

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO

PROCEEDING NO. 22AL-0426G

IN THE MATTER OF ADVICE LETTER NO. 126 FILED BY ROCKY MOUNTAIN NATURAL GAS LLC DOING BUSINESS AS BLACK HILLS ENERGY TO REVISE ITS COLORADO PUC NO. 4 TARIFF FOR AN INCREASE IN RATES AND TO IMPLEMENT OTHER PROPOSED CHANGES, TO BECOME EFFECTIVE NOVEMBER 7, 2022.

**COMMISSION DECISION DENYING EXCEPTIONS TO
RECOMMENDED DECISION NO. R23-0336 AND
MODIFYING DECISION NO. R23-0336**

Mailed Date: July 12, 2023

Adopted Date: July 5, 2023

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I. BY THE COMMISSION**A. Statement**

1. Through this Decision, the Commission addresses the exceptions filed to Recommended Decision No. R23-0336, issued May 30, 2023, by Administrative Law Judge (ALJ) Alenka Han (Recommended Decision).

2. The Recommended Decision permanently suspends the effective date of the tariff sheets filed by Rocky Mountain Natural Gas LLC, doing business as Black Hills Energy (RMNG or the Company) with Advice Letter No. 126, filed October 7, 2022.

3. The Recommended Decision approves a settlement agreement (Settlement Agreement) entered into by the Company, Staff and A M Gas Transfer Corporation (AM Gas). The Settlement results in an \$8.1 million revenue requirement increase, using an historic test year (HTY) and a year-end rate base.¹ The Recommended Decision also establishes a capital structure with an equity range of 50 to 52 percent and a long-term debt range of 48 to 50 percent.² The Recommended Decision establishes an allowable range for return on equity (ROE) between 9.5 and 9.7 percent and a weighted average cost of capital (WACC) of 6.93 percent.³

4. The Colorado Office of the Utility Consumer Advocate (UCA) filed exceptions seeking to reverse or modify portions of the Recommended Decision on June 8, 2023. Responses were filed by RMNG and Staff on June 15, 2023.

¹ Recommended Decision, ¶ 86.

² Recommended Decision, ¶ 42.

³ Recommended Decision, ¶ 48.

5. After considering the filed exceptions, the responses thereto, and the evidentiary record in this Proceeding, we deny the exceptions filed by UCA. We uphold the Recommended Decision except as modified by this Decision.

B. Background

6. Through Advice Letter 126, filed October 7, 2022, RMNG sought a net annual increase in base rate revenue of some \$12.3 million or 39.1 percent over its current annual base rates.⁴ The Company also proposed a capital structure with an equity component of 52 percent and a return on equity (ROE) of 12.25 percent.

7. On May 19, 2023, the ALJ issued her Recommended Decision. The Recommended Decision largely approves the Settlement Agreement.

8. On June 8, 2023, UCA filed exceptions seeking to reverse or modify portions of the Recommended Decision. On June 15, 2023, responses were filed by Staff and AM Gas.

9. On July 5, 2023, the Commission deliberated at the Commissioners' Weekly Meeting on the exceptions, resulting in this Decision granting, in part, and denying, in part, the filed exceptions. Except as expressly modified by this Decision, the Commission upholds the Recommended Decision.

⁴ Recommended Decision, ¶ 30.

C. Discussion and Findings and Conclusion's**1. Overall****a. UCA's Exceptions**

10. UCA raises five substantive issues related to the Recommend Decision, including (1) 13-month average rate base versus year-end method; (2) capital structure; (3) return on equity ("ROE"); (4) a \$1.1 million disallowance for RMNG's gas gathering assets; and (5) the dollar amount of a "Black Box" deduction for other expenses adjustments. UCA states that four arguments support rejecting the ALJ's findings and conclusions, including that the affordability arguments raised by UCA support rejecting or modifying the ALJ's findings and conclusions, the Recommended Decision leads to an unbalanced approach, settlement agreements are not "above reproach" and can be modified or rejected, and approval of settlement agreements should not be dictated by the number of settling parties.

