld's recommended ROE of 8.35% and to the high end value of his ROE range of

² *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n*, 262 U.S. 679 (1923); *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944);

³ *Pepco Holdings, Inc.*, 124 FERC 61,176, p. 118 (2008); *Bangor Hydro-Elec. Co.*, 117 FERC 61,129, pp. 19, 26 (2006); *Kern River Gas Transmission Company*, Opinion No. 486, 117 FERC 61,077, p. 140 & n. 227 (2006); *Southern California Edison Co.*, 131 FERC 61,020, p. 55 (2010).

9.78% would result in recommended and high-end values of 8.56% and 9.99%. TR 293. Mr. Frankenfeld in his testimony recommended adding 19 basis points to his ROE values, but it is not clear from his testimony whether his 19 basis point number was his own calculated value or merely an insignificant misrecollection of Mr. Avera's range. TR 293.

52. In his rebuttal testimony and hearing testimony, Dr. Avera also countered the alleged deficiencies in his analysis cited by Mr. Frankenfeld, asserting inter alia (i) that as noted in Finding 52, the use of proxy groups is both standard practice in utility rate cases, provides a more reliable statistical basis for comparison, and has been repeatedly endorsed by federal and state regulatory agencies, (ii) that the use of a competitive, nonregulated proxy group is beneficial for comparison purposes, both to provide a broader view of the competing investment choices open to available capital and to avoid the "circularity" that can result from the sole reliance on regulated results and has been repeatedly upheld as valid in federal and state rate cases, and (iii) that as recognized in recent FERC decisions, the exclusion of outliers from proxy sample groups is appropriate to maintain the statistical integrity of the sample set and avoid inclusion of values which do not appropriately reflect the difference in risk and return expectations between utility debt and equity investment. TR 26-28, 44-47, 54, 347-348; Ex BHP 54, pp. 8-10, 16.

53. The Commission finds that the capital structure, cost of debt and ROE values proposed in the Settlement Stipulation as described in the Staff Memorandum are, in the context of the Settlement Stipulation, supported by substantial evidence and by the preponderance of the evidence and are just and reasonable to BHP and its ratepayers, having given "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 . . . and to earn a fair and reasonable return upon the value of its property." SDCL 49-34A-8. Ex Staff 2, p. 14; Ex Staff 4, Exhibit___BCL-1. The ROE rate is within the range found to be reasonable by Staff and its ROE expert witness, is significantly below the values found just and reasonable by BHP's ROE expert but acknowledged by such expert to be fair and reasonable in the context of the Settlement Stipulation and resolution of the case, and is within, or not materially outside, the range of reasonable values advanced by RCC's ROE expert when adjusted for reasonable flotation costs.

54. Additionally, the Commission finds that the justness and reasonableness of the ROE value to ratepayers is significantly enhanced through the Settlement Stipulation's significant de facto ROE reductions over the three-year rate moratorium period resulting from the Surplus Energy Credit and from the PMI's \$2,000,000 minimum guarantee and increased sharing percentage. When the effects of these revenue reductions are factored in, the ROE falls well within both the Staff's and RCC's experts' ranges of reasonable ROE values. TR 354.

Staff Adjustments

55. Other than its evidence concerning the inclusion of Wygen III in rate base, including its evidence concerning the potential load reduction effects of DSM and energy efficiency programs, and the appropriate return on equity value and, to a lesser extent, the capital structure components of the rate of return proposed in the Settlement Stipulation, RCC offered no evidence or argument contesting any of the adjustments offered by Staff and included in the Settlement Stipulation. TR pp. 279-356, 378-473; Exs RCC 1-21.

56. The Commission finds that the adjustments proposed in the Settlement Stipulation are just and reasonable and are approved by the Commission.

Refund of Overcharges

57. In its Order Granting Request for Authority to Implement an Interim Rate Increase issued on March 23, 2010, the Commission required BHP to keep an accurate account in detail of all amounts received by reason of the interim increase, specifying by whom and on whose behalf the amounts were paid as provided under SDCL 49-34A-17. Following the hearing on July 6, 2010, the Commission considered the issue of refund or credit, pursuant to SDCL 49-34A-17 and 49-34A-22, of excess charges to customers from and after April 1, 2010, under the interim rates approved by the Commission. The issues before the Commission included what interest rate was appropriate, what mechanism or mechanisms were appropriate for effecting the refunds or credits, and how should discontinued, non-creditable accounts with minimal refund balances be treated.

