

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO**

PROCEEDING NO. 16AL-0326E

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IN THE MATTER OF ADVICE LETTER NO. 721 FILED BY BLACK HILLS/COLORADO ELECTRIC UTILITY COMPANY, LP TO INCREASE ITS BASE RATES FOR ALL RATE SCHEDULES, IMPLEMENT A GENERAL RATE SCHEDULE ADJUSTMENT, REVISE ITS TRANSMISSION COST ADJUSTMENT TARIFF, AND IMPLEMENT OTHER PROPOSED CHANGES TO ITS COLORADO PUC NO. 9-ELECTRIC TARIFF TO BE EFFECTIVE JUNE 5, 2016.

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**DECISION PERMANENTLY SUSPENDING TARIFF  
SHEETS, ESTABLISHING RATES,  
AND REQUIRING COMPLIANCE FILINGS**

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Mailed Date: December 19, 2016  
Adopted Date: November 30, 2016

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## **I. BY THE COMMISSION**

### **A. Statement**

1. This Decision permanently suspends the effective date of the tariff sheets for rates filed by Black Hills/Colorado Electric Utility Company, LP (Black Hills or Company) under Advice Letter No. 721 on May 3, 2016. We establish new rates that Black Hills may implement for effect on January 1, 2017, based on the extensive record in this Proceeding.

2. As discussed below, we authorize Black Hills to increase its base rate revenues by \$636,267 through the implementation of a General Rate Schedule Adjustment (GRSA) of 2.3552 percent. We also approve an extension of the Clean Air-Clean Jobs (CACJA) Adjustment rider for the purpose of collecting the costs associated with Black Hills' investment in a new LM6000 gas-fired generating unit that replaces the capacity of the W.N. Clark Generating Station coal-fired generation facility retired under the CACJA.

**B. Discussion**

3. On May 3, 2016, Black Hills filed proposed tariffs under Advice Letter No. 721 with tariff sheets and supporting Direct Testimony and Exhibits as a Phase I base rate proceeding as it is known in Colorado. The case primarily addresses Black Hills' revenue requirement, which is the amount of revenue it needs to collect from ratepayers to cover all operating and capital costs incurred to provide service. If the rate case had been filed for additional Commission determinations on how Black Hills' costs should be allocated to various classes of customers and how the Company's rates should be designed for electric utility service, the proceeding would also include a Phase II. Because this case includes only a Phase I but not a Phase II, the Company's proposed increase in base rate revenues is expected to be implemented through a GRSA that increases each component of Black Hills' currently effective base rates proportionately.

4. On May 20, 2016, the Commission set the matter for hearing and suspended, for a period of 120 days, or until October 3, 2016, the effective date of the proposed tariffs filed under Advice Letter No. 721.<sup>1</sup>

5. On June 30, 2016, we granted permissive interventions and established the parties in this Proceeding.<sup>2</sup> The parties include Black Hills; Staff of the Colorado Public Utilities Commission (Staff); the Colorado Office of Consumer Counsel (OCC); the City of Pueblo, Fountain Valley Authority and the Board of Water Works of Pueblo, Colorado, (jointly, Public Intervenors); Pueblo County; LaFarge/Holcim (U.S.) Inc.; and Energy Outreach Colorado (EOC).

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<sup>1</sup> Decision No. C16-0430, issued May 20, 2016, Proceeding No. 16AL-0326E.

<sup>2</sup> Decision No. C16-0608-I, issued June 30, 2016, Proceeding No. 16AL-0326E.

6. On June 30, 2016, pursuant to § 40-6-111(1), C.R.S., we suspended, for an additional 90 days, or until January 1, 2017, the effective date of the proposed tariffs filed under Advice Letter No. 721.<sup>3</sup>

7. On August 16, 2016, we conducted a public comment hearing in Pueblo, Colorado.

8. On August 30, 2016, Staff, the OCC, EOC, Pueblo County, and the City of Pueblo filed Answer Testimony and Exhibits. Staff, the OCC, and EOC filed corrections to certain pre-filed testimony prior to the hearings.

9. On September 27, 2016, Black Hills filed Rebuttal Testimony and Exhibits. The Company filed corrections to certain pre-filed testimony prior to the hearings.

10. On September 27, 2016, EOC filed Cross-Answer Testimony and Exhibits responding to the Answer Testimony filed by Staff and the OCC.

11. We conducted the hearings in this matter from October 18, 2016, through October 24, 2016. Hearing Exhibit Nos. 1 through 42, including confidential and highly confidential versions of pre-filed testimony, as well as Hearing Exhibit Nos. 43 through 48, 50, 53 through 55, and 57 through 74 were offered and admitted into the evidentiary record. Hearing Exhibit Nos. 49 and 56 were marked for identification but not offered into the evidentiary record. Hearing Exhibit Nos. 51 and 52 were admitted into the evidentiary by administrative notice. Hearing Exhibit No. 75 was offered but not admitted into the evidentiary record.

12. On November 4, 2016, post-hearing Statements of Position were filed by Black Hills, Staff, the OCC, EOC, Pueblo County, and the Public Intervenors.

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<sup>3</sup> Decision No. C16-0608-I, issued June 30, 2016, Proceeding No. 16AL-0326E.

13. On November 10, 2016, responsive Statements of Position were filed by Black Hills, Staff, and the OCC.

14. On November 30, 2016, at our Commissioners' Weekly Meeting, we deliberated on Black Hills' rate request and the issues raised in this Proceeding and adopted this Decision.

15. On November 30, 2016, we directed Black Hills and the intervening parties to participate in a Technical Conference to assist us in establishing the approved increase in Black Hills' electric utility base rate revenues, the associated GRSA, and the CACJA Adjustment rider consistent with our deliberations.<sup>4</sup>

16. On December 7, 2016, Black Hills presented at the Technical Conference its cost of service model, updated to reflect the Commission-approved adjustments to the 2015 Test Year as we discussed during our deliberations on November 30, 2016. Black Hills derived the approved increase in electric base rate revenues and the GRSA to be set forth in the Company's tariffs. In addition, Black Hills presented the calculation of the CACJA Adjustment rider revenue requirement and the CACJA Adjustment rider rates consistent with our deliberations. Black Hills also presented information on the bill impacts associated with the approved rate increases.

## **C. Prehearing Motions**

### **1. Motion *in Limine***

17. On September 22, 2016, Black Hills filed a Motion *in Limine* to exclude testimony from Staff witness Fiona Sigalla. The motion asks the Commission to reject Staff's request to reserve its right to modify Ms. Sigalla's Answer Testimony to include additional recommendations about the treatment of certain pension expenses resulting from Black Hills'

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<sup>4</sup> Decision No. C16-1093-I, issued November 30, 2016, Proceeding No. 16AL-0326E.

acquisition of Aquila in 2008. Black Hills asserts that it will be harmed by any additional Answer Testimony filed by Staff because Black Hills will not have sufficient time to investigate, analyze, and rebut the testimony before hearing.

18. Staff has not filed any additional testimony since its filing deadline of August 30, 2016, nor has it moved for permission to file additional testimony. Staff opposes the motion, arguing that it: (1) is procedurally unfounded and untimely; and (2) improperly seeks to limit Staff's right to modify its recommendations.

19. We deny the Motion *in Limine* because Staff has not asked to supplement its testimony with additional evidence, and Staff is permitted to change its recommendation in its Statement of Position (SOP) if new or different evidence is presented in Rebuttal Testimony or during hearing.

## **2. Motion to Strike**

20. On October 4, 2016, Black Hills filed a Motion to Strike approximately 1,100 pages of attachments to Staff witness Fiona Sigalla's Answer Testimony. According to Black Hills, these attachments are irrelevant, lack proper foundation, and/or their probative value is outweighed by the potential to confuse the issues in this Proceeding or waste Commission and party resources.

21. There are four categories of attachments that Black Hills seeks to strike: (1) workpapers related to Staff's recommendations on the Company's authorized return on equity (ROE); (2) publicly available financial information about Black Hills Corporation (BHC); (3) publicly available reports about economic and budget outlooks; and (4) articles from Natural Gas Intelligence about BHC's natural gas operations.

22. Staff subsequently withdrew approximately 300 pages of attachments, leaving 800 pages that Black Hills seeks to strike. Staff argues that the attachments should be admitted because they are relevant to the issues presented in this rate case and because they contain information useful to the Commission and the parties in evaluating Ms. Sigalla's testimony.

23. At hearing, we allowed Staff to lay additional foundation for Attachment FDS-61, titled "Sigalla ROE Workpaper."

24. We deny Black Hills' Motion to Strike because Black Hills' concerns with Staff's attachments go to the weight that the Commission will give the evidence, not to its admissibility. Additionally, we find that the attachments, as modified, are relevant to the issues presented in this case, and they help the Commission and the parties understand and evaluate Ms. Sigalla's testimony.

**D. Black Hills' Rate Request**

25. Black Hills seeks a net increase in its revenues of approximately \$8.5 million dollars. The Company proposes to collect this increase in revenues through an increase in its GRSA. The increased GRSA also would collect revenues now recovered through the CACJA Adjustment rider as well as the revenues recovered through the Transmission Cost Adjustment (TCA) and the Purchased Capacity Cost Adjustment (PCCA). The proposed "combined" GRSA would cause a proportional increase in base rates of 12.72 percent, for an overall revenue increase of 5 percent and an increase of about 5 percent in the average residential customer's bills. The effective date of the proposed GRSA is January 1, 2017.