11. UCA objects to the Settlement Agreement on affordability grounds because it claims that the net base rate revenue increase resulting from the Settled Revenue Requirement and the roll-in of System Safety and Integrity Rider (SSIR) investments of \$8,159,9242 will not result in just and reasonable rates that are in the public interest. UCA argues that the bill increase for on-system shippers will affect end-use customers and that Black Hills Colorado Gas, Inc., recently filed a combined Phase I and II gas rate case which will also increase rates for Black Hills' residential customers. UCA claims that affordability is a theme raised in this Proceeding but that the ALJ stated no conclusion regarding affordability, which UCA claims it is required to do by § 40-6-109(2), C.R.S.

12. Second, UCA claims that 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. and that the Recommended Decision's statement in paragraph 87 conflicts with these statutory directives, leading to an unbalanced approach.

13. Third, UCA disagrees with the ALJ's statement that tossing out settlement agreements reached through compromise and active negotiation can have the chilling effect of disincentivizing parties and utilities from reaching settlements in future proceedings. UCA argues that the Commission has previously rejected settlement agreements in their entirety and otherwise modified by the Commission.

14. Finally, UCA argues that, by inference, the ALJ suggests that because three of the four parties entered into the Settlement Agreement, the default is to approve it. UCA argues that the ALJ accorded too much deference to the Settling Parties positions and made unsupported assumptions that the provisions of the Settlement Agreement must be in the public interest and that they would result in the just and reasonable rates solely because three out of the four parties in the case agreed to settle.

b. Overall Findings and Conclusions

15. Overall, we find that the ALJ's Decision reached a reasonable outcome in this Proceeding. We find that the established rates are just and reasonable and reach an outcome in the public interest.

16. However, we also find that the Recommended Decision's statement in Recommended Decision Para. No. 89 does not fully comport with the Commission's policies on

settlements in adjudicated proceedings. As indicated by Commission Rule 1408(a) of Commission's Rules of Practice and Procedure, 4 Code of Colorado Regulations (CCR) 723-1, the Commission encourages parties to settle issues as appropriate. However, settlement is not encouraged at all costs. The Commission has a prevailing duty to ensure rates are just and reasonable and in the public interest and at times that may require modifying settlement agreements, if appropriate. The Commission routinely modifies or amends settlement agreements as needed to ensure the final outcome is in the public interest and does so without concerns of chilling future settlement efforts. We therefore amend paragraph 89 to the extent it conflicts with the findings provided here.

2. Rate Base Valuation, Capital Structure, and ROE

a. Recommended Decision

17. The Recommended Decision approved a year-end method to calculate RMNG's base rate revenue requirement and annual depreciation as proposed by the Settlement Agreement.⁵ The ALJ found that a year-end method was just and reasonable for several reasons. First, she finds it significant that the revenue requirement was agreed upon by three of the parties to the Proceeding and that approving it is in line with the Commission's position on settlement agreements. Second, she finds that the settled revenue requirement is reasonable because it is based on a methodology previously used by the Commission. Overall, she finds the proposal to use the year-end method to calculate RMNG's base rate revenue requirement and annual depreciation is just and reasonable.⁶

18. The Recommended Decision approves the Settlement Agreement's proposed capital structure of WACC set at 6.93 percent, an equity range of 50 to 52 percent, and an ROE in

⁵ Recommended Decision, ¶ 94.

⁶ UCA Exceptions, p. 20.

the range of 9.5 to 9.7 percent. While the ALJ recognizes that UCA argues these ranges could be lower, the finds that UCA offers little to support its proposed figures beyond the assertion that the proposed capital structure numbers would lower the revenue requirement. The ALJ finds credible testimony in the record that the Company made considerable concessions and agreed to a WACC substantially less than it requested originally. In conjunction with that and the fact that the Settlement Agreement is “forward-looking,” meaning that the company and Staff will work closely together moving forward regarding the capital structure, she finds the capital structure just and reasonable.⁷

