Decision No. R19-1033

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO

PROCEEDING NO. 19AL-0075G

IN THE MATTER OF ADVICE LETTER NO. 1 FILED BY BLACK HILLS COLORADO GAS, INC. TO PLACE IN EFFECT ITS NEW P.U.C. VOLUME NO. 1 TARIFF ESTABLISHING NEW RATE SCHEDULES AND BASE RATES FOR ALL NATURAL GAS SALES AND TRANSPORTATION SERVICES, INCREASING JURISDICTIONAL BASE RATE REVENUES, COMBINING EXISTING GAS COST ADJUSTMENT ("GCA") AREAS INTO NEW GCA REGIONS, IMPLEMENTING A DISTRIBUTION SYSTEM INTEGRITY RIDER, REVISING THE CONSTRUCTION ALLOWANCE CALCULATION METHOD, AND OTHER PROPOSED TARIFF CHANGES TO REPLACE AND SUPERSEDE ITS P.U.C. VOLUME NO. 3 TARIFF (FORMERLY BLACK HILLS/COLORADO GAS UTILITY COMPANY, INC.) AND P.U.C. VOLUME NO. 7 TARIFF (FORMERLY BLACK HILLS GAS DISTRIBUTION, LLC) IN THEIR ENTIRETY, TO BECOME EFFECTIVE ON MARCH 4, 2019.

RECOMMENDED DECISION OF ADMINISTRATIVE LAW JUDGE CONOR F. FARLEY PERMANENTLY SUSPENDING TARIFF SHEETS, ADDRESSING SYNERGIES FROM SOURCEGAS ACQUISITION, DENYING REQUESTS FOR DSIR, BASE RATE AREA CONSOLIDATION, AND REVISED CONSTRUCTION ALLOWANCES, GRANTING STIPULATED GCA CONSOLIDATION, GRANTING STIPULATION ADDRESSING CERTAIN TRANSPORTATION ISSUES, REQUIRING FILINGS, AND SHORTENING TIME FOR FILING RESPONSES TO EXCEPTIONS

Mailed Date: December 27, 2019

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I. STATEMENT

A. Summary of Proceeding

1. This proceeding has been flawed from the beginning. The flaws derive from decisions made by Black Hills Colorado Gas, Inc. (BHCG or the Company) before it filed this

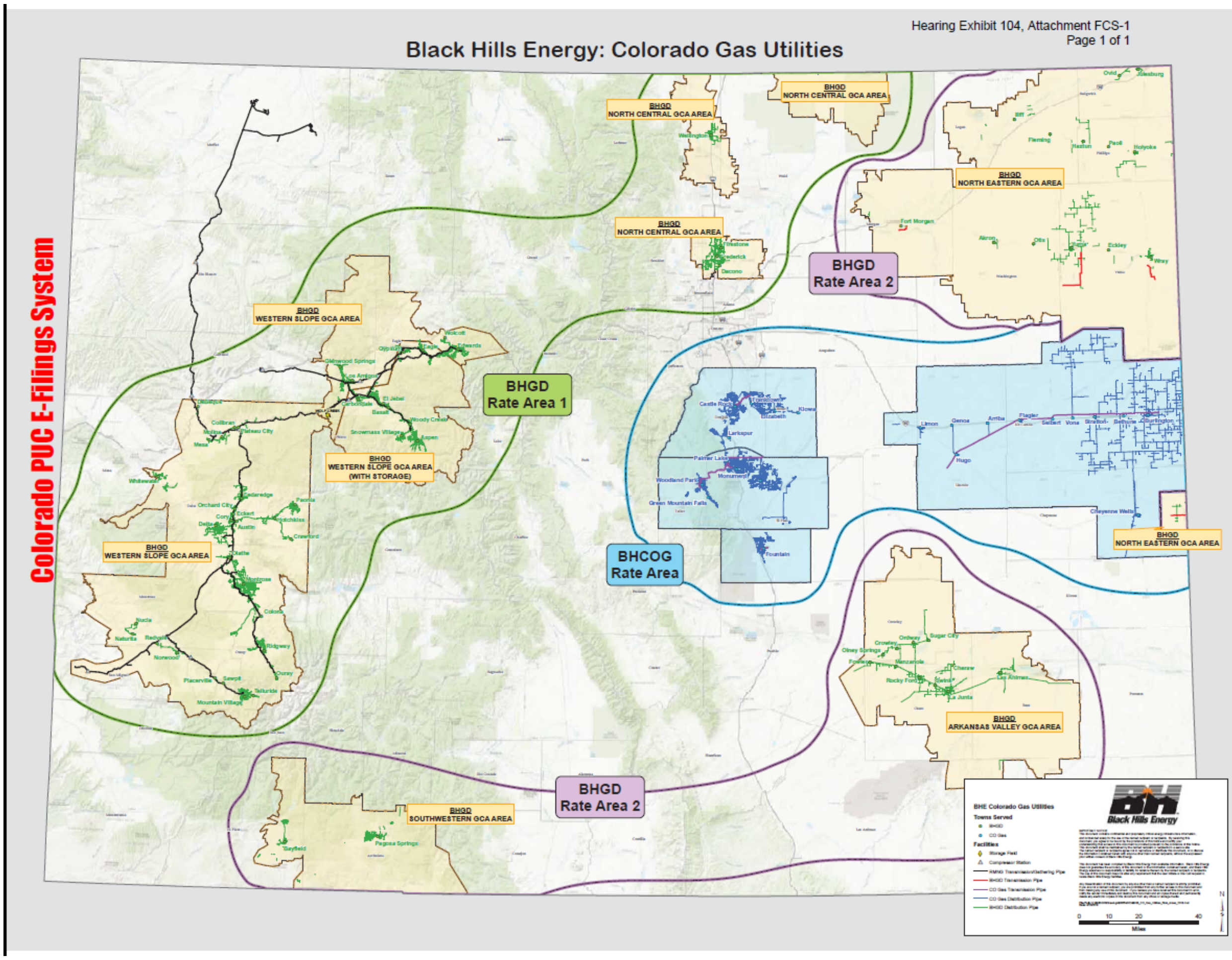
proceeding. The flaws have resulted in an inefficient and otherwise problematic result in this proceeding.

2. On February 1, 2019, BHCG filed Advice Letter No. 1 with supporting Attachments and pre-filed testimony. Advice Letter No. 1 proposes both a new revenue requirement and a new rate design. It is thus a combined Phase I and II rate proceeding that must be fully adjudicated before the Commission in this proceeding within 210-days, as required by § 40-6-111, C.R.S.[1]

3. But that is not all. Advice Letter No. 1 also proposes to consolidate the rates and tariff sheets of Black Hills/Colorado Gas Utility Company, Inc. (BHGU) and Black Hills Gas Distribution, LLC (BHGD) into Colo. PUC No. 1 for BHCG. BHGU held the legacy assets from Aquila, Inc., which BHCG acquired in 2008. BHGD held the legacy assets of SourceGas Distribution, LLC, Rocky Mountain Natural Gas, LLC, SourceGas, LLC, and SourceGas Holdings, LLC (collectively, SourceGas), which BHCG acquired in 2016. BHGD has two base rate areas and six gas cost adjustment areas (GCAs). BHGU has one rate area and one GCA.

[1] After BHCG filed this proceeding, § 40-6-111, C.R.S. was amended to allow an advice letter to be suspended for a maximum of 250 days.

Attachment FCS-1 to Hearing Exhibit 104, which shows the existing base rate areas and GCA areas of BHGD and BHGU (collectively BHCOG), is shown below:[2]



4. Advice Letter No. 1 seeks to consolidate the cumulative three base rate areas into a single base rate area for the purpose of establishing an overall revenue requirement for BHCG.

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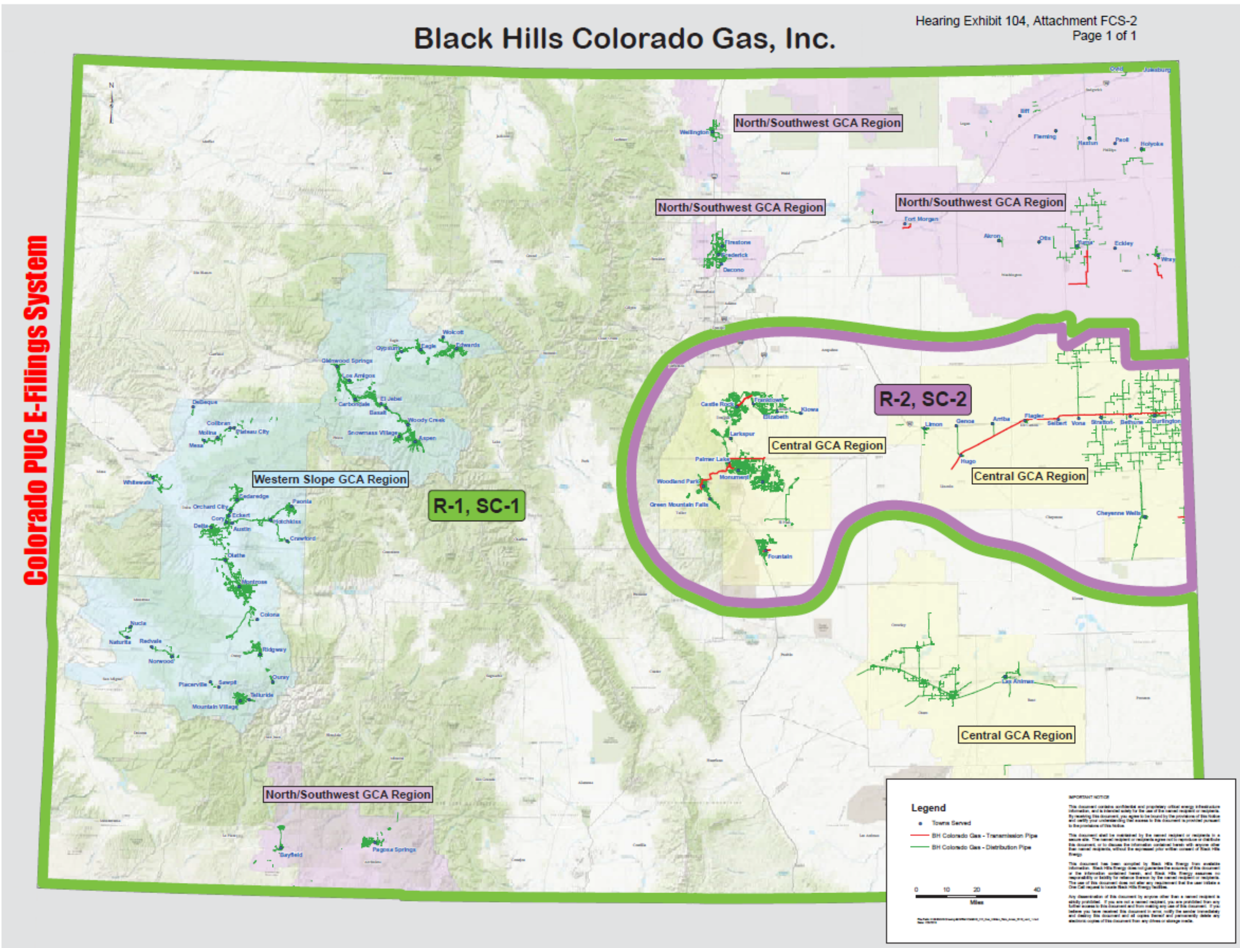
[2] BHGD's base rate areas are depicted as "BHGD Rate Area 1" and "BHGD Rate Area 2" on Hearing Exhibit 104, Attachment FCS-1. BHGD's GCA areas are depicted on Exhibit 104, Attachment FCS-1 as the "North Central GCA Area," "North Eastern GCA Area," "Arkansas Valley GCA Area," Southwestern GCA Area," "Western Slope GCA Area," and "Western Slope GCA Area (with Storage)." BHGU's base rate area and GCA area are depicted as "BHCOG Rate Area" on Exhibit 104, Attachment FCS-1.

However, for purposes of rate impact mitigation, BHCG proposes separate rates for two new base rate areas derived exclusively through rate design and not through separate determinations of revenue requirements. Advice Letter No. 1 further proposes to consolidate seven GCA Areas of BHGD and BHGU into three GCAs. Attachment FCS-2 to Hearing Exhibit 104, which shows the proposed consolidation down to two base rate areas and four GCA areas, is shown below:



Among the supporting Attachments filed by BHCG was the single statewide Revenue Requirement Study (RRS) and the single statewide Class Cost of Service Study (CCOSS).

5. Finally, Advice Letter No. 1 also proposes a new Distribution System Integrity Rider (DSIR) that would allow BHCG current recovery of safety and integrity investments. This

is significant because such riders are inconsistent with the historical cost-recovery process for utilities insofar as they permit current recovery of a significant amount of costs. Other utilities have proposed such riders, but have not done so in advice letters that raised the plethora of other substantive issues raised in the advice letter filed in this proceeding.

6. In terms of the breadth of the issues it raises therefore, Advice Letter No. 1 is at least atypical in the recent history of the Commission. In fact, the Administrative Law Judge (ALJ) is not aware of another proceeding that contained as many important substantive issues as this one. Put simply, it was entirely predictable at the outset that the depth and breadth of the issues raised by Advice Letter No. 1 would strain the resources of the Commission and the Intervenors, and thereby lead to a less than fulsome record, and compromise the Commission's ability to review, digest, and analyze the record on each issue. This is regrettable given the importance of the issues involved in this proceeding.

7. Even more regrettable are the flaws that appeared in BHCG's case as the proceeding progressed. As explained in more detail below, on April 24, 2019, BHCG filed "updates" and "corrections" to the RRS filed at the outset of the proceeding that resulted in an increase of the revenue requirement by $996,324 to $74,177,387. However, BHCG stated that it was "not proposing to revise its February 1, 2019 advice letter filing in order to reflect these changes"[3] and it was "not seeking to increase its requested revenue increase from the [amount] originally proposed in the February 1, 2019 advice letter filing."[4] Instead, BHCG stated that it

[3] Notice at 2.
[4] *Id*.

would cap its revenue requirement at the amount identified in the original Advice Letter and Notice ($73,281,063).[5] This proposed result, which was designed primarily to avoid any further notice requirements, meant that the base rates set forth in the tariff sheets filed with the Advice Letter were not cost-based. The "updates" and "corrections" also caused confusion about whether, in addressing all of the issues in this proceeding, the parties and the Commission should focus on the original RRS, the updated and corrected RRS, or some combination of both. BHCG stated that the parties should focus on the updated and corrected RRS even though the proposed rates were based on the original RRS. BHCG filed these "updates" and "corrections" just before the deadline for answer testimony, which required parties to repeat substantial portions of their work.

8. Another flaw that became apparent in this proceeding was BHCG's decision to file only a consolidated RRS and a consolidated CCOSS at the outset of this proceeding. BHCG did not file an RRS and CCOSS for each of the three existing base rate areas, instead arguing that it was the Intervenors' burden to construct and file, at a minimum, a CCOSS just before answer testimony was to be filed, extending timelines and requiring parties to repeat substantial portions of their work for each of the base rate areas. It is unclear how BHCG expected Intervenors to do this within the time constraints of this proceeding, when BHCG possessed *both* the information necessary to construct the CCOSS's *and* the understanding of that information necessary to efficiently construct the CCOSS's. In fact, BHCG stated that it would take eight weeks for BHCG itself to produce the unconsolidated CCOSS's, which means it would have likely taken any of the Intervenors significantly longer to accomplish the same feat.

[5] *Id*. at 2, 3-4.

9. As explained more fully below, at the end of the hearing, BHCG decided to extend the proceeding to supplement the record with four new CCOSS's (one for each of the existing base rate areas, and one for the combination of the BHGU Rate Area and BHGD Rate Area 2) (Supplemental Proceeding). This was done in response to the position taken by Trial Staff of the Commission (Staff) and the Office of Consumer Counsel (OCC) that the Commission could not determine whether the consolidated and mitigated rates proposed by BHCG were just and reasonable. The Supplemental Proceeding involved an expedited proceeding with deadlines for Supplemental Direct Testimony in support of the new CCOSS's, Supplemental Answer Testimony, and one additional hearing day.

10. The four new CCOSS's and Supplemental Testimony revealed that BHCG's consolidation proposal is driven in large part by the financial consequences of the DSIR for all ratepayers, but particularly the ratepayers in BHGD Rate Area 2. BHCG had not produced a separate CCOSS for each of the existing base rate areas and/or a bill impact analysis including the DSIR for BHGD Base Rate Area 2 before the August hearing. The Supplemental Proceeding was not, however, designed for the ALJ and the Intervenors to re-examine the DSIR. As a result, the resulting record has not been adequately developed on the necessity of some or all of the proposed DSIR projects, the DSIR's impact on ratepayers, alternative methods of paying for some or all of the DSIR's projects, and alternatives to the DSIR.

11. As a result of the foregoing, the record in this proceeding is substantially deficient in many areas. While it is sufficiently developed to allow the ALJ to decide the Phase I issues, it does not allow the ALJ to find and conclude that BHCG's proposals on Phase II issues, request for a DSIR, and the requested changes to the construction allowances yield just and reasonable

rates and are in the public interest. For this reason, the ALJ has decided the Phase I issues, but denied BHCG's requests addressing the remainder of the issues in this proceeding.

B. Background

1. Advice Letter

12. BHGU's last Phase I rate case was in Proceeding No. 12AL-628G that resulted in a settlement agreement that the Commission approved in Decision No. R12-1401 on December 5, 2012. BHGU's last Phase II rate design case was in Proceeding No. 08S-290G that resulted in a settlement agreement that the Commission approved in Decision No. R09-0252 on March 10, 2009.

13. BHGD's last Phase I rate case was in Proceeding No. 10AL-455G that resulted in a settlement agreement that the Commission approved in Decision No. R10-1268 on November 24, 2010. BHGD's last Phase II rate design case was in Proceeding No. 08S-108G that resulted in a settlement agreement that the Commission approved in Decision No. R08-0820 on August 7, 2008.

14. As explained above, Advice Letter No. 1 filed on February 1, 2019 proposes changes that make this both a Phase I and Phase II proceeding. It seeks to increase annual base rate revenues by approximately $2.5 million based on an overall annual revenue requirement of $73.2 million. This represents an increase of 3.48 percent above the annual base revenues of the combined companies. The annual base rate revenues are based upon an RRS evaluating the Company's investments, revenues, and expenses for the 12-month period ending June 30, 2018, as adjusted for known and measurable changes through December 31, 2018.

15. BHCG has proposed a 10.15 percent return on equity (ROE), a capital structure of 50.15 percent equity to 49.85 percent debt, and a cost of long-term debt of 4.31 percent. The proposed composite weighted average cost of capital is 7.32 percent. BHCG also seeks to change the basic rate structures and relative amount of revenues collected from each customer class, which would lead to revisions to all rate schedules for gas sales and transportation in BHCG's tariff, Colorado P.U.C. No. 1.

16. In addition to the changes noted above, Advice Letter also seeks to:

a) revise depreciation rates;

b) revise the Line Extension Policy tariff and Construction Allowance calculation method;

c) consolidate tariff provisions setting forth a gas hedging program, the Black Hills Energy Assistance Program (BHEAP), the Demand-Side Management Cost Adjustment, meter sampling program, minimum heating value, budget billing, therm conversion calculations, fuel use, and lost and unaccounted for gas;

d) revise billing due dates and implement a new late payment fee;

e) discontinue interruptible sales and transportation services;

f) reinstate an Asset Optimization Plan providing for the sharing of revenues related to the release of interstate pipeline capacity;

g) establish automatic enrollment of low-income customers in the BHEAP; and

h) provide additional textual changes of a clarifying or housekeeping nature.

17. The proposed rate increase in the original Advice Letter would affect residential and small commercial customers' bills by approximately 8 percent in the proposed Central region, and by approximately 2.6 percent for customers in the Arkansas Valley. Residential customers in the North/Southwest region would see an increase of approximately 5.13 percent in the North Eastern area, but a decrease of 3.2 percent in the North Central area. Residential customers in the Western Slope region would see a decrease of approximately 1.2 percent, with

gas storage customers having a larger decrease of approximately 6.62 percent. The original proposed effective date of the tariffs filed with Advice Letter No. 1 was March 4, 2019.

18. With its Advice Letter, BHCG filed the direct testimony and Attachments of 15 witnesses in support of the Company's proposals and proposed tariffs. Those witnesses are: Sarah A. Bailey, John R. Boughner II, Michael C. Clevinger, Kenneth L. Crouch, Christianne M. Curran, Eric J. Gillett, Douglas N. Hyatt, Kristi L. Johnson, Justin W. Klapperich, Corey L. Koca, Marc I. Lewis, Adrien M. McKenzie, Bruce R. Menzel, Frederic C. Stoffel, and Thomas J. Sullivan. All of these witnesses also filed rebuttal testimony except for Ms. Bailey. However, BHCG filed the rebuttal testimony of David L. Ryan, who had not filed direct testimony.

19. By Decision No. C19-0194 issued on February 22, 2019, the Commission: (a) set March 25, 2019 as the deadline for intervening in this proceeding; (b) set the tariff pages for hearing, which suspended the effective date of the tariff pages filed by BHCG (and thus the proposed increases in rates) until July 2, 2019 pursuant to § 40-6-111(1), C.R.S.; and (c) referred this proceeding to an ALJ for disposition. The proceeding was subsequently assigned to the undersigned ALJ.

20. Staff, the OCC, Bachelor Gulch Village Association (BGVA), The Vail Corporation (Vail), Energy Outreach Colorado (EOC), and AM Gas Transfer Co. (AM Gas) intervened in the proceeding.

2. Procedural Schedule

21. On March 21, 2019, the ALJ issued Decision No. R19-0265-I that, among other things, extended the statutory deadline and scheduled a prehearing conference for April 5, 2019. Following that prehearing conference, the ALJ issued Decision No. R19-0351-I on April 19, 2019 that established a prehearing schedule including a deadline of May 8, 2019 for answer

testimony, scheduled public comment hearings for April 30, 2019 and May 1, 2019 in Glenwood Springs and Castle Rock, Colorado, respectively, and scheduled the evidentiary hearing in this proceeding for June 10 through 13, and 17, 2019.

3. Subsequent Developments

22. On April 24, 2019, BHCG filed a Notice of Filing of Updated and Corrected RRS (Notice), and an Amended Advice Letter No. 1, and Amended Tariff Sheets. In the Notice, BHCG stated that it had made "updates" and "corrections" to the RRS filed at the outset of the proceeding. The updates and corrections caused BHCG's alleged revenue requirement to increase by $996,324 to $74,177,387. However, BHCG stated that it "is not proposing to revise its February 1, 2019 advice letter filing in order to reflect these changes"[6] and it "is not seeking to increase its requested revenue increase from the [amount] originally proposed in the February 1, 2019 advice letter filing."[7] Instead, BHCG stated that it would cap its revenue requirement at the amount identified in the original Advice Letter and Notice ($73,281,063).[8]

23. The Amended Advice Letter No. 1 and Amended Tariff Sheets changed the proposed effective date of the new rates from March 4, 2019 to April 5, 2019. This resulted in "an additional 32 days in the current procedural schedule and allow[ed] the maximum 210-day suspension period to expire on October 31, 2019."[9] In the Notice, BHCG requested that a prehearing conference be convened "as quickly as possible in order to amend the existing procedural schedule in order to extend the dates for Answer Testimony, Rebuttal/Cross Answer

[6] Notice at 2.

[7] *Id*.

[8] *Id*. at 2, 3-4.

[9] *Id*. at 3

Testimony and to reset the hearing dates. [BHCG] believe[d] it [was] not necessary to reschedule the public hearing dates that are currently scheduled for April 30 and May 1, 2019."[10]

24. On April 26, 2019, the ALJ issued Decision No. R19-0374-I that established a deadline of April 30, 2019 to respond to the Notice and scheduled a status conference for May 3, 2019 at 10:00 a.m.

25. Later on April 26, 2019, Staff filed an Unopposed Motion to Vacate the Procedural Schedule and for Waiver of Response Time (Unopposed Motion). In the Unopposed Motion, Staff requested that the procedural schedule be vacated in its entirety and for a waiver of response time to the Unopposed Motion. As support, Staff states that: (a) there is insufficient time within which "to fully analyze Black Hills' Revised Attachment MCC-1 and determine how the changes made impact Black Hills' complex rate and tariff proposals" before answer testimony is due on May 8, 2019;[11] and (b) "[v]acating the existing procedural schedule will allow the [I]ntervenors to focus on any to-be-filed responses to Black Hills' notice and prepare for the status conference without worries about the current May 8, 2019 Answer Testimony due date."[12] Finally, Staff stated that it had conferred with the other parties to this proceeding and was authorized to represent that the Unopposed Motion is unopposed.

26. On April 29, 2019, the ALJ issued Decision No. R19-0375-I that granted-in-part and denied-in-part the Unopposed Motion. The May 8 deadline for answer testimony was vacated, but the request to vacate the remainder of the procedural schedule was denied.

[10] *Id*.

[11] Unopposed Motion at 2.

[12] *Id*. at 3.

27. On May 3, 2019, the ALJ convened the status conference scheduled in Decision No. R19-0374-I. The parties presented oral argument concerning the issues raised by BHCG's filing of the Updated and Corrected RRS, the Amended Advice Letter No. 1, and Amended Tariff Sheets. At the conclusion of the status conference, the ALJ took the issues discussed under advisement and established the deadline of May 13, 2019 for the Parties to file briefs addressing: (a) whether the Updated and Corrected RRS and its impact on the rates in this proceeding required the proceeding to be re-noticed; and (b) the procedural schedule that should be adopted assuming that the proceeding would be re-noticed.

28. On May 13, 2019, BHCG, Staff, the OCC, BGVA, Vail, and EOC filed briefs addressing the issues noted above.

29. Also on May 13, 2019, BHCG filed a Second Amended Advice Letter and Second Amended Tariff Sheets with a new effective date of May 5, 2019. Applying the 210-day suspension period to the new effective date meant that the end of the suspension period would be November 30, 2019. This was an extension of 62 and 30 days of the effective dates of the original advice letter and the revised advice letter, respectively.

30. On May 15, 2019, BHCG filed a Motion to Strike a Portion of the OCC's Brief or, in the Alternative, a Motion for Leave to Respond and Request for Waiver of Response Time (BHCG's Motion to Strike). In the Motion, BHCG argued that the OCC impermissibly requested in its brief filed on May 13, 2019 that the ALJ order BHCG to file an informational 2018 calendar-year historic test year (HTY). BHCG requested that the portion of the OCC's brief addressing the 2018 calendar-year HTY be struck or, alternatively, permission to file a response brief addressing that issue.

31. On May 20, 2019, BHCG filed Revised, Corrected, and Supplemental Direct Testimony to address "[c]oncerns [] raised by Staff and the other intervenors regarding the impact of the two revenue requirement studies and the single class cost of service study filed with the Commission."[13] Specifically, BHCG filed the following testimony:

- Revised Direct Testimony of Fredric C. Stoffel;
- Revised Direct Testimony of Michael C. Clevinger and Attachment MCC-6;
- Revised Direct Testimony of Eric J. Gillen and Attachment EJG-7;
- Corrected Direct Testimony of Douglas N. Hyatt and Corrected Attachment DNH-13;
- Supplemental Direct Testimony of Douglas N. Hyatt and Attachments DNH-14 through DNH-19; and
- Supplemental Direct Testimony of Thomas J. Sullivan and Attachment TJS-6.

The revised, corrected, and supplemental testimony reiterated BHCG's commitment to cap the revenue it is seeking in this proceeding at the amount included in the original advice letter and notice ($73,181,063). It also revealed the impact of the $996,324 in additional revenue identified in the Notice for "illustrative purposes." Specifically, notwithstanding the overall alleged increase of $996,324 in BHCG's proposed total revenue requirement, only the rates for the residential class of customers would increase if the "illustrative" case were put into effect. Specifically, under the "illustrative" scenario, while the volumetric rates of the residential class of customers would increase from $0.18363 to $0.19144 per therm in the proposed R-1 rate area, and from $0.14462 to $0.14880 in the proposed R-2 rate area, the rates for the other classes (small commercial, large commercial, and seasonal/irrigation) would remain the same, as

[13] Black Hills Notice of Filing Revised, Corrected, and Supplemental Direct Testimony and Attachments at 2.

initially proposed by BHCG in its original Advice Letter. And, all other components of BHCG's proposed rates would remain the same due to the mitigation strategy employed by BHCG.[14]

32. On May 22, 2019, Staff filed a Motion to Strike, or in the Alternative, Stay BHCG's Revised, Corrected, and Supplemental Direct Testimony and Attachments (Staff's Motion to Strike). In its Motion, Staff noted that the new testimony "expand[s] the scope of this case beyond what was originally filed and noticed" and "make Black Hills' direct case a moving target."[15] Staff requested that the "new testimony and Attachments [] be stricken, or at the very least stayed, to give the parties some clarity while waiting for the ALJ's decision on the substantial issues already before him for resolution."[16]

33. On June 4, 2019, the ALJ issued Decision No. R19-0469-I in which the ALJ concluded that the Notice, Amended Advice Letters, and Amended Tariff Sheets did not trigger a requirement to provide additional public notice. Nevertheless, the ALJ vacated the procedural schedule, approved a new procedural schedule, vacated and reset the hearing to August 5 through 9, and 12, 2019, denied Staff's Motion to Strike, and denied-as-moot BHCG's Motion to Strike.

34. On June 14, 2019, BHCG filed a Third Amended Advice Letter and Third Amended Tariff Sheets with a new effective date of May 25, 2019, Applying the 120-day and 90-additional-day suspensions entered in Decision Nos. C19-0194 and R19-0265-I, respectively, to the new effective date established December 21, 2019 as the end of the suspension period.[17]

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[14] *Compare* Direct Testimony of Thomas J. Sullivan, Attachment TJS-5 *with* Supplemental Direct Testimony of Thomas J. Sullivan, Attachment TJS-6.

[15] Staff's Motion to Strike at 3.

[16] *Id*. at 4.

[17] Decision Nos. C19-0194 and R19-0265-I issued on February 22, 2019 and March 21, 2019, respectively.

35. At the deadline specified in the procedural schedule, Staff filed the answer testimony of Gabe Dusenbury, Eric R. Haglund, Sandi Kahl, Bridget McGee, Jason J. Peuquet, Erin T. O'Neill, Marianne W. Ramos, and Fiona Sigalla; the OCC filed the answer testimony of Dr. Scott England, Ronald Fernandez, and Cory Skluzak; AM Gas filed the answer testimony of Barton J. Levin; and EOC filed the answer testimony of Sanders Arnold and William P. Marcus.

36. During discovery, BHCG produced an RRS for each of the three existing base rate areas. Staff then made modifications to the RRS's and included them with Bridget McGee's answer testimony filed with the Commission.[18] No party filed CCOSS's for the three existing base rate areas in advance of the hearing.

4. Public Comments

37. The public comment hearings scheduled in Decision No. R19-0351-I took place as scheduled. No member of the public appeared at either public comment hearing.

38. In addition to the scheduled public comment hearings, members of the public were invited to submit written comments regarding the proposed rate hikes associated with this gas rate case. Thirty comments were submitted to the Commission through e-mail or through U.S. Mail.

39. The written comments submitted to the Commission are made part of the record and are considered in reaching the decision points discussed below.

5. Motion to Compel

40. On July 18, 2019, Staff filed a Motion to Compel Documents in Response to Staff's Thirty-Eighth Set of Data Requests (Motion to Compel). Specifically, Staff requested an

[18] Hearing Exhibit 405, Answer Testimony of Bridget McGee, Attachments BAM-1, BAM-2, and BAM-3.

order compelling BHCG to produce: (a) documents related to a presentation made to the Board of Directors of Black Hills Corporation (BHC) by Karen Beachy, who is the Vice President of Growth and Strategy for Black Hills Service Company, LLC, that is "referenced in the BHC Board of Director meeting minutes for January 29-30, 2019" (Data Request CPUC 38-1) (Beachy Presentation);[19] (b) BHC's 2018-2023 strategic plan that is "referenced in the BHC Board of Director meeting minutes for January 29-30, 2019" (Data Request CPUC 38-3) (2018-2023 Strategic Plan);[20] (c) BHC's 2018-2022 strategic plan that is "referenced in the BHC Board of Director meeting minutes for January 23-24, 2019" (Data Request CPUC 38-4) (2018-2022 Strategic Plan);[21] and (d) documents related to an analysis undertaken by Deloitte and Touche regarding "income tax positions and strategies associated with the partnership restructuring employed for purposes of accomplishing the Colorado gas utility consolidation" "referenced in the BHC Audit Committee meeting minutes for August 6, 2018" (Data Request CPUC 38-5) (Deloitte and Touche Analysis).[22] Staff also requested that the response time to the Motion to Compel be shortened to seven days. The OCC supported the Motion to Compel.

41. On July 26, 2019, BHCG filed its Response to the Motion to Compel (Response). In its Response, BHCG argued that Staff had not established that: (a) the requested documents are relevant to one or more of the disputes in this proceeding, or good cause to justify compelling their production because they are relevant to the subject matter of this proceeding, or are reasonably calculated to lead to the discovery of admissible evidence, all pursuant to Colorado Rule of Civil Procedure (C.R.C.P.) 26(b)(1); (b) the requested documents are in the custody or

[19] Response to Motion to Compel at 4-5 (¶ 7).
[20] *Id*. at 5 (¶ 7).
[21] *Id*.
[22] *Id*.

control of BHCG pursuant to C.R.C.P. 34(a); and (c) that the Deloitte and Touche Analysis is not protected by the attorney-client and work product privileges or should otherwise be produced.

42. In Decision No. R19-0655-I issued on August 1, 2019, the ALJ granted-in-part and denied-in-part the Motion to Compel. Specifically, the ALJ compelled the production of the Beachy Presentation, the 2018-2023 Strategic Plan, and the 2018-2022 Strategic Plan. The ALJ denied the portion of the Motion to Compel that sought the Deloitte and Touche Analysis, holding that it was protected by the work-product doctrine and that Staff did not carry its burden of establishing that it "ha[d] substantial need of the materials in the preparation of the case and [was] unable without undue hardship to obtain the substantial equivalent of the materials by other means."[23]

43. Thereafter, BHCG produced the documents and portions of them were admitted into the evidentiary hearing as Exhibits 805 through 820.

6. BHCG-Staff-EOC Partial Stipulation

44. On August 1, 2019, BHCG, Staff, and EOC filed a Partial Stipulation and Settlement Agreement (BHCG-Staff-EOC Partial Stipulation) in which the parties agreed to: (a) combine the BHGU and Arkansas Valley GCAs into a Central GCA; (b) combine the North Eastern, North Central, and Southwestern GCA regions into a North/SW GCA (GCA Consolidation); (c) a fixed residential charge of $12.25 for residential customers (Residential Customer Charge); and (d) a late payment charge of 1.0 percent per month unless the balance is $50 or less, which will be removed for one billing period, but not more than once in any 12-month period, the proceeds from which will be donated to the EOC (Late Payment

[23] C.R.C.P. 26(b)(3) (2012).