26. Black Hills explains that the proposed rate increase is driven primarily by the Company's investment in a new LM6000 gas-fired generating unit scheduled to go into service



by the end of this year. The LM6000 replaces the capacity of the W.N. Clark Generating Station that was retired under the CACJA.

27. As described below, the technical foundation of the Black Hills' rate request is a cost of service study based on the Company's Federal Energy Regulatory Commission account balances for the 2015 Test Year from January 1, 2015 through December 31, 2015. The 2015 Test Year is subject to several *pro forma* adjustments, including the addition of the LM6000 investment costs into Black Hills' rate base.

28. Black Hills states that, in recognition of the potential impacts to customers resulting from this proceeding, the Company made certain decisions to mitigate the rate increase requested, including: (1) requesting the same ROE as approved in the last case, or 9.83 percent; (2) requesting a close to 50 percent equity capital structure notwithstanding the Company's actual equity component of about 52 percent at the end of the 2015 Test Year; (3) bringing forward an imputation of merger synergy savings from BHC's acquisition of the SourceGas companies of \$1.7 million as a revenue requirement reduction; (4) not including contracted contingency costs associated with the LM6000 as part of the investment of that facility included in rate base; (5) imputing revenue associated with customer growth during part of 2015 to the full year through a customer annualization adjustment; and (6) extending the requested amortization of W.N. Clark from two years to four years.<sup>5</sup>

29. As discussed in detail below, Staff, the OCC, Pueblo County, and the Public Intervenors argued against Black Hills' proposed rate increase and challenged many of the proposed adjustments to the Company's 2015 Test Year cost of service study.

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<sup>5</sup> Hearing Exhibit 3, Stoffel Direct, p. 4.

The combination of the proposed changes to the cost of service study advanced by Staff and the OCC would, if adopted by the Commission, cause rates to decrease from current levels notwithstanding the addition of the LM6000 to the Company's rate base. The most significant factor reducing the revenue requirement for Black Hills is the rate of return applied to rate base calculated as the Company's weighted average cost of capital (WACC). Black Hills proposes 7.56 percent as the WACC to be adopted in this Proceeding, a return that is one basis point higher than its currently authorized WACC of 7.55 percent.

30. Staff recommends that Black Hills' authorized ROE be set in a range between 8.20 percent and 9.27 percent, with 8.84 percent used in the cost of service study for determining the revenue requirement. Staff recommends a 43.98 percent equity capital structure and a cost of long-term debt of 4.88 percent, which, when combined with the 8.84 percent ROE, results in a WACC of 6.62 percent. Similarly, the OCC recommends the authorized ROE be set in a range between 8.7 percent and 9.1 percent. These values result in a WACC in the range of 6.74 percent and 6.91 percent when the recommended values for ROE are joined with the OCC's recommendations for a 44 percent equity capital structure and a cost of long-term debt of 5.20 percent.

31. In addition to their recommendations that the Commission adopt a much lower WACC than proposed by Black Hills, Staff and OCC take issue with several of the *pro forma* adjustments made to the Company's 2015 Test Year cost of service. Elimination of or modification to these adjustments would cause further reductions in the Company's revenue requirements. Black Hills estimates that, if adopted by the Commission,

Staff's recommendations would result in a rate decrease with a revenue reduction of at least \$3.6 million.<sup>6</sup>

32. Black Hills counters that the intervening parties' suggestions to the Commission to order a decrease in rates as a consequence of building the LM6000 is contrary to previous Commission decisions approving Black Hills' emission reduction plan pursuant to the CACJA and approving the LM6000; contrary to the *Bluefield* and *Hope* decisions, and Colorado case law ratemaking standards; and contrary to the General Assembly's directives regarding CACJA investments.<sup>7</sup>

#### **E. Public Comment Hearing**

33. Black Hills provides electric service to approximately 95,000 customers in southeastern Colorado. The largest communities served by the Company are City of Pueblo, portions of PuebloWest, Cañon City, and Rocky Ford.

34. We conducted a public comment hearing on Black Hills' rate request in Pueblo on August 16, 2016. Local public officials and Black Hills' customers shared their concerns about the level of the Company's existing rates and its proposals in this Proceeding that would cause a potential increase in bills of around 5 percent for residential customers.

35. There were numerous calls on the Commission to disallow any rate increase. Several commenters addressed what they perceived to be harm to the local business sector and the area's prospects for economic development as a result of Black Hills' rates and service practices. Certain others requested that the costs at issue in this case, and the costs of the new LM6000 in particular, be borne by the Company's shareholders rather than ratepayers.

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<sup>6</sup> Hearing Exhibit No. 4, Stoffel Rebuttal, p. 5.

<sup>7</sup> Black Hills Reply SOP, p. 4.

Some questioned the motives behind the construction of the LM6000 and disputed its need apart from the CACJA.

36. In addition, several grievances were expressed about deposit requirements, disconnection and reconnection policies, and collection practices. Black Hills' demand charge for commercial and industrial rates was another item of contention.

37. Rule 1509(a) of the Commission's Rules of Practice and Procedure 4 *Code of Colorado Regulations* (CCR) 723-1 explains that public comments are not considered evidence in a proceeding but rather "provide a means for interested persons to encourage the Commission in the exercise of discretion."

#### **F. Summary of Findings and Conclusions**

38. Our task in this Proceeding is to establish rates to recover Black Hills' revenue requirements as determined using a cost of service study based on the Company's 2015 Test Year. The revenue requirement we approve represents the total revenues required by the Company to cover both its expenses and to have a fair or reasonable opportunity to earn a fair rate of return. The revenue requirement must be sufficient to ensure safe and reliable service to Black Hills' customers. The rate of return must allow Black Hills to secure adequate financing at a reasonable cost.

39. We have carefully reviewed the evidentiary record in this Proceeding, mindful of the numerous public comments submitted in writing and offered orally at the public comment hearing in Pueblo, Colorado. Based on this review, our consideration of the closing SOPs filed by Black Hills and the intervening parties, and our deliberations on November 30, 2016, we determine the change in Black Hills' rates upon the commercial operation of the new LM6000.

40. The base rate increase we approve by this Decision is the result of a reasonable decrease of 13 basis points in the rate of return to be applied to the 2015 Test Year rate base, lowering the 7.56 percent WACC proposed by the Company to 7.43 percent. The increase in base rate revenues is also the product of the modifications we direct the Company to make to the proposed *pro forma* adjustments to its 2015 Test Year cost of service study. Our decisions on these items for investment costs, expenses, and revenues reduce the rate increase from the level requested by the Company in its May 3, 2016 advice letter filing.

41. With respect to the investment costs of the new LM6000, we permit Black Hills to fully recover its investment costs using the CAJCA Adjustment rider consistent with the associated statutes. We mitigate the rate impact of the introduction of the plant to the Black Hills' generation fleet by using the specific financing used by the Company during the plant's construction to establish a specific rate of return on this particular investment during its first few years of operation.

## **G. Legal Foundation and Burdens of Proof**

### **1. Commission Jurisdiction**

42. Rates and charges for utility service are to be just and reasonable pursuant to § 40-3-101(1), C.R.S. Further, § 40-3-101(2), C.R.S., requires a utility to furnish, to provide, and to maintain such service, instrumentalities, equipment, and facilities as shall promote the safety, health, comfort, and convenience of its patrons, employees, and the public, and as shall in all respects be adequate, efficient, just, and reasonable. *See also*, § 40-3-111, C.R.S.

43. The Commission is the agency charged with the duty of regulating the rates of public utilities within Colorado. § 40-3-102, C.R.S. *See also*, Colo. Const. Art. XXV. The Commission is authorized by statute to conduct hearings to investigate the propriety of

proposed rate changes and to make such orders with regard to a proposed rate as may be just and reasonable.<sup>8</sup>

44. The establishment of just and reasonable rates involves a balancing of investor and consumer interests.<sup>9</sup> As regards the utility, to be just and reasonable, rates must generate revenues sufficient to meet the utility's cost of furnishing services, and provide its investors with a fair and reasonable return on their investments.<sup>10</sup> The Commission must ensure that the utility has adequate revenues for operating expenses and to cover the capital costs of doing business.<sup>11</sup> The revenues must be sufficient to assure confidence in the financial integrity of the utility, in order to maintain its credit and attract capital.<sup>12</sup> As regards ratepayers, the Commission is charged with protecting the interest of the general public from excessive, burdensome rates.<sup>13</sup> The Commission must determine that every rate is just and reasonable and that services provided "promote the safety, health, comfort and convenience of its patrons, employees, and the public, and as shall in all respects be adequate, efficient, just and reasonable."<sup>14</sup>

45. The Commission must consequently set rates that protect the right of a utility and its investors to earn a return reasonably sufficient to maintain the utility's financial integrity, and

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<sup>8</sup> See generally, *Public Service Company of Colorado v. Pub. Utils. Comm'n.* 644 P.2d 933, 938 (1982); *Colorado Ute Electric Association v. Pub. Utils. Comm'n.*, 602 P.2d 861 (1979); *Denver Welfare Rights v. Pub. Utils. Comm'n.*, 547 P.2d 239 (1976); *Consolidated Freightways Corp. v. Pub. Utils. Comm'n.*, 406 P.2d 83 (1965).

<sup>9</sup> *Public Service Company of Colorado v. Pub. Utils. Comm'n.* 644 P.2d at 939.

<sup>10</sup> *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Bluefield Water Works and Improvement Co. v. Public Service Company*, 262 U.S. 679 (1923). See also, *Peoples Natural Gas Div. of N. Natural Gas Co. v. Pub. Utils. Comm'n.*, 567 P.2d 377 (Colo. 1977).