b. UCA Exceptions

19. UCA disagrees with the capital structure components agreed to by the Settling Parties and continues to support an ROE of 9.22% and a WACC adjusted for the increased cost of debt of 6.28 percent as provided in UCA’s answer testimony.⁸ UCA recommends the Commission adopt the capital structure of RMNG’s parent, Black Hills Corporation (BHC), which would mean a capital structure of about 42 percent equity and 52 percent debt, which would reduce revenue requirement by about \$1.3 million. Alternatively, UCA recommends using the capital structure approved for the Company in its last rate case which would decrease the revenue requirement by \$500,000. UCA contends that the Commission should approve the capital structure of BHC for RMNG because “BHC allocates both debt and equity to RMNG as it sees fit, the overall capital structure of the holding company should be used as the capital structure of RMNG.”⁹

⁷ Recommended Decision, p. 99.

⁸ UCA Exceptions, p. 18.

⁹ UCA Exceptions, p. 20.

20. Regarding the test year, UCA contends the ALJ erred in finding and concluding that a year-end rate base valuation is just and reasonable, contending that the record and past Commission decisions on rate base methodology support a 13-month average rate base valuation. UCA argues that a 13-month average rate base would decrease the revenue requirement by \$2 million.

21. UCA also argues that the Commission has historically used the 13-month average approach, because it more accurately reflects the matching principle. UCA disputes RMNG's argument that the Commission does authorize a year-end rate base under certain circumstances such as attrition beyond its control and states that the Company's 2018 – 2022 capital additions were fully within its control.¹⁰

c. Responses

22. RMNG rejects UCA's contention that there is substantial evidence in the record to support the use of a 13-month average rate base, arguing that the evidence is simply that one number is lower than the other. Further, the Company maintains the limited construction season for pipeline projects means that most of its capital additions are placed in service at the end of the year and it did in fact make significant investments during the test year ending 31 December 2022, justifying year-end approach. Additionally, RMNG further contends that UCA is incorrect that the matching principle requires use of an average rate base because 97 percent of RMNG's 2022 capital additions are non-revenue producing plant. RMNG also notes that the Commission adopted a year-end rate base in the Company's last rate case in 2017.¹¹

¹⁰ UCA Exceptions, p. 16.

¹¹ RMNG Response to UCA Exceptions, p. 13

23. RMNG also disputes UCA's arguments on ROE and capital structure, noting that prevailing case law and Commission long-standing practice is to adopt a capital structure that supports the utility's operations unless doing so would be prejudicial to ratepayers. RMNG states that since 2014, the Commission has not adopted BHC's capital structure for any of its gas and electric utilities.

24. Additionally, RMNG argues that the final settled ROE was the result of negotiations that included compromises as to test year and rate base valuation. As these issues were negotiated as whole, modification of one of them would effectively destroy the Settlement.

d. Commission Findings and Conclusions

25. We deny UCA's requests on Exceptions regarding the Recommended Decision's conclusions on the proper test year, capital structure, and ROE for RMNG. Each case before the Commission must be determined on the evidentiary record provided, and we see no reason presented by UCA on Exceptions to change the approach determined appropriate by the ALJ regarding the ROE, capital structure, and test year. We find that the Recommended Decision approving the Settlement Agreement results in just and reasonable rates overall.

26. Specifically, as recognized by the ALJ, we find that using the year-end calculation method to calculate the net base rate and annual depreciation as proposed by the Settling Parties to be fair and reasonable. We also find the arguments put forward by RMNG persuasive as to why the year-end methodology is appropriate in this instance, including that it made substantial year-end investments.

27. We also find that the capital structure established by the Recommended Decision is reasonable. A WACC of 6.93 percent is generally consistent with WACC determinations in other

recent Commission rulings and adopted settlements and the WACC was found to be reasonable by the ALJ because it was substantially less than originally requested by RMNG. We see no reason to change this determination.

3. Gas Gathering Plant Additions

a. Recommended Decision

28. In its original filing, RMNG proposed to include \$1.1 million of capital additions it made in gas gathering facilities since its 2017 rate case. Staff, UCA, and AM Gas each originally opposed this request.