Charge). The GCA consolidation agreement results in the consolidation of seven GCAs into four GCAs, rather than the three GCAs originally proposed by BHCG.

45. The OCC supports the settlement on the Residential Customer Charge and the late Payment Charge in the BHCG-Staff-EOC Partial Stipulation. However, the OCC only supports the GCA Consolidation if the Company monetizes cost savings and includes them as a known and measurable *pro forma* adjustment in the Company's RRS.[24]

46. On August 5, 2019, AM Gas filed a Partial Stipulation and Settlement Agreement (BHCG-AM Gas Partial Stipulation) in which AM Gas stated that it supports the BHCG-Staff-EOC Partial Stipulation.[25]

7. BHCG-AM Gas Partial Stipulation

47. In the BHCG-AM Gas Partial Stipulation, those two parties agreed to: (a) a method for determining the capacity required by transportation customers; (b) tariff provisions addressing telecommunications requirements for Electronic Flow Measurement for transportation customers; (c) the prioritization of residential transportation customers who take service under the small commercial class tariff if a need to curtail gas on the system arises and tariff language to that effect; (d) a contracting methodology for transportation customers; (e) a deposit and credit approval process for transportation customers; and (f) a $50 per customer administrative charge for large transportation customers.

48. No party opposes the BHCG – AM Gas Partial Stipulation.

[24] Partial Stipulation and Settlement Agreement Between BHCG, Staff, and EOC at 8 (¶ 29) (filed on August 1, 2019)

[25] *See* Partial Stipulation and Settlement Agreement Between BHCG and AM Gas at 3 (¶ 12) (filed on August 5, 2019).

8. Hearing

49. The primary hearing took place as scheduled on August 5 through 9, and 12, 2019. During the hearing, the prefiled direct, answer, and rebuttal testimony was admitted into the evidentiary record, and Mr. Camp, Mr. Clevinger, Ms. Curran, Mr. Dusenbury, Dr. England, Mr. Fernandez, Mr. Gillen, Mr. Haglund, Mr. Hyatt, Ms. Johnson, Mr. Koca, Mr. Lewis, Mr. McKenzie, Mr. Menzel, Ms. O'Neill, Mr. Peuquet, Mr. Ryan, Ms. Sigalla, Mr. Skluzak, Mr. Stoffel, and Mr. Sullivan were cross-examined. In addition, Hearing Exhibits 800 through 893, 895 through 967, and 969 through 979, Confidential Hearing Exhibits 805C through 807C, and Highly Confidential Exhibits 808HC through 820HC, 892HC, and 935HC through 938HC were admitted into the evidentiary record.

50. Included among the admitted exhibits were the original and updated RRS filed with the direct testimony of Mr. Clevinger, the RRS's for the three existing base rate areas filed with the answer testimony of Ms. McGee, and the single, statewide CCOSS filed with the direct testimony of Mr. Hyatt. At that time, BHCG had not produced CCOSS's for the three existing base rate areas and Staff and OCC witnesses testified that without them the Commission could not determine whether the rates proposed by BHCG are just and reasonable.

9. Continued Phase II Proceedings

51. At the end of the hearing on August 12, 2019, the ALJ asked BHCG whether it wanted the evidentiary record to be closed in light of the testimony from Staff and OCC witnesses referenced above.[26] After conferring during a recess, BHCG and the other parties agreed to keep the evidentiary record open to allow BHCG to file four additional CCOSS's (one

[26] Staff raised concerns about the lack of CCOSS's in its answer testimony. However, BHCG did not provide such studies in its rebuttal testimony, generally asserting that it was Staff's obligation to provide detailed information for an option different than the Company's proposal.

for each of the existing base rate areas, and one for the combination of the BHGU Rate Area and BHGD Rate Area 2). BHCG also agreed to file a Fourth Amended Advice Letter and Tariff Sheets with a new effective date that would allow sufficient additional time for the development and filing of the new CCOSS's, review and response by the intervening parties, and an additional hearing day addressing the new CCOSS's and the positions of the parties in light thereof. The parties had not worked out the details of the foregoing agreement on August 12, 2019. As a result, they requested that the ALJ schedule a status conference for August 19, 2019, which would give the parties the time necessary to further discuss the agreement and to establish a procedural schedule consistent therewith. Based on the foregoing, the ALJ scheduled a status conference for August 19, 2019 at 11:00 a.m.

52. On August 16, 2019, Staff filed a Notice of Staff and OCC's Proposed Schedule and Procedures for Discussion at August 19, 2019 Status Conference.

53. On August 19, 2019, the ALJ held the status conference. The ALJ discussed with the parties the schedule proposed in the Notice filed on August 16, 2019. At the end of the status conference, the parties agreed to a further procedural schedule. BHCG also agreed to file a Fourth Amended Advice Letter and Tariff Sheets that results in an effective date of March 1, 2020.

54. The ALJ issued Decision No. R19-0831-I on August 28, 2019 that memorialized the agreements and decisions made at the August 19, 2019 status conference.

55. On September 27, 2019, BHCG filed its four new CCOSS's and the supporting supplemental direct testimony of Messrs. Gillen, Hyatt, and Stoffel.

56. On October 17, 2019, Staff filed the supplemental answer testimony of Ms. O'Neill, the OCC filed the supplemental answer testimony of Dr. England, and EOC filed the supplemental answer testimony of Mr. Marcus.

10. Final Hearing Day

57. On October 24, 2019, the final hearing day was held. During the hearing, the prefiled supplemental direct and answer testimony was admitted into the evidentiary record. Messrs. Stoffel, Hyatt, Gillen, and England, and Ms. O'Neill were cross-examined. The ALJ permitted BHCG's witnesses to provide testimony rebutting the supplemental answer testimony at the outset of their live testimony, and the intervening parties then cross-examined each BHCG witness on his direct and rebuttal testimony. Hearing Exhibits 973 through 979 were admitted into the evidentiary record. At the end of the hearing, the ALJ closed the evidentiary record.

11. Statements of Position

58. AM Gas, BGVA, BHCG, EOC, the OCC, Staff, and Vail each filed a Statement of Position (SOP) addressing the current evidentiary record and the decision points based on that record.

12. Technical Conference

59. Because the calculation of BHCG's revenue requirement, the various Phase II proposals, and the proposed DSIR, and their combined translation into just and reasonable rates, is complex, the ALJ ordered a Technical Conference in Decision No. R19-0968-I that issued on December 3, 2019. The ALJ ordered BHCG to model the RRS's, CCOSS's, and bill impacts for the following scenarios: (a) Three Separate Base Rate Areas + No Post-Base Period Capital Additions and Adjustments + No DSIR; (b) Three Separate Base Rate Areas + Post-Base Period Capital Additions and Adjustments + Separate DSIR for each Base Rate Area; (c) Consolidated

Base Rate Areas (BHCG's proposal) + No Post-Base Period Capital Additions and Adjustments + Statewide DSIR (BHCG's proposal); and (d) Consolidated Base Rate Areas (BHCG's proposal) + No Post-Base Period Capital Additions and Adjustments + No DSIR. The ALJ also ordered BHCG to use an ROE of 9.0 percent in the RRS's.

60. Pursuant to Decision No. R19-0968-I, on December 16, 2019 BHCG filed the revised RRS's and CCOSS's with the inputs identified by the ALJ, and the Technical Conference took place on December 18, 2019 at 9:00 a.m.

II. LEGAL PRINCIPLES AND BURDENS OF PROOF

A. Commission Jurisdiction and the Rate Setting Process

61. The Commission's authority to regulate BHCG's gas utility rates, services, and facilities derives from Article XXV of the Colorado Constitution. The Commission is charged with ensuring the provision of safe and reliable utility service at just and reasonable rates for customers pursuant to §§ 40-3-101, 40-3-102, 40-3-111, and 40-6-111, C.R.S.

62. Pursuant to § 40-3-101(1), C.R.S., "[a]ll charges made, demanded, or received by any public utility for any rate, fare, product, or commodity furnished or to be furnished or any service rendered or to be rendered shall be just and reasonable." In interpreting that statute, the Colorado Supreme Court has held that the primary purpose of utility regulation is to ensure that the rates charged are not excessive or unjustly discriminatory.[27]

63. Further, § 40-3-102, C.R.S., states that "[t]he power and authority is hereby vested in the public utilities commission of the state of Colorado and it is hereby made its duty to adopt all necessary rates, charges, and regulations to govern and regulate all rates, charges, and

[27] *Cottrell v. City & County of Denver*, 636 P.2d 703 (Colo. 1981).

tariffs of every public utility of this state to correct abuses; to prevent unjust discriminations and extortions in the rates, charges, and tariffs of such public utilities of this state."

64. The decision to establish rates that will be charged by public utilities is a legislative function that has been delegated to the Commission.[28] The Commission must adopt rates and rate structures that are fair and reasonable.[29] Setting rates "is not an exact science but a legislative function involving many questions of judgment and discretion."[30]

65. In setting rates, the Commission must consider the interests of both the utility's investors and its consumers. Sound judgment in the balancing of their respective interests is how the ratemaking decision is reached rather than by use of a mathematical or legal formula.[31] Consequently, the Commission "may set rates based on the evidence as a whole" and "need not base its decision on specific empirical support in the form of a study or data."[32] In setting rates, the Commission must balance "the investor's interest in avoiding confiscation and the consumer's interest in prevention of exorbitant rates,"[33] and set rates that "protect both: (1) the right of the public utility company and its investors to earn a return reasonably sufficient to maintain the utility's financial integrity; and (2) the right of consumers to pay a rate which accurately reflects the cost of service rendered."[34]

66. The Commission establishes rates to recover the utility's revenue requirements using a test year selected by the Commission. The revenue requirement is the total revenues

[28] *City and County of Denver v. Public Utilities Comm'n.*, 266 P.2d 1105, 1106 (1954).
[29] *Integrated Network Services, Inc. v. PUC*, 875 P.2d 1373, 1381 (Colo. 1994).
[30] *Id.*; *see also PUC v. Northwest Water Corporation*, 168 Colo. 154, 551 P.2d 266 (1963).
[31] *PUC v. Northwest Water Corp.*, 551 P.2d 266, 276 (1963).
[32] *Colorado Office of Consumer Counsel v. PUC*, 275 P.3d 656, 660 (Colo. 2012).
[33] *Colorado Municipal League v. PUC*, 687 P.2d 416, 418 (Colo. 1984).
[34] *Public Service Company of Colorado v. PUC*, 644 P.2d 933, 939 (Colo. 1982).

required by the utility to cover both its expenses and to have a fair or reasonable opportunity to earn a fair rate of return (ROR). While the utility has a reasonable opportunity to realize the ROR set by the Commission, the ROR is not guaranteed.

67. In an appeal from a Commission rate case decision, the Colorado Supreme Court "reiterated that 'it is the result reached, not the method employed, which determines whether a rate is just and reasonable.'"[35] Moreover, the Colorado Supreme Court has consistently held that the doctrine of *stare decisis* does not apply to Commission decisions, and that the Commission's prior decisions cannot be applied as binding precedent in future proceedings involving the same utility or to any other utility. The Commission's decision in each new proceeding must be based upon new, substantial evidence in the record of the new case.[36] Consistent with this principle, the Colorado Supreme Court has noted that:

> [s]ince rate setting is a legislative function which involves many questions of judgment and discretion, courts will not set aside the rate methodologies chosen by the [Commission] unless they are inherently unsound.
>
> *CF&I Steel, L.P. v. Pub. Utils. Comm'n.*, 949 P.2d 577, 584 (Colo. 1997)[.] ...
>
> Indeed,
>
> the [Commission] is not bound by a previously utilized methodology when it has a reasonable basis, in the exercise of its legislative function, to adopt a different one.
>
> *CF&I Steel*, 949 P.2d at 584.[37]

B. Derivation of the Revenue Requirement

68. The revenue requirement formula is:

Revenue requirement = E + r(RB)

[35] *Glustrom v. PUC*, 280 P.3d 662, 669 (Colo. 2012), (quoting *Colorado Ute Electric Association, Inc., v. PUC*, 198 Colo. 534, 602 P.2d 861, 864 (Colo. 1979) (citing *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944))).

[36] *See Colorado Office of Consumer Counsel v. Public Service Company,* 877 P.2d 867, 876 (Colo. 1994); *Colorado-Ute*, 602 P.2d at 865; *B&M Services, Inc. v. PUC*, 429 P.2d 293, 295 (Colo. 1967).

[37] *Glustrom*, 280 P.3d at 669.

WHERE:	E	=	Expenses = O + D + T
	O	=	Operating expenses, including wages and salaries, administrative expenses, taxes other than income taxes, fuel costs, and various maintenance expenses
	D	=	Annual depreciation expenses
	T	=	Income taxes (state and federal)
	r	=	Rate of return (return on bonds, preferred stock, and common stock (equity))
	RB	=	Rate base = v - d
	v	=	(1) Plant in service plus:
			(2) Working capital (cash working capital + materials and supplies)
	d	=	Accumulated depreciation and accumulated deferred income taxes

69. In past rate cases and as discussed below, the Commission has established regulatory principles and methods to use to determine a utility's revenue requirement.

C. Test Year

70. The rate setting process begins with the selection of a test year that is used to evaluate and to adjust (as necessary) the interrelationships of a utility's revenue, expense, and capital investment to determine whether the utility has a revenue excess or deficiency. These components should correspond to each other over the same time period or according to the same operating conditions. This is known as the "matching principle" and it is designed to ensure "that the cost of service reflects the operational relationships and interplay between rate base, expenses, and revenues in a manner that is representative of the period when the resulting rates will be in effect."[38]

[38] Decision No. C11-1373 issued in Proceeding No. 11AL-382E on December 22, 2011 at 20 (¶ 51).

71. It is the interaction of the component parts of a test year and how they are affected by a utility's operations that is important for purposes of rate setting. Obviously, the absolute quantities of these components will change when the test year has ended and the new rate year arrives. Accordingly, the key to test year integrity is to make the interrelationship of revenue, expense, and capital investment as representative of future operations as possible.

72. As noted, the parties disagree over whether the test year used in this proceeding should be an HTY ending on June 30, 2018 with *pro forma* adjustments through the end of December 31, 2019, an HTY ending on June 30, 2018 without *pro forma* adjustments, or an HTY ending on December 31, 2018. An HTY uses revenues, expenses, and rate base from an identified historical period, as adjusted, to determine the utility's revenue requirement.

D. Burden of Proof and Burden of Going Forward

73. Except as otherwise provided by statute, the Administrative Procedure Act imposes the burden of proof in administrative adjudicatory proceedings upon "the proponent of an order."[39] The party bearing the burden must prove its case by a preponderance of the evidence.[40] The evidence must be "substantial evidence," which is defined as "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion ... it must be enough to justify, if the trial were to a jury, a refusal to direct a verdict when the conclusion sought to be drawn from it is one of fact for the jury."[41] This standard requires that evidence of the existence of a contested fact outweighs the evidence to the contrary.[42] That is, the finder of

[39] § 24-4-105(7), C.R.S.

[40] § 24-4-105(7), C.R.S.; § 13-25-127(1), C.R.S.; Rule 1500 of the Rules of Practice and Procedure, 4 *Code of Colorado Regulations* 723-1.

[41] *See*, *e.g.*, *City of Boulder v. Pub. Utils. Comm'n*, 996 P.2d 1270, 1278 (Colo. 2000) (quoting *CF&I Steel, L.P. v. Pub. Utils. Comm'n*, 949 P.2d 577, 585 (Colo. 1997)).

[42] *Mile High Cab, Inc. v. Colorado Public Utilities Comm'n.,* 302 P.3d 241, 246 (Colo. 2013).

fact must find that the existence of a contested fact is more probable than its non-existence for a party to carry its burden.[43]

74. In reaching his decision in this matter, the ALJ is mindful of these principles and of the Commission's duty under the Colorado Public Utilities Law.

E. Analytical Approach

75. In rendering this Decision, the ALJ has carefully reviewed and considered all the evidence introduced by the Parties during the hearing, including the testimony and hearing exhibits, even if this Decision does not specifically address all of the evidence presented, or every nuance of each party's position in each issue. Moreover, the ALJ has considered all the legal arguments set forth in the SOPs, even if the Decision does not explicitly address every legal argument. In rendering this Decision, the ALJ has weighed the evidence and evaluated the credibility of all the witnesses and hearing exhibits.[44]

III. SYNERGIES – SOURCEGAS ACQUISITION

A. Background

76. The Commission approved the acquisition of the SourceGas (including SourceGas Distribution, LLC, which became Black Hills Gas Distribution, LLC and Rocky Mountain Natural Gas, LLC) by Black Hills Utility Holdings, Inc. (BHUH), a subsidiary of Black Hills Corporation, in Proceeding No. 15A-0667G. By Decision No. R16-0058, issued January 22, 2016 in Proceeding No. 15A-0667G, the Commission granted the joint application regarding the proposed transaction, as modified by a settlement agreement, which was approved, in part, and denied, in part. Notably, the settlement agreement stated that the integration of the

[43] *Swain v. Colorado Department of Revenue*, 717 P.2d 507 (Colo. App. 1985).

[44] *See Durango Transportation, Inc. v. Colorado Public Utilities Comm'n.*, 122 P.3d 244, 252 (Colo. 2005); *RAM Broadcasting of Colo., Inc. v. Public Utilities Comm'n.*, 702 P.2d 746, 750 (Colo. 1985).

SourceGas business would entail significant costs that "create long-term efficiencies."[45] A joint motion for expedited approval of Decision No. R16-0058 issued January 22, 2016, further stated that "BHUH's integration activities will have benefits for customers, including a rate reduction."[46]

77. In referring this proceeding to the ALJ, the Commission noted the foregoing statements, and stated as follows:

> In light of the representations made by the settling parties in Proceeding No. 15A-0667G regarding long-term efficiencies and their impacts on rates, we direct the ALJ to address the Company's compliance with the directives in Decision No. R16-0058 and to examine whether the consolidation of Black Hills/Colorado Gas Utility Company Inc. and Black Hills Gas Distribution, LLC resulted in efficiencies and cost savings as reflected in the overall annual revenue requirement of $73.2 million at issue in this Proceeding.[47]

B. Synergy Savings Generally

1. BHCG's Arguments

78. BHCG estimates its overall savings from the acquisition of SourceGas to be approximately $36 million. Of that amount, BHCG's share is approximately $2 million,[48] which BHCG contends is reflected in the revenue requirement proposed in this proceeding.[49] BHCG gave a confidential report to both Staff and the OCC detailing the costs eliminated as a result of the transaction, and this is included as Attachments JWK-15 and JWK-16 to the direct testimony of Justin Klapperich.[50]

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[45] Settlement Agreement filed in Proceeding No. 15A-0667G on November 17, 2015 at 6.

[46] Unopposed Joint Motion for Expedited Approval of Recommended Decision filed in Proceeding No. 15A-0667G on January 25, 2016 at 3 (¶ 7).

[47] Decision No. C19-0194 at 5-6 (¶ 18).

[48] Hearing Exhibit 111 at 36:9-13 (Direct Testimony of Mr. Klapperich).

[49] Hearing Transcript at 60:10-61:20 (October 24, 2019); Hearing Exhibit 111 at 36:14-19.

[50] Hearing Exhibit 111 at 36:20-37:10.

79. BHCG states that in addition to its report on costs eliminated due to the SourceGas acquisition, it presented Attachment JWK-14C which represented a "scorecard" of labor and non-labor synergies by department in order to provide additional information regarding areas where cost reductions were achieved. BHCG states that it used estimates, forecasts, and actual data in the savings determination.[51] No representation was made, however, that the synergies would translate into a rate reduction; instead, BHCG expected that synergies would offset inflationary effects on utility costs, and help defer rate filings.[52] BHCG opposes any imputation of cost savings into the revenue requirement.

2. Intervenors' Arguments

a. Staff

80. Staff argues that the documents produced following the ALJ's decision on the Motion to Compel reveal "a strategic initiative to grow [BHC's] utility earnings and customer base through large-scale acquisitions[,]" such as BHC's 2008 Aquila and 2016 SourceGas acquisitions, which created Black Hills' Colorado gas utility service area.[53] Thereafter, BHC "avoid[ed] rate review proceedings,"[54] which "allow[ed] utility subsidiaries to fully internalize synergies to the benefit of shareholders alone."[55] According to Staff, BHCG absorbed synergies for the benefit of shareholders, while simultaneously raising the cost of service for ratepayers, by implementing wage increases and pension/retiree medical amortizations.[56]

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[51] Hearing Exhibit 111 at 36:9-12; Hearing Exhibit 127 at 10:10-12:6 (Rebuttal Testimony of Mr. Klapperich).

[52] Hearing Exhibit 127 at 12:7-16.

[53] Staff's SOP at 3 (quoting Hearing Exhibit 813 (excerpt of BHC's 2018-2023 Strategic Plan at 22 of 98); Hearing Exhibit 818 (excerpt of BHC's 2017-2022 Strategic Plan at 9-10 of 80).

[54] *Id*. (quoting Hearing Exhibit 817 (excerpt of BHC's 2018-2023 Strategic Plan at 5-6); Hearing Exhibit 820 (excerpt of BHC's 2017-2022 Strategic Plan at 57)).

[55] *Id*. at 30.

[56] *Id*. at 31

81. However, "[c]urrent market premiums for utility properties are extraordinarily high and [BHC's] balance sheet (which was intentionally leveraged to purchase SourceGas) would not allow [BHC] to use sufficient debt to be competitive in a utility sales auction process."[57] For this reason, and because BHC has successfully internalized all of the synergy savings for the benefit of its shareholders, BHC is now "focus[ing] on a more traditional utility growth strategy driven by substantial capital investments for customers, while requesting rate reviews to achieve fair returns for shareholders."[58] According to Staff, the BHC-wide push for "jurisdictional simplification" of the many holding companies and subsidiaries created by BHC's acquisitions phase, and consolidation of BHCG's base rate areas, are part and parcel of BHC's strategic refocus on growth through state rate cases.[59]

82. To recover some of the synergy savings for the benefit of ratepayers, Staff recommends: (a) combining rate case expenses with employee severance costs resulting from the SourceGas acquisition into a separate rider under a three-year amortization; (b) stopping the recovery of pension and retiree medical regulatory assets (that the Commission did not approve) and returning them to ratepayers; and (c) providing to ratepayers 90 percent of an anticipated $24 million in income tax savings that will be realized over a 15-year period as a result of the consolidation of BHGU and BHGD, and tracking the sharing of those savings.[60]

[57] *Id*. at 3 (quoting Hearing Exhibit 813 at 22).

[58] *Id*. at 3-4 (Hearing Exhibit 816 (excerpt of BHC's 2018-2023 Strategic Plan) at 37); Hearing Exhibit 817 (excerpt of BHC's 2018-2023 Strategic Plan at 5-6).

[59] *Id*. at 4.

[60] *Id*. at 31-32.

b. OCC

83. The OCC contends that BHCG did not carry its burden of proving the alleged synergy savings, describing them as "putative."[61] The OCC contends that the claimed savings are estimates, and questions whether the savings are tied to changes in actual costs before and after the acquisition for all categories.[62] The OCC recommends that the Commission consider BHCG's alleged failure to establish the synergy savings as a factor against BHCG's proposals in this proceeding. Alternatively, the OCC asserts that it would be appropriate for the Commission to impute a cost savings amount into the Company's revenue requirement.[63] The OCC also disagrees with the amortization of the Synergy Regulatory Asset, as discussed below.

3. Analysis

84. Contrary to Mr. Klapperich's contention,[64] Black Hills did state in the proceeding to approve the acquisition of SourceGas that the savings resulting therefrom would lead to a rate reduction. As noted above, the Parties – including Black Hills – stated in the Motion for Expedited Approval of Decision No. R16-0058 filed in the proceeding addressing the acquisition of SourceGas that "BHUH's integration activities will have benefits for customers, including a rate reduction."[65] It now appears that, while BHCG contends that the savings of approximately $2 million resulting from the SourceGas acquisition are reflected in the revenue requirement, no clear rate reduction has materialized in BHCG's proposed rates for at least a significant portion

[61] OCC's SOP at 21; Hearing Exhibit 301 at 32:11-33:22 (Answer Testimony of Mr. Skluzak).

[62] Hearing Exhibit 301 at 33:12-22.

[63] *Id*. at 11:16-23; 12:7-12; 34:18-35:3; 40:16-41:2.

[64] Hearing Exhibit 127 at 12:7-16.

[65] Unopposed Joint Motion for Expedited Approval of Recommended Decision filed in Proceeding No. 15A-0667G on January 25, 2016 at 3 (¶ 7).

of BHCG's ratepayers. In fact, a rate increase – including a significant one for significant numbers of ratepayers – is at issue in this proceeding.

85. The ALJ is also concerned by the documents produced pursuant to the decision granting-in-part and denying-in-part the Motion to Compel. The documents speak for themselves. They describe a strategy of acquisitions followed by delayed rate review proceedings to ensure that shareholders – and not ratepayers – receive the benefits of any cost-savings resulting from the acquisitions. Because BHCG delayed rate review proceedings, it also delayed capital expenditures. The end result is that ratepayers have not seen the rate savings promised by BHC in the acquisition proceeding, and now will suffer the consequences of delayed capital investment, particularly in BHGD's Rate Area 2, where BHCG now proposes to spend almost $70 million in capital investments through the DSIR in order to ensure safe and reliable service to 23,000 customers. The ALJ also finds and concludes that BHC knew or reasonably should have known about the necessary capital investments in BHGD's Rate Area 2 before it purchased SourceGas, and that the need for such a high level of capital investment was factored – or should have been factored – into the price paid for SourceGas. To conclude otherwise would defy logic.

86. It is true – as BHCG has repeatedly emphasized – that Staff and the OCC agreed in the settlement agreement reached in the SourceGas acquisition proceeding that BHCG would delay filing a rate case for the SourceGas territories for at least three years after the closing of the acquisition.[66] However, the Staff and the OCC did not have access to the documents produced in this proceeding pursuant to the Motion to Compel indicating that Black Hills had no intention of filing a rate case within that timeframe to ensure that shareholders would receive the benefit of

[66] Decision No. R16-0058 issued in Proceeding No. 15A-0667G on January 22, 2016 at 28 (¶ 86).

the cost savings resulting from the acquisition. If they had, it seems less likely – perhaps significantly so – that they would have agreed to that provision in the settlement agreement. As a result, the ALJ places little weight on Staff's and the OCC's agreement in the SourceGas acquisition settlement agreement to a three-year moratorium on the filing of a rate case.

87. The ALJ will not adopt the recommendations of Staff and the OCC. Instead, as explained below, the ALJ shall deny BHCG's request for a DSIR but shall order BHCG to file a new advice letter and related tariff sheets proposing a DSIR within six months of a final decision.

C. Synergy Regulatory Asset

1. BHCG's Arguments

88. BHCG proposes an amortization of a "Synergy Regulatory Asset" of $440,242 per year for two years, a total recovery of $880,484. The asset consists of severance costs resulting from a reduction in a headcount of 152 employees that occurred in the 18 months following the SourceGas acquisition. The severance costs were allocated to BHCG by BHC, then reduced by 50 percent according to the settlement in the SourceGas acquisition proceeding, Proceeding No. 15A-0667G.[67]

89. BHCG argues that Decision No. R16-0058 in Proceeding No. 15A-0667G authorized a regulatory asset for the severance costs. The settlement agreement stated, in part:

> Black Hills shall establish a regulatory asset (account) to be amortized for determining the revenue requirement in its first rate case. The regulatory asset value shall be established by taking one-half of the sum of the Black Hills' allocated share of the annual base salary of each employee of Black Hills Service Company ("BHSC"), BHUH and the acquired SourceGas companies that have been granted a severance payment agreement within the first eighteen months following the acquisition close. The allocation shall be determined as provided for in the Black Hills cost allocation manuals that are effective at the time of the severance. Black Hills shall not earn a return on the value of the regulatory asset.

[67] Hearing Exhibit 104 at 52:1-30 (Revised Direct Testimony of Mr. Stoffel).

> The amortization expense for determining the revenue requirement in Black Hills' first rate case shall be the value of the regulatory asset amortized over a two year period. There will be no tracking or true-up associated with this amortization.[68]

2. Intervenors' Arguments

a. Staff

90. Staff recommends a three-year amortization of the Synergy Regulatory Asset, coinciding with the three-year amortization of rate case expenses.[69] Staff opposes the recovery of the proposed asset in its current form because it does not have a mechanism to stop recovery after the two-year period is over.[70] Staff agrees with the Company that the Commission did approve recovery of costs associated with employee severance packages, but prohibited the ability to earn a return on the value of that asset.[71]

91. Staff is concerned that approval without a process to end recovery would result in a windfall, because it may be more than two years until the Company files its next rate case.[72] Staff requests that the Commission grant a three-year amortization to coincide with the three year amortization of rate case expenses, and include it in a stand-alone rate rider along with the rate case expenses. After the amortization period, the Commission would require a compliance filing from BHCG to remove the recovery of the amortization and remove the rider.[73]

b. OCC

92. Similar to Staff, the OCC does not oppose the Synergy Regulatory Asset, but raises two concerns. First, the OCC was unable to ascertain if the $880,484 for severance

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[68] *Id*. at 52:11-24 (quoting Settlement Agreement in Proceeding No. 15A-0667G at ¶10.C).
[69] Hearing Exhibit 400 at 133:17-19 (Answer Testimony of Mr. Peuquet).
[70] *Id*. at 132:9-11.
[71] *Id*. at 132:1-5.
[72] *Id*. at 133:5-13.
[73] *Id*. at 133:17-134:9.

expenses was truly a savings of the acquisition, or from normal staffing attrition, thus questioning whether the savings were actually caused by the acquisition. Second, the OCC is concerned about recovery extending beyond the two-year amortization period, and recommends ending its recovery after two years by filing a negative General Rate Schedule Adjustment (GRSA).[74] Notably, the OCC advocates that the Commission guard against all over-recovery of regulatory assets by ordering the Company to adjust its base revenues after recovery ends.[75]

3. Analysis

93. The amortization of the regulatory asset for severance costs, in principle, was approved by the Commission in accordance with paragraph 10.C. of the settlement, as approved by Decision No. R16-0058. The plain language in the settlement agreement authorizes the amortization over two years for purposes of determining the revenue requirement. While Staff's recommendation of a three-year amortization along with the rate case expenses promotes efficiency, the ALJ will decline to modify the Commission's prior approval of the settlement.

94. Staff's and the OCC's concern that the amortization of the Synergy Regulatory Asset be ended in a discrete manner is legitimate. Because the amortization period is limited to two years by the language of the settlement, the ALJ will require BHCG to make a compliance filing after the two-year amortization period to halt recovery and remove the Synergy Regulatory Asset.

[74] Hearing Exhibit 300 at 35:4-36:18 (Answer Testimony of Mr. Skluzak).
[75] *Id*. at 36:7-18.

IV. RATE BASE – POST-BASE PERIOD ADDITIONS

A. BHCG's Argument

95. BHCG proposes to include $35.3 million in post-Base Period capital additions and adjustments from July 1, 2018 through December 31, 2018 (Post-Base Period Capital Additions). BHCG identifies the plant additions on Schedule M-2 of the Company's revised revenue requirement model (Attachment MCC-1), and categorizes them as either "Repair Items" or "Non-Repair Items." The adjustment calculates the first year's revenue requirement for the additional plant placed in service after June 30, 2018. The additions include: (a) approximately $6.8 million to support increased system load due to population growth; (b) approximately $7.6 million for various general plant additions; (c) approximately $2.8 million for various reliability additions; and (d) approximately $18 million for pipeline replacement integrity additions.[76]

96. The Company represents that the adjusted amounts are per-book numbers, known and measurable, and the underlying assets are used and useful.[77] The adjustments only recover revenue requirement associated with plant that is already serving customers, and that will continue to do so when rates go into effect.[78]

97. BHCG also cites the Commission's decisions in Consolidated Proceeding Nos. 11AL-382E and 11AL-387E and Proceeding No. 16AL-0326E in support of its argument that the Commission has approved mid-year ending Base Periods with adjustments through the end of the calendar-year. In the former consolidated proceeding, BHCG contends that the

[76] The specific capital additions are described in Hearing Exhibit 106 at 39:10-41:9 (Direct Testimony of Corey Koca).

[77] *Id*. at 39:10-14; 41:10-12.

[78] *Id*. at 41:10-12.

Commission approved plant additions of $226 million of generation and $46 million of other types of additions.[79] In the latter, BHCG states that the Commission approved approximately $21 million of plant additions in addition to the approval of the Clean Air Clean Jobs Act (CACJA) rider.[80] BHCG concludes that its request to include the post-Base Period adjustments is supported by prior Commission decisions.

98. BHCG asserts that the Post-Base Period Capital Additions do not violate the matching principle. As support, BHCG states that there is never a perfect match and points to its upward adjustment of test period revenues to reflect customer growth and the use of year-end measures of BHCG's capital structure and cost of long-term debt.[81] BHCG argues that there was no need to include replacements and retirements because they have no rate base impact. According to BHCG, when an asset is retired under group asset depreciation, the gross plant account and accumulated reserve balances are reduced by the original cost of the asset.[82]

99. BHCG also asserts that the Commission has deviated from the strict application of the matching principle in past decisions, citing the Commission's decisions in the proceedings noted above and other unspecified decisions "in many rate utility proceedings over the last 30 years" in which the Commission has approved the use of year-end rate base.[83] BHCG concludes that departure from the strict application of the matching principle in this proceeding by approving BHCG's $35.3 million in post-Base Period adjustments is likewise appropriate.

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[79] Hearing Exhibit No. 124 at 12:22-13:12.

[80] *Id*. at 13:13-17.

[81] Hearing Exhibit 124 at 16:11-19 (Rebuttal Testimony of Mr. Clevinger).

[82] *Id*. at 16:4-10.

[83] *Id*. at 16:20-17:3.

B. OCC's Argument

100. The OCC opposes the capital additions, characterizing them as "capital reach" instead of known and measurable *pro-forma* adjustments. The OCC acknowledges that the revisions use per-book numbers that are known.[84] However, the OCC argues that such adjustments violate the regulatory matching principle because they involve only capital additions without corresponding changes to other costs and revenues.