<sup>11</sup> *Public Utilities Commission v. District Court*, 527 P.2d 233 (Colo. 1974).

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

that protect the right of consumers to pay a rate that accurately reflects the cost of service rendered.<sup>15</sup>

46. The setting of just and reasonable rates goes to the very essence of the Commission's constitutional and statutory authority and duty under public utilities law.<sup>16</sup> "It is precisely the Commission's *raison d'être* to determine and prescribe just, reasonable, non-discriminatory, and non-preferential 'rates of every public utility in this state.' Both statutory and case law demonstrate that rate-making, both as to charge and design, is a vital part of the Commission's area of responsibility."<sup>17</sup>

47. The Commission must exercise reasoned judgment in setting rates.<sup>18</sup> Ratemaking is a legislative function<sup>19</sup> and not an exact science.<sup>20</sup> As a consequence, 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."<sup>21</sup> Under the just and reasonable standard, the Commission has the primary responsibility for balancing "the investors' interest in avoiding confiscation and the consumer's interest in prevention of exorbitant rates"<sup>22</sup> and for setting 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

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<sup>15</sup> *Id.*

<sup>16</sup> *Colorado-Ute Electric Association v. Pub. Utils. Comm'n*, 760 P.2d 627, 638 (Colo. 1988).

<sup>17</sup> *Id.* (quoting § 40-3-102, C.R.S.).

<sup>18</sup> *See Mountain States Tel. & Tel. Co. v. Pub. Utils. Comm'n*, 513 P.2d 721, 726 (Colo. 1973).

<sup>19</sup> *City and County of Denver v Pub. Utils. Comm'n*, 226 P.2d 1105 (Colo. 1954).

<sup>20</sup> *Pub. Utils. Comm'n. v. Northwest Water Corporation*, 551 P.2d 266 (Colo. 1963); *see also Colo. Office of Consumer Counsel v. Pub. Utils. Comm'n*, 752 P.2d 1049, 1058-59 (Colo. 1988); *Montrose v. Pub. Utils. Comm'n*, 629 P.2d 619, 623 (Colo. 1981); *Colorado Ute Elec. Ass'n*, 602 P.2d at 864; *Public Util. Comm'n. v. Northwest Water Corp.*, 451 P.2d 266 (Colo. 1969).

<sup>21</sup> *Colorado Office of Consumer Counsel v. Pub. Utils. Comm'n*, 275 P.3d 656, 660 (Colo. 2012); *see also Colorado Municipal League v. Pub. Utils. Comm'n*, 473 P.2d 960, 971 (Colo. 1970).

<sup>22</sup> *Colorado Municipal League v. Public Utilities Commission*, 687 P.2d 416, 418 (Colo. 1984).

to pay a rate which accurately reflects the cost of service rendered.<sup>23</sup> The utility's right to earn a reasonable return incorporates the principle that the Commission-authorized rate of return is not a guaranteed return, but instead, is a return that the utility has a reasonable opportunity to realize.

48. In the context of ratemaking, the Colorado Supreme Court recently reiterated that “it is the result reached, not the method employed, which determines whether a rate is just and reasonable.”<sup>24</sup>

49. The Commission establishes rates to recover the utility's revenue requirements as determined by using the Commission-selected test year. The revenue requirement is the total revenues required by the utility to cover both its expenses and to have a fair or reasonable opportunity to earn a fair rate of return, and in return, to provide safe, reliable service to its customers.<sup>25</sup>

50. In past rate cases and as discussed below, the Commission has established regulatory principles and methods to determine a utility's revenue requirement. 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 PUC unless they are inherently unsound.”<sup>26</sup> Indeed, “the [PUC] 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.”<sup>27</sup>

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<sup>23</sup> *Public Service Company of Colorado v. Public Utilities Commission*, 644 P.2d 933, 939 (Colo. 1982).

<sup>24</sup> *Glustrom v. Colorado Public Utilities Commission*, 280 P.3d 662, 669 (Colo. 2012).

<sup>25</sup> e.g., *Public Service Company of Colorado v. Pub. Utils. Comm'n.*, 644 P.2d 933 at 939.

<sup>26</sup> *CF&I Steel, L.P. v. Pub. Utils. Comm'n.*, 949 P.2d 577, 584 (Colo. 1997).

<sup>27</sup> *CF&I Steel*, 949 P.2d at 584. *Glustrom*, 280 P.3d at 669.



## 2. Burden of Proof and Burden of Going Forward

51. As the party that seeks Commission approval or authorization, Black Hills bears the burden of proof with respect to the relief sought; and the burden of proof is by a preponderance of the evidence.<sup>28</sup> The evidence must be “substantial evidence,” which the Colorado Supreme Court has 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.”<sup>29</sup> The preponderance standard requires the finder of fact to determine whether the existence of a contested fact is more probable than its non-existence.<sup>30</sup> A party has met this burden of proof when the evidence, on the whole and however slightly, tips in favor of that party.

52. This standard for the burden of proof must be integrated with the understanding that in the context of a rate case, the Commission acts in its legislative capacity, and the key issues require policy-based decisions in order to adopt a particular regulatory principle or to change an existing regulatory principle. As such, 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.”<sup>31</sup>

53. Because the Commission has an independent duty to determine matters that are within the public interest,<sup>32</sup> the Commission is not bound by the proposals of the parties. The Commission may do what it deems necessary to assure that the final result is just,

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<sup>28</sup> § 24-4-107(7), C.R.S.; § 13-25-127(1), C.R.S.; 4 CCR 723-1-1500.

<sup>29</sup> *City of Boulder v. Colorado Public Utilities Commission*, 996 P.2d 1270, 1278 (Colo. 2000) (quoting *CF&I Steel, L.P. v. Public Utilities Commission*, 949 P.2d 577, 585 (Colo. 1997)).

<sup>30</sup> *Swain v. Colorado Department of Revenue*, 717 P.2d 507 (Colo. App. 1985).

<sup>31</sup> *Colorado Office of Consumer Counsel*, 275 P.3d at 660.

<sup>32</sup> *Caldwell v. Pub. Utils. Comm’n.*, 692 P.2d 1085, 1089 (Colo. 1984).

reasonable, and in the public interest, provided the record supports the result, and provided the reasons for the policy choices made are stated.<sup>33</sup>

## **H. Cost of Capital**

### **1. Authorized Return on Equity (ROE)**

54. Black Hills requests that the Commission reauthorize its existing ROE of 9.83 percent as approved in the Company's most recent electric Phase I rate case.<sup>34</sup> Black Hills argues that an ROE of 9.83 percent represents a reasonable compromise between balancing the rate impacts on its customers and the need to provide Black Hills with an opportunity to earn a return that is adequate to compensate its investors, maintain financial integrity, and attract capital.<sup>35</sup> Black Hills further concurs with Staff's observation that the Company has not earned its authorized ROE in any year since the Aquila acquisition in 2008, including the recent years where rates were based on the proposed ROE.<sup>36</sup>

55. Black Hills argues that its proposed ROE of 9.83 percent is conservative, because it falls at the low end of the range recommended by its witness Adrien McKenzie, which extends from 9.7 percent to 10.7 percent.<sup>37</sup> Mr. McKenzie's range was determined using several analyses, including discounted cash flow (DCF) models, variations of the Capital Asset Pricing

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<sup>33</sup> See *Colo. Office of Consumer Counsel*, 275 P.3d at 660-61; *Pub. Serv. Co. v. Pub. Utils. Comm'n.*, 26 P.3d 1198, 1207-08 (Colo. 2001) (holding that the Commission acted reasonably in its legislative capacity to accomplish its ratemaking function when it required Public service to include a merger savings adjustment to benefit ratepayers because there was sufficient support in the record); *CF&I Steel, L.P.*, 949 P.2d at 586-87; *Colo. Office of Consumer Counsel v. Pub. Utils. Comm'n.*, 786 P.2d 1086, 1095-97 (Colo. 1990) (holding that the Commission did not act arbitrary or capriciously in setting rates, even though it did not accept any of the experts' opinions in full); *Pub. Serv. Co. v. Pub. Utils. Comm'n.*, 653 P.2d 1117, 1120 (Colo. 1982) (holding that the Commission did not abuse its discretion when it chose not to include out-of-test year debt cost because the decision was reasonable and based on the record).

<sup>34</sup> Decision Nos. R14-1298 and C14-1504, issued October 28, 2014 and December 22, 2014, respectively, Proceeding No. 14AL-0393E.

<sup>35</sup> Black Hills SOP, pp. 15-16.

<sup>36</sup> Hearing Exhibit 4, Stoffel Rebuttal, pp. 5 and 13.

<sup>37</sup> Hearing Exhibit 8, McKenzie Direct, pp. 4-8.

Model (CAPM), a risk premium analysis, and an expected earnings method which referenced the rates of return available from alternative investments of comparable risk. These analyses generally all used a proxy group of 16 electric utilities that he determined had comparable levels of risk to the Company. Black Hills therefore argues that its request for an authorized ROE of 9.83 percent is consistent with the *Hope* and *Bluefield* decisions.<sup>38</sup>

56. Referencing the 9.5 percent ROE recently authorized by the Commission for the gas operations of Public Service Company of Colorado (Public Service),<sup>39</sup> Black Hills states that it is commonly accepted that the ROEs of electric utilities are higher than those assigned to gas utilities due to the greater risk of electric operations.<sup>40</sup> Black Hills also notes that a return above 9.5 percent is warranted, because BHC's credit ratings are lower than those for both Public Service and its parent Xcel Energy Inc.<sup>41</sup>

57. Staff objects to maintaining Black Hills' existing ROE and recommends that the Commission establish the Company's authorized rate in a range between 8.20 percent and 9.27 percent. Staff recommends that the Commission direct Black Hills to use an ROE of 8.84 percent for determining the revenue requirement in this Proceeding.<sup>42</sup> Staff argues that, if adopted by the Commission, its ROE recommendations will not jeopardize the financial integrity of BHC, noting its share price has nearly doubled over the past five years with increasing dividends per share.<sup>43</sup>

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<sup>38</sup> *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679 (1923) (*Bluefield*). *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) (*Hope*).