58. The Commission finds that an interest rate of seven percent (7%) per annum on overcharges during the interim rate period is appropriate in accordance with ARSD 20:10:19:08. Although not applicable in a literal, binding sense to this situation since the overcharges are not customer deposits as that term is intended in ARSD Chapter 20:10:19, the Commission nevertheless finds that the customer charges in excess of the rates approved in this Decision are sufficiently similar and analogous to such customer deposits to justify their similar treatment in this situation. The period of retention by BHP in this case is short, and the use of a simple interest rate results in a straight-forward, easily administered process for computation of the interest amounts creditable or payable on some 64,100 accounts.

59. With respect to the means of effecting the refund or credit, the Commission finds that it is appropriate to allow BHP to issue credits to the bills of existing customers in the amount of the overcharges during the interim period plus interest on the overcharges during such period. The issuance of credits against customer bills that are payable within that month provides what is essentially a cash equivalent to customers and significantly reduces the administrative burden and costs associated with printing, handling and mailing paper checks.

60. For those former customers with currently discontinued accounts who were overcharged during the interim period, the Commission finds that it is reasonable to require BHP to issue and mail refund checks or make direct deposits where possible in the amount of the overcharges plus interest thereon, but that such refund check or direct deposit payments need only be made if the overcharge plus interest amount totals three dollars or more. The Commission finds that the costs and administrative burden of requiring BHP to locate, issue and mail checks to former customers having overcharge plus interest balances of less than three dollars outweigh the benefit that will accrue to such former customers and that such unrefunded amounts would be more beneficially employed through a credit back to customers generally.

61. The Commission finds that for any overcharge amounts plus interest not returnable through either bill credits, refund checks or direct deposits, including those where the overcharge plus interest balance is less than three dollars, it is reasonable to require BHP to credit such amounts with interest to customers as a whole through the ECA account true-up process.

Tariff Sheets

62. BHP filed tariff sheets in connection with the filing of the Settlement Stipulation designed to reflect the rates, terms and conditions of the Settlement Stipulation. Subsequently, BHP filed certain revisions to the tariff sheets to correct certain omissions and clerical errors as described with particularity in the Procedural History section of this Decision. The following tariff sheets to the BHP Tariff have been filed by BHP to conform to the Settlement Stipulation:

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Sixteenth Revised Sheet No. 3
Eighth Revised Sheet No. 4

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Section 3C

Fourth Revised Sheet No. 1
First Revised Sheet No. 2
First Revised Sheet No. 3
First Revised Sheet No. 4
Fourth Revised Sheet No. 5
Third Revised Sheet No. 5A
Second Revised Sheet No. 6
Second Revised Sheet No. 7

Replaces Third Revised Sheet No. 1
Replaces Original Sheet No. 2
Replaces Original Sheet No. 3
Replaces Original Sheet No. 4
Replaces Third Revised Sheet No. 5
Replaces Second Revised Sheet No. 5A
Replaces First Revised Sheet No. 6
Replaces First Revised Sheet No. 7

Fourth Revised Sheet No. 8	Replaces Third Revised Sheet No. 8
First Revised Sheet No. 9	Replaces Original Sheet No. 9
First Revised Sheet No. 10	Replaces Original Sheet No. 10
Third Revised Sheet No. 11	Replaces Second Revised Sheet No. 11
Original Sheet No. 12	
Original Sheet No. 13	
Original Sheet No. 14	
Original Sheet No. 15	
Original Sheet No. 16	
Original Sheet No. 17	
Original Sheet No. 18	
Original Sheet No. 19	

Section 4

Second Revised Sheet No. 4	Replaces First Revised Sheet No. 4
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63. The Commission approves the above-referenced tariff sheet revisions to the BHP Tariff filed by BHP to reflect the rates, terms and conditions of the Settlement Stipulation and this Decision.

General

64. The Commission finds that the rates, terms and conditions proposed in the Settlement Stipulation demonstrate a thorough, penetrating and credible analysis by Staff and its expert witnesses of the data and assumptions underlying the Application and the Settlement Stipulation; balance fairly the interests of BHP and its customers; recover no more than BHP's current revenue requirements, including a reasonable return to its stockholders commensurate with its cost of equity capital; are supported by substantial evidence; and meet the just and reasonable standard set forth in SDCL 49-34A-6, as more specifically delineated in SDCL 49-34A-8, the unreasonable preference or advantage and unreasonable prejudice or disadvantage prohibitory standards of SDCL 49-34A-3 and the fair and reasonable return standard of SDCL 49-34A-8. These settlement rates allow BHP a reasonable opportunity to earn a return that is adequate to enable it to continue providing safe, adequate, and reliable service to its South Dakota retail customers.