101. The OCC states that the proposed changes are more accurately described as out-of-period adjustments than the *pro-forma* adjustments that the Commission has historically allowed. The OCC defines *pro-forma* adjustments as changes made to the test year results to make the test year more representative of the costs and revenues expected to be incurred during the time when new rates will be in effect. Examples of such adjustments include annualizations and normalizations, where the full effect on the future period, including on the cost and revenue side, is known.[85] Out-of-period adjustments, on the other hand, are costs that are expected, with a high degree of certainty, to occur within one year of the end of the test year.[86] At a minimum, such out-of-period adjustments are asymmetrical because they do not include all of the revenue-side effects, and thus make the revenue requirement less representative of the period in which rates will be in effect.[87]

102. The OCC argues that the Company's capital additions are out-of-period adjustments that should not be allowed. The OCC notes that a portion of the $35.3 million was used to remove and replace certain obsolete and outdated plant assets.[88] While BHCG included

[84] Hearing Exhibit 301 at 54:17-55:10 (Answer Testimony of Mr. Skluzak).
[85] *Id*. at 56:19-57:4.
[86] *Id*. at 57:5-8.
[87] *Id*. at 42:7-13.
[88] *See* Hearing Exhibit 106 at 39:10-41:6 (Direct Testimony of Mr. Koca).

all of the new plant that became used and useful from July 1, 2018 to December 31, 2018, it did not subtract out of rate base the old plant that the new plant replaced.[89] Similarly, BHCG includes $6.8 million worth of plant expenditures that came online from July 1, 2018 to December 31, 2018 to accommodate increased system load due to population growth,[90] but does not add the additional revenues associated with that additional capacity.[91] Finally, the OCC takes issue with the annualization process used in the period between June 30, 2018 and December 31, 2018, asserting that it employs a year-end rate base methodology, while the Base Period (July 1, 2017 through June 30, 2018) used a 13-month average rate base.[92]

103. Finally, the OCC distinguishes the Commission's decisions in Proceeding No. 09AL-299E[93] and Proceeding Nos. 11AL-382E and 11AL-387E.[94] Specifically, the OCC argues that the capital adjustments in this proceeding are comparatively small in magnitude and circumstances in which they were expended are not extraordinary.[95]

104. Based on the foregoing, the OCC argues that the post-Base Period additions proposed by BHCG violate the matching principle and do not satisfy the Commission's standard to allow such additions only in extraordinary circumstances. The OCC recommends that the Commission exclude the post-Base Period capital additions and all related costs from the revenue requirement determination. In addition to the removal of the $35.3 million of rate base

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[89] Hearing Exhibit 301 at 60:3-19 (Answer Testimony of Mr. Skluzak).

[90] *Id*. at 55:11-16. *See also* Hearing Exhibit 106 at 40:1-8 (Direct Testimony of Mr. Koca).

[91] Hearing Exhibit 301 at 59:10-14 (Answer Testimony of Mr. Skluzak).

[92] *Id*. at 29:12-15.

[93] Decision No. C09-1446, Proceeding No. 09AL-299E issued December 24, 2009.

[94] Decision No. C11-1373, Proceeding Nos. 11AL-382E and 11AL-387E, ¶¶34-35 and ¶54.

[95] Hearing Exhibit 301 at 61:14-67:6 (Answer Testimony of Mr. Skluzak).

additions, the OCC advocates for specific reversals in the revenue requirement model.[96] The OCC acknowledges that its recommended adjustments are partial adjustments, because they will affect at least cash working capital and income tax expense. Due to the complexity of the reversals required if the recommendation is accepted, the OCC recommends a technical conference be held to address these adjustments.

C. Analysis

1. The Matching Principle and Out-of-Period Adjustments

105. BHCG and the OCC seemingly agree that the matching principle is relevant to the decision of whether to allow BHCG's requested post-Base Period capital additions, but disagree over what the matching principle means and how to apply it to this proceeding. The OCC contends that deviations from the matching principle are reserved for unique and extraordinary situations. BHCG disagrees and, citing Decision No. C11-1373, states that the matching principle justifies post-Base Period additions to rate base to make the test year more "representative of the period when the resulting rates will be in effect."[97] This dispute requires review of Commission decisions addressing the matching principle and out-of-period adjustments.

a. Commission Decisions

106. The matching principle has a long history with the Commission. In Decision No. 87474 issued in 1975, in considering whether to use year-end or average rate base in a

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[96] OCC specifies the following reversals: Accumulated Depreciation of $455,246; ADIT of $(580,541); Depreciation Expense of $910,492; Revenue of $708,637 (replacing it with a revised reversal of $101,234); and Property Tax Expense of $237,506. *Id*. at 68:15-20, and at. 69:1-4.

[97] BHCG's SOP at 14 (citing Decision No. C11-1373 issued in Proceeding No. 11AL-387E on December 22, 2011 at ¶ 51). (Emphasis Omitted) *See also id*. at 14-15 (citing Decision No. R14-1298 issued in Proceeding No. 14AL-0393E on October 28, 2014 at ¶ 91 ("the key to test year integrity is to make the interrelationship of revenue, expense, and capital investment as representative of future operations as possible.")).

combined gas and electric rate proceeding filed by Public Service Company of Colorado (PSCo), the Commission stated:

> The purpose of determining a rate base for the test period is to establish a relationship between investment, revenues and expenses. Then, as a change in one factor in the relationship occurs as a result of growth, a corresponding change in the other factors is expected to occur. It is this relationship that serves as a reliable guideline by which to set rates for the foreseeable future.
>
> If one factor in the relationship is overstated, then the matching relationship is distorted. Use of the year-end rate base approach, as proposed by Public Service, is an example. Public Service's approach takes advantage of its growth in rate base, but makes no corresponding adjustments to revenues or expenses which result from that growth.
>
> Therefore, the Commission is of the opinion that use of average rate base is a sound regulatory principle.[98]

The Commission employed average rate base for the gas department, but approved the use of year-end rate base for the electric department because of that department's significant expenditures on the installation of pollution-control equipment in its facilities, which was required by law.[99] The Commission noted that in the three months from December 31, 1974 to March 31, 1975 the percentage of rate base that the pollution-control equipment comprised had risen from 7.04 to 7.09 percent. Further, the Commission noted that the percentage of rate base that pollution-control equipment would take up was expected to continue to grow to 11.32 percent by March 31, 1977. This continued the dramatic growth of pollution-control equipment as a percentage of rate base, which had been only 1.7 percent at the end of 1968.[100] Noting that the pollution-control equipment was mandated by law and thus beyond the utility's control and was not revenue producing, the Commission held that "the situation is sufficiently unique to justify use of a year-end rate base [and thus departure from the matching principle] at

[98] Decision No. 87474 issued in I&S Docket No. 935 on September 12, 1975 at 15.
[99] *Id*. at 15-16.
[100] *Id*. at 16.

th[at] time."[101] The Commission went on to further underscore the uniqueness of the situation by stating that "[t]his rationale does not appear to be applicable to any other utility subject to this Commission's jurisdiction."[102]

107. Similarly, in Decision No. 91581 issued in 1977, the Commission adopted a year-end rate base for PSCo's gas and electric departments. The Commission cited and endorsed its statement in Decision No. 87474 concerning the matching principle and that employment of an average rate base best serves that principle. However, the Commission found that there was earning attrition beyond PSCo's control and adopted a year-end rate base to offset the effects of that attrition.[103]

108. In Decision No. C93-1346, the Commission addressed whether to use year-end or average rate base in the test-year used to determine rates. In doing so, the Commission first stated that "[t]he purpose of a test year is to provide, as closely as possible, an interrelated picture of revenue, expense, and investment reasonably representative of the interrelationships that will be in place at the time the new rates proposed in a rate case will be in effect."[104] While *pro forma* adjustments to the test year are permitted, they are limited to one-year after the end of the test year to minimize the risk of "distort[ing] th[e] matching and interrelationships of the test year components."[105] The Commission concluded that:

> [i]f a number of adjustments proposed are from outside the cutoff period and the magnitude of the proposed adjustments is significant, it may well indicate that the proposed test year is insufficient and should be updated with a later test year.[106]

[101] *Id*.

[102] *Id*.

[103] Decision No. 91581 issued in I&S Docket No. 1116 on November 1, 1977 at 10-11.

[104] Decision No. C93-1346 issued in Proceeding No. 93S-001EG on October 27, 1993 at 22.

[105] *Id*. at 23.

[106] *Id*.

Based on this background, the Commission adopted a year-end rate base. As support, the Commission cited the installation of $50 million in pollution-control equipment, and the implementation of a $52 million customer information system, both after the test year. The Commission found that these were "out-of-the-ordinary" capital expenditures that were "beyond the control of the Company," and that use of average rate base would not account for these investments.[107] The Commission also concluded that the use of year-end rate base would not distort the relationship between the component parts of the test year.[108]

109. In Consolidated Proceeding Nos. 11AL-382E and 11AL-387E, Black Hills/Colorado Electric Utility, LP (BHCE) proposed a test year ending on December 31, 2010, but also requested that a new approved electric generation facility at the Pueblo Airport Generation Station (PAGS) set to go into service in 2012 be added to rate base, as well as almost $47 million in transmission-related capital asset projects and $6.9 million in additional capital investments completed in 2011 be included in rate base. After a settlement between the parties, the Commission approved the post-test year inclusion of PAGS in rate base because it was an "extraordinary situation."[109] The Commission also approved the part of the settlement that included in rate base the $47 million in transmission-related capital asset projects that was in service by September 30, 2011, finding that it was "associated" with PAGS.[110] However, the Commission denied inclusion of the $6.9 million of distribution projects in rate base, finding that it was "similar to [investments] made during [BHCE's] ordinary course of business," and thus not extraordinary, and "that there will always be some plant investment of these types that will

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[107] *Id*. at 42-43.

[108] *Id*. at 43.

[109] Decision No. C11-1373 issued in Proceeding Nos. 11AL-0382E and 11AL-387E on Dec. 22, 2011 at 15-16 (¶¶ 33-35).

[110] *Id*. at 19 (¶ 48).

not be captured in a test period."[111] In so ruling, the Commission characterized the matching principle as follows:

> The matching principle holds that rate base investment, expenses, revenues, and all other components of a utility's cost of service should correspond to another over the same time period or according to the same operating condition. The matching principle ensures that the cost of service reflects the operational relationships and interplay between rate base, expenses, and revenues in a manner that is representative of the period when the resulting rates will be in effect.[112]

110. In Decision No. R14-1298, BHCE requested that the Commission adopt a current test year (CTY) as the basis for establishing rates, and the OCC proposed an HTY. The HTY ended December 31, 2013, and the CTY used both historical data and forecasts to extend the HTY by one year to December 31, 2014.[113] In considering whether to employ the CTY or HTY for purposes of determining rates, ALJ Garvey first stated that "the key to test year integrity is to make the interrelationship of revenue, expense, and capital investment as representative of future operations as possible."[114] Ultimately, ALJ Garvey adopted the HTY, concluding that BHCE's failure to update the CTY's forecasts with actual per-book data as it had promised at the outset of the proceeding denied the Commission "a critical benchmark with respect to the quality of [BHCE's] forecasts."[115] ALJ Garvey thus effectively concluded that there was a greater likelihood that the HTY would be representative of future operations than the CTY.

b. Conclusions

111. From the foregoing decisions, several conclusions can be drawn. First, "[t]he purpose of a test year is to provide, as closely as possible, an interrelated picture of revenue,

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[111] *Id*. at 20 (¶ 54).
[112] *Id*. at 20 (¶ 51).
[113] Decision No. R14-1298 issued in Proceeding No. 14AL-0393E on October 28, 2014 at 26 (¶ 93).
[114] *Id*. (¶ 91).
[115] *Id*. at 31 (¶ 105).

expense, and investment reasonably representative of the interrelationships that will be in place at the time the new rates proposed in a rate case will be in effect."[116] To ensure that it is representative, the test year must be as close in time to the period during which the rates will be in effect as possible. The test year must also be comprehensive and based on finalized data so that the interrelationship between the revenues, expenses, and investments has integrity, and is thus likely to be replicated during the period in which the rates will be in effect. This last requirement typically means that the test year will not immediately precede the first year in which the rates derived from the test year are in effect because the financial data used in test years typically takes significant time to finalize.

112. Second, out-of-period or *pro forma* adjustments are permitted up to one year after the test year. However, they are typically permitted only in "extraordinary" circumstances over which the utility has little to no control that are likely to lead to attrition. The reason for this limitation is that there is a significant risk that *pro forma* adjustments will undermine the integrity of the interrelationship between the revenues, expenses, and investments in the test year.

113. Third, the need to make the test year as representative of the period when the resulting rates will be in effect as possible does not, by itself, justify *pro forma* adjustments. As noted, the representativeness of a test year is determined by both the closeness in time of the test year to the period during which the resulting rates will be in effect ***<u>and</u>*** the integrity of the interrelationship between the revenues, expenses, and investments in the test year. If the utility proposes a significant number of non-extraordinary *pro forma* adjustments to the test year that it proposed, that fact may indicate that the utility should have considered employing a more recent test year.

[116] Decision No. C93-1346 issued in Proceeding No. 93S-001EG on October 27, 1993 at 22.

2. Application to this Proceeding

114. In this proceeding, there is no credible dispute that the post-Base Period capital adjustments are not extraordinary. Indeed, Messrs. Stoffel and Clevinger both declined to characterize the investments as extraordinary or unusual, instead describing them as "significant" when considered in aggregate.[117] BHCG's Post-Base Period Capital Additions encompass many different capital projects that collectively add up to $35.3 million.[118] The ALJ finds and concludes that they are ordinary-course-of-business investments for ongoing gas operations.

115. In addition, the record supports the conclusion that the proposed post-Base Period capital adjustments are not consistent with the matching principle because, given their magnitude in aggregate, they would undermine the integrity of the interrelationship between revenues, expenses, and investments in the test year. While BHCG contends that it accurately included the revenue requirement effects of the plant additions,[119] evidence in the record suggests otherwise. For example, Mr. Clevinger testified that the property tax in the post-Base Period was estimated using a historical average ratio,[120] admitted that BHCG excluded replacements and retirements from the plant accounts resulted in a reduction to the test period revenue requirement of approximately $250,000,[121] and stated that Operating and Maintenance (O&M) expenses associated with the capital additions are not included in the revenue requirement.[122] Further, Mr. Hyatt stated that BHCG estimated the adjustment for customer growth for residential and

[117] Hearing Transcript at 50:5-51:9 (August 5, 2019); Hearing Transcript at 18:22-19:8 (August 8, 2019).

[118] Hearing Exhibit 108, Attach. MCC-1 at 52 (Mr. Clevinger's Revised Direct Testimony).

[119] Hearing Exhibit 124 at 16:16-17 (Mr. Clevinger's Rebuttal Testimony).

[120] *Id.,* 12:5-7.

[121] Hearing Transcript at 27:14-22 (August 8, 2019).

[122] *Id.* at 47:25-48:2. Mr. Clevinger explained that O&M expenses were not included because none were identified so O&M expenses in the Base Period were assumed. *Id.* at 49:14-20.

small commercial customers based on data from the Base Period,[123] which the OCC challenges on the basis that only $5 million of the capital additions are related to customer growth and therefore the revenue adjustment should only be $101,234 instead of the $708,637 calculated by the Company. The OCC argues persuasively that, while a significant portion of the post-Base Period capital adjustments increased BHCG's load or capacity, the expected investment, revenues, and expenses associated with that increased load are not present in the RRS.[124] Based on this record, the ALJ finds and concludes that BHCG has not carried its burden of establishing that the post-test year adjustments include all investment, revenues, and expenses. Because these differences are significant, the ALJ concludes that the adjustments do not sufficiently adhere to the matching principle, and therefore their approval would not be a just and reasonable outcome.

116. Finally, BHCG used different methodologies to calculate the rate base for the Base Period versus the post-Base Period. Specifically, BHCG used the Commission-preferred 13-month average to calculate the rate base for the Base Period, but an annualization method to calculate rate base added to the post-Base Period.[125] Thus, BHCG divided plant in the Base Period by 13 months, but calculated the cost of the plant in the post-Base Period on a full year basis even though the plant became used and useful at various times during the six-month post-Base Period.[126] Accordingly, the ALJ finds and concludes that the post-Base Period adjustments are in tension with the matching principle because they raise questions concerning the integrity of the interrelationship between revenues, expenses, and investments in the test year.

[123] HE 117, Hyatt Direct, 15:3-19.

[124] HE 301, Skluzak Answer, p. 59:10-14. *See also* Tr. 6, p. 172:15-25.

[125] Tr. 8/8/19, p. 22:12-18.

[126] At hearing, Company witness Clevinger confirmed that $1.2 million of the $33.5 million in post-base rate plant was added within the last ten days of 2018.

117. The decisions cited by BHCG in support of its argument for the inclusion of the post-Base Period adjustments do not mandate a different result. As an initial matter, three of the decisions cited by BHCG – Decision Nos. C09-1446, C11-1373, and R18-0263 issued on April 16, 2018 in Proceeding No 17AL-0654G – addressed settlements. Because settlements in rate proceedings involve concessions across multiple issues, their approval by the Commission, unless otherwise noted, typically does not signify an endorsement of any policy. As a result, decisions approving settlement agreements tend to have less persuasive value. Nevertheless, the ALJ shall address each decision in turn.

118. The Commission rendered Decision No. C09-1446 in Proceeding No. 09AL-299E in unprecedented circumstances. The Great Recession hit in 2007 to 2008 and had a significant impact on this country, including public utilities, which experienced a drop in demand for electricity. Years before, the Commission had approved PSCo's proposal to build Unit 3 of the Comanche Generating Station (Comanche 3) to meet anticipated future demand. In Proceeding No. 09AL-299E, PSCo sought to include Comanche 3 in rate base even though construction delays meant that it would not go online until after the 2008 HTY used in that proceeding even though the drop in electricity demand raised questions as to whether Comanche 3 was even needed. In the Settlement Agreement, the parties proposed to use the 2008 HTY but also allow PSCo to include Comanche 3 and other related transmission projects in rate base even though they would not become used and useful until late 2009.

119. Noting the "unprecedented current economic situation and its resulting impact on electricity demand,"[127] the Commission approved the settlement agreement but limited the

[127] Decision No. C09-1446 at 13 (¶ 30).

duration of the out-of-period adjustment to six months. In so doing, the Commission stated the following:

> While we accept the general approach advocated in the Settlement, to some degree we are uncomfortable with the mismatch of revenues, expenses, and rate base contained in the Settlement. The approach taken by the parties was to reach forward only on a subset of incremental additions to rate base but to leave expense and revenue levels essentially as derived from the 2008 HTY. Therefore, the three components of the test year do not match. Essentially, the Settlement is an attempt to capture certain incremental investments brought into rate base in 2009, and a separate reach forward to capture incremental distribution investment in 2009 and 2010, but without reaching forward to capture changes in revenues or expenses.
>
> We understand the settlement process can be difficult and complicated, and we appreciate the parties' efforts to bring us a more robust set of regulatory principles underlying the settled revenue requirement. However, the degree to which the incremental distribution investment is captured so far into the future, without a better matching from revenues and expenses, is troublesome. We therefore adopt the Settlement's test period, but will cap the reach forward on investment in distribution only to June 30, 2009.[128]

Plainly, the unprecedented economic circumstances and their impact on PSCo played a significant role in the Commission's willingness to permit a significant out-of-period adjustment in Proceeding No. 09AL-299E. However, even under those circumstances, the Commission took seriously the integrity of the interrelationship between revenues, expenses, and investments in the test year.

120. Decision No. R18-0263 issued in Proceeding No. 17AL-0654G addressed another settlement agreement. There, Rocky Mountain Natural Gas LLC, doing business as Black Hills Energy (RMNG) proposed a test year ending June 30, 2017 with capital additions through December 31, 2017 that are not specified in the decision. The resulting revenue requirement proposed by RMNG was $29,003,865. In the settlement, the parties agreed to a revenue

[128] *Id*. at 19 (¶¶ 50-51).

requirement of $24,141,761, which reduced RMNG's original request by $4.9 million or 17 percent. The decision did not contain any comment regarding the matching principle.

121. Finally, in the single litigated proceeding cited by BHCG – Proceeding No. 16AL-0326E – the utility (BHCOE) sought to adjust its 2015 test year to incorporate costs for its LM6000 generating unit, arguing that when the CACJA Adjustment rider expired at the end of 2016 it would not be replaced by an equivalent rider going forward, thereby ending recovery. BHCOE sought the addition as a post-test period *pro forma* capital addition to rate base. The Commission approved the inclusion of the costs, but contrary to the request of BHCOE, authorized the recovery of the costs through the continuation of the CACJA adjustment rider, rather than a GRSA adjustment to rate base.[129] Costs for the LM6000 had, in fact, been recovered in this manner since January of 2015 and were subject to a true-up during the six months following July 1, 2017.[130] The ALJ finds that the specialized recovery treatment of the LM6000 costs in Proceeding No. 16AL-0326E has little persuasive value in determining whether to approve the post-Base Period adjustments in this proceeding.

122. The ALJ also finds and concludes that the decisions analyzed above do not dictate a different outcome in this proceeding. Decision No. C09-1446 addressed extraordinary circumstances that are not present in this proceeding, Decision No. R18-0263 approved a settlement of a far smaller revenue requirement than at issue here with no express discussion of the matching principle that would allow broader conclusions to be drawn regarding the import of the decision, and Decision No. C16-1140 approved recovery of certain costs through a rider, not

[129] Decision No. C16-1140 issued in proceeding No. 16AL-0326E on December 19, 2016 at 33 (¶ 101) and 35 (¶ 105).

[130] *Id.*, ¶ 83.

through a post-base period adjustment to the test year. Accordingly, they contain material factual distinctions.

123. Based on the foregoing, the ALJ finds and concludes that the $35.3 million in Post-Base Period Capital Additions will not be included in the rate base calculation in this proceeding. These Post-Base Period Additions may be incorporated in the next rate case proceeding for recovery. BHCG shall make the proper reversals for all investment, expenses, and revenues associated with the Post-Base Period Additions in its RRS.

V. COST OF CAPITAL

A. Return on Equity

1. BHCG's Argument

a. Summary

124. In this proceeding, BHCG requests that the Commission approve an ROE of 10.15 percent within a reasonable range of 9.6 to 10.9 percent be used in developing the revenue requirement in this proceeding. The current ROEs of BHGU and BHGD are 9.6 percent and 10.0 percent, respectively.[131] BHCG's ROE witness – Adrian McKenzie – originally argued that the ROE should be 10.3 percent. However, at the hearing, he reduced his recommended ROE to 10.15 percent "in light of capital market conditions, specifically, interest rates, since the time [his] direct testimony was prepared."[132] Specifically, Mr. McKenzie stated that the six-month average yield for bond yields for Baa-rated utilities declined by 25 basis points at the end of July 2019 and the 25 basis-point reduction of the overnight lending rate by the Federal Open Market Committee on July 31, 2019, which "culminated a period of expectations in the market

[131] Hearing Exhibit 104 at 30:3-15, 35:19-36:11 (Mr. Stoffel's Revised Direct Testimony).

[132] Hearing Transcript at 79:9-19 (8/6/2019).

that have been reflected in a general downward trend, to some extent, since the time [his direct] testimony was prepared."[133] Mr. McKenzie did not alter his range of reasonableness at the hearing based on the changes in capital market conditions since he submitted his direct testimony.[134]

125. BHCG developed its ROE recommendation using a combination of the Constant Growth Discounted Cash Flow (DCF) model, the Multi-Stage DCF model, the Capital Asset Pricing Model, the Empirical Capital Asset Pricing Model, the Utility Risk Premium Method, and the Expected Earnings Approach. In addition to the model results, BHCG considered other economic factors including flotation costs.

b. Proxy Group

126. BHCG ran these models using data from a proxy group of nine gas utilities that it asserts are risk-comparable to BHCG. The reason a proxy group is used is explained by Mr. McKenzie as follows:

> Application of quantitative methods to estimate the cost of common equity requires observable capital market data, such as stock prices and beta values. Moreover, even for a firm with publicly traded stock, the cost of common equity can only be estimated. As a result, applying quantitative models using observable market data only produces an estimate that inherently includes some degree of observation error. Thus, the accepted approach to increase confidence in the results is to apply alternative quantitative methods to a proxy group of publicly traded companies that investors regard as risk-comparable. The results of the analysis for the same of companies are relied upon to establish a range of reasonableness for the cost of equity for the specific company at issue.[135]

127. The proxy group used by BHCG is as follows: Atmos Energy Corp. (Atmos), Chesapeake Utilities, New Jersey Resources, NiSource Inc. (NiSource), Northwest Natural Gas

[133] *Id*. at 82:9-12, 113:16-115:14.

[134] *Id*. at 107:20-108:1.

[135] Hearing Exhibit 110 at 8:2-12 (Mr. McKenzie's Direct Testimony).

Northwest Natural), One Gas, Inc., South Jersey Industries, Southwest Gas, and Spire Inc.[136] According to BHCG, each of these companies is publicly traded, is a gas utility, has an investment grade credit rating from Standard and Poor's (S&P) and Moody's, is not currently involved in significant merger or acquisition activity, has not cut dividend payments during the past six months, and has not announced a dividend cut since that time. Mr. McKenzie also compared and contrasted several "risk indicators" for each proxy company and BHC, which is BHCG's parent company. The risk indicators are the credit ratings issued by S&P, Moody's, and Value Line's Safety Rank, Financial Strength Rating, and beta measure. Mr. McKenzie used BHC as the point of comparison for these risk indicators because BHCG does not issue its own debt or equity, but instead "obtains its debt and equity capital solely from BHC."[137] As a result, BHC – but not BHCG – is rated by S&P, Moody's, and Value Line.

128. The average for each of the "risk indicators" for BHCG's proxy group and BHC are shown below:

Proxy Group/BHC	**Credit Ratings**		**Value Line**		
	S&P	**Moody's**	**Rank**	**Strength**	**Beta**
Proxy Group (Average)	A-	A3	2	A	0.67
BHC	BBB+	Baa2	2	A	0.80

According to Mr. McKenzie,

> [t]he average single-A minus ratings corresponding to the [Proxy] Group place their credit risks solidly within the investment grade range. The somewhat lower ratings for BHC indicate slightly more risk. The average Value Like risk indicators for the [Proxy] Group are similar to those of BHC, although BHC's higher beta value, again, indicates somewhat more risk. Considered together, a comparison of these objective measures, which incorporate a broad spectrum of risks, including financial and business position, relative size, and exposure to

[136] *Id*. at 8:1-7:10.

[137] *Id*. at 7:1-4.

> company-specific factors, indicates that investors would likely conclude that the overall investment risks for BH Colorado Gas are comparable to, if not greater than, those of the firms in the [Proxy] Group.[138]

Mr. McKenzie concluded that these factors make the companies in its proxy group the most similar to BHCG for purposes of analyzing the ROE.[139]

129. BHCG further notes that: (a) the members of its proxy group have more cost recovery mechanisms than BHCG, which would lead "investors to view the risks of [BHCG] as higher than the proxy group in this important respect;"[140] (b) "the general consensus in the investment community [is] that the cost of long-term capital will be higher over the period when rates established in this proceeding will be in effect;"[141] and (c) "[b]y lowering the income tax allowance reflected in rates and requiring the eventual refund of excess accumulated deferred income taxes, the [Tax Cut and Jobs Act of 2017] is widely expected to result in reduced cash flow and weaker credit metrics for utilities,"[142] which allegedly caused Moody's to downgrade the utility sector outlook on June 18, 2018 from stable to negative.[143]

130. Mr. McKenzie also used a non-utility proxy group of low-risk companies from various industries because utilities "have to compete with non-regulated firms for capital."[144] Mr. McKenzie stated that the results from using the non-utility proxy group were "not directly considered in arriving at [his] recommended ROE range of reasonableness; however, it is [his]

[138] *Id*. at 11:11-10:3.
[139] *Id*. at 11:18-10:3.
[140] *Id*. at 13:12-13.
[141] *Id*. at 18:11-13.
[142] *Id*. at 19:8-10.
[143] *Id*. at 20:9-20.
[144] *Id*. at 62:5-7.

opinion that this is a relevant consideration in evaluating a fair and reasonable ROE for the Company."[145]

c. Models

(1) Constant Growth DCF Model

131. With that background, BHCG ran the models noted above using data for the proxy group. According to BHCG, the Constant Growth DCF model relies on the following strict assumptions that are unrealistic:

> a constant growth rate for both dividends and earnings; a stable dividend payout ratio; the discount rate exceeds the growth rate; a constant growth rate for book value and price; a constant earned rate of return on book value; no sales of stock at a price above or below book value; a constant price-earnings ratio; a constant discount rate; . . . and all of the above extend to infinity.[146]

Nevertheless, it is worthwhile to consider the results of the Constant Growth DCF model because it "provides a workable and practical approach to estimat[ing] investors' required return that is widely referenced in utility ratemaking."[147]

132. The key variables for the Constant Growth DCF model are expected dividend yield and investors' long-term earnings growth expectations for each of the proxy group members.[148] Mr. McKenzie calculated the expected dividend yield by dividing the average stock price for each proxy group member over the 30-day period ending November 2, 2018 by the estimated dividends to be paid in the coming year. This resulted in estimated dividend yields for the proxy companies ranging from 1.9 to 3.5 percent, with an average of 2.7 percent.[149] As to

[145] *Id*. at 62:1-4.
[146] *Id*. at 29, n.38.
[147] *Id*.
[148] *Id*. at 30:6-13.
[149] *Id*. at 30:8-11, 14-20, Attach AMM-4 at 1.

investor's long-term growth expectations, Mr. McKenzie used projections from Value Line, Thomson Reuters (IBES), Zacks Investment Research (Zacks),[150] and a sustainable growth estimate calculated with the formula "br+sv," where "b" is the expected retention ratio, "r" is the expected earned ROE, "s" is the percent of common equity expected to be issued annually as new common stock, and "v" is the equity accretion rate.[151] In calculating the sustainable growth estimate, Mr. McKenzie used estimates from Value Line.[152] Mr. McKenzie's resulting average estimates for the long-term earnings growth of each of the proxy group members ranged from 5.5 to 11.4 percent.[153]

133. In reaching his final ROE results, Mr. McKenzie threw out four "illogical" individual results below 7.3 percent. The lower threshold represents a 100 basis-point premium over the historical and projected average bond yield for a utility with a "Baa" rating like BHCG. Because Mr. McKenzie believes that investors would require at least a 100 basis-point premium to invest in BHCG's common stock versus bonds, he eliminated any Constant Growth DCF estimates below 7.3 percent.[154]

134. Mr. McKenzie also threw out the following four high-end ROE estimates: Northwest Natural Gas at 33.3 percent using Value Line's growth rate, NiSource at 21.1 percent using Value Line's growth rate, and South Jersey Industries at 15.8 percent using IBEs' and Zacks' growth rates. This left Atmos' 13.8 percent as the high end of the Constant Growth DCF

[150] *Id*. at 35:16-20, Attach. AMM-4 at 2.
[151] *Id*. at 36:1-18.
[152] *Id*., Attach. AMM-5.
[153] *See id*., Attach. AMM-4 at 2.
[154] *Id*. at 37:1-39:12.

results.[155] Based on the foregoing, the application of the Constant Growth DCF model to BHCG's proxy group was as follows:

Source of Growth Rate Used in Constant Growth DCF Model	**Cost of Equity**	
	Average	**Midpoint**
Value Line	11.5%	11.4%
IBES	8.6%	8.6%
Zacks	8.1%	8.3%
br + sv	10.5%	10.9%

(2) Multi-Stage DCF Model

135. According to BHCG, "the Multi-Stage DCF Model entails estimating the dividends investors expect to receive from holding a share of stock and the price that they expect to sell it for at some point in the future."[156] The holding period of the share is 30 years.[157]

136. For the first stage of the holding period (years 1 to 5), BHCG calculated annual dividends using a growth rate that is the average of the Value Line, IBES, Zacks, and "br + sv" long-term growth rates used in the Constant Growth DCF model.[158] For the third-stage (years 25 to 30), BHCG used the historical real gross domestic product (GDP) annual growth rate from 1929 to 2017, which was 3.34 percent. BHCG also used an assumed inflation rate of 2.0 percent based on the Federal Open Market Committee's *Statement on Longer-Run Goals and Monetary Policy Strategy*, which was amended on January 31, 2017.[159] This resulted in an assumed future

[155] *Id*. at 41:6-9; *id*., Attach. AMM-4 at 3.
[156] *Id*. at 43:3-5.
[157] *Id*. at 7-9.
[158] *Id*. at 43:10-13.
[159] *Id*. at 44:4-18, n.56.

nominal GDP growth rate of 5.41 percent.[160] The second stage growth rate "is computed by transitioning from the first stage to the third stage growth rate in equal annual increments," and the sale price of the share at the end of year 30 is calculated using a formula incorporating, among other things, the first and third stage growth rates.[161] "The cost of equity is then estimated by imputing the discount rate necessary to equate the projected dividends and terminal stock price to the recent price for each of the companies in the [proxy] group."[162]

137. BHCG's application of the Multi-Stage DCF model resulted in an average cost of equity for the nine members of the proxy group of 9.0 percent, and a midpoint of 9.4 percent. BHCG did not throw out any results for individual members of the proxy group because, in contrast to the results of the Constant Growth DCF model, the results of the Multi-Stage DCF model were grouped in a narrower range from 7.9 to 11.0 percent. Consequently, there were no unambiguously illogical results to be excluded.

(3) Capital Asset Pricing Model

138. Under the Capital Asset Pricing Model (CAPM), "a stock's required return is a function of the risk-free rate (R_f), plus a risk premium that is scaled to reflect the relative volatility of a firm's stock price, as measured by beta (β)."[163] Beta is a calculation of "the tendency of a stock's price to follow changes in the market. A stock that tends to respond less to market movements has a beta less than 1.00, while stocks that tend to move more than the market have betas greater than 1.00."[164] The CAPM is calculated using the following formula:

$$R_j = R_f + \beta_j(R_m - R_f)$$

[160] *Id*. at 44:4-18; Attach. AMM-6 at 1.
[161] *Id*. at 43:13-17.
[162] *Id*. at 44:1-3.
[163] *Id*. at 45:10-12.
[164] *Id*. at 45:6-9.

where: R_j = required rate of return for stock j;

R_f = risk-free rate;

β_j = beta for stock j;

R_m = expected return on the market portfolio.[165]

139. Mr. McKenzie used data from IBES, Zacks, and Value Line to calculate the R_m value, and obtained the beta value for each of the companies in the proxy group from Value Line.[166] According to Mr. McKenzie, Value Line's betas generally are higher than betas calculated by other companies because Value Line adjusts them upward to account for "the observed tendency of beta to converge toward the mean value of 1.00 over time."[167] For the risk-free rate, Mr. McKenzie used the average yield on 30-year Treasury bonds for the six-months ending October 2018.[168]

140. Using this data, Mr. McKenzie's results for the calculation of R_j for the companies in the proxy group range from 8.9 to 11.0 percent, with an average of 10.2 percent and a midpoint of 9.9 percent.[169] However, Mr. McKenzie adjusted these results to account for the alleged impact of a company's size on investors' required ROR for that company, which is not fully captured by a company's beta. According to BHCG, investors expect higher returns for smaller companies compared to larger companies, and the results thus must be adjusted based on the relative size of the companies in the proxy group.[170] This adjustment results in values ranging from 9.7 to 12.3 percent, with an average of 11.5 percent and a midpoint of 11.0 percent.[171]

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[165] *Id*. at 46:9-10.
[166] *Id*. at 46:12-15; 45:1-5.
[167] *Id*. at 50:9-10.
[168] *Id*. at 50:19-21.
[169] *Id*., Attach. AMM-7.
[170] *Id*. at 47:6-48:9.
[171] *Id*., Attach. AMM-7.