<sup>39</sup> Decision Nos. R15-1204 and C16-0123, issued November 16, 2015 and February 16, 2016, respectively, Proceeding No. 15AL-0135G.

<sup>40</sup> Hearing Exhibit 9, McKenzie Rebuttal, p. 26. Hearing Exhibit 37, Fernandez Answer, p. 42.

<sup>41</sup> Hearing Exhibit No. 8, McKenzie Direct, p. 9.

<sup>42</sup> Staff SOP, p. 11.

<sup>43</sup> Hearing Exhibit 28, Sigalla Answer, p. 70.

58. Staff completed some of the same types of analyses as Black Hills, including DCF models. Staff also used data for a subset of the Company's 16 proxy group utilities, challenging the inclusion of certain companies due to pending acquisitions or business composition. However, certain aspects of Staff's DCF analyses differ significantly from Black Hills' models, particularly with respect to projected growth rates. In its single-stage DCF analysis, Staff derives the growth rate from a survey of security analysts' estimates of five-year growth in earnings per share.<sup>44</sup> In its Multi-Stage DCF analysis, Staff uses the forecasted long-term GDP growth rate of the Congressional Budget Office.<sup>45</sup>

59. Notably, Staff did not use the results of the DCF models to derive its recommendation for the ROE of 8.84 percent. That figure instead derives from a calculation that adds the current 30-Year Treasury rate of 2.41 percent (determined over a period of four months) to the 6.43 percent spread between Black Hills' approved ROE from its 2010 rate case and the Treasury rate at that time.<sup>46</sup> (Staff notes that Black Hills' first rate case in Colorado was in 2010, Proceeding No. 10AL-008E.)

60. The OCC recommends that the Commission establish an authorized ROE within a "zone of reasonableness" of 8.7 percent to 9.1 percent.<sup>47</sup> The OCC's recommendation is based on its DCF and CAPM analyses as well as an examination of recently authorized returns and risk premiums.

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<sup>44</sup> Hearing Exhibit 28, Sigalla Answer, p. 53.

<sup>45</sup> Hearing Exhibit 28, Sigalla Answer, pp. 58-59.

<sup>46</sup> Hearing Exhibit 28, Sigalla Answer, p. 68.

<sup>47</sup> OCC SOP, p. 10.

61. The OCC alleges that Black Hills' modeling techniques artificially increase the Company's ROE results.<sup>48</sup> For example, in regard to Black Hills' Single-Stage DCF model, the OCC charges that Black Hills inappropriately removed a number of results that it deemed were too low and therefore "illogical."<sup>49</sup> With respect to the Multi-Stage DCF, the OCC points out that, compared to the method used from Black Hills' prior rate case, terminal values were changed, a different inflation assumption was used, and some results were selectively eliminated.<sup>50</sup>

62. In response, Black Hills characterizes the recommendations of both Staff and the OCC as "extreme" and "out of the mainstream."<sup>51</sup> Black Hills asserts that if a nearly 100 basis point decrease in ROE were to be approved by the Commission, the reduction of such magnitude would have serious consequences for Black Hills in the investment community.<sup>52</sup>

63. Black Hills also argues that the results of the ROE analyses of Staff and the OCC are far out of line with the national average ROE of 9.81 percent for vertically integrated utilities in the last 24 months as well as with the average for the first 6 months of 2016 of 9.66 percent.<sup>53</sup> Black Hills further alleges that Staff's recommended ROE of 8.84 percent is based on an illegitimate estimation technique.<sup>54</sup> Specifically, Black Hills argues that matching the spread derived from the Company's 2010 rate case with more current Treasury rates improperly mixes two time periods that have very different economic characteristics.

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<sup>48</sup> Hearing Exhibit 37, Fernandez Answer, p. 31.

<sup>49</sup> Hearing Exhibit 37, Fernandez Answer, p. 27.

<sup>50</sup> Hearing Exhibit 37, Fernandez Answer, p. 31.

<sup>51</sup> Hearing Exhibit 9, McKenzie Rebuttal, p. 1.

<sup>52</sup> Hearing Exhibit 9, McKenzie Rebuttal, p. 6.

<sup>53</sup> Hearing Exhibit 9, McKenzie Rebuttal, Attachment AMM-12.

<sup>54</sup> Hearing Exhibit 9, McKenzie Rebuttal, p. 26.

64. The ROE analyses provided by the parties have relevance to our decision on the range for the authorized ROE and the specific point within that range that will be used to establish the Company's revenue requirement. It is the prerogative of the Commission to establish a range based on the full body of facts and evidence in the record in this case, which is not limited solely to the results produced by any one ROE analysis.<sup>55</sup> We also recognize that the accepted methods available for establishing an ROE for a regulated utility are imperfect, and it is evident in this Proceeding that the methods used by the parties are subject to legitimate criticisms.<sup>56</sup>

65. We conclude that the authorized ROE for Black Hills will be established within the range from 9.0 percent to 10.0 percent.<sup>57</sup> We agree with Black Hills that rates below 9.0 percent are not reasonable for the Company and should be disregarded. The decreases in the authorized ROEs advocated by Staff and the OCC are unprecedented and unsound and will not be adopted here. Returns in excess of 10.0 percent also are excessive based on the record here. Authorized ROEs for vertically integrated utilities are trending downward due to historically low Treasury rates and the low risk profile of the utility sector.<sup>58</sup>

66. Because our authorized range from 9.0 percent to 10.0 percent is based on the financial analyses of other electric utilities, it satisfies the reasonableness standards in *Hope* and *Bluefield*, particularly since the analyses are based on financial measures for other

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<sup>55</sup> See, e.g., *Colo. Office of Consumer Counsel*, 275 P.3d at 660-61.

<sup>56</sup> See, *Colo. Municipal League v. Pub. Utils. Comm'n.*, at 971 (“[t]he commission, in addition to the consideration of arithmetic figures and algebraic equations, must evaluate the effect of a large number of factors. This evaluation flows as a stream bounded on each side by the limits of discretion.”).

<sup>57</sup> Commissioner Frances A. Koncilja does not join in these findings and conclusions.

<sup>58</sup> Hearing Exhibit 28, Sigalla Answer, p. 4.

financially-sound electric utilities that have similar or comparable risks.<sup>59</sup> Furthermore, the range includes the 9.83 percent that the Company claims to be sufficient to ensure investor confidence in BHC's integrity and to maintain and to support the utility's credit.

67. We approve an ROE of 9.37 percent for purposes of determining the Black Hills' revenue requirement in this Proceeding. This figure is supported by our examination of the results of certain Multi-Stage DCF analyses which have been favored in recent Commission decisions.<sup>60</sup> While the 50 basis point reduction is significant, it is not unprecedented.<sup>61</sup> We find that an ROE of 9.37 percent is reasonable for establishing rates in this Proceeding, since it allows for measured reduction in the Company's weighted average cost of capital given the other considerations regarding the cost of debt and the capital structure that are discussed below.

## 2. Cost of Debt

68. In its last Phase I rate case, the Commission approved 5.29 percent as the cost of the Company's long-term debt.<sup>62</sup> The 5.29 percent figure is also the actual cost of debt for the Company's 2015 Test Year.<sup>63</sup>

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<sup>59</sup> *Hope Natural Gas Co.*, 320 U.S. at 605 ("Rates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid, even though they might produce only a meager return on the so-called 'fair value' rate base."); *Bluefield Water Works & Improvement Co.*, 262 U.S. at 690 ("Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service are unjust, unreasonable and confiscatory.").

<sup>60</sup> See *Mountain States Tel. & Tel. Co.*, 513 P.2d at 727; see also Decision Nos. R13-1307 and C13-1568, issued October 22, 2013 and December 23, 2013, respectively, Proceeding No. 12AL-1268G; Decision Nos. R14-1298 and C14-1504, issued October 28, 2014 and December 22, 2014, respectively, Proceeding No. 14AL-0393E; and Decision Nos. R15-1204 and C16-0123, issued November 16, 2015 and February 16, 2016, respectively, Proceeding No. 15AL-0135G.

<sup>61</sup> Decision No. C11-1373, issued December 22, 2011, Proceeding No. 11AL-387E. Decision No. C12-0494, issued May 9, 2012, Proceeding No. 11AL-947E.

<sup>62</sup> Decision Nos. R14-1298 and C14-1504, issued October 28, 2014 and December 22, 2014, respectively, Proceeding No. 14AL-0393E.

<sup>63</sup> Hearing Exhibit 6, Nooney Direct, p.10.