65. The Commission finds that neither the Industrial Settlement between BHP and the Industrial Intervenors nor the Commission's approval of the Industrial Settlement has affected the costs to be recovered from BHP's other customers under the Settlement Stipulation.

66. The Commission finds that the "lumpy" rate impact of Wygen III is mitigated in the Settlement Stipulation by the establishment of the Surplus Energy Credit during the transition period from 2010 to 2013 as ratepayer energy requirements are expected to grow. Initially, in the first year the new rates are in effect, this provision will credit ratepayers with \$2.5 Million through the annually modified energy cost adjustments. Over the next two years as customer requirements grow, the Surplus Energy Credit is reduced to \$2.25 Million and \$2.0 Million, respectively. Also, in recognition of the expectation that Wygen III will enhance BHP's power marketing opportunities, the Settlement Stipulation provides that 65% of pretax PMI will be credited to retail ratepayers and that regardless of actual PMI, ratepayers will receive a minimum credit of \$2 Million per annum. Finally, the Settlement Stipulation imposes a three-year

moratorium prohibiting BHP from filing any application for an increase in base rates that would become effective prior to April 1, 2013, unless BHP experiences an "Extraordinary Event." The Commission finds that these provisions afford a very significant savings benefit to ratepayers.

67. Although the Commission finds that the Settlement Stipulation will result in just and reasonable rates, the Commission nevertheless also finds that greater confidence would be provided in future rate cases that the rates for which approval is sought are just and reasonable if supported by a more thorough and substantive process of collection, analysis and presentation of information on energy efficiency and DSM efforts and their impacts. The Commission accordingly finds that, in addition to the Settlement Stipulation's requirement that BHP consider additional DSM programs including conservation programs in its next IRP process, BHP must include in its next general rate application, in addition to statutory requirements, a report detailing BHP's energy efficiency and DSM efforts and the impact of those efforts. TR 528-530.

68. To the extent that any Conclusion of Law set forth below is more appropriately a finding of fact, that Conclusion of Law is incorporated by reference as a Finding of Fact.

CONCLUSIONS OF LAW

1. The following South Dakota statutes are applicable: SDCL 49-34A-1, 49-34A-3, 49-34A-6, 49-34A-8, 49-34A-8.3, 49-34A-8.4, 49-34A-10 through 14, 49-34A-17, 49-34A-19 through 49-34A-19.2, 49-34A-21, 49-34A-22, and 49-34A-101 and applicable provisions of SDCL Chs. 1-26 and 15-6. The Commission has jurisdiction in this matter pursuant to one or more of the above statutes.

2. The following South Dakota administrative rules are applicable: ARSD Chapters 20:10:01 and ARSD 20:10:13.

3. SDCL 49-34A-6 provides:

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, including penalty for late payments, to the end that the public shall pay only just and reasonable rates for service rendered.

SDCL 49-34A-8 provides:

The commission, in the exercise of its power under this chapter to determine just and reasonable rates for public utilities, 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, including taxes and interest, and including adequate provision for depreciation of its utility property used and necessary in rendering service to the public, and to earn a fair and reasonable return upon the value of its property.

SDCL 49-34A-8.4 further provides:

The burden is on the public utility to establish that the underlying costs of any rates, charges, or automatic adjustment charges filed under this chapter are prudent, efficient, and economical and are reasonable and necessary to provide service to the public utility's customers in this state.

SDCL 49-34A-11 states that “[t]he burden of proof to show that any rate filed is just and reasonable shall be upon the public utility filing same.”

SDCL 49-34A-17 provides:

The public utility may implement the proposed rate or practice if:

- (1) The proposed rate or practice has not been suspended or is no longer subject to suspension;
- (2) The commission has not issued a final decision; and
- (3) Thirty days has passed from the date of filing.

In the case of a proposed increased rate, the commission may, by order, require the public utility to keep an accurate account in detail of all amounts received by reason of the increase, specifying by whom and in whose behalf the amounts are paid. Upon completion of the hearings and decision, the commission may by further order require the public utility to refund, with interest, to customers, the portion of the increased rates found to be unjust, unreasonable, or discriminatory. The refund shall be carried out as provided in §§ 49-34A-22 and 49-34A-23. If the commission does not issue a final decision within twelve months from the date the proposed rate or practice was filed, the commission may not require a refund of increased rates charged after the twelve months.