(4) Empirical Capital Asset Pricing Model

141. The Empirical Capital Asset Pricing Model (ECAPM) adjusts the CAPM results to account for the observed tendency of "low-beta securities [like utilities to] earn returns somewhat higher than the CAPM would predict, and high-beta securities [to] earn less than predicted."[172] To accomplish the adjustment, the risk premium associated with each company is calculated by weighting the market risk premium by 25 percent and the company-specific risk premium by 75 percent. The CAPM formula is thus revised as follows:

$$R_j = R_f + 0.25((R_m - R_f)) + 0.75[\beta_j(R_m - R_f)]$$

Making this adjustment to the CAPM formula yields higher results for the proxy group, with an average of 12.3 percent and a midpoint of 11.9 percent.[173]

(5) Utility Risk Premium Method

142. Under the Utility Risk Premium Method, "[t]he cost of equity is estimated by first determining the additional return investors require to forego the relative safety of bonds and to bear the greater risks associated with common stock, and by then adding this equity risk premium to the current yield on bonds."[174] BHCG estimated the equity risk premiums for utilities by subtracting the average yield on single-A public utility bonds from the average allowed return for gas utilities for each quarter between 1980 and Q3 2018.[175] Because "current interest rate levels have diverged from the average interest rate level in the data set,"[176] BHCG adjusted upwards the risk premium.[177] Using the average yield on Baa public utility bonds for

[172] *Id*. at 48:17-18.
[173] *Id*., Attach. AMM-8.
[174] *Id*. at 52:11-14.
[175] *Id*. at 53:22-52:2.
[176] *Id*. at 54:14-15.
[177] *Id*. at 54:5-54:4.

the six months ending October 2018 resulted in a 10.05 percent implied ROE.[178] Alternatively, using forecasted yields for Baa public utility stocks from 2019 to 2024 resulted in a 10.87 percent implied ROE.[179]

(6) Expected Earnings Approach

143. The expected earnings on common equity of the companies in BHCG's proxy group are calculated using projections from Value Line. After adjusting them from year-end values to average returns, the projected ROEs for the members of the proxy group average 11.1 percent with a midpoint of 11.8 percent.

d. Flotation Costs

144. Flotation costs are the costs associated with the sale of new issues of common stock, including "services such as legal, accounting, and printing, as well as the fees and discounts paid to compensate brokers for selling the stock to the public."[180] According to BHCG, the average flotation costs in the electric and gas industries from 2002 to 2017 were 3.2 percent.[181] Applying a 3.2 percent upward adjustment to calculated dividends used in the Constant Growth DCF analysis results in an average of a 9 basis-point increase in Mr. McKenzie's estimated ROE's.[182] However, Mr. McKenzie did not adjust his ROE recommendation based on flotation costs, he states that it "is a relevant consideration in evaluating a fair and reasonable ROE for BH Colorado Gas."[183]

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[178] *Id*. at 55:16-54:4; Attach. AMM-9 at 1.
[179] *Id*. at 56:12-19; Attach. AMM-9 at 2.
[180] *Id*. at 60:11-14.
[181] *Id*. at 61:3-9; Attach. AMM-11.
[182] *Id*. at 61:8-10.
[183] *Id*. at 61:10-13.

e. Conclusion

145. In reaching his recommendation, Mr. McKenzie downplayed the ability of the DCF models to accurately forecast ROEs, based at least in part on "prevailing conditions in capital markets," though he did not specify what those conditions are.[184] In support, he cited decisions from the Indiana Utility Regulatory Commission and the Federal Energy Regulatory Commission (FERC), as well as opinions from the authors of alleged treatises. All of the cited sources advocate an approach that considers the results of multiple models, not just DCF models.[185] As noted, based on such an approach, BHCG argues that the Commission should set the ROE at 10.15 percent within a reasonable range of 9.6 to 10.9 percent.

2. Intervenors' Arguments

a. Staff's Argument

(1) Summary

146. Staff's recommends an ROE of 9.0 percent, but states that the Commission should feel empowered to authorize an even lower ROE.[186] Staff relies primarily on the Multi-Stage DCF model as its preferred ROR approach, and encourages the Commission to continue to give principal attention to this method. Staff argues that this recommendation better aligns the Company's ROE with the Multi-Stage DCF model results, recognizes the reduction in risk as an outflow of the approval of the DSIR, and reflects the principle of gradualism in ratemaking.[187] This single ROE would be applicable for BHCG, because it is the legal entity that receives debt and equity allocations from its parent company. Staff further argues that BHGD and BHGU

[184] *Id*. at 26:16-19.

[185] *Id*. at 24:10-26:2.

[186] Hearing Exhibit 400 at 122:9-14 (Answer Testimony of Mr. Peuquet).

[187] *Id.* at 123:1-125:10.

were combined in the beginning of 2019, so the Commission should evaluate the Company as a combined entity for purposes of its evaluation.[188]

(2) Proxy Group

147. Mr. Peuquet used the same criteria as BHCG to select a proxy group, but included four additional ones. In addition to satisfying BHCG's criteria, to be included in Staff's proxy group, a company must also be a combination electric and gas utility, have an S&P credit rating between BBB- and A, have a market capitalization of $24 billion or lower, and have a Value Line beta coefficient within 25 basis points of BHC.[189] Mr. Peuquet required the proxy group members to be combination electric/gas utilities because BHCG does not issue debt or equity. Instead, BHC issues equity and debt for all of its regulated subsidiaries, including BHCG and BHC's other regulated electric utilities. For this reason, Mr. Peuquet believes that BHC (and not BHCG) must be used as the point of comparison for purposes of selecting the proxy group, and a proxy group that includes only gas utilities would not adequately reflect the risks and prospects of BHC.[190] Similarly, requiring the credit ratings, market capitalization, and beta coefficients of each proxy group member to be closer to BHC's credit rating, market capitalization, and beta coefficient makes the proxy group more similar to BHC.[191] Using the foregoing criteria yields a proxy group consisting of Ameren Corporation, Avista Corporation, CenterPoint Energy, CMS Energy, DTE Energy, Northwestern Corporation, WEC Energy Group, and NiSource. Only NiSource is included in the proxy groups used by both BHCG and Staff.[192]

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[188] *Id*. at 125:12-126:9.
[189] Hearing Exhibit 400 at 67:11-70:2 (Answer Testimony of Jason J. Peuquet).
[190] *Id*. at 68:1-15.
[191] *Id*. at 68:16-70:2.
[192] *Id*. at 70, Table JJP-5.

(3) Models

(a) Constant Growth DCF

148. In calculating the dividend yield component of the Constant Growth DCF model, Mr. Peuquet used a "well-established . . . approach" to estimate the annual dividend for each company in its proxy group.[193] Mr. Peuquet did this because different companies in the proxy group increased their dividend rates at different times throughout the year. Thus, according to Mr. Peuquet, using the dividend paid at a particular point in time – as Mr. McKenzie did – may not provide an accurate estimate of the dividend yield over time.[194] In addition, Mr. Peuquet used 60-day and 180-day average stock prices for each of the members of its proxy group, in contrast to Mr. McKenzie's use of 30-day averages. Such averaging over longer periods can "smooth out" any short-term significant increases or decreases in the stock prices.[195] Finally, for the growth rate, Mr. Peuquet used five-year estimates for the earnings per share of its proxy group members provided by Zacks, First Call, and Value Line.[196]

149. Mr. Peuquet's results from his application of the Constant Growth DCF model yielded results that ranged from 6.2 to 12.06 percent. The mean of Mr. Peuquet's results were 8.92 percent and 9.01 percent using the 60-day average stock prices and 180-day average stock prices, respectively. The median of the results were 8.77 percent and 8.88 percent using the 60-day average stock prices and 180-day average stock prices, respectively.[197]

[193] *Id*. at 76:1-2.
[194] *Id*. at 75:13-21.
[195] *See id*. at 77:9-78:3.
[196] *Id*. at 76:4-13.
[197] *Id*. at 76:15-77:4, Table JJP-6.

150. Because the range of Mr. Peuquet's results is substantially narrower than Mr. McKenzie's, Mr. Peuquet did not have to throw out any of his results. As noted above, Mr. McKenzie threw out eight of the results from his application of the Constant Growth DCF model to BHCG's proxy group because they were illogically high or low. Mr. Peuquet suggests that his results are more reliable because "excluding certain results injects additional subjectivity into the process."[198] It also calls into question the comparability of Mr. McKenzie's proxy group to BHC.[199]

(b) Multi-Stage DCF

151. Mr. Peuquet argues that a historical growth rate should not be used in the third stage of the Multi-Stage DCF, instead advocating for the use of a forecasted growth rate.[200] As support, Mr. Peuquet states that the historic growth rate used by Mr. McKenzie (3.4 percent) is not expected to be achieved in the future because of our aging population and resulting decrease in the labor force participation rate, declining productivity growth, and rising publicly-held federal debt.[201] According to Mr. Peuquet, "nearly every well-respected forecasted and surveying organization expects that medium and long-term GDP growth in the U.S. will be" between 1.7 and 2.1 percent.[202] Thus, using Mr. McKenzie's historic growth rate in the third-stage of the Multi-Stage DCF model substantially overstates the expected future growth rate and skews the results of the model upward. For this reason, and because "[b]y definition[] the DCF model and

[198] *Id*. at 79:7-8.

[199] *See id*, at 78:12-14 ("The purpose of creating a proxy group is to try to simulate to the closest degree possible the risks and characteristics of a particular company. Therefore, the modeled results for each proxy company are important, assuming that the proxy group accurately reflects many of the characteristics of the company in question.").

[200] *Id*. at 85:1-87:18.

[201] *Id*. at 88:1-90:8.

[202] *Id*. at 85:17-87:18.

its variations are forward-looking," Mr. Peuquet argues that "it is imperative to use forward looking data in order for the model to produce the most reliable results possible."[203] Mr. Peuquet argues that the Commission should use the Congressional Budget Office's long-term forecasted nominal GDP growth rate of 4.0 percent, which consists of projected growth rates of the real GDP of 1.9 percent and inflation of 2.0 percent.[204]

152. Using a long-term growth rate of 4.0 percent and 60-day and 180-day average prices of the stocks of the proxy group members, and calculating the terminal value of cash flows using the perpetual growth method and the exit multiple method, yields the following results:

	ROE	
	Mean	Median
Perpetual Growth Method		
60-day Average Stock Price	8.16%	8.19%
180-day Average Stock Price	8.38%	8.49%
Exit Multiple Method		
60-day Average Stock Price	8.16%	8.19%
180-day Average Stock Price	8.38%	8.49%
Average of All 60-Day Results	**7.77%**	
Average of All 180-Day Results	**7.92%**	
Average of All Results	**7.85%**[205]	

153. Mr. Peuquet also argues that if a historical growth rate is used, it should be a geometric average of the historic growth rate from 1929 to 2017, instead of the arithmetic

[203] *Id*. at 90:15-18.

[204] *Id*. at 87:1-3; 93:12-16. It is not clear how the sum of 1.9 percent and 2.0 percent results in 4.0. The ALJ assumes that it must be attributable to rounding.

[205] *Id*. at 98:1-2 (Table JJP-9).

average used by Mr. McKenzie. Mr. Peuquet states that the arithmetic average does not take into account the effect of compounding, while the geometric average does. He also states that compounding must be taken into effect in determining the growth rate to be used. According to Mr. Peuquet, using the geometric average lowers the 1929 to 2017 growth rate from the 3.34 percent level used by Mr. McKenzie to 3.22 percent. Mr. Peuquet did not provide a calculation of the ROE using the geometric average growth rate from 1929 to 2017 and Staff's proxy group results.

154. Finally, Mr. Peuquet rejects Mr. McKenzie's criticism of the DCF models and recommendation that the Commission place little weight on their results. According to Mr. Peuquet, the pillar of Mr. McKenzie's theory is that the Federal Reserve has maintained a low-interest rate environment that has caused utility stock prices to increase and their yields to decline. These two inputs have caused unreasonably low results from the DCF models. Mr. Peuquet states that Mr. McKenzie believes that the DCF results are not predictive because the Federal Reserve will likely raise interest rates in the future, which will cause utility stock prices to decrease, utility dividend yields to increase, and the DCF models to produce higher ROE results.[206]

155. Mr. Peuquet concludes that Mr. McKenzie's argument regarding the validity of the DCF model results is incorrect for three reasons. First, the efficient market theory, which is "a pillar of financial theory," states that stock prices "reflect all known information and probability-weighted expectations regarding the future" including "probability-weighted expectation regarding future Federal Reserve actions, changes in long-term interest rates, likely

[206] *Id*. at 100:11-101:17.

fiscal policy changes, and any other important market information."[207] Thus, if Mr. McKenzie's prediction that the Federal Reserve will continue increasing interest rates is correct, that information is reflected in the current stock prices, and thus the dividend yields, of the members of his proxy group.

156. Second, the assumption in Mr. McKenzie's argument that the Federal Reserve will continue raising interest rates has been called into question. Mr. Peuquet notes that the Federal Reserve's Open Market Committee stated in March 2019 that "it had no plans to raise interest rates for the remainder of 2019" and then in June 2019 issued a statement that has led "market analysts [to] pric[e] in at least two 25 basis-point reductions in the rate during the remainder of 2019."[208] As a result, the prediction that underlies Mr. McKenzie's criticism of the DCF models appears to be incorrect.

157. Third, the exit multiple method of estimating the terminal value of cash flows "accounts for stock valuations today when establishing a terminal value for investor cash flows."[209] Mr. Peuquet concludes that "if proxy company stock valuations do indeed happen to be high relative to what they be in the future, the resulting ROEs from this methodology will also be higher."[210] Mr. Peuquet thus rejects Mr. McKenzie's argument that current market conditions call into question the results of the DCF models.

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[207] *Id*. at 102:18-20, 103:5-8.
[208] *Id*. at 103:17-18, 104:5-7.
[209] *Id*. at 105:9-11.
[210] *Id*. at 105:9-11.

(4) Conclusion

158. Based on the foregoing, Mr. Peuquet asserts that the Commission should adopt an ROE of 9.0 percent, but should feel comfortable using an ROE below 9.0 percent. Mr. Peuquet does not identify the reasonable range of the ROE.

b. OCC's Argument

(1) Summary

159. The OCC, like Staff, recommends an ROE of 9.0 percent based on an average of the four ROR models employed by the OCC: the CAPM, Constant Growth DCF, the "Commission-approved" Multi-Stage DCF,[211] and an analysis of recently authorized national ROEs. The results of these models produced an ROE range of 8.3 to 9.6 percent. Other ROE considerations, in addition to declining capital costs, included the expected ROEs used by the Company's pension group that show lowered returns for both large cap and small cap U.S. equity; lower Weighted Average Cost of Capital that were authorized by the Company in its acquisition of SourceGas; reduction of risk as a result of increased customer charges; and the financial stability that would be afforded by approval of the DSIR. The OCC argues that recent trends in the capital markets are favorable, with falling 30-year U.S. Treasury bond yields and strong demand for stocks, which has led investors to require lower equity premiums.

(2) Proxy Group

160. Mr. Fernandez states that BHCG's proxy group is reasonable. However, Mr. Fernandez excluded from his proxy group one company used by BHCG – Northwest Natural

[211] The OCC chose a Multi-Stage DCF methodology previously justified by the Commission in two previous PSCo gas rate cases, Proceeding Nos. 12AL-1268G and 15AL-0135G. Hearing Exhibit 302 at 37:5-10 (Answer Testimony of Mr. Fernandez).

Gas. Mr. Fernandez excluded Northwest Natural Gas because in 2018 it changed its name, completed a corporate reorganization, and has since acquired several water utility operations.

(3) Models

(a) Constant Growth DCF

161. Mr. Fernandez states that

> [t]he main difference between Mr. McKenzie's and my DCF results are the growth rates. Mr. McKenzie pulled his growth data in August and November 2018, while I pulled my data in April 2019. Growth rates estimates have been lowered in that 4 to 6 month period. Some of Mr. McKenzie's data has become stale. If Mr. McKenzie's were to update his growth figures, his model results would be closer to mine.[212]

Mr. Fernandez also excludes the Value Line's predicted future growth rate for NiSource because "it appeared that Value Line did not normalize the results for the Greater Lawrence incident" in which a series of gas distribution system-related explosions and fires occurred in Lawrence, Massachusetts, killing one person and injuring 21 others, destroying 5 homes and other structures, and damaging 131 others.[213] According to Mr. Fernandez, "NiSource recorded a loss of approximately $757 million for third-party claims and approximately $266 million in 2018 for other incident-related expenses in connection with the Greater Lawrence Incident."[214] Value Line's estimated future growth rate for NiSource was 15 percent, which Mr. Fernandez believes is too high considering the "Greater Lawrence Incident."[215]

162. Mr. Fernandez also believes it would be inappropriate to rely on the results of Mr. McKenzie's non-utility proxy group because the companies therein operate in a much

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212 Hearing Exhibit 302 at 30:3-7 (Answer Testimony of Mr. Fernandez).
213 *Id*. at 32:5-17.
214 *Id*. at 32:15-17.
215 *See id*. at 32:5-17.

different operating environment. According to Mr. Fernandez, "[n]on-regulated companies have different dividend policies, different growth rates, etc., than regulated companies."[216] Mr. Fernandez also cites two decisions in Commission proceedings in which non-utility companies were rejected as members of the proxy groups in those proceedings.[217]

163. Based on the foregoing, the result of Mr. Fernandez's constant growth DCF analysis were ROE estimates ranging from 8.1 to 10 percent, with an overall average of 8.9 percent.[218]

(b) Multi-Stage DCF

164. Mr. Fernandez used "a modified version of the Staff's Multi-Stage DCF model to support the [OCC's] recommended ROE," which Mr. Fernandez states was "selected" in Decision No. R13-1307, and "referenced again" in Decision No. R15-1204.[219] For the variables, Mr. Fernandez used for each of the members of his proxy group a 200-day stock average, earnings growth forecasts from Zack's, Value Line, and First Call, and a long-term growth rate of 5.19 percent, which consists of the geometric average of the annual growth rate from 1929 to 2018 plus an expected inflation rate of 1.97 percent which is derived from the TIPS Spread.[220] Mr. Fernandez's Multi-Stage DCF result is an estimated ROE of 8.97 percent.[221]

[216] *Id*. at 34:17-18.

[217] *Id*. at 35:1-20 nn. 37-38 (*citing* Decision No. C11-1373 issued in Proceeding No. 11AL-387E on December 22, 2011 and Decision No. R14-1298 issued in Proceeding No. 14AL-0393E on October 28, 2014).

[218] *Id*. at 29:13-14; Attach. RAF-6.

[219] *Id*. at 37:1-10 nn. 39-40 (*citing* Decision No. R13-1307 issued in Proceeding No. 12AL-1268G on October 22, 2013 at ¶ 313 and Decision No. R15-1204 in Proceeding 15AL-0135G on November 16, 2015 at ¶ 291).

[220] *Id*. at 37:17-20, 38:10-15.

[221] *Id*. at 42:5-6, Attach. RAF-7.

165. Mr. Fernandez agrees with Mr. Peuquet that Mr. McKenzie improperly used the arithmetic, as opposed to the geometric, average of the long-term growth rate.[222] When the geometric average is used, and Mr. McKenzie's br+sv growth estimate is removed from the calculation, Mr. Fernandez states that Mr. McKenzie's Multi-Stage DCF model result would be an estimated 8.0 percent ROE.[223]

(c) Other Models

166. Mr. Fernandez agrees with Mr. McKenzie's use of 30-year Treasury bonds for the risk-free rate and Beta values from Value Line in his CAPM analysis, but disagrees with Mr. McKenzie's 11.1 percent earnings-per-share growth rate and size adjustment. Mr. Fernandez states that if the 6.5 percent projected growth rate for the gas utilities in the proxy group is used and the size adjustment is eliminated, the estimated ROE from Mr. McKenzie's application of the CAPM model is 7.6 percent.[224] Mr. Fernandez also made other changes to the inputs for the CAPM model. Specifically, he used historical equity risk premiums from Duff & Phelps, used equity risk premiums based on both mid- and large-cap companies (rather than just the latter, as Mr. McKenzie did), eliminated Mr. McKenzie's size adjustment, and excluded Northwest Natural Gas from the proxy group. Running the model with these changes yielded an average ROE of 8.3 percent.[225]

167. Mr. Fernandez did not employ the ECAPM, Utility Risk Premium, or Expected Earnings models. He asserts that the Commission has never relied on any of them and their

[222] *Id*. at 40:13-41:10.
[223] *Id*. at 39:19-40:2, 42:1-2.
[224] *Id*. at 23:20-24:2.
[225] *Id*. at 26:9-21, 27:21-23.

results should not be used in the ROE determination. He recommends that the Commission not consider or rely on the results of those models.

(4) Other Factors

168. Mr. Fernandez states that the Commission approved a 9.6 percent ROE in BHCG's last rate case in 2012. Since then, authorized ROEs for both electric and gas utilities have decreased, which continues a trend over the last decade and is consistent with a similar decrease in yields on ten-year treasury bonds over the same period. In 2019, the average ROE authorized by other state utility commissions has been 9.6 percent. Mr. Fernandez concludes that equity costs have decreased overall, which has caused authorized utility ROEs to decrease.[226]

169. Mr. Fernandez also notes that BHC has not had any trouble attracting debt or equity investors and its stock returns have outperformed other regulated utilities and the market as a whole. As support, he cites BHC's issuance of $700 million in long-term debt in 2018 and the ability to issue sufficient debt and equity to finance the $1.89 billion acquisition of SourceGas in 2016, and the increase in BHC's stock price from approximately $20 to $80 per share over the last ten years. Mr. Fernandez concludes that this establishes BHCG's existing ROE of 9.6 percent is too high. Finally, Mr. Fernandez recommends rejecting Mr. McKenzie's adjustment for flotation costs.

(5) Conclusion

170. Based on the foregoing, Mr. Fernandez recommends that the Commission adopt an ROE of 9.0 percent within a range of reasonableness of 8.3 to 9.6 percent.[227]

[226] *Id*. at 47:1-50:5, 52:8-9.

[227] *Id*. at 76:3-14.

3. Analysis

a. Legal Standard

171. BHCG's gas utility operations are capital-intensive, which makes the determination of the authorized ROE of critical significance to its cost of service. The authorized ROE must be sufficient to support the Company's capital requirements, since necessary investments are made to provide adequate and reliable service.

172. In determining the ROE, the Commission must satisfy the standards articulated in *Bluefield Waterworks and Improvement Co. v. Public Service Comm'n. of West Virginia*, 262 U.S. 679 (1923) and *Federal Power Comm'n. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). BHCG's authorized ROE must be similar to the returns to investors who own shares in other businesses having comparable financial characteristics and business risks. *Bluefield* and *Hope* further require that the established ROE supports BHCG's financial integrity, including its credit rating that serves as a basis for securing debt at reasonable rates. Setting the ROE is a balancing art. If it is set unreasonably high, ratepayers may be burdened with excessive costs and current investors could receive a windfall. If it is set too low, service quality may be jeopardized, because BHCG will not be able to raise new capital on reasonable terms.

b. Proxy Group

173. Under the standard enunciated by *Bluefield* and *Hope*, BHCG's authorized ROE must be similar to the returns to investors who own shares in other businesses having comparable financial characteristics and business risks. For this reason, it is necessary to establish a group of companies that are both publicly traded and comparable to BHCG to serve as its "proxy" for purposes of determining the ROE. The parties agree with this overall process, and BHCG and the OCC agree on a number of gas utilities to be included in the proxy group. Those gas utilities

are: Ameren Corp., Atmos, Chesapeake Utilities, New Jersey Resources, NiSource Inc., One Gas, Inc., South Jersey Industries, Southwest Gas, and Spire Inc. Of course, BHCG and the OCC used different inputs into the models as summarized above and these different inputs caused the different conclusions concerning the ROE that they reached.

174. As noted above, Staff took a different approach using combination electric/gas utilities in its proxy group. Staff did this because BHC – and not BHCG – issues the equity and debt for BHCG (and BHC's other regulated subsidiaries). Staff thus believes that BHC is the proper point of comparison for selecting the proxy group.[228] Like the OCC, Staff also used different inputs (other than the composition of the proxy group) in the models, which contributed to different modeled outcomes.

c. ROEs Awarded to Other Utilities

175. As a general matter, the parties also agree that ROEs awarded in rate cases throughout the United States are relevant to the determination of the ROE in this proceeding. However, the parties disagree about what data points to include in the analysis. BHCG argues that all ROEs awarded to gas utilities (in settled proceedings and fully-litigated proceedings) should be included, the average of which is 9.62 percent from 2017 to 2019.[229] BHCG states that ROEs awarded to electric utilities should not be included in the analysis.[230]

176. Conversely, Staff asserts that all ROEs awarded to both electric and gas utilities in settled and fully-litigated proceedings are relevant. Staff states that average ROEs for both electric and gas utilities have declined significantly from 2008 to 2018, from 10.37 to

[228] *Id*. at 68:1-15.

[229] Hearing Exhibit 126 at 7:3-9:3; 68:1-12 (Rebuttal Testimony of Mr. McKenzie).

[230] *Id*. at 8:8-9:3.

9.57 percent for electric utilities, and from 10.39 to 9.57 percent for gas utilities.[231] The OCC cites the same data for gas-only utilities, but also notes that gas-only utilities have been awarded an average of 9.6 percent in the first half of 2019.[232] As to 2019, Staff points to an ROE of 9.0 percent awarded in a settled natural gas and electric proceeding in New York in March 2019, an 8.75 percent ROE awarded in a proceeding involving an electric utility in South Dakota in May 2019, and 8.69 percent ROEs awarded to two electric utilities in Illinois in 2018.[233]

177. The OCC focuses on ROEs authorized nationwide since 1990, as well as ROEs authorized by the Commission since 2012.[234] The OCC also states that electric utilities are slightly riskier than gas utilities, which has been reflected in the awarding of ROEs to electric utilities that are on average 13 basis points higher than natural gas utilities. Based on the Commission's decision to set Black Hills Electric's ROE at 9.37 percent in 2016, the OCC asserts that an ROE of 9.24 percent for BHCG is justified.[235]

178. Finally, BHCG focuses on the implications of the recent ROE decisions by the Commission. BHCG first notes that the Commission in 2018 approved rates of 9.35 and 9.45 percent for PSCo and Atmos, respectively. However, BHCG also notes that PSCo and Atmos are both single-A rated by credit rating companies, and concludes based on bond spreads that BHCG's ROE should be "at least 40 points higher."[236]

[231] Hearing Exhibit 400 at 117:2-118:9 (answer Testimony of Mr. Peuquet).
[232] Hearing Exhibit 302 at 47:15-17.
[233] *Id*. at 118:10-119:9.
[234] Hearing Exhibit 302 at 47:2-50:5 (Answer Testimony of Mr. Fernandez).
[235] *Id*. at 47:20-48:4.
[236] BHCG's SOP at 25-26.

d. Long-Term Growth Rates

179. The parties disagree about whether the long-term growth rates used in the Multi-Stage DCF model should be derived from historical data or forecasts. BHCG and the OCC agree that historical growth data should be used. BHCG used data from 1929 to 2017, and the OCC used data from 1929 to 2019. However, while the OCC used a geometric average of the historic growth rate, BHCG used an arithmetic average. The geometric average results in a lower average growth rate than that derived from the arithmetic average.

180. Staff, on the other hand, used a forecast of future growth rates. As noted, Mr. Peuquet contends that virtually no expert believes the future growth rate will match the average growth rate since 1929, which Mr. Peuquet and many outside experts believe occurred due to conditions that are not currently present and will not be present for the foreseeable future. Thus, using an average historical growth rate creates unreasonably high results from the Multi-Stage DCF model. To the extent that an average historical growth rate is used, Mr. Peuquet believes that a geometric average should be employed.

e. Models

181. The Commission's recent decisions in fully-litigated Phase I rate cases place considerable weight on the Multi-Stage DCF model in the determination of the authorized ROE. In December 2013, the Commission approved a 9.72 percent ROE for the gas department of PSCo, in Decision No. R13-1307 in Proceeding No. 12AL-1268G. The ALJ found the Multi-Stage DCF model to be the better model and analysis for establishing an authorized ROE in that proceeding.[237] In December 2014, the Commission again established an authorized ROE

[237] Decision No. R13-1307, Proceeding No. 12AL-1268G, ¶ 313. The Commission affirmed the ALJ regarding PSCo's authorized ROE by Decision Nos. C13-1568 (mailed December 23, 2013) and C14-0152 (mailed February 10, 2014) in Proceeding No. 12AL-1268G.

using results from a Multi-Stage DCF model, which the ALJ determined to be the preferred approach, because it best reflected the equity marketplace and resulted in the most just and reasonable rates.[238] In both rate cases, the Multi-Stage DCF model results were not the only analyses considered by the Commission. In Decision No. R15–1204, issued on November 16, 2015 in Proceeding No. 15AL-0135G, the Commission once again established an authorized ROE of 9.50 percent for PSCo's gas utility operations using results from a Multi-Stage DCF model.[239] Finally, in Proceeding No. 17AL-0429G, the ALJ relied on a Multi-Stage DCF model in setting the ROE at 9.7 percent. While the Commission modified the ROE, it did not indicate any desire to decrease its reliance on the Multi-Stage DCF. In these proceedings, the Commission considered alternative models such as the CAPM and the Bond Yield Plus Risk Premium models, but the Commission placed primary emphasis on the results of the Multi-Stage DCF.

182. More recently, on May 11, 2018, the Commission upheld Decision No. R18-0318-I in Proceeding No. 17AL-0363G issued by the undersigned ALJ, in which PSCo was awarded a 9.35 percent ROE. In Decision No. R18-0318-I, "the results of no single model predominate[d]" and "the determination of the ROE consider[ed] both the qualitative and quantitative analyses of the parties."[240] Notably, FERC has provided similar guidance, stating that "there is no single approach or methodology for determining the correct rate of return."[241] Nonetheless, Staff states that it continues to rely principally on the Multi-Stage DCF as its preferred approach, and argues that the Commission should also be consistent in its approach.

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[238] Decision No. C14-1504 (mailed December 22, 2014) in Proceeding No. 14AL-0393E.

[239] The Commission upheld the ALJ regarding the Company's authorized ROE in Decision No. C16-0123 (mailed February 16, 2016) in Proceeding No. 15AL-0135G.

[240] Decision No. R18, 0318-I at 80-81 (¶185).

[241] Hearing Exhibit 110 at 22 n. 25 (Direct Testimony of Adrien McKenzie).

183. Here, all of the parties have employed the Constant Growth and Multi-Stage DCF models in their analyses of the appropriate ROE. As to those models, the parties employed various inputs and assumptions. As noted, they disagree over, among other things, the composition of the proxy group, the time-period over which to measure long-term growth, and the time period over which to calculate average stock prices. BHCG and the OCC employed the CAPM methodology, but again disagreed as to the various inputs and assumptions. Among other things, they disagree over growth rates, and whether certain companies should be included or excluded based on firm size. BHCG employed the ECAPM, Risk Premium, and Expected Earnings models. Staff and the OCC question the reliability of these models. Finally, although the Company states it made no express adjustment for flotation costs in its models, Staff estimates that the application of an upward adjustment to calculated dividends in the Constant Growth DCF model results in a 9 basis-point upward adjustment to the ROE. Both Staff and the OCC oppose inclusion of flotation costs.

f. Financial Condition of BHC

184. Both Staff and the OCC cite BHC's stock price performance as evidence of financial strength. Specifically, Staff cites the fact that BHC's stock has outperformed the returns of the S&P 500 index, as well as the indices specific to utilities,[242] and the OCC cites the increase of BHC's stock price from approximately $20 to $80 per share over the past ten years.[243] Staff argues that BHC's stock performances justifies a reduction – not an increase – of BHCG's ROE.

[242] Hearing Exhibit 400 at 106 and 107.

[243] Hearing Exhibit 302 at 50:9-10 (Answer Testimony of Ron Fernandez).

185. BHCG has not argued or presented evidence that is it has faced difficulty accessing capital. In fact, the record supports the opposite conclusion. Indeed, the OCC notes that BHC was able to issue hundreds of millions of dollars in debt and equity in order to finance its acquisition of SourceGas. Further, Staff notes S&P's upgrade of BHC's credit rating by S&P from BBB to BBB+ in August 2018, and all credit rating agencies currently post a ratings outlook of "stable."[244] Despite the potential for cash flow reductions as a consequence of the Tax Cuts and Jobs Act (TCJA), no credit rating agency has lowered the Company's credit rating, and credit rating agencies do not appear to be downgrading utility ratings as a general matter.[245] BHCG does not directly refute the evidence of its strong financial condition, but maintains that a reduction in the ROE to the levels proposed by the Intervenors would not be supportive of its operations in Colorado.

g. Impact of the DSIR

186. The parties disagree about the impact of approval of the DSIR on the overall risk profile of BHCG. Staff argues that approval of the DSIR lowers the perceived risk of BHCG.[246] The DSIR, according to Staff, provides a "near-guarantee" on earnings for approved integrity projects and allows the Company to improve safety and reliability while mitigating the risk of such a large capital expenditure. The OCC asserts that, for assets in the DSIR program, there is "virtually no risk" in recovery because such risk would be transferred from the Company to its

[244] Hearing Exhibit 400 at 59, Table JJP-3. (Answer Testimony of Jason Peuquet).
[245] Hearing Exhibit 110 at 19:2-8. (Direct Testimony of Adrien McKenzie).
[246] Hearing Exhibit 400 at 123:1-5. (Answer Testimony of Jason Peuquet).

ratepayers.[247] The OCC also cites to a policy statement on cost recovery mechanisms by the FERC that this reduction in risk is a factor that should be acknowledged in the ROE.[248]

187. BHCG dismisses the arguments of Staff and the OCC primarily on the grounds that such infrastructure trackers are widely prevalent in the utility industry. Most of the companies in BHCG's proxy group have some form of infrastructure cost tracker, and BHCG notes that it lacks revenue decoupling or weather normalization mechanisms, which others in the proxy group do have.[249] BHCG also asserts that there is no basis to conclude that its existing operations have lower risk than others in the proxy group. At the hearing, Mr. McKenzie testified that approval of the DSIR does not change investors' views of the riskiness of BHC "to any measurable extent."[250] Thus, the market's view of BHC's risk level would be the same irrespective of whether BHCG operates with or without a DSIR.

h. Interest Rate Trends

188. A fundamental premise in rate setting, and the determination of the ROE, is that rates should be set in a forward-looking manner so that they will be representative of the time period in which rates go into effect. Both Staff and the OCC assert that interest rate trends have been on a decline since the economic downturn of the late 2000s. While BHCG states that interest rates have increased three times in the last three quarters, more recent statements and actions by the Federal Open Market Committee (FOMC) show a reversal in the direction of the federal funds rate. Indeed, during this proceeding the FOMC reduced the federal funds overnight lending rate on July 31, 2019, by 25 basis points from 2.25 to 2.0 percent.