69. Black Hills requests, however, that the Commission adjust the cost of debt in the cost of service downward to 5.20 percent.<sup>64</sup> The lower amount reflects the addition of \$40 million of additional debt to the Company's capital structure at cost of 4.40 percent.<sup>65</sup>

70. Staff opposes Black Hills' proposed cost of long-term debt of 5.20 percent, arguing that the Company has not realized sufficient benefit from today's low interest rates. Staff recommends that the Commission instead adopt a cost of debt of 4.88 percent, which is based on pricing the \$40 million additional debt at 1.275 percent (the short-term Corporate Term Loan rate paid by BHC that was subsequently refinanced on August 9, 2016) instead of 4.4 percent.<sup>66</sup>

71. In response, Black Hills states that it would be inappropriate to use the 1.275 percent rate. Black Hills explains that the 1.275 rate was what BHC had paid on a short-term Corporate Term Loan that was subsequently refinanced on August 9, 2016.<sup>67</sup> Black Hills also argues it is not appropriate to price the financing of long-term utility assets based on short-term borrowing rates, because short-term rates are subject to interest rate fluctuations.<sup>68</sup>

72. We conclude that it is reasonable to use 5.29 percent as the cost of Black Hills' long-term debt in the determination of the rate of return to be applied to its 2015 Test Year rate base.<sup>6970</sup> The 5.29 percent rate is the combination of \$200 million in senior unsecured notes due

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<sup>64</sup> Black Hills SOP, p. 12.

<sup>65</sup> Hearing Exhibit 6, Nooney Direct, p. 11.

<sup>66</sup> Hearing Exhibit 28, Sigalla Answer, p. 30.

<sup>67</sup> Hearing Exhibit 7, Nooney Rebuttal, p. 19.

<sup>68</sup> Hearing Exhibit 7, Nooney Rebuttal, p. 19.

<sup>69</sup> *Colorado Municipal League*, 473 P.2d at 971.

<sup>70</sup> Commissioner Frances A. Koncilja does not join in these findings and conclusions.



in 2020 with an all-in cost of 5.96 percent and \$150 million of senior unsecured notes with an all-in cost of 4.40 percent.<sup>71</sup>

### 3. Capital Structure

73. Black Hills proposes a *pro forma* capital structure of 50.92 percent equity to 49.08 percent debt, which the Company claims will be a close representation of the Company's actual capital structure on December 31, 2016.<sup>72</sup> Specifically, Black Hills proposes to adjust the Company's actual capital structure at the end of the 2015 Test Year to reflect an infusion of approximately \$19.4 million of equity and the assignment of approximately \$40 million in debt from BHC. Black Hills states that it generally targets an equity-to-capitalization level of approximately 50 percent to 52 percent to support BHC's credit ratings.<sup>73</sup>

74. Staff recommends that the Commission instead establish a capital structure for the Company's cost of service study of 43.98 percent equity and 56.02 percent debt, which is the capital structure of BHC as of December 31, 2015.<sup>74</sup> Staff acknowledges that the Colorado Supreme Court ruled in its *Peoples* Decision<sup>75</sup> that the capital structure of the operating utility (here, Black Hills) should be used.<sup>76</sup> However, Staff argues that the Company's ratepayers are prejudiced by Black Hills' actual capital structure because the requested equity component would be higher than its parent's capital structure.<sup>77</sup>

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<sup>71</sup> Hearing Exhibit 11. Clevinger Rebuttal, Attachment MCC-5, Schedule G-1.

<sup>72</sup> Black Hills SOP, p. 6.

<sup>73</sup> Hearing Exhibit 6, Nooney Direct, p. 6.

<sup>74</sup> Staff SOP, p. 9.

<sup>75</sup> *Peoples Natural Gas*, 567 P.2d at 379.

<sup>76</sup> Hearing Exhibit No. 28, Sigalla Answer, pp. 34 and 35.

<sup>77</sup> Hearing Exhibit No. 28, Sigalla Answer, p. 40.

75. Staff concedes that BHC's capital structure has changed markedly in the last few years due to an increase in leverage caused in part by the SourceGas acquisition, in addition to the effects of non-regulated subsidiaries.<sup>78</sup> Staff also expresses concern about BHC's high debt level because it could cause the capital markets to perceive higher financial risk. Nevertheless, Staff argues that the Company could maintain a lower percentage of equity without negatively impacting the perception of investors.<sup>79</sup>

76. The OCC also opposes Black Hills' proposed capital structure, and, like Staff, recommends using BHC's actual capital structure at the end of 2015.<sup>80</sup> The OCC argues that the actual capital structure of the parent BHC will not prejudice ratepayers because the operating entity's proposed structure is artificial and created by the parent, thereby causing ratepayers to bear higher costs.<sup>81</sup>

77. The OCC takes issue with the Company's addition of the forecasted \$19.4 million equity infusion in 2016, which it argues is not known and measurable for ratemaking purposes.<sup>82</sup> The OCC further opposes the allocation of the \$40 million in additional debt to the operating utility, claiming that the amount is arbitrary.<sup>83</sup> The OCC posits that an allocation of \$140 million of debt from BHC would make the structures of the parent BHC and operating utility the same at the end of 2015. The OCC explains that assigning the Company the same capital structure as

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<sup>78</sup> Hearing Exhibit No. 28, Sigalla Answer, p. 37.

<sup>79</sup> Hearing Exhibit No. 28, Sigalla Answer, p. 40.

<sup>80</sup> OCC SOP, p. 13.

<sup>81</sup> Hearing Exhibit 37, Fernandez Answer, pp. 3-4.

<sup>82</sup> Hearing Exhibit 37, Fernandez Answer, p. 5.

<sup>83</sup> Hearing Exhibit 37, Fernandez Answer, p. 5.

BHC will match the risk characteristics that are being evaluated to determine the cost of capital in this Proceeding.<sup>84</sup>

78. Black Hills responds that Staff and the OCC appear to disregard the Company's efforts to manage the capitalization in a manner that represents how the Company finances utility investments in support of its overall financial integrity.<sup>85</sup> Black Hills refutes the OCC's suggestion that the Company's *pro forma* adjustments to the 2015 Test Year are arbitrary and are neither known nor measurable.<sup>86</sup> The Company also argues that, because BHC's debt structure is over-leveraged due to the recent acquisition of the SourceGas companies, that capital structure is not appropriate for the determination of the revenue requirement for Black Hills.<sup>87</sup>

79. We find no reason to deviate from the principle that the methods of raising capital should be left to the discretion of management "[u]nless it has been demonstrated by a substantial showing that rate payers are materially prejudiced by the actual capital structure which finances utility operations, the PUC should use the actual capital structure in calculating rates."<sup>8889</sup> We therefore adopt the Company's 2015 Test Year capital structure of 52.39 percent equity to 47.61 percent debt.

#### **4. Weighted Average Cost of Capital (WACC)**

80. Black Hills seeks approval of an overall WACC of 7.56 percent.<sup>90</sup>

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<sup>84</sup> Hearing Exhibit 37, Fernandez Answer, p. 6.

<sup>85</sup> Hearing Exhibit 7, Nooney Rebuttal, p. 7.

<sup>86</sup> Hearing Exhibit 7, Nooney Rebuttal, pp. 12-13.

<sup>87</sup> Hearing Exhibit 7, Nooney Rebuttal, 16.

<sup>88</sup> *Peoples Natural Gas* at 379.

<sup>89</sup> Commissioner Frances A. Koncilja does not join in these findings and conclusions.

<sup>90</sup> BHCOE Updated COS Model (11-4-16), Statement G, filed by Black Hills on November 4, 2016.

81. Based on our foregoing determinations, we establish the WACC for the base rate cost of service study to be 7.43 percent ( $[52.39\% \times 9.37\%] + [47.61\% \times 5.29\%] = 7.43\%$ ).

82. We find the 13 basis point reduction from the Company's proposal will not diminish BHC's ability to attract the funds necessary to satisfy Black Hills' capital requirements so that it can meet its obligation to provide adequate and reliable service to its customers.<sup>91</sup>

## **I. LM6000 Cost Recovery**

### **1. Black Hills Proposed Adjustment to 2015 Test Year Rate Base**

83. Black Hills has recovered the financing costs associated with the new LM6000 through the CACJA Adjustment rider since January 2015. The CACJA Adjustment rider was approved by the Commission under § 40-3.2-207(3), C.R.S., and has been implemented for the duration of the construction of the LM6000.

84. Black Hills takes the position that the CACJA Adjustment rider will terminate, except for a remaining true-up in 2017, when the LM6000 goes into service, which also is expected to be when new rates go into effect as a result of this Proceeding.<sup>92</sup> Black Hills argues that when the CACJA Adjustment rider expires at the end of 2016, it will not be replaced by an equivalent rider going forward, and thus, the associated recovery will come to an end.<sup>93</sup>

85. Consistent with its view that the CACJA Adjustment rider should terminate, Black Hills makes an adjustment to the 2015 Test Year cost of service to include the first full-year revenue requirement for the LM6000, based on a 13-month average net plant in-service for 2017, and associated depreciation expense and taxes. Black Hills argues that its approach for including

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<sup>91</sup> See *Pub. Serv. Co.*, 644 P.2d at 939; *Public Utilities Commission v. District Court*, 527 P.2d at 234-35.

<sup>92</sup> Hearing Exhibit 3, Stoffel Direct, p. 5.

<sup>93</sup> Black Hills SOP, p. 17.

the LM6000 investment costs in rate base and for including associated expenses and other costs in the cost of service is consistent with recent Commission electric rate case decisions for both Public Service and Black Hills.<sup>94</sup>

86. Black Hills submitted an update to the final cost estimate for the LM6000 when it filed its SOP on November 4, 2016.<sup>95</sup> The attachment shows that the subtotal for the project costs before consideration of the contingency costs and the costs of spare parts remains identical to the estimate the Company provided when the rate case was filed, or \$62.7 million. Black Hills shows that through October 31, 2016, the Company has spent \$57.6 million as compared to the \$62.7 million final cost estimate. The attachment further indicates that the Company no longer seeks to recover the unallocated contingency costs of approximately \$2.2 million and that it has reduced the costs of spare parts from \$500,000 to \$200,000. The total projected cost is therefore roughly \$62.9 million.