4. SDCL 49-34A-101 provides:

There is hereby established a state renewable, recycled, and conserved energy objective that ten percent of all electricity sold at retail within the state by the year 2015 be obtained from renewable, recycled, and conserved energy sources. . . . This objective is voluntary, and there is no penalty or sanction for a retail provider of electricity that fails to meet this objective.

5. BHP is a “public utility” as defined in SDCL 49-34A-1(12).

6. The Application was properly filed with the Commission on September 30, 2009, included all schedules and information required by ARSD 20:10:13, and was jurisdictionally complete.

7. The 180 day suspension of BHP’s proposed rates was approved by vote of the Commission on October 20, 2010, and imposed pursuant to the order of the Commission issued on November 3, 2010. BHP had the statutory authority pursuant to SDCL 49-34A-17 to “implement the proposed rate or practice” on April 1, 2010, and pursuant to the Commission’s order so authorizing, BHP’s approved reduced rate was lawfully implemented on April 1, 2010.

8. The Industrial Joint Motion and Industrial Settlement were duly and lawfully granted and approved by the Commission without objection by any party through its Order Approving Joint Motion for Approval of Settlement Stipulation issued on June, 16, 2010.

9. In accordance with the prevailing case law as presented to the Commission in the briefs and arguments of the parties in connection with the Commission's proceedings on May 27 and June 1, 2010, the appropriate issue for hearing in this case, where one intervening party has not joined in and has objected to the Settlement Stipulation, is whether the rates, terms, and conditions set forth in the Settlement Stipulation are just and reasonable as demonstrated by the evidence and satisfy the standards for approval under South Dakota law, with BHP having the burden of proof as to such issue and with all parties having the right to a full hearing on the merits.

10. As specified by the Commission in its decision rendered on June 1, 2010, and its June 8, 2010, Procedural Order Regarding Pre-Hearing Matters, a hearing on the merits of this matter was held on June 28 and 29 and July 6, 2010, with all parties whose issues had not been previously resolved participating and afforded a full opportunity for hearing on the merits of their issues.

11. There is no statutory provision or administrative rule in this state requiring a public utility to perform an integrated resource plan or to implement a demand side management, energy efficiency or conservation program. The Commission's statutory authority with respect to adjudicating the adequacy of a public utility's efforts in such regard in this rate proceeding is limited to the evaluation of such efforts in the overall and general context of whether the public utility's planning and resource selection processes and decisions have been consistent with its burden of establishing that the underlying costs of its filed rates, charges, or automatic adjustment charges are prudent, efficient, and economical and are reasonable and necessary to provide service to the public utility's customers in this state.

12. The Commission concludes that the amendment it imposed on the Settlement Stipulation to require BHP to include in its next general rate application, in addition to statutory requirements, a report detailing BHP's energy efficiency and DSM efforts and the impact of those efforts is reasonable and consistent with the Commission's obligations and authority under SDCL 49-34A-3, 49-34A-6 and 49-34A-8, particularly in the context of BHP's stipulation on the record regarding its non-objection to such condition.

13. BHP, in conjunction with Staff as a co-settling party, produced evidence sufficient to meet its burden of proof pursuant to SDCL 49-34A-8.4 to establish that the underlying costs of the rates, charges, or automatic adjustment charges filed under this chapter pursuant to the Settlement Stipulation are prudent, efficient, and economical and are reasonable and necessary to provide service to the public utility's customers in this state.

14. BHP demonstrated that the resource planning process it performed reasonably concluded that Wygen III was reasonable and necessary to provide service to the public utility's customers in this state, particularly in the context of the facts and circumstances present and available to BHP at the time the decision to proceed with such resource addition was made. BHP reasonably determined that the need for additional generation could not be feasibly or prudently be supplanted by DSM and that additional generation was necessary to meet its obligation to provide adequate and reliable electric service to its customers in this state.

15. Giving 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, including taxes and interest, and including adequate provision for depreciation of its utility property used and necessary in rendering service to the public, and to earn a fair and reasonable return upon the value of its property, the Commission concludes that the rates, terms and conditions before the Commission pursuant to the Settlement Stipulation, as amended by the Commission, are just and reasonable and are approved for service on and after April 1, 2010.