[247] Hearing Exhibit 302 at 61:14-20. (Answer Testimony of Ron Fernandez).
[248] *Id.*, at 62:8-11.
[249] Hearing Exhibit 126 at 44:7-22.
[250] Hearing Transcript at 122:16-24 (8/6/19).

189. Bond yields have also declined in recent times. In fact, Mr. McKenzie testified that the 15 basis-point reduction in his recommended ROE presented at the hearing is attributable to the decline in Baa-rated utility bonds over a recent six-month period.[251] The OCC also presented evidence that the yield on U.S. Treasury bonds declined from an average of 3.11 percent in 2018 to 3.01 percent in 2019, which continued an overall downward trend over the past decade.[252] Mr. McKenzie argued that growth forecasts in the near-term by respected analysts predict that interest rates will rise.

i. Conclusion

190. The ALJ has given thorough consideration to the parties' analyses. The wide range of results and the divergence of positions on inputs and assumptions confirm the need for the Commission to exercise its judgment in considering the various factors that explain the differences in the calculations. The ALJ examined and considered the quantitative results of each ROR model presented by the parties in this proceeding. All of the methodologies presented in this proceeding are generally-accepted by the ROR analyst community. In the determination of the ROE, no single ROR model was favored, and the ALJ agrees in principle that each model result has validity and should be appropriately considered.

191. The ALJ also gave thorough consideration to the parties' arguments concerning qualitative factors that affect the risk profile of the Company. These factors include the financial stability afforded to the Company by approval of the DSIR, the historically low level of U.S. Treasury and utility bond yields, the perception of the Company in the marketplace as evidenced by its stock price and credit agency rating, the low likelihood of a credit agency

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[251] *Id.*, at 82:20-25 and 83:1-11.

[252] Hearing Exhibit 302, Attachment RAF-8 and at 17:8-12. *Also see* 49: Figure RAF-1 (Answer Testimony of Ron Fernandez).

downgrade of the Company, the trends in authorized ROEs for natural gas utilities, and BHC's ability to access capital. Taken as a whole, these factors lend credibility to an ROE that is on the lower end of the spectrum between the position of the Company and the Intervenors.

192. On balance, the ALJ finds that the analyses of the Intervenors supporting a reduction in the Company's authorized ROE is more persuasive than BHCG's analysis in support of its conclusion that the ROE should increase. In the determination of the range of reasonableness and ROE, the ALJ used a variety of inputs and considered all of the ROR models used by the parties, but the ALJ did not consider flotation costs, as the Commission has consistently rejected them, and no party presented a compelling reason to reverse course and include flotation costs in this proceeding.

193. Based on the foregoing, the range of reasonableness for the ROE in this proceeding is 9.2 to 9.6 percent, and an authorized ROE of 9.5 percent will be used for purposes of determining the revenue requirement.

B. Cost of Debt

1. BHCG's Argument

194. The long-term debt cost of a utility is the sum of the weighted-average amount of each individual debt issuance assigned to the utility and its respective interest rate, adjusted for financing costs.[253] BHCG requests that the Commission approve a cost of long-term debt of 4.31 percent. This rate is based on the cost of long-term debt that was assigned to BHGU and BHGD as of December 31, 2018. BHCG presented the 4.31 percent rate in its rebuttal

[253] Hearing Exhibit 109 at 18:14-16 (Revised Direct Testimony of Ms. Curran).

testimony, which is different from the 4.32 percent it recommended in its direct testimony. BHCG attributes the difference to an error made in calculating the cost of debt presented in its direct case.

195. As noted above, BHC – and not BHCG – issues the debt for its subsidiaries, including BHCG. BHCG states that BHC issues the debt because it is more efficient and cost-effective for BHC to issue larger amounts of debt, and then assign portions of the debt to BHC's subsidiaries (including BHCG) via inter-company loans. Otherwise, it would be more difficult and expensive for the BHC's subsidiaries to attract investors, due to the fact that each would issue smaller amounts of debt at less competitive pricing.[254]

196. BHGU's current cost of debt for purposes of setting rates, established in Proceeding No. 12AL-628G, is 7.22 percent. The debt cost for BHGD for setting rates is 6.005 percent, which was established in Proceeding No. 10AL-455G.[255] As of June 30 2018, the actual cost of debt of BHGU and BHGD was 4.4 percent and 3.86 percent, respectively.[256] As noted above, BHGU and BHGD have been consolidated into BHCG.

197. As of June 30, 2018, BHCG's cost of long-term debt was 4.01 percent, which consisted of the following assignments of $129 million in debt from BHC to BHGC: (a) $22.56 million at a "cost of money" rate of 4.08 percent that matures in 2026; (b) $18.8 million at a 2.54 percent rate that matures in January 2019; (c) $22.56 million at a rate of 4.37 percent that matures in 2046; (d) $30.08 million at a rate of 4.15 percent that matures in

[254] *Id*. at 19:11-21:2.
[255] *Id*. at 18:20-19:2.
[256] Hearing Exhibit 403, Attachment FDS-9 at 3, 5 (Answer Testimony of Ms. Sigalla).

2027; and (e) $35 million at a 4.40 percent rate that matures in 2023.[257] BHCG's cost of long-term debt increased to 4.31 percent by December 31, 2018 due to the allocation from BHC to BHCG of $28.9 million of a $400 million debt-issuance on August 17, 2018 at a rate of 4.51 percent and with a maturity date of 2033.[258] The debt replaced the $18.8 million in debt previously allocated by BHC to BHGC that matured on January 11, 2019 with a rate of 2.54 percent.[259] The difference in the rates and debt amounts (2.54 percent for the $18.8 million and 4.51 percent for the $28.9 million, and a decrease in the principle of the other debt components due to repayments made between June 30, 2018 and December 31, 2018) caused BHCG's overall amount of "long-term" debt to increase from $129 million to $136 million and its cost of debt to increase by 30 basis points.[260] BHCG requests that the Commission set the cost of long-term debt at its actual, higher cost as of December 31, 2018 (4.31 percent).[261]

198. The $28.9 million component of the $136 million overall debt with a rate of 4.51 percent and a maturity date in 2033 contains "make-whole" costs, which allows the issuer to pay off remaining debt early but at a certain cost.[262] The $30.08 million component (as of June 30, 2018) contains the costs of a "swap-lock," which was employed by BHC to hedge against the rate increasing between the time that BHC decided to issue the notes and the date that the notes were actually issued.[263] BHCG states that it is appropriate to pass these costs along to ratepayers because the decision to use the "swap-lock" was reasonable at the time it was made

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[257] Hearing Exhibit 108, Revised Attachment MCC-1 at Schedule G-1 (Revised Direct Testimony of Mr. Clevinger).

[258] *Id. See also* Hearing Exhibit 109 at 15:11-16:3 (Revised Direct Testimony of Ms. Curran).

[259] Hearing Exhibit 108, Revised Attachment MCC-1 at Schedule G-1; Hearing Exhibit 109 at 15:11-16:3; Hearing Exhibit 125 at 20:18-21:12.

[260] Hearing Exhibit 108, Revised Attachment MCC-1 at Schedule G-1.

[261] Hearing Exhibit 125 at 19:16-19.

[262] Hearing Exhibit 302, Attachment RAF-3; Hearing Exhibit 125 at 24:1-25:12.

[263] Hearing Exhibit 302, Attach. RAF-3; Hearing Exhibit 125 at 25:13-26:20.

given prevailing market conditions, and including the make-whole costs is consistent with FERC Uniform System of Accounts (USOA) General Instruction 17(b).[264]

199. As to allegations by Staff and the OCC that BHC assigns more expensive debt to regulated utilities and less expensive debt to its unregulated subsidiaries for improper reasons, BHCG states it allocates debt fairly between its subsidiaries in light of their risk-tolerance and prevailing market conditions. BHC assigns to BHCG long-term debt to finance long-term capital assets. If it financed long-lived assets with short-term or variable-rate debt (albeit at a lower cost than long-term debt), it would introduce higher levels of refinancing risk and interest rate risk into the financing of those assets, which risk would be borne by BHCG's ratepayers. In contrast, the shareholders of BHC's unregulated subsidiaries bear the interest rate and refinancing risk of shorter-term and variable rate debt. BHC believes it is more appropriate for the shareholders of its unregulated subsidiaries, rather than the ratepayers of its regulated subsidiaries, to bear the risk of interest rate risk and refinancing risk, which is the reason it assigns shorter-term and variable-rate debt to its unregulated subsidiaries. BHCG also notes that the Commission rejected a similar argument by Staff and the OCC in its last electric Phase I rate case.[265]

200. BHCG has previously sought permission from the Commission to assume on a long-term basis pursuant to § 40-1-104, C.R.S., the $35 million component (at a rate of 4.4 percent with a maturity date of 2023) of the overall $136 million "long-term" debt used by BHCG for purposes of calculating the 4.31 percent cost of long-term debt that BHCG asks the Commission to approve.[266] The Commission gave its approval in Decision No. C15-0098.[267] The

[264] Hearing Exhibit 125 at 24:1-26:20.

[265] *Id*. at 28:9-33:9.

[266] *See* Hearing Exhibit 108, Revised Attachment MCC-1 at Sched. G-1.

[267] Decision No. C15-0098 issued in Proceeding No. 15A-0024SG on January 29, 2015.

remainder of the debt at issue here – $101 million – is not currently long-term debt because it has been assigned to BHCG by BHC on a short-term basis (*i.e.*, notes with a term of one-year or less).[268] BHCG states that "[i]f approved for ratemaking purposes in this proceeding, the Company plans to file a securities application with the Commission requesting authorization to assume the $101 million as long-term financing on a permanent basis."[269]

2. Intervenors' Arguments

a. Staff

201. Staff recommends a cost of long-term debt of 4.32 percent as of December 31, 2018, the same cost requested by BHCG in its Direct Testimony.[270] Staff also recommends the Commission state that it does not support BHC allocating debt to BHCG for cost of service in future proceedings. In the alternative, Staff recommends that rates should be set using either the 4.19 percent cost allocated to the unregulated affiliate Black Hills Energy Services, or the 4.28 percent cost of debt that has been allocated to BHUH to finance the Company's acquisition premium.

202. Staff expresses concern about the allocation of debt by BHC to its subsidiaries and, similar to its arguments in Proceeding No. 18A-0869SE, Staff argues that BHC regularly assigns higher cost debt to regulated entities. Staff claims that, because of this demonstrated trend that is prejudicial to ratepayers, it does not believe it is in the public interest for the BHC Treasurer to allocate debt. Staff also suggests that the recently incurred debt may have

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268 Hearing Exhibit 125 at 26:15-20; 27:17-28:8.

269 *Id*. at 28:6-8.

270 At the hearing, Staff witness Sigalla stated that she was aware the Company corrected its initial testimony reducing the cost of debt from 4.32 to 4.31 percent, but maintained her recommendation of 4.32 percent due to inconsistencies between the corrected testimony and what was provided in discovery. Hearing Transcript at 306:8-20 (8/9/19).

been used to finance the acquisition premium at a lower cost. Finally, Staff compares the methods used to allocate debt by the regulated utilities in Colorado, and shows that no other utility follows BHC's methodology that results in higher cost debt assigned to regulated entities.

b. OCC

203. The OCC recommends a cost of long-term debt of 3.85 percent at the end of its proposed HTY, on June 30, 2018. The OCC opposes the 4.32 percent cost of debt originally proposed by the Company, citing similar arguments made by Staff that the Company has demonstrated a pattern of assigning higher cost debt to Colorado. The OCC accuses the Company of "gaming the system," by paying off low cost debt early and replacing it with a much higher cost of debt to be used in setting rates. Specifically, the OCC points to the fact that BHC paid off a note with a low 2.54 percent rate just before the end of 2018. It was replaced with another issuance with a rate of 4.53 percent, which amounts to a 78-percent increase in the cost of this portion of debt that was only in effect for approximately 5 percent of 2018. However, BHCG then chose to base its cost of debt in this proceeding using the higher rate of 4.53 percent, leading to a revenue requirement increase of $800,000.

204. The OCC argues that BHCG added deferred financing costs, which include administrative costs associated with issuing debt; make-whole costs, which allows the issuer to pay off remaining debt early at a certain cost; and swap lock costs based on a derivative contract typically used for hedging. While the OCC agrees with the addition of deferred financing costs, it objects to inclusion of the make-whole costs, particularly the 0.055 percent fee for the $400 million issuance due in 2033. These costs related to the remarketing of the Remarketable Junior Subordinated Notes were issued in the acquisition of SourceGas, and thus should not be recovered from ratepayers. The OCC is also opposed to the recovery of swap lock costs, arguing that no approval was obtained for such costs and they are imprudent because they made the debt unreasonably expensive.

205. The OCC also objects to BHCG's failure to obtain approval from the Commission pursuant to § 40-1-104, C.R.S., to take on the $28.9 million debt at a rate of 4.51 percent in the second half of 2018. The OCC notes that "[t]his newly assigned debt issue will have the highest interest rate in [BHCG's] debt portfolio," and replaced the lowest cost debt.[271] The OCC contends that this debt assignment without permission from the Commission "continues [BHC's] disturbing practice of assigning low cost debt to its non-regulated subsidiaries and assigning high cost debt to its regulated subsidiaries," which the OCC also argued in Proceeding No. 18A-0869SE.[272]

206. The OCC recommends that the Commission require BHC to assign the lowest cost debt to Colorado, or in the alternative, require the cost of any future debt assigned to BHCG to be lower than the cost of debt assigned to the non-regulated subsidiaries. The OCC states that either of these alternatives would promote a fairer allocation of debt issued to subsidiaries, would avoid subsidies between regulated and unregulated subsidiaries, and would prevent BHC from assigning the highest cost debt to Colorado. Further, the OCC states that "[u]nless the Company is willing to adjust all aspects of its Test Period to December 31, 2018, change its debt allocations procedures, and obtain Commission approval for new debt issues," it recommends using actual debt cost from June 30, 2018, which it states is 3.85 percent.[273] The OCC calculated

[271] Hearing Exhibit 302, Rev. 1 at 11:10-11.
[272] *Id*. at 11:13-15.
[273] *Id*. at 16:5-12.

the 3.85 percent cost of debt by subtracting the swap lock costs from the cost calculation for the notes due in 2027.[274]

3. Analysis

a. Cost of Debt

207. The OCC has not demonstrated that the cost of long-term debt should be calculated as of June 30, 2018, thereby excluding the debt adjustments for the six-month period from June 30 through December 31, 2018. Therefore, the ALJ finds that ratepayers will not be prejudiced by the actual cost of debt, as calculated by the Company at 4.31 percent as of December 31, 2018.

208. The ALJ also will not disallow the inclusion of the swap lock and make-whole (remarketing) costs in the calculation of the long-term debt cost. BHCG's decision to use swap locks to protect the company (and ratepayers) from large interest rate movements when a decision had been made to issue debt but was not expected to be executed immediately was reasonable. While BHCG's hedge did not result in a reduction in the cost of debt, it was reasonable under the circumstances.

209. Similarly, BHCG established that the remarketing costs related to the Remarketable Junior Subordinated Notes due in 2033, or make-whole costs, were booked in accordance with the FERC's USOA accounting General Instruction 17(b). According to the cited language, the costs associated with such loss on reacquired debt may be accounted for and may be either written off immediately or amortized in accordance with the 17(b) Instruction. At the hearing, the OCC did not refute the Company's rebuttal argument.

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[274] *Id*. at 16:8-12; Hearing Exhibit 302, Attach. RAF-3

210. Further, in regard to the OCC's arguments that such costs should be assigned to the SourceGas acquisition, the OCC did not contest the Company's argument that the proceeds of the new debt were used to pay off the $250 million notes due in 2019 and the Equity Units that helped to provide the necessary equity to appropriately capitalize the Company and fund its long-life assets. Therefore, the remarketing costs related to the Remarketable Junior Subordinated Notes will be included in the cost of debt calculation.

b. Conversion of Short-Term to Long-Term Debt

211. The ALJ is concerned by BHC's approach to obtaining approval from the Commission for the assumption of long-term debt by its regulated subsidiaries. As conceded by BHCG in this proceeding, $101 million of the $136 million in "long-term" debt identified by BHCG is not, in fact, long-term debt. Instead, it is short-term debt that BHC has been assigning to BHCG in annual short-term (one-year) notes. According to BHCG, it is only after the Commission has approved using the $101 million in debt for purposes of calculating rates that BHCG will file an application seeking approval for BHC to assign the $101 million to BHCG on a long-term basis pursuant to § 40-1-104, C.R.S.

212. This process is problematic. Section 40-1-104, C.R.S., allows a public utility like BHCG to assume long-term debt, which is defined as debt with a term longer than 12 months, only with the approval of the Commission. The public utility must file an application seeking the approval before assuming the debt, and the Commission "shall enter its order approving the [application] . . . unless the [C]ommission finds that such transactions are inconsistent with the public interest or that the purpose thereof is not permitted or is inconsistent with the provision of this section."[275]

[275] § 40-1-104(2), C.R.S.

213. BHCG's process of seeking Commission approval in Phase I rate cases of the inclusion of short-term debt in the capital structure as long-term debt before seeking to assume the debt as long-term debt pursuant to § 40-1-104, C.R.S., places the Commission in a difficult position. Indeed, in such application cases BHCG argues that it would be inconsistent for the Commission to find that the assumption of debt on a long-term basis is "inconsistent with the public interest" after it has already approved the inclusion of the debt in the capital structure that is used for setting rates in a Phase I rate case. BHCG also points to the fact that ratepayers have been paying bills calculated based on the Commission-approved rates before BHCG files the application seeking to assume the debt from BHC on a long-term basis. BHCG's sequencing places maximum pressure on the Commission to approve the application filed pursuant to § 40-1-104, C.R.S.

214. The ALJ recommends that Black Hills be ordered to, in the future, obtain approval for the conversion of short-term debt to long-term debt and/or to assume long-term debt pursuant to § 40-1-104, C.R.S., before it seeks approval of including the debt in its capital structure in a Phase I rate case. If it does not, the Commission should treat the debt as short-term debt and include all short-term debt in the capital structure. The ALJ seriously considered doing this in this proceeding, but the record is inadequate on BHCG's short-term debt and did not allow the ALJ to make any findings thereon with a sufficient degree of confidence for purposes of including it in the capital structure.

C. Capital Structure

1. BHCG's Arguments

215. BHCG requests approval of its 2018 year-end capital structure, which was 50.15 percent equity and 49.85 percent debt. The Company represents that this was its actual capital structure at the end of the test period, and use of the actual capital structure in ratemaking is a long-standing principle of the Commission. BHCG as an operating entity does not directly access the credit markets, and thus does not have a stand-alone capital structure. BHCG's financing and liquidity needs are provided through BHC, and the Treasurer is responsible for determining the operating entity's capital structure. BHCG argues that approval of its recommended capital structure will allow the Company to maintain its financial integrity by obtaining favorable financing costs and vendor terms, maintain its credit rating, and improve its ability to access capital at a reasonable cost while reducing the likelihood of a downgrade by credit reporting agencies.

216. BHCG states that the requested year-end 2018 capital structure includes debt and equity issuances since June 30, 2018. BHCG explains that the changes were necessary because the Company had a high level of debt after the acquisition of SourceGas in 2016, and it decided to attempt to maintain an approximately 50 percent equity to 50 percent debt ratio. BHCG asserts that the consolidation at issue in this case had no material impact on the Company's decision to seek a year-end 2018 capital structure.

217. In Proceeding No. 10AL-455G, BHGD's most recent gas rate case, the Commission approved a capital structure that reflected 50.48 percent equity and 49.52 percent long-term debt. This was the actual capital structure of SourceGas, BHGD's parent company at that time, as of December 31, 2009. In BHGU's last rate case in Proceeding No. 12AL-0628G, the Commission approved a hypothetical capital structure of 50 percent equity and 50 percent long-term debt. The capital structures in both proceedings were part of settlements approved by the Commission.

218. Credit reporting agency ratings are an important concern when determining the capital structure. Credit reporting agencies issue credit ratings only for BHC as the publicly traded entity, as opposed to BHCG as an individual operating company. At the end of calendar year 2018, BHC had a senior unsecured credit rating of BBB+ by Fitch and S&P, and Baa2 by Moody's. BHCG asserts that its parent company's credit ratings are integral to its ability to issue debt, and also to access the short-term debt markets for utility operations. A strong credit rating lowers interest costs, which benefits customers. BHCG asserts that approving its requested capital structure will allow it to maintain its credit rating.

219. BHCG rejects Staff's use of a period of March 1, 2018 to February 28, 2019 to determine the capital structure, which is two months past what the Company proposes as the end of the test period for two reasons. First, blending historical capital structures are not representative of the structure that was put into place to finance the Company's specific capital additions. Second, Staff's structure improperly includes a tranche of $18.8 million that is part of an issuance that was retired and replaced in late 2018. BHCG's rate base was in a state of rapid growth during the time selected for the average, and certain assets were retired and replaced. The Company asserts that the use of averaging is therefore problematic because it dilutes and partially reflects the effect of these changes.

2. Intervenors' Arguments

a. Staff

220. Staff recommends a capital structure that, in contrast with the Company, incorporates a two-tiered ratio of debt with rates for both long-term and short-term debt. Staff proposes a capital structure consisting of 49.36 percent long-term debt, 1.13 percent short-term debt, and 49.51 percent equity. Staff believes the time has come to include short-term debt in the capital structure because it has been a significant source of capital that the Company relies upon to fund ongoing operations. Staff calculates that BHCG had a monthly short-term debt balance of nearly $1.5 million in 2018, which rose to more than $3 million from March 2018 to February 2019. Staff argues that other jurisdictions such as Arkansas have included short-term debt in Black Hills' capital structure, and Minnesota, North Dakota, Wisconsin, and Michigan have included it in the capital structure for Xcel Energy.

221. Staff recommends that short-term debt be included in the capital structure at its associated cost, which is lower than that of long-term debt. Staff calculates its short-term debt cost of 2.85 percent, based on total short-term debt expenses across the 12 months from March 2018 to February 2019 of approximately $1 million, and total monthly short-term debt balances of approximately $36 million during the same time period.

222. Staff supports its argument to include short-term debt by explaining that when a utility begins a capital project, it becomes moot whether the source of funding was derived from short-term debt, long-term debt, or equity. Staff asserts that all money is "fungible," where dollars are indistinguishable and may be used interchangeably for any purpose. Because short-term debt is less expensive, it is in the public interest to incorporate the lower rate to decrease the overall cost of debt. Staff recommends that the debt levels be calculated on an average basis, rather than a point-in time basis, because it better reflects the actual capital structure that the Company relies on to finance rate base. A point-in-time approach may not reflect levels typically seen throughout the year if the Company has recently issued equity or received equity allocations.

223. Staff argues that its proposed capital structure is not likely to lead to a credit downgrade of BHC based on credit metrics. The metric used for cash flow, which is

instrumental, is sufficient to support BHC's current credit ratings and maintain the Company's financial integrity. BHC's credit outlook is currently stable with all three credit reporting agencies, and Staff notes that in August of 2018, S&P upgraded BHC from BBB to BBB+. Staff posits that adopting its recommendation on capital structure should not jeopardize the financial integrity of either BHCG or BHC.

b. OCC

224. The OCC recommends a capital structure of 50.11 percent equity and 49.89 percent long-term debt. Unlike Staff, the OCC does not advocate for a separate short-term debt ratio. The OCC objects to BHCG's use of a *pro forma* hybrid test period ending December 31, 2018 based on its arguments that the Base Period, which is the correct test period, ends on June 30, 2018. The OCC asserts that incorporating a post-Base Period capital structure violates the principle that the capital structure should be matched to the revenues, expenses, taxes, rate base, and other aspects coinciding with the test period, and a violation of this well-recognized principle is not in the public interest.

225. The OCC argues that the post-Base Period adjustments after June 30, 2018 are flawed because they were either partially adjusted with actual figures, not adjusted at all, or include forecasts. The OCC claims that in some instances, forecasts were used even when actual data was available. The adjustments to the capital structure by the Company included an allocation of debt by BHCG of $7.0 million, and an increase to the equity ratio by $7.2 million based on projected 2018 net income. The OCC rejects such adjustments and supports the use of the actual capital structure as of June 30, 2018 without post-Base Period adjustments.

3. Analysis

226. The Colorado Supreme Court has held that, unless it is demonstrated by a substantial showing that ratepayers are materially prejudiced by the actual capital structure that finances utility operations, the Commission should use that actual utility capital structure in calculating rates.[276] The Colorado Supreme Court has not, however, specified the types of debt included in the capital structure. Nevertheless, the Commission has excluded short-term debt from the actual capital structures it has approved in the past.

227. Here, Staff's argument that short-term debt should be included in the capital structure relies primarily on the principle that money is fungible, which means that all debt – including short-term debt – is used to fund BHCG's operations, including short- and long-term projects. The fungibility of money is undisputed. It is also undisputed, however, that: (a) BHCG takes out short-term debt principally to finance Construction Work In Progress (CWIP), and other short-term operational and working capital needs; and (b) CWIP is not included in rate base in this proceeding.[277] Without CWIP in rate base, the ALJ finds and concludes that there would be a mismatch if short-term debt were included in the capital structure.

228. In addition, there is insufficient evidence to conclude that short-term debt has been used to finance long-term investments. BHCG states that it does not use short-term debt to finance long-term rate base because of the higher refinancing risk and interest rate risk associated with short-term debt. Moreover, BHCG presented evidence that its short-term debt balances

[276] *Peoples Natural Gas v. Public Utilities Commission*, 567 P.2d 377 (Colo. 1977).

[277] In proceedings where CWIP has been included in the rate base, it is customary to include an Allowance for Funds Used During Construction (AFUDC) offset to earnings.

fluctuate throughout the year, even reaching a balance of $0 in some months.[278] This supports the conclusion that BHCG does not rely on short-term debt instruments on a long-term basis.

229. The ALJ also finds and concludes that Staff has not provided sufficient justification to use its averaging methodology from March 2018 to February 2019. BHCG has established that the averaging methodology used by Staff introduces considerable ambiguity which, when compared to the Company's methodology, would result in a lower level of confidence as to the proper structure. Although averaging may be a valid methodology in certain circumstances, those circumstances are not present here.

230. Finally, the ALJ observes that the record demonstrates a disparity between the parties with respect to the specific equity adjustments made after June 30, 2018. All parties agree that a $7 million debt allocation was made in September 2018. However, Staff states in testimony that $9 million in equity was added in September, 2018, and subsequent amounts totaling $6 million were made through February, 2019.[279] The OCC states that $7.2 million in equity was added between June 30 and December 31, 2018.[280] In rebuttal, the Company represents that an equity infusion of $6 million was made between June 30 and December 31, 2018, and acknowledges no other additions.[281]

231. The ALJ finds and concludes that the actual capital structure as of December 31, 2018, on balance, is the most appropriate for determining rates in this proceeding. Further, the record does not establish that use of the actual capital structure as of December 31, 2018 is

[278] Hearing Exhibit 400 at 48:17-19 (Answer Testimony of Mr. Peuquet).
[279] *Id*. at 56:13-18.
[280] Hearing Exhibit 302 at 8:3-5 (Answer Testimony of Mr. Fernandez).
[281] Hearing Exhibit 125 at 11:1-5 (Rebuttal Testimony of Ms. Curran).

prejudicial to ratepayers. Therefore, the capital structure of 50.15 percent equity and 49.85 percent debt as of December 31, 2018 shall be approved.

D. Weighted Average Cost of Capital (WACC) and Return on Rate Base

232. Based on the findings and conclusions above, a WACC value for the 2016 test year with known and measurable adjustments is approved as follows:

	Ratio	Cost	Weighted Cost
Debt	49.85%	4.31%	2.15%
Equity	50.15%	9.50%	4.76%
Total	100.0%		**6.91%**

VI. INCOME STATEMENT

A. Equity Compensation

1. BHCG's Argument

233. BHCG seeks recovery of $426,126 for equity compensation, which is the expense amount recorded during the Base Period.[282] In support, BHCG argues that "[e]quity compensation is a real operating expense associated with recruiting, compensating, and retaining employees." BHCG asserts that recent Commission decisions have been inconsistent on the question of recovery of equity compensation.[283]

2. Intervenors' Arguments

a. Staff's Argument

234. Staff argues that 50 percent of the costs associated with providing equity compensation to managers and executives should be disallowed because it benefits both

[282] Hearing Exhibit 129 at 7:4-9:18 (Rebuttal Testimony of Ms. Johnson).

[283] BHCG's SOP at 32 (citing Decision Nos. R18-0014 (allowing recovery of 100 percent), R18-0318-I (allowing recovery of 50 percent), 15AL-0135G (allowing recovery of 100 percent).

shareholders and customers. As a result, shareholders and ratepayers should share the costs of equity compensation. As support, Staff cites Decision No. R18-0318-I.

b. OCC's Argument

235. The OCC states that when additional equity is issued, the percentage of equity in the capital structure increases. Since equity is more expensive than debt, Black Hills' cost of capital increases. Under ROR regulation, a higher cost of capital allows the opportunity to earn more on their rate base. The OCC argues that is exactly what is happening in this case. The Company has proposed *pro forma* increases in the equity due to retained earnings and equity compensation.[284] The OCC states that in Black Hills' last two rate cases, equity compensation expense was disallowed.[285] The OCC recommends the Commission remove the requested equity compensation expenses from the test period to be consistent with previous rulings.

3. Analysis

236. Based on the arguments of Staff and OCC and the cited Commission decisions, the ALJ removes 50 percent of the requested equity compensation expenses from the test period, consistent with previous rulings. The ALJ is concerned about the larger equity base resulting from equity compensation programs gives companies an opportunity to earn more. In addition, this outcome is the most consistent with the recent Commission decisions cited by the parties.

B. Amortization of Non-Protected ADIT

1. BHCG's Argument

237. The change in Federal Income Tax rate required a revaluation of the accumulated deferred income tax (ADIT) accounts as of December 31, 2017 as it reduced the Federal Income

[284] Hearing Exhibit 302 at 68:13-70:16.
[285] *Id*. at 70:17-71:19.

Tax rate for corporations from 35 percent to 21 percent effective January 1, 2018. All regulated utilities had to create regulatory liabilities associated with this revalued ADIT to return to customers the tax payments that were collected at 35 percent under established rates but would be paid at 21 percent as of January 1, 2018. Black Hills proposes to separate the non-protected ADIT into two buckets: property-related and non-property-related.

238. Black Hills proposes to delay collection of the non-property-related non-protected ADIT until its net operating loss ADIT has been reduced to zero, and then apply average rate assumption method to the remaining non-plant ADIT. The Company states it will propose an appropriate amortization method at a future base rate review. Black Hills does not anticipate collecting the non-property-related non-protected ADIT from customers until after the next base rate review, presumably earning a return on this regulatory asset.[286]

239. Black Hills proposes returning the non-protected plant excess ADIT of \$3.7 million to ratepayers over decades, while having ratepayers pay the non-protected non-plant excess ADIT of \$1.4 million over a much shorter period of time. Black Hills states it established a regulatory asset for these costs based on the fact that: (A) the Commission has treated these costs as recoverable in the cost of service in the past; and (B) these costs have been treated as allowable costs by the Commission for other utilities in its jurisdiction.[287]

2. Intervenors' Arguments

a. Staff's Argument

240. Staff recommends amortizing the non-protected ADIT over three years and netting the non-protected property-related with the non-protected non-property related so that

[286] Hearing Exhibit 403 at 27:12-28:16 (Answer Testimony of Ms. Sigalla).

[287] Hearing Exhibit 112 at 9:5-12:12 (Revised Direct Testimony of Mr. Crouch).

both the regulatory asset and the regulatory liability are extinguished. Staff argues that the overpayment of income taxes related to non-protected ADIT are dollars that, in hindsight given the TCJA, did not need to be collected from ratepayers. Staff believes this money is owed back to the ratepayers who paid extra in their gas bills over the past several years for federal tax liabilities that Black Hills will not pay.[288]

b. OCC's Argument

241. OCC recommends that the non-protected plant related excess ADIT regulatory liabilities be netted against the non-protected non-plant related excess ADIT regulatory assets, and that the remaining balance be refunded to ratepayers in a one-time credit on their bill. The result of this proposal would be a $2,267,415 one-time credit for ratepayers and will close out the non-protected excess ADIT issue for BHCOG. The OCC argues that Black Hills has selected a non-protected excess ADIT methodology that benefits the Company at the expense of ratepayers. They argue that the selected methodology is not consistent with how this item has been approved for other Colorado utilities.[289]

3. Analysis

242. The ALJ finds and concludes that BHCG has not satisfied its burden of establishing that its proposed treatment of the non-protected ADIT is in the public interest. The ALJ finds and concludes that Staff's proposal to amortize the non-protected ADIT over three years and to net the non-protected property-related with the non-protected non-property related so that both the regulatory asset and the regulatory liability are extinguished is the best option.

[288] Hearing Exhibit 403 at 29:1-32:6 (Answer Testimony of Ms. Sigalla); Staff's SOP at 33.

[289] Hearing Exhibit 302 at 72:2-75:10 (Testimony of Mr. Fernandez).

C. Tax Savings Sharing

1. BHCG's Argument

243. BHCG states that there will be $24 million income tax savings accruing to Black Hills Gas Holdings, LLC (BHGH), which is an affiliate of BHCG. BHCG states that these tax savings

> result from a portion of the nondeductible goodwill recorded as part of the SourceGas Acquisition becoming tax deductible through future amortizations over the next 15 years. This goodwill is recorded at the BHGH level and does not affect the books and record of BH Colorado Gas. The tax benefit derives directly from this goodwill, which is not included in rate base or reflected anywhere in the revenue requirement as the Company agreed in a Commission-approved settlement in the SourceGas Acquisition proceeding never to seek recovery from customers. It is therefore a shareholder cost, from which customers are and will continue to be protected.[290]

BHCG is thus effectively arguing that because the Company agreed not to recover any acquisition premium from ratepayers in the settlement in Proceeding No. 15A-0667G (the SourceGas Acquisition Proceeding), ratepayers should not receive any of the benefit from the tax savings associated with that premium. Put differently, because shareholders have solely funded goodwill, shareholders should solely benefit from the tax savings associated with that goodwill.[291] According to BHCG, this conclusion is reinforced by the fact that BHCG's ratepayers received a $200,000 annual revenue benefit as a result of the settlement in the SourceGas Acquisition Proceeding.[292] Finally, BHCG argues that the Commission would have to "pierce the corporate veil" to provide some or all of the tax benefits "recorded at the BHGH level" to BHCG's ratepayers.[293]

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[290] BHCG's SOP at 26 (citations omitted).

[291] *See id*.

[292] *Id*. at 29.