87. Black Hills witness Kimberly Nooney explained through pre-filed written testimony and oral testimony at hearing how the Company addressed the financing of the LM6000 during its construction in addition to the financing of other ongoing capital investments. She testified that the Company works to manage its capitalization to be representative of the way in which the Company finances utility investments.<sup>96</sup> She explained that the permanent assignment of \$40 million of additional debt to Black Hills from BHC's \$525 million 2013 senior unsecured note issuance corresponds to the financing of new capital projects coming on line in 2016 including the LM6000.<sup>97</sup> At hearing, she clarified upon cross-examination that

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<sup>94</sup> Black Hills SOP, pp. 21-22.

<sup>95</sup> Updated LM6000 Construction Costs filed by Black Hills on November 4, 2016.

<sup>96</sup> Hearing Exhibit 7, Nooney Rebuttal, p. 6.

<sup>97</sup> Hearing Exhibit 7, Nooney Rebuttal, p. 13.

the Company's proposed adjustments to its capital structure from year end 2015 through year end 2016, including the \$40 million assignment of debt and approximately \$19 million of infused equity, reflected the financing for the LM6000 to achieve an equity component in the Company's capital structure in a target range of 50 percent to 52 percent.<sup>98</sup>

## **2. Five-Percent Reasonableness Standard**

88. By Decision No. C14-0007, the Commission granted Black Hills a certificate of public convenience and necessity for the development and ownership of the LM6000. The Commission also granted Black Hills a presumption of prudence for up to 5 percent of the Company's revenue requirement at the time the Company requests cost recovery.<sup>99</sup>

89. Black Hills witness Michael Clevinger argues that the total cost of the LM6000 meets the 5 percent threshold addressed in Decision No. C14-0007.<sup>100</sup> Attachment MCC-6 to Mr. Clevenger's Rebuttal Testimony (Hearing Exhibit No. 11) calculates that the total annual cost of the LM6000 as a percentage of revenues is 4.84 percent.<sup>101</sup>

90. The OCC contests Black Hills' calculation of the Five-Percent Reasonableness Standard. The OCC alleges that Black Hills made a significant change in the method used to calculate its revenues since the Commission established the 5 percent revenue requirement threshold. Specifically, the OCC contends that revenues collected through the Company's Energy Cost Adjustment, including fuel costs, should not be included in the threshold calculation

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<sup>98</sup> Transcript October 19, 2016, pp. 26-30.

<sup>99</sup> Decision No. C14-0007, issued January 6, 2014, Proceeding Nos. 13A-0445E, 13A-0446E and 13A-0447E.

<sup>100</sup> Hearing Exhibit 10, Clevinger Direct, p. 13.

<sup>101</sup> Hearing Exhibit 11, Clevinger Rebuttal, Attachment MCC-6.

to determine the revenue requirement impact of the LM6000's costs. The OCC recommends that the Commission disallow recovery of costs over the 5 percent threshold.<sup>102</sup>

91. Black Hills argues that the OCC's calculation of the revenue requirement impact of the LM6000 is flawed because it excludes fuel costs from the calculation.<sup>103</sup> Black Hills further states that the OCC is the only intervenor that alleges that the Company has exceeded the 5 percent reasonableness standard threshold.

92. Black Hills argues that it has shown in this Proceeding that the investments and costs incurred by the Company associated with the decommissioning of W.N. Clark and development of the LM6000 are prudent. Black Hills argues that, other than the loss on the sale of the coal pile at the W.N. Clark Station, no party challenged any of the LM6000 costs or investment as imprudent.<sup>104</sup>

### **3. EOC Objection to GRSA Recovery of LM6000 Costs**

93. Black Hills' residential customers pay a monthly fixed Customer Charge of \$16.50.

94. EOC calculates the effective Customer Charge with the current GRSA of 1.945 percent to be \$16.82. EOC similarly calculates the effective Customer Charge with the proposed GRSA of 12.72 percent to be \$18.62. EOC explains that the Company's proposed use of a combined GRSA will result in some of the highest fixed customer charges in the region and will unfairly shift costs to ratepayers, that are primarily caused by the addition of generation.

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<sup>102</sup> OCC SOP, pp. 16-17.

<sup>103</sup> Black Hills Reply SOP, p. 11.

<sup>104</sup> Black Hills SOP, pp. 21-22.

EOC argues that increasing fixed costs through the GRSA, absent any cost-allocation rationale, is bad public policy which fails to result in just and reasonable rates.<sup>105</sup>

95. EOC further argues that a GRSA is neither required nor authorized by Colorado statute and is not used in other adjacent jurisdictions. EOC states that “the line between a Phase I and a Phase II case is not as clear as the Company – or Staff – has suggested.”<sup>106</sup>

96. EOC concludes that the record in this case demonstrates that increases to fixed customer charges will have an even greater impact on low-income customers than increases that are realized through changes to a per-kWh energy charge.<sup>107</sup>

97. EOC recommends that, until new rates go into effect following a Phase II case, the Commission should allocate the increased generation costs in a separate interim rider, on the same basis approved in the last Phase II case, through the energy or demand charges of customer classes, and avoid the GRSA and resultant higher fixed charges.<sup>108</sup>

#### **4. LM6000 Cost Recovery by Continuation of CACJA Adjustment Rider**

98. We conclude that OCC’s proposal to disallow costs in excess of its Five-Percent Reasonableness Standard test is inconsistent with § 40-3.2-207(1)(a), C.R.S. We agree with Black Hills that with the exception of the W.N. Clark station coal pile, no party has challenged any cost associated with the Company’s investment in the LM6000 as imprudent. We also agree with Black Hills that § 40-3.2-207(1)(a), C.R.S., entitles the Company to recover fully the costs that it prudently incurs in developing, constructing, operating, and maintaining replacement capacity constructed pursuant to its emission reduction plan approved pursuant to the CACJA.

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<sup>105</sup> EOC SOP, p. 10.

<sup>106</sup> EOC SOP, p. 12.

<sup>107</sup> EOC SOP, p. 18.

<sup>108</sup> EOC SOP, p. 19.



99. We further concur with Black Hills' analysis that the CACJA Adjustment rider was approved pursuant to § 40-3.2-207(1)(b), C.R.S., such that the Commission was required to allow current recovery of construction work in progress at the Company's WACC during the construction, startup, and preservice implementation phases of the LM6000 project. Based on the record in this Proceeding, the purpose of § 40-3.2-207(1)(b), C.R.S., has been fulfilled.

100. We disagree, however, with Black Hills witness Stoffel who alleges that: "Even though it is clear that the new LM6000 generation unit is the primary cause of this rate review filing, it is not appropriate to fundamentally repurpose the existing CACJA rider to recover the full cost of this asset."<sup>109</sup> While the "special regulatory practice" contemplated by the General Assembly in § 40-3.2-207(1)(b), C.R.S., will expire when the LM6000 begins commercial operations, there is no statutory requirement that base rate recovery through a GRSA is the exclusive means by which the Commission can adhere to the requirements of § 40-3.2-207(1)(a), C.R.S.

101. Black Hills is authorized to recover the costs associated with the new LM6000 through the continuation of the CACJA Adjustment rider rather than through a GRSA adjustment to base rates. Consistent with the discussion below, the CACJA Adjustment rider will facilitate the application of a specific rate of return on the LM6000 investments as compared to the WACC developed above for the 2015 Test Year rate base. Continued cost recovery through the rider also will preserve established class allocations of costs that a GRSA otherwise would eliminate,

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<sup>109</sup> Hearing Exhibit No. 4, Stoffel Rebuttal, p. 23.

thereby reducing the impact of this Phase I rate case on the fixed Customer Charge for residential customers.<sup>110</sup>

102. The rate of return we establish above for application to the Company's rate base was determined based on the actual equity component of about 52 percent at the end of the 2015 Test Year and the actual cost of debt for the same period. Based on the testimony of Black Hills witness Nooney, we apply the Company's \$40 million debt assignment and \$19 million of infused equity that were proposed by the Company to reduce the equity component in the base rate cost of service study to derive an equity component in a capital structure specific to the underlying financing of the construction of the LM6000. The resulting equity component of roughly 33 percent combines with the 9.37 percent authorized ROE established above and the projected cost of the assigned debt of 4.40 percent for a rate of return to be applied to the LM6000 of 6.02 percent.<sup>111</sup> We find that this treatment of the Company's financing costs results in the proper return on the LM6000 as it enters into service and operates for a few years until the Company's next electric rate proceeding, when the continuation of the CACJA Adjustment rider may be reexamined.<sup>112</sup> This approach for cost recovery also advances the Company's aim to use the proposed debt assignment and equity infusion in 2016 to mitigate the potential impacts to customers resulting from this Proceeding.

103. In compliance with this Decision, Black Hills shall file in an advice letter tariff compliance filing a revised CACJA Adjustment rider for effect on January 1, 2017.

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<sup>110</sup> See *Public Service Co.*, 644 P.2d at 941-42 (holding that the commission has discretion to determine the best use of bill riders to best offset price increases for ratepayers); *CF&I Steel*, 949 P.2d at 586-88 (the Commission can make its own independent judgment from the evidence in the record; it does not need to adopt the position of any one party).