29. In the Settlement Agreement, AM Gas, Staff, and RMNG agreed to the inclusion of these costs in rate base, as well as to RMNG studying the options associated with gathering assets for future consideration and to work with Commission Staff on the specific contents of the analysis. RMNG will also analyze options for the future operation of the Rifle Processing Plant and will “reach out” to Public Service Company of Colorado, which jointly owns the plant with RMNG, to discuss “long-terms plans associated with additional investments” at the plant.

30. In addition to approving this term of the Settlement Agreement, the Recommended Decision found specifically that evidence in the record of this proceeding supports RMNG’s actions. The ALJ supports its decision to allow the inclusion of capital additions into rate base for gas gathering facilities by citing images of exposes pipes positioned between hills and testimony that the pipes are at least 50 to 60 years old.¹² The ALJ finds that repair work and work done to bury at grade 60-year-old pipes is reasonable and prudent, particularly in light of the increasing use of Colorado’s backcountry regions.

¹² Recommended Decision, ¶¶ 104-15.

b. UCA Exceptions

31. UCA contends the ALJ erred with respect to \$1.1 million in cost recovery for the burial of two above-ground pipelines for the Keystone Project, a gas gathering project in RMNG's North Gathering System. UCA argues that the project is in a rural, non-high consequence area, that no damage has been reported for the two spans of the project, and that no risks have been identified. Therefore, UCA argues that the ALJ erred in authorizing cost recovery.¹³

32. UCA also argues that a decrease in gas transported through RMNG's gathering facilities is important to prudence determinations, as decreasing throughput could lead lower revenues and higher customer costs. UCA contends that RMNG failed to provide revenue data to support its gas gathering revenues. Further, UCA argues that RMNG failed to provide sufficient proof that ongoing investments in operation and maintenance for its gas gathering system were being prudently and fairly incurred. UCA contends that RMNG did not act prudently when it invested in the Keystone Project in 2020 despite knowing that throughput has declined in that portion of the system.¹⁴

c. Responses

33. RMNG responds to UCA's request on exceptions to disallow cost recovery for the gas gathering assets by characterizing UCA's argument as not based on facts or evidence. RMNG points to testimony from its witnesses that discusses that the integrity initiatives were necessary to address high risk of top-of-ground pipelines and that the projects ranked high on the Company's risk ranking methodology. RMNG also disputes UCA's contention that the gas gathering assets do not support the rest of the Company's system, and argues that the gathering assets are used to

¹³ UCA Exceptions, p. 24.

¹⁴ UCA Exceptions, pp. 25-26.

provide transportation service, so a failure at the Keystone Ranch would have resulted in significant impacts to the Company's ability to serve customers.¹⁵ RMNG also contends that UCA is arguing for a new financial prudence standard, and that in a similar situation in Proceeding No. 22AL-0046G, the Commission rejected similar arguments and allowed another gas utility to continue to include gas gathering assets in base rates.¹⁶

d. Commission Findings and Conclusions

34. We deny UCA's exceptions on this point. We find that the ALJ's Recommended Decision to allow for cost recovery of the costs related to the gas gathering assets to be a well-supported conclusion, justified by the record, and in the public interest. Like the ALJ, we are convinced that these expenditures were just and reasonable and thus should be included in base rates because of evidence in the record, including that these exposed pipelines presented a safety concern and because of the age of the pipe in this instance. We are convinced by the evidence presented by RMNG that this was a known safety risk and that there is a need to maintain the Keystone Ranch pipeline. We therefore uphold the ALJ's decision on this point to approve the Settlement Agreement term and deny UCA's request.

4. Other Disallowances

a. Recommended Decision

35. The Recommended Decision approves a term from the Settlement Agreement that allows for a \$250,000 disallowance for "other expense adjustments settled together."¹⁷ This adjustment represents the settling parties' resolution of differing positions on several RMNG

¹⁵ RMNG Response to UCA Exceptions, pp. 23-24.

¹⁶ RMNG Response to UCA Exceptions, pp. 24-25.