[293] *Id*. at 26

2. Staff's Argument

244. Staff recommends that ratepayers receive 90 percent of the tax benefit ($21,600,000) and Company shareholders retain 10 percent ($2,400,000). According to Staff, BHCG should be rewarded for engaging in tax planning that benefits ratepayers, however, ratepayers should get the bulk of these benefits. This conclusion is reinforced by the tax losses incurred from the resetting of the ADIT and the other costs associated with the acquisition and consolidation, such as severance costs and higher financing costs from debt to finance the acquisition premium.[294]

3. Analysis

245. The ALJ finds and concludes that the record does not support Staff's request for ratepayers to receive 90 percent of the $24 million in tax savings noted above. Staff has not persuasively argued that ratepayers should receive tax savings accruing to an entity different from BHCG from which ratepayers receive gas service. Accordingly, Staff's request shall be denied.

D. Wages Adjustment and Pension Impact of Incentive Pay

1. BHCG's Argument

246. BHCG seeks *pro forma* labor adjustments for known and measurable changes in total cash compensation. The Company proposed to adjust Base Period labor costs to reflect wage adjustments in September 2018, planned merit increases of 2.5 percent in March 2019, annual incentive compensation reflecting 100 percent of target but capped at 15 percent, as well as benefits, overtime, call-out, and standby pay. BHCG cites a number of national compensation and benefit surveys used to evaluate the competitiveness of its compensation and that provide

[294] Staff's SOP at 32.

base salary and incentive compensation in concluding that its average base pay was "competitive and reasonable" as of November 5, 2018.[295] Under these circumstances, BHCG asserts that "the Commission should not intrude on management decision-making regarding the necessary compensation to attract and retain skilled employees by capping recovery at arbitrary limits."[296]

247. Black Hills states that Staff does not provide any compensation studies demonstrating that the compensation levels of the Company are in fact outside of the range of other similar utilities. Compensation surveys inform Black Hills about the cost of talent and where compensation range midpoints should be set. In addition, Black Hills argues that Ms. Sigalla's analysis that it was significantly higher is flawed in that she included various types of employee pay adjustments, not just the annual merit increase. The analysis of actual salaries above the budgeted 2.5 percent merit increase should be ignored as that wage increase analysis has no impact on the 2.5 percent base pay merit increase adjustment.

248. Finally, BHCG states that the pension expense amount of $109,984 requested for inclusion in rates does not reflect the impact of 2019 merit increases. The requested pension expense amount is based on actuarial valuation data as of January 1, 2018, which reflects pensionable pay through 2017. According to BHCG, none of the *pro forma* pay adjustments were reflected in the requested pension expense.[297] Further, the Company believes that tracking the impact on future pension expense related specifically to the 2019 merit increase or incentive payments above target would be administratively burdensome, especially as the group of

[295] BHCG's SOP at 30-31.

[296] *Id*. at 31.

[297] Hearing Exhibit 130 at 4:15-23 (Rebuttal Testimony of Mr. Menzel).

participants impacted by the increase or incentive payments terminate employment and payment of their benefits commence.[298]

2. Staff's Argument

249. Staff recommends disallowing recovery of any incentive pay or pension impact associated with salary increases above 2.5 percent. Staff argues testimony provided by the Company only supports 2.5 percent salary increases, but states that through its requested revenue requirement and *pro forma* adjustments thereto, BHCG is seeking recovery for higher increases. Staff recommends that recovery be denied here in this proceeding for the salary increases, but that BHCG be directed to request cost recovery for the 2.5 percent salary increases in its next rate case.[299]

250. Staff further states that incentive pay is included in the calculation of pension benefits. Incentive payments that are larger than authorized by the Commission boost pension costs higher than requested for recovery at each rate case, leading to underfunding of the pension plan and increased costs for ratepayers. The Company argues that incentive payments, particularly those made near retirement, will permanently boost pension payments for the lifetime of the employee.[300] Citing Decision No. C16-1140,[301] Staff concludes that the pension impact of salary increases above 2.5 percent should be removed from the revenue requirement and thus borne by the Company.

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[298] *Id*. at 8:3-18.

[299] Staff's SOP at 33-34.

[300] Hearing Exhibit 403 at 77:7-81:2 (Answer Testimony of Ms. Sigalla).

[301] *Id*. at 77:17-78:10.

3. Analysis

251. The ALJ finds and concludes that BHCG has carried its burden of establishing that cost recovery for the wage adjustments should take place in this proceeding. The ALJ finds and concludes that Staff has not provided sufficient evidence supporting its position.

E. Recovery of Pension and Retiree Expenses, Creation of Regulatory Assets

1. BHCG's Argument

252. BHCG is requesting recovery of amortized prior service costs and actuarial gains and losses in pension-related and other post-employment benefits (OPEB)-related regulatory assets created at the time of the Aquila and SourceGas acquisitions. According to BHCG,

> [t]hese amortized expenses relate to the pension and OPEB plan obligations assumed by Black Hills in its acquisition of Aquila's and SourceGas's Colorado gas utility businesses and would have continued to be expensed and recovered by Aquila and SourceGas in their public utility rates had the acquisitions not taken place. Under generally accepted accounting principles, the Company was ***required*** to record these regulatory assets and continue to amortize the costs on its income statement.[302]

BHCG states that it was not required to file an application seeking approval from the Commission to create a regulatory asset with respect to costs and gains and losses. BHCG concludes that it should be permitted to recover these regulatory assets.

2. Staff's Argument

253. Staff recommends the Commission deny recovery of the pension and retiree medical assets, arguing that dollars that have already been recovered should be returned to ratepayers using a three-year amortization. Staff states the Commission has not issued any decision approving either the creation or recovery of these pension and retiree medical regulatory assets. The Commission became aware of these regulatory assets during the last electric rate

[302] BHCG's SOP at 32-33 (emphasis added) (Footnotes 162 and 163 omitted).

case, Proceeding No. 16AL-0326E. Staff believes Black Hills should not be allowed to create or recover regulatory assets before requesting permission from the Commission. Staff argues it is likely that these assets led to an adjustment to the SourceGas purchase price. Allowing BHCG to recover them now would constitute double recovery.[303]

3. Analysis

254. After careful consideration of the arguments presented by BHCG and Staff, the ALJ shall deny recovery of the amortized costs and actuarial gains and losses in the pension-related and OPEB-related regulatory assets. The ALJ shall grant Staff's request that BHCG return to ratepayers dollars that have already been recovered using a three-year amortization.

F. Whitewater Distribution System Rate Condition

1. BHCG's Argument

255. BHCG proposes to eliminate a special rate condition that was put in place at the time the Whitewater certificate of public convenience and necessity (CPCN) was approved in 2005, when the utility was owned by Kinder-Morgan. The Company states the project has cost more than expected, and revenues have been less than anticipated. The gross plant in service was about $1 million greater than Kinder Morgan's estimate of $1.5 million. There are about half the number of customers that Kinder Morgan projected for the second year of operation. Black Hills is proposing to commence recovery of the full remaining net plant investment that includes the amount in excess of the original estimate.[304]

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[303] Hearing Exhibit 403 at 69:11-77:5 (Answer Testimony of Ms. Sigalla).

[304] BHCG's SOP at 41-42.

2. Staff's Argument

256. Staff recommends the Commission retain the Whitewater System rate condition that was designed to protect ratepayers. Staff does not believe it is fair to ask ratepayers to pay for costs in excess of those projected at the time the Whitewater System was approved by the Commission. Staff states that investments made as part of the ordinary course of business, such as new meter lines, service lines, and main extensions constructed to connect new customers are not appropriate to be recovered outside of the rate condition.[305]

3. Analysis

257. The Commission established the Whitewater condition to "protect ratepayers from the risk of unrealized, optimistic assumptions about, *e.g.,* the number of customers, . . . capital costs, [and] expenses."[306] The project cost more than expected and the number of customers is lower than expected. Accordingly, the ALJ agrees with Staff that it is appropriate to hold BHCG, which is Kinder Morgan's successor, to this obligation. However, investments made to improve reliability of the system are reasonable costs for recovery in this proceeding.

G. Adjustments to Accumulated Depreciation, ADIT, Depreciation Expense, Revenue, and Property Tax Expense for Capital Based on Post-Base Period Capital Additions

258. Black Hills made a series of *pro forma* adjustments associated with its Post-Base Period Capital Additions. Those adjustments are as follows: (a) Accumulated Depreciation – $455,246; (b) ADIT – $(580,541); (c) Depreciation Expense – $910,492; (d) Revenue – $708,637; and (e) Property Tax Expense – $237,506.[307]

[305] Staff's SOP at 35.
[306] Decision No. R05-0269 issued in Proceeding No. 04A-113G on March 4, 2005 at ¶ 85.
[307] Hearing Exhibit 300, Rev. 1 at 68:12-69:4 (Answer Testimony of Mr. Skluzak).

259. If the Post-Base Period Capital Additions are denied, the OCC recommends the reversal of these adjustments as follows: full reversal of the Accumulated Depreciation, ADIT, Depreciation Expense, Property Tax Expense, and partial reversal of the Revenue Adjustment by $101,234.[308] In its rebuttal testimony, BHCG did not respond to the OCC's proposed adjustments in the event the Post-Base Period Adjustments are not approved.

260. Based on the foregoing, and because the Post-Base Period Capital Additions have been denied, the ALJ finds and concludes that the adjustments proposed by the OCC are necessary and shall be made.

VII. PHASE II

A. Consolidation of Base Rate Areas

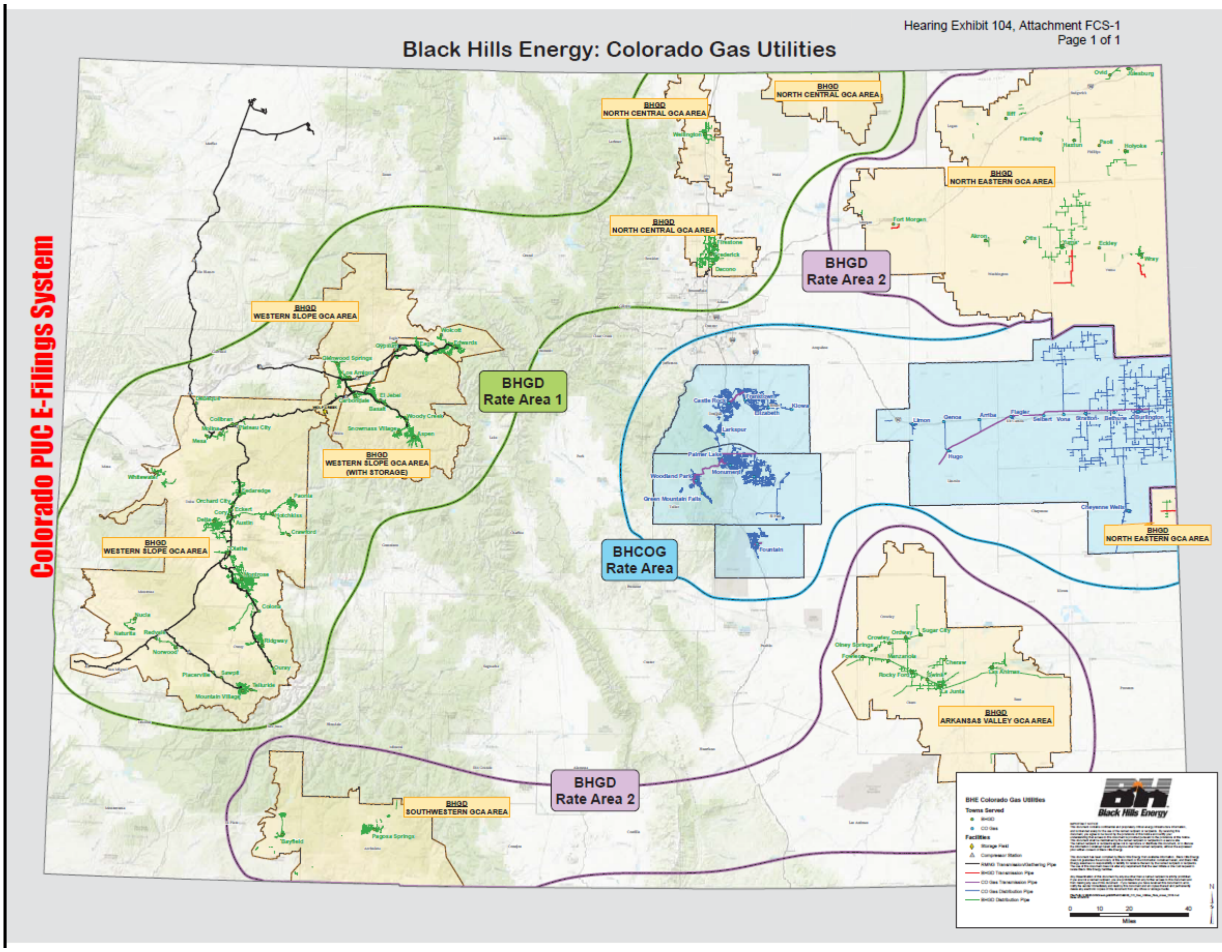
1. Background

261. As explained above, BHCG proposes to consolidate the rates and tariffs for BHGU and BHGD into Colo. PUC No. 1 for BHCG. BHGD has two base rate areas and six GCAs. BHGD Rate Area 1 has approximately 75,000 ratepayers (~67,400 residential) in primarily Western Slope communities, such as Montrose, Glenwood Springs, and Aspen, as well as northern Front Range, such as Firestone and Erie. BHGD Rate Area 2 has approximately 23,000 ratepayers (~19,700 residential) in: (a) North Eastern plains communities, such as Yuma and Wray; (b) Arkansas Valley communities, such as La Junta and Rocky Ford; and (c) a few communities in the Southwest, such as Pagosa Springs.

262. BHGU has one base rate area and one GCA and has approximately 86,000 ratepayers (~80,000 residential) in primarily Front Range communities, such as Castle

[308] *Id*. at 68:12-69:4, 70:1-71:21 (Accumulated Depreciation), 72:1-11 (ADIT), 77:17-80:6 (Revenue Adjustment), 82:9-83:13 (Depreciation Expense and Property Tax Expense).

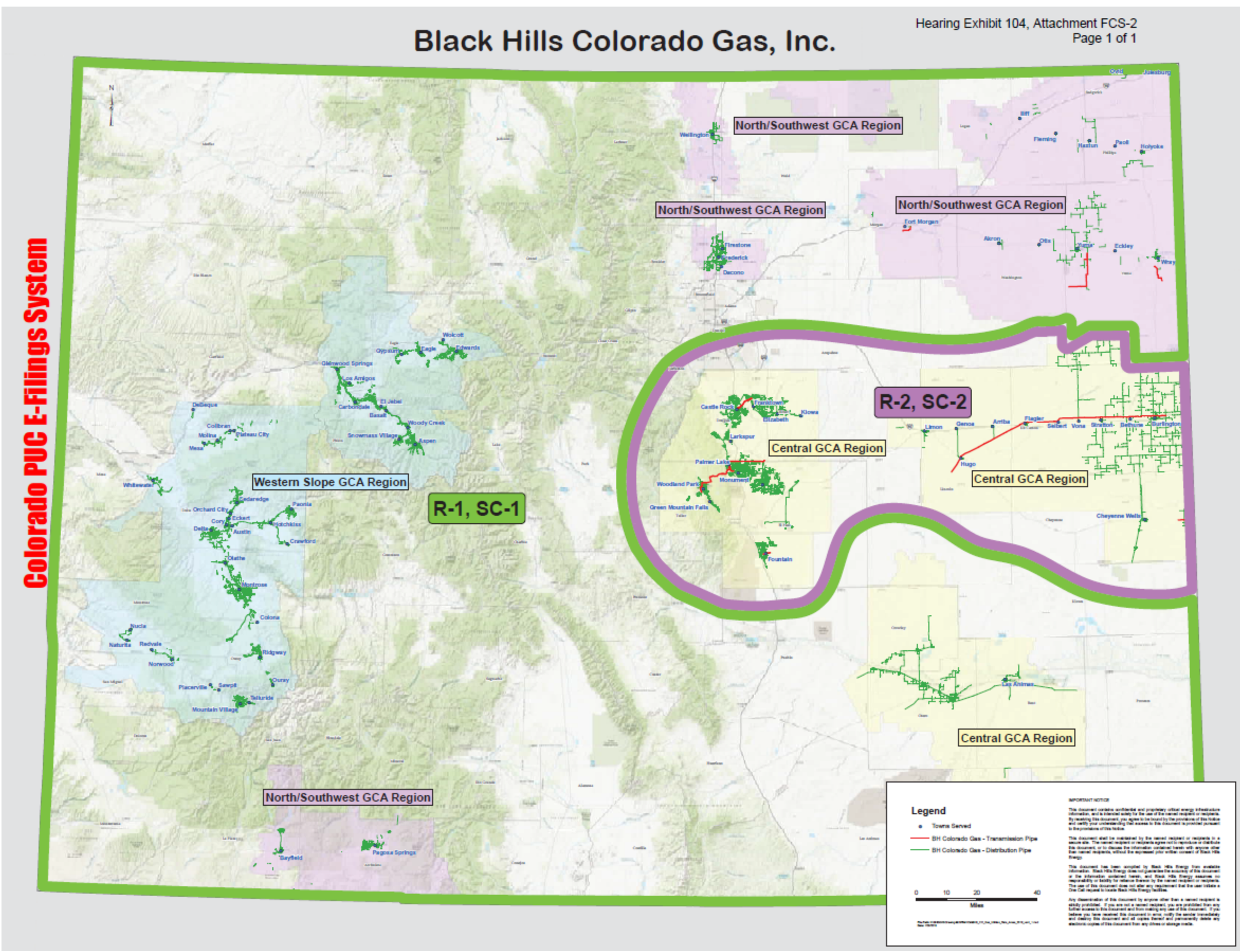
Rock, Monument, and Fountain. This rate area also includes some more rural communities on the eastern plains along the I-70 corridor. Attachment FCS-1 to Hearing Exhibit 104, which shows the existing base rate areas and GCA areas of BHGD and BHGU (referred to as "BHCOG"), is shown below:[309]



263. In this proceeding, BHCG seeks to consolidate the cumulative three base rate areas into a single base rate area and thereby establish a single overall revenue requirement for BHCG. However, for purposes of rate impact mitigation, BHCG proposes two new base rate

309 BHGD's base rate areas are depicted as "BHGD Rate Area 1" and "BHGD Rate Area 2" on Hearing Exhibit 104, Attachment FCS-1. BHGD's GCA areas are depicted on Exhibit 104, Attachment FCS-1 as the "North Central GCA Area," "North Eastern GCA Area," "Arkansas Valley GCA Area," Southwestern GCA Area," "Western Slope GCA Area," and "Western Slope GCA Area (with Storage)." BHGU's base rate area and GCA area are depicted as "BHCOG Rate Area" on Exhibit 104, Attachment FCS-1.

areas exclusively through rate design and not through the derivation of separate revenue requirements. Advice Letter No. 1 further proposes to consolidate the seven GCAs of BHGD and BHGU into three GCAs. Attachment FCS-2 to Hearing Exhibit 104, which shows the proposed consolidation down to two base rate areas and four GCA areas, is shown below. Finally, BHCG proposes to reduce the number of customer classes to four – residential, small commercial, large commercial, and seasonal/irrigation – and has developed and is proposing new rates for each of the customer classes.



264. On August 1, 2019, BHCG, EOC, and Staff filed the BHCG-Staff-EOC Partial Stipulation in which the parties agreed to consolidate: (a) the BHGU GCA and Arkansas Valley GCA into a new Central GCA region; and (b) the North Eastern, North Central, and

Southwestern GCAs into a new North/SW GCA region. As part of the settlement, BHCG agreed to forego the consolidation of the Western Slope and Western Slope with Storage GCAs into a new single GCA. As a result of the settlement, BHCG would have four GCA areas.

2. BHCG's Argument

265. BHCG proposes to consolidate its tariffs, rates, terms, and conditions for providing gas distribution services to its Colorado gas customers. According to BHCG, statewide rates serve the public interest because a combined cost of service will be spread over a maximized customer base, which means that more customers will benefit from additional revenues generated from the growth "on one side of the state."[310] More growth is projected for the eastern half of Colorado. BHCG argues that "when large investments are necessary for one area of the system, the associated costs will be averaged and spread across all of BH Colorado Gas's customers, thereby mitigating the impacts customers would experience if the system consisted of multiple smaller rate areas."[311] BHCG points to the statewide rates of PSCo and Atmos as examples of the benefits of utility consolidation, and further asserts that it would be unfair to deny BHCG the consolidation that the Commission permitted PSCo and Atmos to undertake.[312]

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[310] Hearing Exhibit 104 at 24:13-16 (Direct Testimony of Mr. Stoffel).

[311] *Id*. at 24:16-19.

[312] *Id*. at 24:19-22. *See* Hearing Transcript at 49:24-50:3 (October 24, 2019); Hearing Exhibit 957 (Decision No. R09-1381 issued in Proceeding No. 09AL-507G on December 11, 2009) (approving consolidation of Atmos' four base rate areas into one); Hearing Exhibit 975 (Decision No. C95-796 issued in Proceeding No. 95I-394G on August 21, 1995) (approving consolidation of PSCo's three base rate areas into one).

266. However, in this proceeding BHCG proposes an intermediate step toward statewide rates. The reason is that BHCG believes that "the impacts to certain customer classes that would result from statewide cost-based rates [are] too extreme to accomplish . . . in one rate proceeding."[313] BHCG thus proposes two base rate areas to mitigate the rate impacts for residential customers now served under the legacy rates of Black Hills Colorado Gas. The two rate areas are shown in Attachment FCS-2 on the previous page and "generally conform to the areas served by the legacy companies."[314] BHCG "envisions that it will propose standard statewide rates for all customers in the same class in its next rate review proceeding that includes a cost allocation and rate design process (Phase II)."[315] However, the Company "does not have a plan to file another rate review at this time. The timing of the next rate review proceeding will depend, among other things, on the outcome of the instant proceeding."[316]

267. BHCG achieves its ultimate outcome of the two base rate areas shown above by performing inter-class and intra-class mitigation following the assignment of costs and revenue requirements to the four new customer classes through the single CCOSS. To begin with, BHCG

[313] *Id*. at 104:9-11.
[314] *Id*. at 27:16-21.
[315] *Id*. at 23:15-17.
[316] *Id*. at 23:17-20.

calculated cost-based revenues and compared them to current revenues. The results are as follows:

Description	Total Company	Residential	Small Commercial	Large Commercial	Seasonal/ Irrigation
Revenues from Cost-Based Rates[317]	$188,981,062	$139,642,475	$18,684,738	$27,774,354	$2,879,494
Increase (Decrease) from Current Rates[318]	$3,459,040	$6,636,583	($492,064)	($2,382,598)	($302,881)

BHCG determined that these numbers resulted in too large of a rate increase for the residential class of ratepayers, particularly in light of the decreases for the other ratepayer classes. As a result, BHCG engaged in inter-class mitigation that effectively zeroed out the revenue decrease for the small commercial, large commercial, and seasonal/irrigation classes and transferred the amounts from each to the residential class. From the perspective of cost-causation, the proposed interclass mitigation resulted in the subsidization of the residential class of ratepayers

[317] Hearing Exhibit 118, Attachment DNH-17 at 2 (line 54) (Direct Testimony of Mr. Hyatt).

[318] *Id*. (line 66).

by the small commercial, large commercial, and seasonal/irrigation ratepayer classes and thereby lowered the amount of revenue collected from the residential class as follows:

Description	Total Company	Residential	Small Commercial	Large Commercial	Seasonal/ Irrigation
Revenues from Mitigated Rates[319]	$188,980,667	$136,464,721	$19,176,769	$30,156,851	$3,182,326
Increase (Decrease) from Current Rates[320]	$3,458,645	$3,458,829	($33)	($101)	($50)

268. The bill impact of these interclass mitigated revenues for residential ratepayers broken out by GCA area is as follows:[321]

Residential

Current GCA Area	BHGU	North Central	North Central	West Slope	West Slope (With Storage)	Northeast	Arkansas Valley	Southwest
% Change	11.4%	3.0%	-3.9%	-4.1%	-5.1%	2.8%	4.9%	4.1%

[319] *Id*. at 3 (line 78).
[320] *Id*. (line 97).
[321] Hearing Exhibit 118, Attachment DNH-18 at 2 (line 84).

Similarly, the bill impact for small business ratepayers is as follows:[322]

Small Business

Current GCA Area	BHGU	North Central	West Slope	West Slope (With Storage)	Northeast	Arkansas Valley	Southwest
% Change	13.0%	-5.5%	-4.5%	-4.4%	5.8%	6.5%	6.2%

269. Based on the foregoing,

> [BHCG] determined that the impacts to the Residential and Small Commercial customers served in the BH Colorado Gas system were too high. In order to address these potential impacts, the Company determined that an intraclass mitigation approach should be developed to reduce the impact of going to standard statewide rates in one step. The proposed R-1 and R-2 rates (also SC-1 and SC-2) . . . achieve this result. Instead of going to a standard statewide rate, this intraclass mitigation provides for lower rate impacts on the legacy [BHGU] system.[323]

To effectuate its intra-class mitigation strategy, BHCG: (a) limited the increase in any residential rate schedule to 8 percent; (b) limited the increase in any small business rate schedule to 10 percent; (c) limited the intra-class mitigation to the volumetric rates; and (d) maintained the overall revenue levels for each class.[324]

[322] *Id.*, Attachment DNH-18 at 5 (line 84).

[323] Hearing Exhibit 115 at 39:2-8 (Direct Testimony of Mr. Sullivan).

[324] *Id*. at 39:9-40:2.

270. BHCG's intra-class mitigation led to the following bill impacts for residential[325] and small business[326] ratepayers:

Residential

Current GCA Area	BHGU	North Central	North Central	West Slope	West Slope (With Storage)	Northeast	Arkansas Valley	Southwest
% Change	8.0%	5.2%	-1.7%	-2.1%	-3.1%	5.0%	7.5%	6.3%
+/- From Inter-class Mitigation	-3.4%	2.3%	-2.2%	2.0%	2.0%	2.2%	2.6%	2.2%

Small Business

Current GCA Area	BHGU	North Central	West Slope	West Slope (With Storage)	Northeast	Arkansas Valley	Southwest
% Change	10.0%	-4.9%	-4.0%	-3.8%	6.4%	7.2%	6.9%
+/- From Inter-class Mitigation	-3.0%	-0.6%	-0.5%	0.6%	0.6%	0.7%	0.7%

271. BHCG concedes that "rates should be fully cost-based"[327] but that the statewide mitigated rates it is proposing are not cost-based and instead result in the shifting of costs between and within classes, as revealed by the charts above.[328] As noted, the cost-shifting is a result of both the inter-class (reducing costs assigned to the residential class by reassigning such costs to other non-residential rate classes) and intra-class (shifting costs among customers within

[325] Hearing Exhibit 118, Attachment DNH-18 at 3 (line 104).
[326] *Id.*, Attachment DNH-18 at 5 (line 84).
[327] Hearing Exhibit 104 at 29:6-11 (Direct Testimony of Mr. Stoffel).
[328] Hearing Exhibit 136 at 4:18-21 (CCOSS Direct Testimony of Mr. Stoffel).

a rate class but in different rate areas) mitigation. BHCG also agrees that there is no possibility of future physical connection between the three existing rate areas, there is a substantial rate disparity between the existing rate areas, and there are no efficiencies resulting in cost savings that will result from the consolidation of the base rate areas.[329] All three of these factors have been used by the Commission in previous proceedings to analyze whether rate area consolidation is appropriate; they counsel against consolidation in this proceeding.[330]

272. Nevertheless, BHCG argues that its proposed statewide, non-cost-based rates should be implemented for three primary reasons. First, implementing statewide rates will "simplify interactions with customers and will reduce the administrative costs of managing our regulated gas utility business. The consolidation of the Company's tariffs, terms and conditions, and rates is consistent with the way the Company operates as a single entity."[331]

273. Second, such an outcome is "consistent with other major utilities in Colorado"[332] such as PSCo and Atmos, each of which have a single base rate area. As support, BHCG states:

> The fact that it is more costly from an investment standpoint to connect communities to supply sources in mountainous areas and in rural areas than in urban locations along the Colorado Front Range is also true for PSCo's and Atmos's Colorado gas systems, both of which provide natural gas service to similarly diverse geographical regions in Colorado.[333]

Because the Commission permitted PSCo and Atmos to consolidate its similarly disparate rate areas resulting from corporate acquisitions, BHCG should be allowed to do so as well. Failure to do so "would be an impediment to achieving the [] benefits [such as spreading the cost of large

[329] Hearing Transcript at 31:8-35:7 (October 24, 2019).
[330] *Id*. at 35:8-36:9.
[331] Hearing Exhibit 104 at 26:22-27:4.
[332] *Id*. at 27:4.
[333] BHCG's SOP at 38.

investments across all of BHCG's customers] and would exacerbate the rate disparities between base rates areas that currently exist."[334]

274. Third, and most importantly, BHCG believes that its proposal is most consistent with the public interest.[335] As support, BHCG points to the combined impact of the base rate increases and the DSIR. The table below summarizes the bill impact for residential ratepayers of consolidation versus no consolidation:[336]

Current Base Rate Area	**Current GCA Area**	**Proposed Base Rates**	**DSIR "Zone"**	**2020**	**2021**	**2022**	**2023**	**2020 - 2023 Total**
BHGU	BHGU	Statewide[337]	Statewide	9.20%	1.86%	1.88%	1.57%	14.51%
BHGU	BHGU	Stand-alone	Stand-alone	4.24%	1.19%	1.93%	1.25%	8.61%
BHGD-RA1	W/o Storage	Statewide[338]	Statewide	-2.00%	1.86%	1.88%	1.57%	3.31%
BHGD-RA1	W/o Storage	Stand-alone	Stand-alone	0.96%	0.77%	0.37%	0.15%	2.25%
BHGD-RA1	W/Storage	Statewide[338]	Statewide	-1.83%	1.86%	1.88%	1.57%	3.48%
BHGD-RA1	W/Storage	Stand-alone	Stand-alone	0.95%	0.77%	0.37%	0.15%	2.24%
BHGD-RA1	North Central	Statewide[338]	Statewide	-1.99%	1.86%	1.88%	1.57%	3.32%
BHGD-RA1	North Central	Stand-alone	Stand-alone	1.20%	0.77%	0.37%	0.15%	2.49%
BHGD-RA2	North Eastern	Statewide[338]	Statewide	6.35%	1.86%	1.88%	1.57%	11.66%
BHGD-RA2	North Eastern	Stand-alone	Stand-alone	19.83%	8.89%	8.63%	9.07%	46.42%
BHGD-RA2	Southwestern	Statewide[338]	Statewide	1.56%	1.86%	1.88%	1.57%	6.87%
BHGD-RA2	Southwestern	Stand-alone	Stand-alone	14.64%	8.89%	8.63%	9.07%	41.23%
BHGD-RA2	Ark. Valley	Statewide[338]	Statewide	3.79%	1.86%	1.88%	1.57%	9.10%
BHGD-RA2	Ark. Valley	Stand-alone	Stand-alone	18.12%	8.89%	8.63%	9.07%	44.71%

[334] *Id*. at 37.

[335] Hearing Exhibit 121 at 12:19-23 (Rebuttal Testimony of Mr. Stoffel).

[336] The numbers in the table are taken from Hearing Exhibit 138, Attachment EJG-15 (CCOSS Direct Testimony of Mr. Gillen).

[337] These are statewide rates including BHCG's interclass and intraclass mitigation proposal.

The table shows that if the DSIR is approved and the rate areas are not consolidated, the ratepayers in BHGD Rate Area 2 will suffer a significant increase in their bills from 2020 to 2023. Moreover, a significant portion of those increases is caused by the capital expenditures in BHGD Rate Area 2 that BHCG proposes to recover through the DSIR. Thus, in order to mitigate this impact on BHGD Rate Area 2, BHCG proposes to consolidate the rate areas and to implement a statewide DSIR.

275. BHCG also states that it

> is financially agnostic as between the retention of the existing rate structure, the Company's proposed consolidations, and the Staff's recommended structure. BH Colorado Gas believes that its proposals are more consistent with the public interest since the costs of system and future projects will be more evenly spread throughout the Company's geographical footprint.[338]

As to the argument raised by Staff and the OCC that BHCG financially benefits from consolidation because . . . , BHCG states that "when we look at the end result of this case, and if the Commission determines that there should be consolidation and we derive the set of rates, the margin that will be recovered by each of those decatherm sales or the throughput is going to be the same."[339]

276. As to the three factors noted above and cited by Staff and the OCC for analyzing the question of whether to consolidate (the absence of a substantial rate disparity between the base rate areas, evidence of present or future physical connection between systems serving each base rate area, and potential future operational efficiencies from consolidation yielding cost savings), BHCG concedes that none of the factors support consolidation in this proceeding. However, BHCG notes that Commission decisions addressing consolidation have not "appl[ied]

[338] Hearing Exhibit 121 at 12:19-23 (Rebuttal Testimony of Mr. Stoffel).

[339] Hearing Transcript at 49:1-6 (October 24, 2019).

the same factors to support consolidation."[340] Moreover, BHCG states that "where those decisions and settlements provided the change in average monthly bills for residential customers, they exceeded the change proposed by the Company in this proceeding."[341]

277. Finally, BHCG argues that disallowing consolidation could lead to the type of subsidization that Staff and the OCC oppose in this proceeding. Specifically, BHCG states that, if the Commission disallows consolidation and BHCG is forced to move forward with its three different rate areas, it is unlikely that the Commission would permit BHCG to subsequently file a Phase I rate proceeding with respect to only one of its base rate areas in Colorado. Instead, it is likely that the Commission would want to review the net performance of all three rate areas before deciding Phase I rate issues for any one rate area. BHCG further states that, under those circumstances, it is unlikely that it would file a Phase I rate case unless there is net underearning of all three rate areas. This means that if the aggregate underearning of one or two rate areas is exceeded by the overearning of the remaining rate area(s), BHCG would not likely file a Phase I rate case. This would result in the overearning rate area(s) effectively subsidizing the underearning rate area(s).[342]

3. Intervenors' Arguments

a. Staff

278. Staff argues that BHCG has not satisfied its burden of establishing that consolidation is in the public interest and would produce just and reasonable rates. As support, Staff points to the three factors noted above that have been used by the Commission to analyze

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[340] BHCG's SOP at 39.

[341] *Id*.

[342] *Id*. at 40-41.

proposals to consolidate base rate areas: (a) the absence of a substantial rate disparity between the base rate areas; (b) evidence of present or future physical connection between systems serving each base rate area; and (c) potential future operational efficiencies from consolidation yielding cost savings.[343] Staff argues that in making its case for consolidation BHCG ignored these factors, instead focusing on "final bill impacts for residential customers and what feels acceptable."[344] However, when confronted by Staff, BHCG ultimately conceded that none of these factors apply to BHCG's proposed consolidation.