<sup>111</sup> Commissioner Frances A. Koncilja does not join in the decision to use a 4.40 percent cost of debt and a 9.37 percent authorized ROE.

<sup>112</sup> See *Public Service Co.*, 644 P.2d at 941-42; *CF&I Steel*, 949 P.2d at 586-88.

The CACJA Adjustment rider rate should be designed to collect the first full-year revenue requirement for the LM6000 based on a 13-month average net plant in-service for 2017 and associated depreciation expense. The net plant value should be based on the updated cost information filed by Black Hills on November 4, 2016.<sup>113</sup> The return included in the rider-recovered revenue requirement should be based on the rate of return discussed above. Property taxes, incremental Operations and Maintenance expenses, allocations, and other costs should be recovered through base rates consistent with the Company's *pro forma* adjustments to the 2015 Test Year cost of service.<sup>114</sup>

104. The annual revenue requirement to be collected by the CACJA Adjustment rider shall not change unless modified by the Commission in a future Phase I rate case proceeding. However, the class cost allocators used to establish the rate values shall be modified as necessary based on the results of the Company's next Phase II rate case.

105. Because the CACJA Adjustment rider will no longer serve as a special regulatory practice under § 40-3.2-207(3), C.R.S., the mechanism will not be used to "true-up" costs with revenues after December 31, 2016. The final true up will be in the six months beginning July 1, 2017, consistent with the terms of the existing CACJA Adjustment rider tariff sheets.

106. We agree with the EOC's assessment that the CACJA Adjustment rider has been collected from residential and small general customers as a per-kWh energy charge only and from larger customers as a demand charge. We also concur with the EOC's analysis that CACJA Adjustment rider costs have been allocated to customer classes based on allocators established in a Phase II rate case.

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<sup>113</sup> Updated LM6000 Construction Costs filed by Black Hills on November 4, 2016

<sup>114</sup> Commissioner Frances A. Koncilja does not join in the decision to allow recovery of the allocations.

107. The Commission approved the \$16.50 per month Customer Charge in Proceeding No. 12AL-1052E, finding that it was reasonable in light of the results of the Company's class cost of service study reviewed in that Phase II proceeding.<sup>115</sup> Effective increases in the Customer Charge as the result of implementing a substantial GRSA diminishes the cost basis of the specific design of the charge. We also agree with the EOC that a substantial increase in the GRSA can have a negative impact on low-use and low-income customers. We therefore see benefits of continuing the CACJA Adjustment rider for the recovery of the costs of the LM6000 because it will moderate the increase in the GRSA adopted by this Decision and alleviate the effective increase to the monthly fixed residential Customer Charge.

**J. Base Rate Revenue Requirements**

**1. Rate Base**

**a. Rate Base Calculation**

108. Black Hills calculates the rate base for the 2015 Test Year at year end, arguing that a year-end calculation is appropriate because it provides a more accurate picture of the Company's investments throughout the test year and because it helps to address the earnings attrition that the Company claims it is experiencing.<sup>116</sup> Black Hills states that while the Commission has authorized a 13-month average rate base in many rate cases, the approach is not appropriate in this Proceeding because the average test year calculation assumes investment balances from mid-2015, which adds six months to the lag between the time of investments and recovery through rates, thereby exacerbating earnings attrition. Black Hills quantifies the difference between a year-end test year rate base and an average test year rate base at nearly

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<sup>115</sup> Decision No. C13-0794, issued June 28, 2016, Proceeding No. 12AL-1052E.

<sup>116</sup> Hearing Exhibit 10, Clevinger Direct, pp. 8-9.

\$12 million, or 2.5 percent of the rate base, annualized to a 5 percent growth rate for the test year. Black Hills asserts this as evidence of earnings attrition.<sup>117</sup>

109. Staff proposes that the Commission direct Black Hills to calculate rate base using a 13-month average for the 2015 Test Year, but allowing a year end value for the LM6000 as a *pro forma* adjustment.<sup>118</sup> Staff states that it generally supports an average test year calculation, as that is what the Commission has historically used. Staff also notes, however, that a year-end test year is appropriate in certain circumstances, such as when a non-revenue producing investment is at issue. Staff determines that the LM6000 is a non-revenue producing investment and should therefore be subject to a year-end test year value.

110. The OCC's position is that the year-end test year distorts the regulatory matching principle and that the Commission should require an average test year as it has in the most recent Black Hills and Public Service rate cases.<sup>119</sup> The OCC also disputes Black Hills' claim of earnings attrition, stating that cost recovery for the LM6000, which will go on line after the 2015 Test Year, makes up for any earnings attrition. Specifically, the OCC notes that \$11.4 million of Black Hills' \$14.7 million revenue requirement comes from Black Hills' compliance with the CACJA and that adding in this amount after the test year offsets any earnings attrition. The OCC further asserts that the difference in the pre-tax revenue requirement between a year end test year and average test year is 0.78 percent and does not warrant a change from the average test year that the Commission has used in recent cases.<sup>120</sup>

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<sup>117</sup> Hearing Exhibit 10, Clevinger Direct, pp. 9-10.

<sup>118</sup> Hearing Exhibit 29, McGee Answer, pp. 3 and 11.

<sup>119</sup> Hearing Exhibit 36, England Answer, pp. 7-8.

<sup>120</sup> Hearing Exhibit 36, England Answer, pp. 9-11.

111. Black Hills responds that neither Staff nor the OCC provide evidence that a 13-month average test year is appropriate for correctly accounting for Black Hills' plant investments in the second half of 2015 and matching those investments to rates.<sup>121</sup> Black Hills also rejects the OCC's position that earnings attrition will be offset by the LM6000 adjustment to rate base and that any earnings attrition is not large enough to warrant the use of a year-end test year. Black Hills states that the LM6000 comprises 10 percent of the Company's total rate base and that earnings attrition from the remainder of rate base should be addressed through a year-end test year.

112. We have considered the Company's proposal to use a year-end calculation of the 2015 Test Year rate base and the factors that Black Hills claims support its adoption in this Proceeding. We find that a 13-month average test year is appropriate. Not only is an average rate base calculation consistent with our decisions in recent rate cases, we find no compelling evidence in this case of earnings attrition that would support the use of a year-end test year.

**b. ARRA Grant**

113. In its proposed rate base, Black Hills includes \$3.7 million in Treasury Grant (ARRA Grant) funds, which is 50 percent of the unamortized portion of an \$8.3 million grant the Company received for the development of the Busch Ranch Wind Project.<sup>122</sup> Black Hills states that this inclusion is consistent with Commission decisions in its last rate case, in which the Commission allowed the Company to include 50 percent of the ARRA Grant in rate base.<sup>123</sup> Black Hills states that the Commission, while not allowing return on the full ARRA Grant

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<sup>121</sup> Hearing Exhibit 11, Clevinger Rebuttal, p. 9.

<sup>122</sup> Hearing Exhibit 10, Clevinger Direct, p. 34.

<sup>123</sup> Decision Nos. R14-1298 and C14-1504, issued October 28, 2014 and December 22, 2014, respectively, Proceeding No. 14AL-0393E.

amount, did allow the 50 percent inclusion as encouragement for utilities to seek federal funding for renewable energy projects.<sup>124</sup>

114. Black Hills also provides an analysis showing that when 50 percent of the ARRA Grant is included in rate base, the revenue requirement yields a benefit to customers of nearly \$471,000 and to the Company of about \$276,000.<sup>125</sup> If the Company is not allowed to include any of the ARRA Grant in rate base, as recommended by Staff and OCC, Black Hills claims the customer benefit is about \$724,000 and the Company's benefit is \$0. Black Hills concludes that disallowing any benefit to the Company is a disincentive to pursuing grant funding.

115. Staff states that although the Commission encourages federal grant funding for renewable projects, the Company benefitted from not having to acquire the funds in the capital markets. Staff's position is that the ARRA Grant should be treated as contribution in aid of construction (CIAC).<sup>126</sup>

116. The OCC asserts that because the money expended by Black Hills for Busch Ranch did not require it to use its own capital, the funds should not be included in rate base. The OCC states that Black Hills has realized a benefit of \$446,363 through the inclusion of the ARRA Grant in the last rate case and recommends that the funds now be disallowed in rate base. OCC states that the language of Decision No. C14-1504 leaves doubt as to the intent of the Commission in the future treatment of the ARRA Grant and that the grant is similar to CIAC.<sup>127</sup>

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<sup>124</sup> Hearing Exhibit 14, Crouch Direct, p. 9.

<sup>125</sup> Hearing Exhibit 11, Clevinger Rebuttal, p. 14 and Attachment MCC-8.

<sup>126</sup> Hearing Exhibit 34, Reis Answer, p. 29.

<sup>127</sup> Hearing Exhibit 36, England Answer, pp. 20-22.

117. Black Hills refutes the recommendation from both Staff and OCC that the ARRA Grant be treated as CIAC. Black Hills notes that the grant was accepted in lieu of investment tax credits, which is not true of CIAC.<sup>128</sup>

118. We reject the inclusion of the remaining portion of the ARRA Grant in Black Hills' rate base. When Black Hills received the grant, it did so without a guarantee that the Commission would allow the funds to be included in rate base. This risk was offset by the interest free nature of the grant. The Commission has never stated that Black Hills is entitled to rate base the ARRA Grant indefinitely, and in fact has allowed the benefit of more than \$440,000 thus far.