¹⁷ Recommended Decision, ¶ 110.

expense categories, including employee compensation costs related to the equity compensation and long-term incentive plan, the geographic pay differential, and bonus pay, as well as board of directors' expenses, and rate case expenses.¹⁸

36. Instead of addressing each category of expenses separately, the Settling Parties agreed to resolving all these issues with a \$250,000 adjustment to operation and maintenance expenses in the test year used to establish rates. The Settling Parties contend that this sum represents a “just and reasonable resolution of these disputed issues.”¹⁹

37. The ALJ found that a \$250,000 disallowance sum for these expense categories represents a compromise reached by the parties and that this disallowance was just and reasonable.

b. UCA Exceptions

38. In its Exceptions, UCA argues that the disallowance for the employee compensation costs, board of director expenses, and rate case expenses, should be \$400,000 and not \$250,000 as established by the Recommended Decision.²⁰ UCA contends that the record supports its higher figure because increasing the settlement adjustment would promote the public interest. UCA points to its own testimony that supports certain, larger, disallowances, including a larger disallowance for geographic pay differentials and rate case expenses.²¹

c. Responses

39. In response, RMNG contends that UCA’s position is unsupported by any ratemaking principle and that UCA provides no evidence as to why this settled position is not a

¹⁸ Recommended Decision, ¶ 58.

¹⁹ Recommended Decision, ¶ 59.

²⁰ UCA Exceptions, p. 27.

²¹ UCA Exceptions, p. 28.

fair, just, and reasonable compromise of the issues taken together. Furthermore, RMNG cites UCA's witness England's statement that the \$250,000 compensated UCA for the issues it raised in answer testimony, but that "there's still some room to play with this disallowance, should the ALJ see it necessary."²² RMNG argues that UCA does not explain why the \$250,000 figure is not a fair, just, or reasonable compromise of the issues together.

d. Commission Findings and Conclusions

40. We find that the ALJ reached a reasonable conclusion in approving the \$250,000 settlement adjustment proposed by the Settlement Agreement and therefore deny UCA's exceptions on this point.

41. We find that, overall, the arguments presented by parties in this record justify some disallowance for the categories accounted for in the settlement adjustment and that the settled amount of \$250,000 reaches a just and reasonable outcome as proposed. The \$250,000 amount was reached by Settling Parties with varying perspectives and advocacy in this Proceeding. The ALJ's Recommended Decision, including her decision to accept the \$250,000 settlement adjustment is just and reasonable in light of the record as a whole. We are unpersuaded by UCA's arguments that a higher settlement adjustment would result in just and reasonable rates based on the record of this Proceeding, and do anything other than upset the careful balance reached by the Recommended Decision in this Proceeding.

²² RMNG Response to Exceptions, p. 29.

II. ORDER**A. The Commission Orders That:**

1. The exceptions to Recommended Decision No. R23-0336 filed by the Colorado Office of Utility Consumer Advocate on June 8, 2023, are denied, consistent with the discussion above.

2. The tariff sheets filed by RMNG pursuant to Advice Letter No. 126 are permanently suspended.

3. RMNG shall file on not less than two business days' notice to the Commission, modified tariff sheets consistent with the Recommended Decision and this Decision. RMNG shall file the compliance tariff sheets in a separate proceeding and on not less than two business days' notice. The advice letter and tariff sheets shall be filed as a new advice letter proceeding and shall comply with all applicable rules. The effective date of the newly filed tariff sheets shall be July 15, 2023.

4. The 20-day time period provided by § 40-6-114, C.R.S., to file an application for rehearing, reargument, or reconsideration shall begin on the first day after the effective date of this Decision.

5. This Decision is effective upon its Mailed Date.

**B. ADOPTED IN COMMISSIONERS' DELIBERATIONS MEETING
July 5, 2023.**

(S E A L)



ATTEST: A TRUE COPY

A handwritten signature in cursive script that reads "Rebecca E. White".

Rebecca E. White,
Director

THE PUBLIC UTILITIES
COMMISSION
OF THE STATE OF COLORADO

ERIC BLANK

MEGAN M. GILMAN

TOM PLANT

Commissioners