16. BHP has met its burden of proof pursuant to SDCL 49-34A-8.4 and is entitled to approval of the rates as filed in the Settlement Stipulation as amended by the Commission, subject to the terms and conditions thereof. The Joint Motion is granted and the Settlement Stipulation is approved subject to the Commission's amendment regarding reporting of DSM efforts and results in a subsequent general rate filing.

17. SDCL 49-34A-17 and 49-34A-22 permit, but do not require, the Commission to order a public utility to refund or credit amounts charged on an interim basis in excess of amounts chargeable under the rates as approved. Having found that refund or credit of excess charges is appropriate in this case, the Commission concludes that BHP should be ordered to make bill credits or refunds to customers and former customers as set forth with particularity in Findings 57-61. ARSD 20:10:19:08 requires a public utility to pay interest at the rate of seven percent (7%) per annum on customer deposits. Although not applicable per se to the overcharges by BHP in this case, the Commission concludes that the customers with overcharges are similarly situated to those having funds held by BHP on deposit and that ARSD 20:10:19:08 affords an appropriate guideline for the Commission's exercise of reasonable discretion as to the appropriate interest rate to be applied in this situation. The Commission concludes that not requiring BHP to locate, issue checks and mail refunds to discontinued accounts having a balance of less than three dollars including interest, but rather to credit any such unpaid amounts to current and future customers as a whole through the ECA, is reasonable and is not an unreasonable preference, advantage, prejudice, or disadvantage among customers under SDCL 49-34A-6.

18. To the extent that any of the Findings of Fact in this decision are determined to be conclusions of law or mixed findings of fact and conclusions of law, the same are incorporated herein by this reference as a Conclusion of Law as if set forth in full herein.

19. The Commission concludes that the Application and all required filings have been filed with the Commission in conformity with South Dakota law and that all procedural requirements under South Dakota law, including public hearing requirements, have been met or exceeded.

It is therefore

ORDERED, that the Joint Motion for Approval of Settlement Stipulation between BHP and the Commission Staff is granted; and it is further

ORDERED, that in addition to the Settlement Stipulation's requirement that BHP consider additional DSM programs including conservation programs in its next IRP process, BHP must include in its next general rate application, in addition to statutory requirements, a report detailing BHP's energy efficiency and DSM efforts and the impact of those efforts; and it is further

ORDERED, that the Settlement Stipulation and the rates, terms, conditions and agreements contained therein are approved as so modified; and it is further

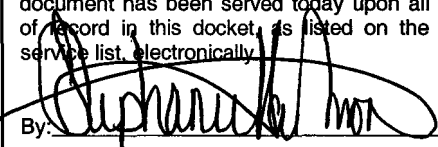
ORDERED, that BHP shall make refunds or credits to customers of its overcharges together with interest on such amounts in accordance with the limitations, terms and conditions set forth with particularity in Findings of Fact 57-61 and Conclusion of Law 17; and it is further

ORDERED, that the tariff sheet additions and revisions to the South Dakota Electric Rate Book, Tariff Schedules Applicable to Electric Service of Black Hills Power, Inc. filed by BHP with the Settlement Stipulation and subsequent corrective filings as described with particularity in the Procedural History section of this Decision and delineated in detail in the Findings of Fact are hereby approved, effective April 1, 2010.

Dated at Pierre, South Dakota, this 11th day of August, 2010.

NOTICE OF ENTRY AND OF RIGHT TO APPEAL

PLEASE TAKE NOTICE that this Final Decision and Order was duly issued and entered on the 11th day of August, 2010. Pursuant to SDCL 1-26-32, this Final Decision and Order will take effect 10 days after the date of receipt or failure to accept delivery of the decision by the parties. Pursuant to ARSD 20:10:01:30.01, an application for a rehearing or reconsideration may be made by filing a written petition with the Commission within 30 days from the date of issuance of this Final Decision and Order; Notice of Entry. Pursuant to SDCL 1-26-31, the parties have the right to appeal this Final Decision and Order to the appropriate Circuit Court by serving notice of appeal of this decision to the circuit court within thirty (30) days after the date of service of this Notice of Decision.

CERTIFICATE OF SERVICE
The undersigned hereby certifies that this document has been served today upon all parties of record in this docket, as listed on the docket service list, electronically.
By: 
Date: <u>08/11/10</u>
(OFFICIAL SEAL)

BY ORDER OF THE COMMISSION:


DUSTIN M. JOHNSON, Chairman


STEVE KOLBECK, Commissioner


GARY HANSON, Commissioner