279. As to the first factor, Staff states that the substantial rate disparity between the BHCG's existing base rate areas would lead to substantial subsidization of BHGD ratepayers by BHGU ratepayers that is not in the public interest if the Commission approves BHCG's consolidation proposal. As support, Staff states

> [t]he net result of the Company's consolidation and mitigation proposals reflects [BHGU] residential customers paying $26/year above their cost to serve, BHGD rate area 1 residential customers pay[ing] $42/year below their cost to serve and BHGD rate area 2 residential customers pay[ing] $53 below cost. This shift in revenue obligation is a result of both the inter-class (shifting cost away from the residential class to other rate classes) and intra-class (shifting costs among customers within a rate class but in different rate areas) mitigation. In total, the Company proposes to shift $1.85 million in cost obligation away from residential customers onto other rate classes. The intra class mitigation then shifts approximately $2 million in cost obligation away from the BHGD rate areas onto the BHCOG area.[345]

280. According to Staff, this subsidization is not in the public interest because it is economically inefficient. Specifically, it sends the wrong price signals to all ratepayers and thus causes ratepayers in high-cost areas to over-consume and ratepayers in low-cost areas to under-consume. Subsidization also incentivizes ratepayers to make inefficient home heating

[343] Staff's SOP at 8-10.

[344] *Id*. at 10.

[345] Hearing Exhibit 408 at 16:3-13 (CCOSS Answer Testimony of Ms. O'Neill).

investment decisions. Staff explains how, and why this outcome is not in the public interest, as follows:

> Price signals provide consumers information regarding economic investment decisions. If a price signal is too low, consumers will under-invest in efficient appliances or fuel switching. If a price signal is too high consumers will over-invest in efficient appliances or fuel switching. Consider customers in mountain or rural communities in BHGD Rate Area 2. Under Black Hills' proposal, these customers would pay substantially less than the cost they impose on the system. Some of these customers might have switched to propane or other sources of home heating if they paid the full cost of their service, reducing the overall system cost. Alternatively, customers in [BHGU] who pay more than their cost of service, could look at switching to electric heat when that option is not actually cheaper on a cost-basis. As these low-cost customers migrate away from the system, costs increase for the remaining customers.
>
> In summary, accurate price signal lead to economically efficient choices regarding consumption and investment. Inaccurate prices signals lead to inefficient choices and place upward pressure on overall system costs.[346]

281. Staff notes that more low-income ratepayers will be adversely affected by consolidation than if consolidation is rejected. As support, Staff first notes that "while BHGD rate area 2 has a higher percentage of low-income ratepayers than the other rate areas, it has fewer low-income customers overall due to its smaller size."[347] Specifically, Staff states that there are approximately 6,300 low-income ratepayers in the BHGU rate area versus 4,200 in BHGD Rate Area 2.[348] Staff believes that the best way to address the needs of low-income ratepayers is through the Black Hills Energy Assistance Program (BHEAP), but recognizes that BHEAP has insufficient resources to address all of their needs. Staff concludes that consolidation leading to higher rates for a higher number of low-income ratepayers in BHGU's

[346] Hearing Exhibit 408 at 32:3-18 (CCOSS Answer Testimony of Ms. O'Neill).
[347] *Id*. at 37:11-13.
[348] *Id*. at 37:13-16.

rate area is not a better option than denying consolidation and raising the rates for a smaller number of low-income ratepayers in BHGD Rate Area 2.[349]

282. Staff states that the evidence "suggests" that BHCG's consolidation proposal is part and parcel of its corporate strategy benefitting BHCG's shareholders but not its ratepayers. Specifically, Staff states that BHCG's consolidation proposal is part of its "BHC's multi-state strategic plans discussed in Hearing Exhibits 805P though 820P"[350] that includes "BHC's strategic refocus on growth through state rate cases."[351] However, Staff does not clearly explain the alleged causal connections between the three.

283. Finally, Staff notes that "the Commission is charged to protect *all* ratepayers' interests while ensuring rates are sufficient to cover a utility's legitimate costs."[352] According to Staff, consolidation does not protect all ratepayers, but effectuates a dramatic change that greatly favors certain groups of ratepayers over others. Staff concludes that proper application of the Commission's charge leads to the conclusion that BHCG has not satisfied its burden of establishing that consolidation is in the public interest.

b. OCC

284. The OCC argues that consolidation would not be in the public interest because it would not yield just and reasonable rates. The OCC states that the investment per ratepayer in the current BHGD 1 ($1,811) and BHGD 2 ($1,902) is significantly higher than the investment per ratepayer in the current BHGU rate area ($924). Complete consolidation of the base rate areas would result in an average investment per ratepayer of $1,414, which would be an increase

[349] *Id*. at 37:17-38:4.
[350] Staff's SOP at 14.
[351] *Id*. at 4.
[352] *Id*. at 10.

of $488 for BHGU ratepayers.[353] This represents a subsidy flowing from BHGU ratepayers to BHGD ratepayers in the amount of over $6.3 million each year.[354] Moreover, within the BHGD rate areas, consolidation would yield a subsidy flowing from BHGD 1 to BHGD 2.[355]

285. The OCC also contends that BHCG is "mask[ing] these impacts through mitigation."[356] "The OCC is open to the concept of rate mitigation," but it cannot "stray too far from the concept of cost causation."[357] Given that the combination of the revenue requirement and CCOSS results in a $5.9 million increase for the residential customer class, but only $3.5 million overall (thus resulting in reductions in rates for the other classes), the OCC concludes that inter-class mitigation to reduce the rate impact on the residential class is appropriate. However, the OCC concludes that "mingling costs from one rate area to the next, or what has been labelled intra-class mitigation, should not be allowed."[358]

286. Finally, the OCC makes the same argument as Staff concerning the financial benefit to BHCG of consolidation. Specifically,

> if consolidation is approved, the Company will be able to capture additional overall revenues because BHGU customers will be providing more revenue through higher rates than the actual cost to serve those customers. This is further exacerbated when combined with the fact that the Company expects the BHGU area to be its fastest growing area.[359]

The OCC concludes that BHCG's proposal for consolidation should be denied.

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[353] Hearing Exhibit 104 at 26:1-7; Hearing Exhibit 303 at 5:12-18 (CCOSS Answer Testimony of Dr. England).

[354] Hearing Exhibit 303 at 8:1-3.

[355] OCC's SOP at 30.

[356] *Id*. at 31.

[357] Hearing Exhibit 301 at 18:13-15 (Answer Testimony of Dr. England).

[358] *Id*. at 19:7-13.

[359] OCC's SOP at 31 (citations omitted).

4. BGVA

287. BGVA supports BHCG's consolidation and mitigation proposals. It states that Staff and the OCC offered nothing more than "staid, formulaic reasons why consolidation and mitigation should not be permitted" that represents cost-based dogmatism.[360] BGVA states that "Black Hills should be able to act as one unified utility provider as opposed to an amalgamation of past entities."[361]

5. EOC

288. EOC supports consolidation, stating that that BHCG's proposal is "sound, just, and reasonable."[362] EOC focuses on the "spreading [of] costs over a greater customer base" resulting from consolidation that will benefit "[t]he most rural, poorest, and least populous part of the Company's service territory."[363] As support, EOC cites the evidence in the record that BHGD Rate Area 2 has a lower median household income than the other two existing base rate areas and 21.5 percent of the population in BHGD 2 is in poverty. EOC disagrees with the import of Staff's argument that a higher number of low-income ratepayers will be negatively impacted by consolidation versus no consolidation because there are 6,300 ratepayers in poverty in BHGU's rate area versus 4,200 in BHGD Rate Area 2. EOC notes that

> using Staff's revenue requirement, the impact of consolidating rates is significantly less for BHGU residential customers (a 3.7% increase to bill impacts from 0.0% under no consolidation) than it would be for BHGD 2 residential customers (from 10.8% without consolidation down to 4% with consolidation). A low-income customer is better able to handle a 4% increase in rates, than an 11% increase in rates, no matter where he or she may live.[364]

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[360] BGVA's SOP at 4, 11.

[361] *Id*. at 10.

[362] EOC's SOP at 4.

[363] *Id*.

[364] *Id*. at 15.

289. EOC also cites the significant rate increases for BHGD 2 that will occur regardless of whether the DSIR is approved. Specifically, EOC quotes Mr. Gillen's testimony that BHCG will "construct the $69.7 million of Base Rate Area 2 DSIR projects" within the next five years with or without approval of the DSIR.[365] According to EOC, "[t]his means 'an extra $7 million of Base Rate Area 2 DSIR annual revenue requirements to absorb into a Class Cost of Service Study that will design rates for 23,000 customers.'"[366] EOC concludes that the Commission should grant consolidation.

6. Vail

290. In its SOP, Vail makes two points in support of consolidation. First, BHCG's requested revenue increase, rates, and bill impacts are likely to decrease when the Commission's decisions on the Phase I issues are processed through the RRS and CCOSS's. For this reason, Vail recommends that the Commission reserve judgment on consolidation until the impact of the Commission's Phase I decisions on the revenue requirement are understood. Vail cites the principle that "it is the result reached rather than the method used that is the measure of whether the outcome will be just and reasonable" in support of this approach.[367]

291. Second, it is difficult to determine cost causation within the three existing base rate areas due to their geographic makeup. Specifically,

> BH Gas Distribution Rate Area 1 includes two separated service areas on the West Slope plus three separated areas on the northern Front Range. BH Gas Distribution Rate Area 2 includes separated areas on the northern and south central eastern Plains plus the San Luis Valley. The BH Gas Utility Rate Area

[365] *Id*. at 12 (citing Hearing Exhibit 134 at 46:3-5 (Rebuttal Testimony of Mr. Gillen)) (emphasis omitted).

[366] *Id*. (citing Hearing Exhibit 134 at 46:6-10 (Revised Direct Testimony of Mr. Gillen)) (emphasis omitted).

[367] Vail's SOP at 3.

> includes two separated areas, one in the predominantly urban area south of Denver and the other in the agricultural area in the east central Plains.[368]

Vail states that there has to be subsidization between the separate service areas within the existing base rate areas. Vail concludes that "[c]onsolidation of all three [base rate areas] into a single rate area would be no less precise and would have the benefit of efficiency."[369]

7. Analysis

292. This is a difficult decision. There are compelling arguments both in favor of, and against, consolidation. However, after considering the evidence in this proceeding and balancing the interests BHCG's ratepayers and shareholders, the ALJ finds and concludes that BHCG has not satisfied its burden of establishing that consolidation is in the public interest.

293. As an initial matter, no party advocates for the consolidation of the BHGU Rate Area and BHGD Rate Area 2 that would result in two remaining rate areas – the combined BHGU and BHGD Rate Area 2, and BHGD Rate Area 1. As explained above, at the urging of the Intervenors, BHCG provided CCOSS's for such a scenario in the continued proceedings that followed the hearing in August. However, after reviewing the CCOSS's produced by BHCG in September, no party found the consolidation of the BHGU Rate Area and BHGD Rate Area 2 sufficiently compelling to advocate for it. As no party presented evidence or argument in support of this scenario, the ALJ finds and concludes that the burden of establishing that the consolidation of the BHGU Rate Area and BHGD Rate Area 2 is in the public interest has not been satisfied.

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[368] *Id*. at 4.

[369] *Id*.

294. As to BHCG's consolidation proposal, it is undisputed that none of the factors cited by the Commission in previous consolidation decisions support BHCG's consolidation proposal. Those factors are: (a) the possibility of future physical connection between the three existing rate areas; (b) the absence of a substantial rate disparity between the existing rate areas; and (c) potential future operational efficiencies from consolidation yielding cost savings. Here, BHCG has conceded that there is no possibility of future physical connection between the three existing rate areas, there is a substantial rate disparity between the existing rate areas, and there are no efficiencies resulting in cost savings that will result from the consolidation of the base rate areas. Accordingly, the three factors employed by the Commission in the past in determining whether to grant base rate area consolidation weigh heavily against granting BHCG's proposed consolidation.

295. As to rate disparity, Staff offered uncontradicted evidence that BHCG's current volumetric rates "range from 27% below the weighted average [rate (BHGU)] to 26% above [(BHGD 1)] for residential customers and 21% below [(BHGU)] to 13% above [(BHGD 1)] the weighted average [rate] for commercial customers."[370] In each case, the rates are for BHGU and BHGD Rate Area 1, respectively.[371] The weighted average rate operates as a proxy for statewide rates. As to proposed rates, the volumetric rates for residential customers under BHCG's revenue requirement would "range from 13 percent below [BHGU] to 22 percent above [BHGD 2] the weighted average cost and small commercial customer costs [would] rang[e] from 5 percent below to 19 percent."[372] Under Staff's proposed revenue requirement, the range would be

[370] Hearing Exhibit 401 at 26:18-27:2 (Answer Testimony of Ms. O'Neill).
[371] *Id*. at 27 (Table ETO-4).
[372] Hearing Exhibit 408 at 28:4-7 (Ms. O'Neill's CCOSS Answer Testimony).

-18 percent to 35 percent for residential ratepayers, and -8 percent to 19 percent for small commercial ratepayers.[373]

296. BHCG does not dispute that rates should be as fully cost-based as possible. This standard exists, at least in large part, to incentivize economically efficient behavior by both the utility and its ratepayers, and to avoid the over- or under-collection of revenues based on systematic differences in growth rates within a utility's service territory. While it is generally accepted that some level of mitigation and thus subsidization between and within ratepayer classes is permitted in the process of setting just and reasonable rates, the second consolidation factor – the degree of rate disparity between rate areas – operates as a check on the deviation from the cost-based standard. Specifically, as the rate disparity between existing rate areas increases, the degree of inter- and intra-class subsidization necessary to mitigate the highest rates in the consolidation process increases, which decreases the cost-basis of the final rates. As a result, the Commission has held that a substantial disparity in the rates in the areas proposed to be consolidated is an important factor weighing against consolidation. If the disparity is substantial, then consolidation is unlikely to be in the public interest because of the resulting high degree of subsidization and thus deviation from the cost-based principle.

297. Here, BHCG does not dispute that its proposed rates substantially deviate from the cost-based standard. The cost-shifting is a result of both the inter-class (shifting cost away from the residential class to other rate classes) and intra-class (shifting costs among customers within a rate class but in different rate areas) mitigation proposed by BHCG. As Ms. O'Neill has persuasively argued, because the degree of subsidization in BHCG's proposed rates is high, it will cause ratepayers to make economically inefficient choices regarding consumption and

[373] *Id*. (Table ETO-8).

investment that will, in turn, place upward pressure on overall system costs.[374] It will also increase the likelihood of the over-collection of revenues, as its proposed rates in the BHGU rate area substantially exceed the cost of delivering the service and the highest anticipated growth is in the BHGU rate area as well.

298. The Commission decisions addressing consolidation cited by BHCG do not mandate a different result. As an initial matter, BHCG is correct that not all of the Commission's consolidation decisions have cited or discussed the three factors described above. However, that appears to be a function of the fact that the decisions addressed settlement agreements in rate cases involving several issues, including consolidation. Under such circumstances, it is unsurprising that the decisions included varying degrees of discussion of the consolidation factors.[375]

299. In addition, in each of the decisions that do address one or more the three factors, the Commission found that at least one of them weighed in favor of consolidation. Specifically, in Decision No. C95-0796, the Commission accepted the representations in the settlement agreement that consolidation would lead to efficiencies that would, in turn, lead to rate reductions, and that the distribution and transmission systems were interconnected.[376] In Decision No. R07-0154, the Commission accepted the parties' agreement that the rate areas would be interconnected in the future, that there were efficiencies to be gained from consolidation, and that there was no significant rate disparity justifying denying consolidation.[377]

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[374] Hearing Exhibit 408 at 32:3-18 (CCOSS Answer Testimony of Ms. O'Neill).

[375] *See* Hearing Exhibit 976 (acceptance of settlement agreement with little discussion of consolidation); Hearing Exhibit 977 (same).

[376] Hearing Exhibit 975 at 12 (¶ 6.b) (Decision No, C95-0796 issued in Docket No. 95I-394G on August 21, 1995).

[377] Hearing Exhibit 954 at 14-15 (¶¶ 53-54), 19 (¶ 73) (Decision No. R07-0154 issued in Proceeding No. 06S-394G on February 22, 2007).

Finally, in Decision Nos. R08-0820 and R09-1381, the Commission found that there was no substantial rate disparity between the rate areas in approving the parties' agreement to consolidate.[378]

300. Here, in contrast, the parties have not entered into a settlement agreement in which they have agreed to consolidation. In addition, it is undisputed in this proceeding that none of the three factors cited by the Commission in previous consolidation decisions noted above support consolidation here. Under these circumstances, the Commission Decisions cited and relied upon by BHCG do not persuasively support consolidation in this proceeding.

301. Based on the foregoing, the ALJ finds and concludes that BHCG has not satisfied its burden of establishing that its consolidation proposal is in the public interest.

B. Remainder of Phase II

302. As discussed above, the Company's proposed rate consolidation is denied. As a result, rates must be determined for each of the three existing base rate area. However, no party proposed specific rates for the non-consolidated rate areas. And, though Black Hills presented an RRS and CCOSS for each existing rate area in the Supplemental Proceedings, the studies are insufficient by themselves to produce rates that the ALJ can find and conclude are just and reasonable due to the changes made by this Decision to the inputs to the studies. Accordingly, BHCG shall be ordered: (a) to implement a GRSA to adjust current rates proportionally for each rate area; and (b) to file a Phase II rate case within six months of a final Commission decision in this proceeding.

[378] Hearing Exhibit 953 at 21-22 (¶ 62) (Decision No. R08-0820 issued in Consolidated Proceeding Nos. 08S-108G and 08A-127G on August 7, 2008); Hearing Exhibit 957 at 24 (¶ 71) (Decision No. R09-1381 issued in Proceeding No. 09AL-507G on December 11, 2009).

303. The history of this proceeding helps to understand this conclusion. The argument presented by BHCG for consolidation involved significant mitigation applied to the allegedly cost-based rates produced by the consolidated CCOSS. Specifically, BHCG determined that the rates produced by the consolidated CCOSS were not just and reasonable because of the significant impact on the residential class of ratepayers that would bear the entire $2.5 million increase in overall revenues determined by the Company's RRS when the other proposed rate classes would experience a substantial decrease in rates. BHCG then engaged in extensive interclass and intraclass mitigation to generate rates that BHCG contends are just and reasonable even though they depart significantly from their cost-basis. The interclass mitigation involved: (a) application of the principle that no customer class would receive a decrease in revenues when another class would receive an increase, which resulted in a decrease of the revenue collected from the residential class and an increase in the revenue collected from the remainder of the revised classes; (b) changes made to the customer charges for each of the revised customer classes based on considerations that are unique to each class; and (c) changes made to the volumetric rates to all of the classes based on considerations that are unique to the Residential class, on the one hand, and the Small Commercial, Large Commercial, and Seasonal/Irrigation classes, on the other hand. The intraclass mitigation involved similarly complicated rules created and applied by BHCG to further soften the blow to the Residential class that led to the creation of a second base rate area.[379] Significantly, the Intervenors had an opportunity to consider and investigate BHCG's substantially-mitigated consolidated proposed rates. Based on that review, Staff and the OCC concluded that the substantially-mitigated consolidated proposed rates are not

[379] *See* Hearing Exhibit 115 at 36:1-41:2 (describing the interclass and intraclass mitigation undertaken by BHCG) (Revised Direct Testimony of Mr. Sullivan).

just and reasonable. As a result, a record exists on the mitigation of the proposed consolidated rates.

304. As explained in detail above, at the hearing that took place from August 5 through 9, and 12, 2019, Staff and OCC witnesses testified that without CCOSS's for the three existing base rate areas, the Commission could not determine whether the consolidated and highly mitigated rates proposed by BHCG are just and reasonable. This led BHCG to request that the evidentiary record be held open in order to allow BHCG to file four additional CCOSS's (one for each of the existing base rate areas, and one for the combination of the BHGU Rate Area and the BHGD Rate Area 2). The ALJ granted BHCG's request and approved a stipulated supplemental schedule (Supplemental Schedule). The Supplemental Schedule was expedited and was limited to direct testimony in support of the four new CCOSS's, answer testimony due 2.5 weeks after the filing of the new CCOSS's and supporting testimony, and one additional hearing day.[380]

305. BHCG filed the four supplemental RRS's and CCOSS's and supporting testimony pursuant to the Supplemental Schedule. BHCG performed little analysis with respect to the development of cost-based rates generated from the new CCOSS's. In addition, the Intervenors had comparatively little time to review the four Supplemental CCOSS's and the Supplemental Direct Testimony. As a result, there is little in the record concerning the cost-based rates generated from the Supplemental RRS's and CCOSS's.

306. Finally, the five RRS's in this proceeding contain BHCG's inputs for which it is advocating in this proceeding. As the discussion of the Phase I issues above makes clear, there are several disputed inputs that have changed as a result of the ALJ's decisions. As the starting

[380] Decision No. R19-0714-I issued on August 28, 2019.

point for the CCOSS's is the result of the RRS's, and the RRS's have now changed significantly based on the ALJ's decisions above, the CCOSS's and the cost-based rates they produce will change significantly as well.

307. In order to attempt to understand those changes, the ALJ held the Technical Conference on December 18, 2019. The Technical Conference and filed RRS's and CCOSS's revised consistent with the ALJ's inputs were helpful. Among other things, they underscore that the RRS's and CCOSS's revised consistent with the ALJ's inputs generate cost-based rates that are substantially different from the rates previously proposed in this proceeding. Moreover, when the remainder of inputs are changed consistent with this Decision, the cost-based rates generated by the CCOSS's are even more substantially different. Yet, there is nothing in the record concerning whether such rates are just and reasonable as-is, or whether they should be modified through rate design and potentially mitigation.

308. Based on the foregoing, the ALJ cannot find and conclude that rates generated as a result of the decisions contained herein are just and reasonable. Specifically, the analysis of whether such cost-based rates are just and reasonable and whether any modifications through rate design or mitigation is warranted cannot be conducted based on this record. Similarly, the question of whether implementation of the stipulated statewide monthly customer charge for the residential class of $12.25 leads to unreasonable impacts that require mitigation cannot be determined based on this record. Quite simply, the record is insufficient for the ALJ to make a determination on that question.

309. Finally, holding one or more additional technical conferences is not a reasonable option. As Staff explained at the hearing in August, given the number of questions that are outstanding, it is unreasonable to expect that a technical conference would yield a record from

which the Commission could conclude that resulting rates are just and reasonable.[381] In addition, given that the evidentiary record is closed, the parties could not provide substantive guidance to the Commission regarding whether the rates generated from the RRS's and CCOSS's revised consistent with this Decision generate rates that require modification, and, if so, how to establish just and reasonable rates.

310. Based on the foregoing, the ALJ recommends that the remainder of the Phase II issues be denied. Put simply, BHCG has not satisfied its burden of establishing that the proposed rates resulting from its Phase II analysis are just and reasonable. In addition, the ALJ recommends that BHCG be ordered to: (a) implement a GRSA to adjust current base rates proportionally for each existing base rate area; and (b) file a Phase II rate case within six months of a final Commission decision in this proceeding. The rates resulting from the application of a GRSA are found to be just and reasonable, as they are based on existing rates with a proportional increase or decrease to implement the necessary change in revenue requirements. In the future Phase II filing, the Company shall provide, at a minimum, a proposal with CCOSS's for each existing base rate area and all rates for each base rate area. The Company is not precluded from proposing consolidated rates as an alternative.

311. This outcome is the consequence of BHCG's decision at the outset of this proceeding to submit a single consolidated RRS and CCOSS. Had Black Hills provided CCOSS's for each rate area as a part of its direct testimony, parties would likely have been able to adequately analyze and critique the resulting rates and propose alternative ones, thus allowing just and reasonable cost-based Phase II rates to be implemented in this case. However, because the Company chose not to provide this option, the only reasonable remedy is to order a separate

[381] Transcript at 108:23-111:17 (August 9, 2019).

Phase II rate case. Of course, this outcome is problematic for many reasons, not the least of which being that it will lead to higher rate case expenses, which is addressed below in the section addressing rate case expenses. However, given that a rate design resulting from a Phase II proceeding is likely to be in place for an extended period of time, the ALJ finds and concludes that this outcome is in the public interest.[382]

VIII. DSIR

A. BHCG's Argument

312. BHCG proposes a DSIR with an initial term of four years, effective January 1, 2020, for approved DSIR projects completed in years 2019 through 2023. Through the DSIR, BHCG would recover the cumulative approved costs of projects completed through 2023, or until the next rate review, when DSIR costs would be rolled into base rates. The projects are in the Company's integrity programs that accelerate the replacement of higher-risk pipe and improve system data.[383]

313. The projects to be pursued each year of the DSIR and their costs will be identified in a report filed on November 1 of the preceding year to become effective on the following January 1.[384] Once it is in place, BHCG will meet with Staff and the OCC on April 30, July 30, and October 1 of each year "to discuss projects for that year, provide any updates, and discuss projects intended to be completed the next year."[385] These discussions will address, among other things, a business plan, technically precise project scopes, specific statements of need, discussion of threat magnitude and schedule of risk mitigation, and accurate project cost estimates.

[382] *See* Proceeding No. 08S-290G (BHGU's last Phase II proceeding); Proceeding No. 08S-108G (BHGD's last Phase II proceeding).

[383] Hearing Exhibit 104 at 8:12-9:2 (Revised Direct Testimony of Mr. Stoffel).

[384] *Id*. at 8:17-22.

[385] BHCG's SOP at 4.

Potential projects will be evaluated and prioritized based largely on relative risk between the projects, not on an absolute risk analysis.[386] BHCG would provide a report by April 1 "detailing the costs incurred during the previous year and providing an opportunity for interested parties to challenge any of the activities or their respective costs."[387]

314. The DSIR rates that BHCG proposes to apply on a volumetric basis "will be calculated using the same concepts approved in this rate review proceeding. . . . includ[ing] applying the approved WACC from this proceeding to the 13-month average rate base calculation."[388] As proposed, the annual DSIR rate increase would be capped at 2.5 percent, even though BHCG currently estimates that the annual increase would be 1.3 percent or less.[389]

315. Currently, BHCG anticipates spending almost $118 million on DSIR projects through 2023. Of that, $69.7 million would be spent on DSIR projects in BHGD Rate Area 2, including on the yard line and at-risk meter relocation projects. This represents almost 60 percent of the total DSIR spending.[390] Given that BHGD Rate Area 2 has approximately 23,000 ratepayers,[391] that means that BHCG proposes to spend $3,000 per ratepayer in BHGD Rate Area 2, which would double the rate base in that area.[392]

316. BHCG states that it could take over 100 years to mitigate these risks if the replacement programs are not accelerated.[393] This is the primary reason BHCG is requesting the Commission's authorization for the DSIR. However, at the hearing, BHCG stated that it would

[386] Transcript at 142:15-145:22.
[387] *Id*. at 5.
[388] Hearing Exhibit 120 at 26:1-4 (Revised Direct Testimony of Mr. Gillen).
[389] *Id*. at 25:7-19.
[390] Hearing Exhibit 134 at 43:10-44:2 & Table EJG-16.
[391] *Id*. at 46:6-13.
[392] Transcript at 110:25-111:4 (October 24, 2019).
[393] Hearing Exhibit 106 at 33:11-15 (Revised Direct Testimony of Mr. Koca).

accelerate the replacement of high-risk facilities even if the Commission denies its proposed DSIR program.[394]

317. BHCG states that it will file an application for a CPCN for its At-Risk Meter Relocation and Yard Line Replacement Programs. Nevertheless, the Company requests approval for cost recovery through the DSIR conditional upon CPCN approval, or a declaratory order that a CPCN is not necessary. While a CPCN is being pursued, BHCG proposes that any at-risk meters and yard lines associated with any projects associated with the Problematic Pipe Replacement Program be replaced and included in the DSIR. Black Hills also agrees that only capital costs will be included.[395]

318. BHCG opposes Staff's recommended two DSIR rate zones. According to BHCG, Staff's East-West DSIR proposal would increase rates to the low-income areas when paired with Staff's proposal to maintain existing base rate areas, and would limit accelerated replacement of problematic pipe projects in the Arkansas Valley area. Similarly, BHCG believes that the degree of DSIR spending in BHGD Base Rate Area 2 and the resulting bill-impact on the ratepayers in that area requires the consolidation of the base rate areas in order to mitigate the impact of the DSIR on them.[396]

B. Intervenors' Arguments

1. Staff

319. Staff recommends that there be two separate riders -- one for customers in eastern Colorado and one for customers in western Colorado.[397] Staff supports the Problematic Pipe

[394] Transcript at 141:15-142:13 (August 7, 2019).
[395] BHCG's SOP at 10.
[396] Hearing Exhibit 138 at 14:1-13 (Supplemental CCOSS Testimony of Mr. Gillen, Rev. 1).
[397] Hearing Exhibit 402 at 6:1-2 (Answer Testimony of Mr. Dusenbury).

Replacement Program initiative but recommends separating it into three distinct initiatives: Thin Walled Tubing Distribution Replacement Program; Vintage Steel Distribution Replacement Program; and PVC Distribution Replacement Program.[398] Staff recommends a three-year term, increasing the prudency review period from 60 to 90 days, and reducing the cap to 1.0 percent for a statewide DSIR rate or a 1.75/0.5 percent cap for eastern and western DSIR zones, respectively.[399]

320. Staff also recommends that the Commission require the Company to apply and report the most stringent Pipeline and Hazardous Materials Safety Administration (PHMSA) code requirements for any work deemed to be an Eligible DSIR Project, as defined in the proposed tariff.[400] Staff further recommends that the Commission require the Company to maintain an integrity plan that documents continuous improvement in key integrity management metrics.[401] Next, Staff recommends requiring a detailed annual reporting requirement with a baseline assessment and mitigation plan that includes precise project scope definitions, identification of the associated threat and performance plan outline schedule for mitigation, project-to-project mitigation prioritization based on threat identification and a numerical risk assessment for each proposed project, and an integrity plan complying with ASME/ANSI B31.8S.[402] Last, the Company's DSIR Five-Year Plan should have a complete and thorough Business Plan Discussion, technically precise project scopes, specific statements of

[398] Hearing Exhibit 406 at 40:13-41:15 (Answer Testimony of Ms. Ramos).
[399] Exhibit 402 at 9:7-12:16 (Answer Testimony of Mr. Dusenbury).
[400] Hearing Exhibit 406 at 34:1-39:17 (Answer Testimony of Ms. Ramos).
[401] *Id*. at 77:10-13.
[402] *Id*. at 36:2-21.

need, discussion of threat magnitude, schedule of risk mitigation, and accurate project cost estimates.[403]

321. Staff proposes the criteria the Commission has considered for past integrity management initiatives: (a) The costs constitute a significant portion of the utility's total expenditures; (b) The expenditures are beyond the utility's control; (c) The expenditures are increasing at a rate in excess of the general rate of inflation; and (d) The expenditures are volatile.[404] Staff asserts that the proposed DSIR meets these criteria.

2. OCC

322. The OCC opposes implementation of the DSIR, recommending that the Company address pipeline safety and integrity in the normal course of business. However, OCC recommends several changes to the program if approved, including: elimination of At-Risk Meter Relocation and Yard Line Replacement Program, reducing the term of the DSIR to three years, allowance of capital costs only, and allowing a return, but at the cost of debt.[405]

3. EOC

323. EOC takes no position on the merits of the DSIR. However, if the Commission approves the DSIR, the EOC recommends that the Company prioritize funding for the At-Risk Meter Relocation and Yard Line Replacement Program for Low-Energy Assistance Program recipient households.[406]

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[403] *Id*. at 37:2-16.

[404] *Id*. at 14:6-15:8.

[405] Hearing Exhibit 301 at 136:1-19 (Answer Testimony of Mr. Skluzak); Hearing Exhibit 302 at 60:10-62:11.

[406] Hearing Exhibit 700 at 6:13-17 (Answer Testimony of Mr. Arnold).

C. Analysis

324. Though the Commission has approved integrity management programs for several gas utilities in Colorado, the ALJ finds and concludes that BHCG has not satisfied its burden of establishing that implementation of the DSIR is in the public interest at this time for three reasons.

325. First, BHCG lists certain types of pipe material and other conditions that it claims to warrant expedited replacement outside of the ordinary course of business, but provides little information establishing the risk level that warrants the expedited cost recovery proposed in its DSIR program, or how the proposed projects fit within this threshold risk level. For example, the Problematic Pipe Replacement Program lists bare and poorly coated steel, PVC, and steel tubing as requiring replacement, but it does not provide detailed evidence demonstrating that these materials warrant the expedited replacement and rate recovery treatment of the DSIR program, other than that they are currently the highest risk materials on its system. The Company discusses its prioritization systems used to rank projects to establish which project to replace first, but this ranking does not include a determination of the threshold level of risk that warrants the "extraordinary" treatment of current recovery.[407] Further, the Company asserts that integrity management is evolving and there may be new situations that need to be addressed and that there may be additional future PHMSA requirements. The record does not allow the ALJ to conclude with confidence, therefore, that: (a) all of the projects proposed to be included in the DSIR warrant the extraordinary treatment of current recovery; (b) BHCG has a legitimate and reasonable plan for when the DSIR will no longer be necessary; or (c) BHCG has a framework

[407] Decision No. R11-0743 issued in Proceeding No. 10AL-963G on July 8, 2011 at 18 (¶ 57) (describing PSCo's Pipeline System Integrity Adjustment (PSIA) as "[an] extraordinary cost recovery program").

with objective criteria that the Commission can use to determine when proposed DSIR projects warrant current recovery through the DSIR or can be addressed in the ordinary course of business.[408]

326. Second, BHCG has not established that it is in the public interest to double the rate base in BHGD Rate Area 2, which only has approximately 23,000 ratepayers, in four years. Similarly, BHCG has not adequately explained why it is in the public interest for ratepayers to bear 100 percent of these significant costs ($69.7 million) resulting from the acquisition of SourceGas when BHCG stated in Proceeding No. 15A-0667G that the acquisition would cause no net harm to ratepayers.[409] In fact, in seeking the Commission's approval of the SourceGas acquisition, BHCG told the Commission that it would "have benefits for customers, including a rate reduction."[410]

327. It is hard to believe that BHCG was unaware of the apparently poor state of the gas infrastructure in BHGD Rate Area 2 when BHCG made this statement to the Commission. Since then, the Black Hills corporate family has booked approximately $36 million in savings resulting from the acquisition, but only approximately $2 million has been allocated to BHCG.[411] While BHCG contends this $2 million in savings is reflected in the revenue requirement proposed in this proceeding,[412] it is not readily apparent that ratepayers have received the benefit

[408] *See* Decision No. R15-1204 issued in proceeding No. 15AL-0135G on November 16, 2015 at 32 (¶ 111) (requiring PSCo to include in any request to extend the PSIA "a plan stating how the PSIA will be terminated in the future, including: 1) a thorough analysis of all projects to be included in an ongoing PSIA; 2) the criteria used to determine whether future projects qualify for PSIA treatment; 3) a timeline for all PSIA projects to be completed; and, 4) a plan stating how remaining projects in the PSIA and other future pipeline replacements or significant safety expenditures will be addressed through the ordinary course of business when the PSIA is terminated").

[409] Unopposed Joint Motion for Expedited Approval of Recommended Decision at 5 (¶ 17) (filed January 25, 2016 in Proceeding No. 15A-0667G).

[410] *Id*. at 3 (¶ 7).

[411] Hearing Exhibit 111 at 36:9-13 (Direct Testimony of Mr. Klapperich).

[412] Hearing Transcript at 60:10-61:20 (October 24, 2019); Hearing Exhibit 111 at 36:14-19.

of those savings. Even assuming that they did, it appears likely that Black Hills booked most, if not all, of the remainder of the $36 million savings for the benefit of its shareholders. Under these circumstances, it is difficult to conclude that the ratepayers will suffer no net harm as a result of Black Hills' acquisition of SourceGas, particularly when the Company's proposed rate consolidation would result in Rate Area 1 and BHCOG paying some of the Rate Area 2 costs.

328. Third, the record does not contain any analysis of alternatives to DSIR investments to reduce or eliminate costs in the BHGD Rate Area 2. Given the proposed doubling of rate base in five years, all possible alternatives should be thoroughly explored.[413] As Staff suggests, ratepayers may switch to other fuels if they pay for the costs of their service, including for system upgrades through the DSIR.[414] The record does not contain any analysis of customer attrition in BHGD Rate Area 2 or the resulting changes in demand if customers receive cost-based price signals. Further, the record does not contain any analysis of the level of subsidization *within* BHGD Rate Area 2. Since the proposed DSIR investment would double the amount of *average* rate base, it is likely that certain areas within BHGD Rate Area 2 would have significantly higher investment per customer. The extraordinary level of DSIR investment in BHGD Rate Area 2 warrants a thorough investigation into these details.

329. Fourth, the record is insufficient to adequately assess the DSIR given its significant financial consequences for all ratepayers, but particularly the ratepayers in BHGD Rate Area 2. BHCG argues that the bill impact on BHGD Rate Area 2's ratepayers

[413] For example, alternate construction options, system reconfiguration, pressure reductions, "beneficial electrification" (*see* § 40-3.2-106(6)(a), C.R.S.) or other demand reduction.

[414] Hearing Exhibit 408 at 32:9-13 (Supplemental CCOSS Answer Testimony of Ms. O'Neill) ("Some of these customers might have switched to propane or other sources of home heating if they paid the full cost of their service, reducing the overall system cost. Alternatively, customers in BHCOG who pay more than their cost of service, could look at switching to electric heat when that option is not actually cheaper on a cost-basis.").

caused by that area's high level of DSIR spending and relatively low number of ratepayers dictates consolidation of the base rate areas in order to mitigate the DSIR's financial impact.[415] Yet, BHCG did not produce a bill impact analysis including the DSIR for BHGD Base Rate Area 2 or the other existing base rate areas before the August hearing.[416] This was due to the fact that BHCG did not produce a separate CCOSS for each of the existing base rate areas before the August hearing. After the ALJ ordered the continued proceedings, BHCG provided the CCOSS's and the bill impact analysis for each of the existing rate base areas.[417] The bill impacts for BHGD Rate Area 2 under BHCG's consolidation and DSIR proposals, under Staff's proposals, and under the scenario in which consolidation is not granted and the DSIR is approved are as follows:[418]

Current Base Rate Area	Current GCA Area	Proposed Base Rates	DSIR "Zone"	2020	2021	2022	2023	2020 - 2023 Total
BHGD-RA2	North Eastern	Statewide[419]	Statewide	6.35%	1.86%	1.88%	1.57%	11.66%
BHGD-RA2	North Eastern	Stand-alone	Stand-alone	19.83%	8.89%	8.63%	9.07%	46.42%
BHGD-RA2	North Eastern	Stand-alone	East Zone	15.87%	3.11%	3.60%	3.20%	25.78%
BHGD-RA2	Southwestern	Statewide[421]	Statewide	1.56%	1.86%	1.88%	1.57%	6.87%
BHGD-RA2	Southwestern	Stand-alone	Stand-alone	14.64%	8.89%	8.63%	9.07%	41.23%
BHGD-RA2	Southwestern	Stand-alone	East Zone	-1.85%	3.11%	3.60%	3.20%	8.06%
BHGD-RA2	Ark. Valley	Statewide[421]	Statewide	3.79%	1.86%	1.88%	1.57%	9.10%
BHGD-RA2	Ark. Valley	Stand-alone	Stand-alone	18.12%	8.89%	8.63%	9.07%	44.71%
BHGD-RA2	Ark. Valley	Stand-alone	East Zone	-0.22%	3.11%	3.60%	3.20%	9.69%

[415] Hearing Exhibit 138 at 14:1-13 (Supplemental CCOSS Direct Testimony of Mr. Gillen, Rev. 1); Hearing Exhibit 134 at 47:1-49:5 (Rebuttal Testimony of Mr. Gillen).

[416] Hearing Exhibit 134 at 49:1-5 (Rebuttal Testimony of Mr. Gillen).

[417] Hearing Exhibit 138, Attach. EJG-15.

[418] *See id*.

[419] These are statewide rates after BHCG's interclass and intraclass mitigation proposal.

These bill impacts show that the BHGD Rate Area 2 ratepayers will experience bill increases from 41.23 percent to 46.42 percent in the next four years if the DSIR is approved but base rate area consolidation is not. As a result, it was not until the supplemental proceedings that the financial impact of the proposed DSIR on the ratepayers of BHGD Rate Area 2 became clear.

330. The Supplemental Proceedings were expedited. They were designed to give BHCG the opportunity to supplement the record with the CCOSS's for each of the base rate areas so that a comparative analysis of the full range of options could be undertaken. The supplemental proceedings were not designed for the ALJ and the Intervenors to re-examine the DSIR. As a result, the record has not been adequately developed on the necessity of some or all of the proposed DSIR projects, the DSIR's impact on ratepayers, alternative methods of paying for some or all of the DSIR's projects, and alternatives to the DSIR.

331. Based on the foregoing, the ALJ cannot conclude based on the record in this proceeding that it is in the public interest to approve the proposed DSIR. Accordingly, BHCG's request for a DSIR shall be denied and BHCG shall be ordered to file a new advice letter and related tariff sheets proposing a DSIR within six months of a final decision in this proceeding. In the new DSIR filing, the Company shall address all concerns listed above. In rendering this decision, the ALJ is relying on BHCG's repeated sworn statements that, irrespective of whether the DSIR is approved, it will make the investments necessary to keep its gas system safe.

IX. MISCELLANEOUS ISSUES

A. Weather Normalization

1. BHCG's Argument

332. Proposed rates are developed based on test-year volumes. As a result, it is important to determine whether the weather during the test year was "normal." "If test year weather conditions deviate from normal, it is necessary to adjust heating load to recognize what

volumes would have been if condition were normal."[420] BHCG defines normal weather as the average of the ten years preceding June 30, 2018, expressed in Heating Degree Days (HDDs).

333. Colorado's climate has warmed in recent decades. As a result, more recent years better reflect the current and future "normal" weather than years in the more distant past. BHCG concludes that "a 30-year average is more likely to overestimate normal HDDs compared to 20-year average and similarly a 20-year average is more likely to overestimate normal HDDs compared to the Company's 10-year Rolling Average."[421]

2. Intervenors' Arguments

a. Staff's Argument

334. Staff recommends using a 20-year average to calculate the normal HDDs. Staff states that Black Hills used a 2018 test period that was, in most of its service territory, warmer than normal. However, Staff asserts that ten years is too short a period to determine a "normal" value for a variable as volatile as weather. Staff recommends a 20-year average to strike an acceptable balance between providing more stability than the 10-year average while being more responsive to the trend of declining HDDs than the 30-year average.[422]

b. OCC's Argument

335. The OCC recommends using the 1981 to 2010 normal HDDs published by the National Oceanic and Atmospheric Administration. The OCC asserts that the Company's proposal to use ten years has a significant impact on what is considered "normal," producing

[420] BHCG's SOP at 42.
[421] *Id.* at 43.
[422] Staff's SOP at 32-33.

additional revenues of almost $2.6 million. The OCC concludes that a longer period is warranted.[423]

3. Analysis

336. The ALJ finds and concludes that the use of Staff's 20-year average in calculating the normal HDDs is the most reasonable. The ALJ agrees with Staff that the Company's ten-year proposal does not provide an adequate period to develop a "normal" value. Staff's proposal provides a reasonable compromise between the traditional 30-year normal and the short-term view proposed by the Company.

B. Construction Allowances

1. BHCG's Argument

337. BHCG proposes a single revenue-based construction allowance for its entire Colorado service territory, rather than the different amounts currently provided by BHGU and BHGD. BHCG proposes to use the methodology of BHGD, which would result in the following increases:

Construction Allowances under Current Tariffs and Company's Proposal[424]

	Current	Proposed	Percent Change
BH Gas Utility			
Residential	$550	$1,060	+93%
Small Commercial	$686	$1,740	+154%
BH Gas Distribution			
Rate Area 1 Residential	$790	$1,060	+34%
Rate Area 1 Small Commercial	$790	$1,740	+120%
Rate Area 2 Residential	$830	$1,060	+27%
Rate Area 2 Small Commercial	$830	$1,740	+110%

[423] OCC's SOP at 23-24.

[424] *See* Hearing Exhibit 404 at 22 (Table ERH-2) (Answer Testimony of Mr. Haglund); BHCG's SOP at 44.

According to BHCG, its proposal: (a) "strikes a balance between existing customers' increased rate base and future customers' new load and revenues to pay increased rate base;" (b) "better reflects the long-term value of new customers and the benefits to existing customers;" and (c) "is conservative cost-based proposal and still substantially less than the gas utility that most closely resembles BH Colorado Gas from a size, rates, and footprint in Colorado."[425]

338. The Company also proposes to eliminate its current line extension financing option.

2. Intervenors' Arguments

a. Staff's Argument

339. Consistent with its recommendation not to consolidate rate areas, Staff believes that construction allowances should be calculated using the local rates in each of the three existing rate areas. Staff agrees that the Company should use a single methodology to calculate construction allowances. However, Staff opposes BHCG's proposal to use the construction allowance calculation methodology currently used by BHGD, and instead proposes to use the method currently used by BHGU. Staff asserts that the BHGU approach is the more appropriate and analytically sound methodology, as it uses only the revenues tied to mains and service line investment. The BHGD approach improperly includes all revenues tied to all distribution investment.[426]

340. Staff also opposes the Company's proposal to eliminate line extension financing options currently offered under BH Gas Utility's and BH Gas Distribution's tariffs. Staff recommends that the Commission establish the construction allowance methodology using the

[425] BHCG's SOP at 44.
[426] Staff's SOP at 40-41.

current BHGU approach and order BHCG to file a compliance filing at the conclusion of this proceeding to implement the new construction allowance amounts.

b. OCC

341. The OCC recommends denying the Company's construction allowance proposals because BHCG has failed to meet its burden of proof to show that the significant construction allowance increases are just and reasonable and in the public interest. The OCC recommends that the Company be ordered to adopt the existing BHGU methodology that results in flat fees, rather than the more complicated and less transparent BHGD methodology that uses a flat fee plus a dollar amount per therm above a base annual usage therm amount.

3. Analysis

342. BHCG bears the burden of proving that its proposed construction allowances are just and reasonable. In addition, with respect to construction allowances, Rule 4210(b)(IV) of the Commission's Rules Regulating Gas Utilities and Pipeline Operators, 4 *Code of Colorado Regulations* 723-4, requires the utility to "ameliorate the rate and service impact upon existing customers." In general, this rule requires line extension provisions to address the potential subsidy between new and existing customers caused by setting the construction allowance too high (in which case existing customers would subsidize the connection of new customers) and too low (in which case the new customers would subsidize existing customers).

343. Here, the parties generally proposed the adoption of one of several procedures currently used by one of the BHCG's affiliated companies, but did not conduct a thorough or robust analysis of whether the resulting construction allowances will result in just and reasonable rates, or whether subsidization will occur between existing and new customers. In addition, no party compared the actual costs to connect customers against the various proposed construction

allowances.[427] As a result, there is no evidence in the record concerning whether the proposed construction allowances result in a subsidy between existing and new customers and, if so, how much of a subsidy. Based on the foregoing, the ALJ finds and concludes that BHCG did not carry its burden in establishing that its proposed construction allowances are just and reasonable, or whether they would result in a subsidy between new and existing ratepayers. For these reasons, BHCG's construction allowance proposals shall be rejected.

344. Nevertheless, the record does support the conclusion that the existing construction allowances are likely out-of-date. Accordingly, BHCG shall be ordered to file for approval with the Commission, in a new proceeding, revised construction allowance rates, terms, and conditions within nine months of a final decision in this proceeding. BHCG shall present a thorough and detailed analysis of all aspects of the Company's existing and proposed construction allowance rates, including a detailed assessment of actual costs to connect new customers and whether any subsidy exists between new and existing customers under existing and proposed tariffs. The Company shall present a full analysis of the cost impacts of new customers on its system, including impacts of direct costs such as main and service costs and additional revenues, as well as indirect costs such as billing, engineering, customer service, and costs to upgrade capacity of the existing system that are necessary to accommodate the new loads. BHCG shall also include an assessment of the overall efficiency and transparency of its construction allowance policies and whether improvements can be made, consistent with Senate Bill 17-271.

[427] Transcript at 57:5-14 (August 7, 2019).

C. Gas Storage Inventory Cost

1. BHCG's Argument

345. BHCG proposes to move all cost recovery for gas storage inventory out of rate base, such that cost recovery will occur through a separate gas storage inventory cost (GSIC) component for each GCA area instead. The Company further proposes to earn its WACC on the average storage inventory balance. BHCG states that the alternative – earn based on short-term rates – has been rejected by the Commission in two Commission rate review proceedings, Proceeding Nos. 17AL-0429G and 12AL-1268G.

2. OCC's Argument

346. The OCC agrees with BHCG's proposal. However, OCC believes that BHCG should earn at the Corporate Revolving Line of Credit rate on the average storage inventory balance. As support, the OCC cites BHC's Form 10-K in which the Company stated that the actual financing for its gas storage inventory is at "the actual cost of borrowing under the Corporate Revolving Credit Facility of Black Hills Corporation."

3. Analysis

347. The ALJ agrees with Black Hills that it is not appropriate to use short-term rates for the GSIC. As Discussed in Decision No. R13-1307, gas storage includes short-term transactions as well as long-term, and application of a single short-term rate is not appropriate. Accordingly, the ALJ finds and concludes that BHCG's proposal is in the public interest.

D. De-Rated Pipe Adjustment

1. BHCG's Argument

348. As part of a system upgrade that was undertaken in conjunction with an approved System Safety Integrity Project, RMNG installed a larger diameter pipeline parallel to a section

of an existing Glenwood Springs to Aspen line and de-rated the old section to a lower operating pressure. This asset was removed from rate base through a *pro forma* adjustment to the test period revenue requirement in RMNG's rate review in Proceeding No. 17AL-0654G, and this adjustment was ultimately reflected in the settled revenue requirement approved by the Commission in that proceeding. The OCC was a party to that settlement. BHCG now proposes to transfer the old line to BHGD and include it in BHGD's rate base pursuant to a *pro forma* adjustment.[428]

2. OCC's Argument

349. The OCC recommends disallowing the post-Base Period rate base addition made in November 2018 related to the de-rated pipe. The OCC asserts that this is a sale between affiliates, and is an improper *pro forma* adjustment outside of the test period. The OCC also questions whether this sale was a fair transaction for BHCG's ratepayers. The OCC recommends that the amount of $445,497 on line 67 in Schedule M-2 – "Other Rate Base Items - Additions & Adjustments" in Clevinger Revised Attachment MCC-1, be reversed; as well as Accumulated Depreciation - $4,566, Accumulated Deferred Income Tax - $(927), and Depreciation Expense - $9,133.[429]

3. Analysis

350. The ALJ finds and concludes that the OCC's recommended disallowance related to the de-rated pipe is not in the public interest. The pipe at issue was removed from RMNG rate base and is proposed to be added to BHGD rate base. Regardless of whether it is categorized as a sale or transfer, operation of the pipe has changed from transmission service to distribution

[428] BHCG's SOP at 16-17.
[429] OCC's SOP at 26-27.

service as a part of an approved RMNG System Safety Integrity Project. At the hearing, Mr. Stoffel testified that virtually the same book amount for the de-rated pipe was transferred from RMNG to BHCG, and there are no incremental revenues associated with the de-rated pipe.[430] Accordingly, the OCC's recommended disallowance shall be denied.

E. Credit Card Processing Fees

1. BHCG's Argument

351. BHCG proposes that, as part of the consolidation to a single rate area, transaction costs for credit card and Automated Clearing House (ACH) fees should be included in rates and be collectively paid by all customers in the BHGU and BHGD rate areas instead of on an individual basis. Currently, only BHGU customers pay these fees, while customers in BHGD's rate area do not. BHCG argues that "socializing" the fees over the entire customer base will result in a small rate impact, but improve the overall customer experience.[431]

352. Customers in the BHGU area currently pay a vendor directly to process bill payments using credit cards and ACH fees. BHGU customers currently pay $1.45 per residential transaction and $7.50 per commercial transaction when they pay with a credit card, $2.00 for CheckFree service, and $0.20 when the bill is paid by ACH.[432] Customers in the BHGD area are not charged specific transaction fees because such expenses were included as a component of the settled revenue requirement in the Company's last rate case, Proceeding No. 10AL-0455G.

[430] Transcript at 60:4–61:21 (August 6, 2019).
[431] Hearing Exhibit 120 at 21:19-23:5 (Revised Direct Testimony of Mr. Gillen).
[432] *Id*. at 22:9-11.

353. The Company also proposes to increase the current credit card/ACH limit from $1,000 to $50,000 for commercial customers. BHCG states that the existing $1,000 per transaction limit has been an ongoing source of complaints for large-volume customers.[433]

354. BHCG states that the Company's proposal aligns with how most businesses handle credit card/ACH payments. BHCG points out that costs for processing payments by mail are normally recovered as an O&M expense in the RRS, and costs for processing credit card transactions should be done the same way. BHCG argues that customers disapprove of being charged for using credit cards, and this is a complaint commonly heard by the customer service department. The Company's proposed method, on the other hand, would improve the customer experience.

355. BHCG states that even if the Commission approves the Staff and OCC's recommended adjustments of $229,935 it is especially inappropriate to remove the additional $88,988 of O&M expense. The Company argues that these costs were incurred and booked during the base period, and are normal and ongoing business operations that occurred during the base period.[434]

356. Finally, in its SOP, BHCG states that "Section 5-2-212 of the Uniform Consumer Credit Code prohibits sellers and lessors from imposing a surcharge on any customer who elects to pay by credit card in any sales or lease transaction."[435] BHCG thereby suggests that § 5-2-212, C.R.S., prohibits it from charging individual ratepayers the transaction fees resulting from paying by credit card, thus requiring such fees to be socialized.

[433] *Id*. at 23:1-5.

[434] Hearing Exhibit 134 at 22:14-23:6 (Rebuttal Testimony of Mr. Gillen).

[435] BHCG's SOP at 45 (citing § 5-2-212, C.R.S.).

2. Staff's Argument

357. 119. Staff recommends that the Commission reject BHCG's proposal for socializing credit card/ACH transaction fees across its customer base. Staff argues that customers who do not pay utility bills with credit cards should not be required to subsidize customers who use credit cards or ACH transfers for payments. Staff recommends that charges associated with these services should be modeled after PSCo, where customers using such services are transferred to a credit processing company which then charges the customer directly. Staff calculates the associated charges, which are included as an O&M expense, at $229,935 which includes $75,000 in costs for increasing the credit card/ACH payment limit from $1,000 to $50,000 for commercial customers. Staff advocates that this amount be disallowed in the calculation of the revenue requirement.[436]

3. OCC's Argument

358. 120. Like Staff, the OCC opposes the socialization of costs for fee payments and points out that while BHGD socializes the cost of the fees to the customer base, BHGU uses a pay-as-you-go methodology. The OCC recommends that BHGU and BHGD adopt a common practice, and should place the recovery on the cost causers by using the pay-as-you-go methodology. The OCC argues that there is no evidence that ratepayers prefer a socialized payment processing fee, or are opposed to paying the fee on an individual basis.[437] The OCC differs from Staff in the calculation of the reduction to the O&M expenses by including both the booked amount of $88,988 and the *pro forma* adjustment of $229,935, for a total revenue requirement reduction of $318,941.[438]

[436] Hearing Exhibit 407 at 7:1-10:15 (Answer Testimony of Ms. Kahl).

[437] Hearing Exhibit 301 at 32:11-36:7 (Answer Testimony of Dr. England).

[438] *Id*. at 36:1-7.

4. Analysis

359. The ALJ observes that the existence of two different methods for the collection of credit card/ACH fees in the BHGU and BHGD rate areas is inconsistent, and the continued disparity would be prejudicial to ratepayers that bear the burden of socialized costs versus those who pay those costs individually. The ALJ finds and concludes that a common policy applied to all rate areas is in the public interest.

360. In its testimony, the EOC highlights the impact of fixed charges on low-income customers, stating that higher fixed utility charges disproportionately impact vulnerable households.[439] The ALJ finds and concludes that, for the reasons cited by EOC, socializing the credit card/ACH fees that are then paid by all ratepayers has the same effect on low-income households as higher fixed charges. It forces low-income households to pay a portion of the socialized costs of paying by credit card or ACH irrespective of whether they use the service, which thereby eliminates the ability of such households to avoid the charge by paying by other means.

361. Utility regulation strives to base recovery on cost causation principles, assigning recovery to the individuals or entities that most directly give rise to the cost incurred. Of course, this is an imperfect principle, and there are certain circumstances in which the Commission is willing to diverge from a rigorous application of the cost causation principle if doing so is in the public interest.

362. Here, based on the foregoing and the record in this proceeding, the ALJ finds and concludes that: (a) BHCG has not carried its burden that socializing the costs of credit card and ACH transaction fees are in the public interest; (b) the pay-as-you-go method for credit

[439] Hearing Exhibit 700 at 12:13-17:9 (Answer Testimony of Mr. Arnold).

card/ACH fees and the CheckFree service should be applied to both the BHGU and BHGD service areas, and the adjustment of $229,935 shall be removed from the revenue requirement; and (c) the OCC's request to include in the adjustment the additional $88,988 of O&M expense is not compelling.

363. Finally, BHCG raised its argument that § 5-2-212, C.R.S., prohibits it from charging individual ratepayers the transaction fees resulting from paying by credit card, thus requiring such fees to be socialized, for the first time in its SOP. As such, the Intervenors have not been given the opportunity to respond to it. Moreover, given that the argument is presented in a single sentence – in fact, the last sentence in the body of its SOP – BHCG has not explained why its current practice of charging individual ratepayers in the BHGU Rate Area for credit card transaction fees is not improper under § 5-2-212, C.R.S. Under these circumstances, the ALJ finds and concludes that BHCG has waived this argument and the ALJ will not consider it.[440]

F. Consolidation of DSM, Hedging, and BHEAP Programs

364. BHCG proposes to consolidate the Demand Side Management (DSM), hedging, and BHEAP. Staff supports the consolidation and no party opposes it. Accordingly, and because the ALJ finds and concludes that it is in the public interest, BHCG's proposal to consolidate these programs shall be granted.

G. BHCG-Staff-EOC Partial Stipulation

365. As noted above, no party opposes the BHCG-Staff-EOC Partial Stipulation on principle. The OCC is the only party that has expressed opposition, but that is on the limited basis that the ratepayers should enjoy the savings from the GCA consolidation. Specifically, the

[440] *Vitetta v. Corrigan*, 240 P.3d 322, 330 (Colo. App. 2009) (declining to consider argument presented for the first time in a reply brief because it did not give the opposing party the opportunity to respond to it and did not allow a complete record on the argument to be developed).

OCC wants the Company to monetize the cost savings resulting from the consolidation of GCAs from seven to three, and includes them as a known and measurable *pro forma* adjustment in the Company's revenue requirement.[441] The OCC has not stated that such consolidation is contrary to the public interest.

366. Based on the foregoing, the ALJ finds and concludes that, except for the $12.25 residential customer charge, the BHCG-Staff-EOC Partial Stipulation is in the public interest. For this reason, the BHCG-Staff-EOC Partial Stipulation is approved-in-part and denied-in-part. The proposal to adopt a residential customer charge of $12.25 is denied based on the decision to deny the remainder of Phase II issues. Otherwise, the BHCG-Staff-EOC Partial Stipulation is granted. The OCC's request that the Company monetize the cost savings resulting from the consolidation of GCAs from seven to three, and includes them as a known and measurable *pro forma* adjustment in the Company's revenue requirement is denied.

H. BHCG – AM Gas Partial Stipulation.

367. As noted above, no party opposes the BHCG – AM Gas Partial Stipulation. Accordingly, and because the ALJ finds and concludes that it is in the public interest, the motion to adopt the BHCG – AM Gas Partial Stipulation shall be granted.

I. Rate Case Expenses

1. BHCG's Argument

368. BHCG proposes to recover its rate case expenses, originally estimated at $800,000 and subsequently updated to $950,000, through a three-year amortization. BHCG based the original estimate "on the level of expenses incurred in recent rate review proceedings

[441] Partial Stipulation and Settlement Agreement Between BHCG, Staff, and EOC at 8 (¶ 29) (filed on August 5, 2019)

by other utilities of BHC in Colorado, including Black Hills Colorado Electric and Rocky Mountain Natural Gas."[442] However, because BHCG incurred rate case expenses of $707,000 through the filing of rebuttal testimony, BHCG increased its estimate at that time to $950,000.[443] Notwithstanding that it did not include the expenses resulting from the Supplemental Proceedings, BHCG is willing to stick with the $950,000 estimate. BHCG states that it is willing, "following the conclusion of the proceeding, to submit to Staff and the OCC a summary of its final rate case expenses, along with supporting documentation, for their review."[444]

2. Intervenors' Arguments

a. Staff's Argument

369. Staff states that the Commission should deny recovery of rate case expenses resulting from BHCG's revision of its direct case that resulted in the filing of the Revised, Corrected, and Supplemental Direct Testimony. Those expenses amount to $44,168. Staff also states that BHCG should not recover any expenses incurred as a result of the Supplemental Proceedings. Finally, Staff requests that BHCG only be permitted to recover any rate case expenses through a three-year rider, not an amortized cost through rate base. As justification, Staff states that "[a] rider permits recovery of only the exact amount of rate case expenses allowed by the Commission."[445]

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442 Hearing Exhibit 121 at 45:20-46:3 (Rebuttal Testimony of Mr. Stoffel).

443 *Id*. at 47:4-11.

444 BHCG's SOP at 37 (citing similar procedure approved in Proceeding Nos. 12AL-1268G and 16AL -326E).

445 Staff's SOP at 37.

b. OCC

370. The OCC argues that the Commission should deny recovery of BHCG's rate case expenses in this proceeding. As support, the OCC states that BHCG has not supported its request. The OCC does not dispute "whether the Company is entitled to recover prudently incurred and reasonable rate case expenses, but that the Company refused to provide any evidence that the amounts estimated or incurred were reasonable given the complete lack of detail provided in its testimony and exhibits."[446] The OCC argues that, at a minimum, BHCG "should not be allowed additional rate case expenses incurred because of the Company's errors and its April 24, 2019 filing."[447]

3. Analysis

371. After careful review of the arguments and evidence presented by the parties, the ALJ shall disallow 20 percent of the $950,000 in rate case expenses requested by BHCG. This is the amount that the ALJ estimates BHCG's mistakes and flawed approach to this proceeding contributed to increasing the costs of this proceeding. It would be unfair to expect the ratepayers to shoulder those costs. BHCG's request to continue this proceeding to allow it "to submit to Staff and the OCC a summary of its final rate case expenses, along with supporting documentation"[448] is denied.

[446] OCC's SOP at 25.
[447] *Id*.
[448] BHCG's SOP at 37.

X. ORDER

A. The Commission Orders That:

1. For the reasons stated above,

a. The requests by Trial Staff of the Commission (Staff) and the Office of Consumer Counsel (OCC) regarding the synergy savings resulting from the acquisition of SourceGas Distribution, LLC, Rocky Mountain Natural Gas LLC, SourceGas LLC, and SourceGas Holdings LLC are denied.

b. Black Hills Colorado Gas, Inc. (BHCG or the Company) is ordered to make a compliance filing after the two-year amortization period to halt recovery of the Synergy Regulatory Asset.

c. BHCG's proposal to include \$35.3 million in Post-Base Period capital additions and adjustments from July 1, 2018 through December 31, 2018 in rate base is denied.

d. BHCG's requested *pro forma* adjustments to accumulated depreciation, accumulated deferred income tax (ADIT), depreciation expense, revenue, and property tax expense related to the Post-Base Period capital additions are denied.

e. The authorized return on equity (ROE) is established within the range of 9.2 percent to 9.6 percent. An ROE of 9.5 percent is approved to calculate rates. A cost of long-term debt of 4.31 percent is approved.

f. BHCG's capital structure for the 2016 test year of 50.15 percent equity and 49.85 percent debt is approved.

g. The Weighted Average Cost of Capital value for the 2018 test year ending June 30, 2018 is 6.91 percent as detailed above.

h. BHCG shall henceforth obtain approval for the conversion of short-term debt to long-term debt and/or to assume long-term debt pursuant to § 40-1-104, C.R.S., before it seeks Commission approval to include the debt in its capital structure in a Phase I rate case.

i. BHCG is permitted to recover 50 percent of the requested equity compensation, or $213,063.

j. BHCG shall amortize the non-protected ADIT referenced above over three years and net the non-protected property-related with the non-protected non-property related so that both the regulatory asset and the regulatory liability are extinguished.

k. Staff's request to split the approximately $24 million in tax savings between ratepayers (90 percent) and shareholders (10 percent) is denied.

l. BHCG's requested *pro forma* labor adjustments for known and measurable changes in compensation are granted.

m. BHCG's request to recover the amortized costs and actuarial gains and losses in the pension-related and other post-employment benefits-related regulatory assets is denied, and BHCG shall return to ratepayers dollars that have already been recovered using a three-year amortization.

n. BHCG's proposal to eliminate the Whitewater Distribution System rate is denied. BHCG can recover reasonable costs that are incurred to improve reliability of the Whitewater Distribution System.

o. BHCG's proposal to consolidate the existing base rate areas is denied.

p. The remainder of BHCG's Phase II-related proposals are denied.

q. BHCG shall: (i) implement a General Rate Schedule Adjustment (GRSA) consistent with the Phase I decisions in this Decision to adjust current base rates proportionally for each of the Company's three existing base rate areas; and (ii) file a Phase II rate case within six months of a final Commission decision in this proceeding.

r. BHCG's request for a Distribution System Integrity Rider (DSIR) is denied. BHCG shall file a new advice letter and related tariff sheets proposing a DSIR within six months of a final decision in this proceeding. In the new DSIR filing, the Company shall address all concerns listed above and any others necessary to a complete an analysis of all options.

s. In calculating normal Heating Degree Days for purposes of performing weather normalization, Staff's 20-year average shall be employed.

t. BHCG's construction allowance proposal is denied. BHCG shall file for approval of revised construction allowances within nine months of a final decision in this proceeding. BHCG's filing shall include the detailed analysis noted above.

u. BHCG's proposal: (a) to move cost recovery for gas storage inventory out of rate base and into a separate gas storage inventory cost component for each gas cost adjustment area; and (b) to earn its weighted average cost of capital on the average storage inventory balance, is granted.

v. The OCC's proposal to disallow BHCG's transfer of the de-rated Aspen to Glenwood Springs pipe to BHGD's rate base pursuant to a *pro forma* adjustment is denied.

w. BHCG shall apply the pay-as-you-go method for credit card/ Automated Clearing House fees and the CheckFree service to both the Black Hills/Colorado Gas Utility Company, Inc. and Black Hills Gas Distribution, LLC service areas and the related adjustment of $229,935 shall be removed from the revenue requirement.

x. BHCG's proposal to consolidate the Demand Side Management, hedging, and Black Hills Energy Assistance Programs is granted.

y. The Motion to Approve Partial Stipulation and Settlement Agreement Between BHCG, Staff, and Energy Outreach Colorado (BHCG-Staff-EOC Partial Stipulation) filed on August 1, 2019 is granted-in-part and denied-in-part. The stipulated statewide monthly customer charge for the residential class of $12.25 is denied, consistent with the discussion above. Otherwise, the BHCG-Staff-EOC Partial Stipulation is granted.

z. The Motion to Approve Partial Stipulation and Settlement Agreement between BHCG and AM Gas Transfer CO. filed on August 5, 2019 is granted.

aa. $190,000 of the $950,000 in rate case expenses requested by BHCG to be recovered from ratepayers is disallowed.

2. The effective date of the tariff sheets filed by BHCG pursuant to Advice Letter No. 1 as amended, is permanently suspended. and shall not be further amended

3. The tariff sheets filed with Advice Letter No. 1 are permanently suspended and shall not be further amended. BHCG shall file modified rates and tariff sheets within a consolidated Colo. PUC No. 1 consistent with the terms of this Decision and the Settlement Agreement as modified by this Decision. Colo. PUC No. 1 shall include tariff sheets and rate schedules that continue the implementation of BHCG's three separate base areas and set forth the existing Commission-approved base rates for each of the three base rate areas to be modified by three new separate GRSA's, consistent with the discussion above.

4. Given the breadth of changes to rates proposed by BHCG and established by this Decision, BHCG shall file the modified rates and tariff sheets on not less than 21 days' notice to the Commission. The advice letter and tariff sheets shall be filed as a new advice letter proceeding and shall comply will all applicable rules. In calculating the proposed effective date, the date the filing is received at the Commission is not included in the notice period and the entire notice period must expire prior to the effective date. The advice letter and tariff must comply in all substantive respects to this Decision in order to be filed as a compliance filing.

5. This Recommended Decision shall be effective on the day it becomes the Decision of the Commission, if that is the case, and is entered as of the date above.

6. As provided by § 40-6-106, C.R.S., copies of this Recommended Decision shall be served upon the parties, who may file exceptions to it.

a. If no exceptions are filed within 20 days after service or within any extended period of time authorized, or unless the Recommended Decision is stayed by the Commission upon its own motion, the Recommended Decision shall become the decision of the Commission and subject to the provisions of § 40-6-114, C.R.S.

b. If a party seeks to amend, modify, annul, or reverse a basic finding of fact in its exceptions, that party must request and pay for a transcript according to the procedure stated in § 40-6-113, C.R.S. If no transcript or stipulation is filed, the Commission is bound by the facts set out by the administrative law judge, and the parties cannot challenge these facts. This will limit what the Commission can review if exceptions are filed.

7. If exceptions to this Recommended Decision are filed, they shall not exceed 30 pages in length, unless the Commission for good cause shown permits this limit to be exceeded.

8. Response time to any exceptions shall be shortened to seven days.

9. If BHCG files exceptions, it shall file with its exceptions an updated revenue requirement, updated class cost of service studies, updated GRSA calculations, and corresponding bill impacts for each of its three existing base rate areas. The updates must reflect the decisions made in this Decision.

(S E A L)

ATTEST: A TRUE COPY

Doug Dean

Doug Dean,
Director

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

CONOR F. FARLEY

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Administrative Law Judge