**c. LM6000 Spare Parts**

119. As part of its proposed rate base in its May 3, 2016, advice letter filing, Black Hills included \$500,000 for spare parts for the LM6000.<sup>129</sup>

120. Staff questioned the necessity of this inclusion, stating that the amount is inappropriate because the LM6000 should have a warranty, the plant is expected to run minimal hours, and the Company has not yet ordered spare parts and has not listed which parts it will be ordering.<sup>130</sup>

121. Black Hills refutes Staff's claim that the spare parts are unnecessary.<sup>131</sup> However, the Company also provides a new estimate of the cost of the parts and determines that \$200,000 would be the upper bound for the spare parts.<sup>132</sup>

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<sup>128</sup> Hearing Exhibit 15, Crouch Rebuttal, p. 13.

<sup>129</sup> Hearing Exhibit 10, Clevinger Direct, p. 20.

<sup>130</sup> Hearing Exhibit 29, McGee Answer, p. 13.

<sup>131</sup> Hearing Exhibit 13, Lux Rebuttal, p. 3.

<sup>132</sup> Hearing Exhibit 11, Clevinger Rebuttal, p. 35.



122. We find that it will be necessary to have spare parts for a plant such as the LM6000 and find that \$200,000 is an appropriate amount in the Company's cost of service calculations.

## **2. Expenses**

### **a. Property Taxes**

123. Black Hills' cost of service study includes 2017 projected property taxes of \$8,673,000, about \$1,503,000 more than the actual 2015 year-end net property taxes.<sup>133</sup> The Company maintains that its property tax expenses are expected to increase over the next several years because of the LM6000 coming on line, the expiration of the City of Pueblo's property tax abatement, which has allowed a property tax incentive of 50 percent at the Pueblo Airport Generation Station for the last five years, and additional plant investments in 2018 and 2019. Black Hills also requests a regulatory asset to defer variances in annual property taxes.

124. Staff recommends rejecting the Company's request for a deferred account for property taxes because Black Hills has not demonstrated that the property taxes constitute unusual circumstances that would warrant a deferred account.<sup>134</sup> Staff argues that a deferred account would remove the Company's incentive to operate efficiently. Staff further maintains that Black Hills' 2018 property tax amount is more appropriate than the 2017 value because the 2018 calculation includes the full value of the LM6000.<sup>135</sup>

125. The OCC states that Black Hills' request for a deferred account for property taxes would shift risks from Black Hills to ratepayers, giving the Company guaranteed recovery of all

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<sup>133</sup> Hearing Exhibit 10, Clevinger Direct, p. 43.

<sup>134</sup> Hearing Exhibit 34, Reis Answer, p. 34.

<sup>135</sup> Hearing Exhibit 34, Reis Answer, p. 36.

property tax expenses, and should be rejected. The OCC asserts that Black Hills has not made a compelling argument for the deferred account and that the Company offered no support for the projected increases in plant investment that Black Hills includes as a factor in its request for the deferred account.<sup>136</sup>

126. In response, Black Hills argues that Staff and the OCC misconstrue the effect of deferred accounts. Black Hills Witness Clevinger states that Black Hills is not requesting approval in this proceeding for future property tax expenses, but rather, the Company seeks to ensure that property taxes incurred above a base amount are allowed for consideration in a future rate case.<sup>137</sup> However, Black Hills also states that if a deferred account is not allowed for property tax expenses, the Company will accept Staff's recommendation to use 2018 property tax amounts.<sup>138</sup>

127. We conclude that Black Hills has not provided evidence that the increasing tax burden is unique or unusual enough to warrant a deferred account. Property taxes are a known and measurable expense that are paid in arrears. We therefore reject Black Hills' request for a deferred accounting of its property taxes.

128. Additionally, because the 2018 property tax amount includes the full value of the LM6000, we direct Black Hills to use that amount in its cost of service study.

#### **b. Pension Expense**

129. Black Hills proposes to use a five-year average (2012 to 2016) of pension expenses in its cost of service study.<sup>139</sup> Company witness Kimberly Nooney explains that

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<sup>136</sup> Hearing Exhibit 36, England Answer, pp. 37-38.

<sup>137</sup> Hearing Exhibit 11, Clevinger Rebuttal, p. 20.

<sup>138</sup> Hearing Exhibit 11, Clevinger Rebuttal, p. 19.

<sup>139</sup> Hearing Exhibit 10, Clevinger Direct, p. 27.

the assumptions associated with determining the pension create uncertainty, volatility, and unpredictability. Therefore, according to Black Hills, the best representation of costs going forward is an average.<sup>140</sup>

130. Black Hills also describes several steps it has implemented to reduce future pension plan expense. This includes closing the pension plans to new entrants after 2009 and freezing pension benefits for a significant number of employees beginning January 1, 2010.<sup>141</sup> Black Hills states as a result of these actions, less than 22 percent of employees continue to earn additional pension benefits as of 2015 year-end.<sup>142</sup>

131. Staff asserts that Black Hills has not provided adequate support for its pension expense request. Instead, Staff recommends that pension cost recovery be limited to the 2016 expense projection of \$903,883.<sup>143</sup> Countering the Company's assertion that pension expenses are too variable to predict, Staff introduced Confidential Hearing Exhibit 44 at the evidentiary hearing. This exhibit, a study prepared for Black Hills by consulting company Aon Hewitt providing cost estimates through 2025, shows a steady decline in the overall annual pension expense. Staff argues that this is a reasonable expectation for a plan that is closed to new participants.<sup>144</sup>

132. We find Staff's position to be a better representation of annual pension expenses going forward and direct Black Hills to include \$903,883 as the pension expense in the revenue requirement calculation. Black Hills' testimony regarding its efforts to reduce pension expense

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<sup>140</sup> Hearing Exhibit 6, Nooney Direct, pp. 17-18.

<sup>141</sup> Hearing Exhibit 6, Nooney Direct, p. 15.

<sup>142</sup> Hearing Exhibit 7, Nooney Rebuttal, p. 24.

<sup>143</sup> Staff SOP, p. 18.

<sup>144</sup> Staff Reply SOP, p. 7.

combined with data projections from Confidential Hearing Exhibit 44 show an overall continued decrease in the estimated annual pension expenses for the Company.

**c. Aquila Pension Amortization Expense**

133. Black Hills seeks to amortize prior service costs and actuarial gains and losses related to the pension plan for employees of Aquila, the predecessor of the Company. Black Hills explains that upon Black Hills Utility Holdings, Inc.'s (BHUH) acquisition of Aquila in July 2008, the Company established a regulatory asset and has continued to amortize costs since that time.<sup>145</sup> Black Hills asserts the ongoing requirements of Aquila's pension plan were assumed and that no additional pension plan obligations are part of this regulatory asset.<sup>146</sup>

134. Black Hills contends it should be allowed to continue recovering these costs because they are for services provided by the employees of the Company. Further, Black Hills states that the Company is complying with FASB rules in accounting for the expense as a regulatory asset that is being amortized over the remaining service life of the participants based on actuarial assumptions at the time of valuation.<sup>147</sup> Additionally, Black Hills points out that the amortization represents an expense that, except for the acquisition transaction, would have been recognized in future expense and recovered in rates by Aquila for these same employees.

135. Staff recommends an adjustment of approximately \$573,000 to remove the inclusion of the Aquila pension amortization as a recoverable expense in this proceeding.<sup>148</sup> Staff is concerned that the Commission has not authorized this amortization. Additionally, Staff views these costs as prior period expenses and states it is well established in Colorado that

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<sup>145</sup> Black Hills Reply SOP, p. 15.

<sup>146</sup> Black Hills SOP, p. 34.

<sup>147</sup> Hearing Exhibit 7, Nooney Rebuttal, pp. 25-26.

<sup>148</sup> Staff SOP, p. 2.

there is a constitutional prohibition against retroactive ratemaking. Further, Staff argues that there are a number of unanswered questions regarding this issue and that it has not been properly requested, noticed, supported, or explained. Staff states that there is no evidence in the record to support the Company's assertion that these costs would have been expensed and recovered as pension expense by Aquila.<sup>149</sup>

136. Black Hills argues the record is incomplete in that it does not support Staff's challenges regarding the appropriateness of including an amortization of prior service costs as recoverable expenses. The Company states that because this amortization was established in accordance with accrual accounting per Generally Accepted Accounting Principles, current recovery of these costs does not violate the rule against retroactive ratemaking.<sup>150</sup>

137. We will allow the amortization expense to remain in the cost of service for this Proceeding because the proposed expense was represented as being included in pension expenses in prior Company rate cases.<sup>151 152</sup> Nevertheless, we concur with Staff that the record in this Proceeding does not answer many questions surrounding the Aquila pension issue. Therefore, we direct Black Hills to include in its direct case in its next Phase I rate case proceeding more detailed information regarding this matter.

#### **d. Employee Recognition Expenses**

138. Black Hills seeks to recover costs incurred for its employee rewards programs. Black Hills asserts these costs are a reasonable part of the Company's recognition and compensation package and should be recoverable. Further, Black Hills states these programs

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<sup>149</sup> Staff SOP, pp. 19-24.

<sup>150</sup> Black Hills Reply SOP, pp. 15-16.

<sup>151</sup> Hearing Exhibit 7, Nooney Rebuttal, p. 27.

<sup>152</sup> Commissioner Frances A. Koncilja does not join in these findings and conclusions.

provide an opportunity for employees to recognize work colleagues for contributions that support the business, reinforces company values, and promote teamwork. This in turn benefits customers through developing and promoting a stable and engaged workforce.<sup>153</sup>

139. Staff disagrees and recommends that the Commission disallow the \$69,208 in employee recognition expenses. Staff argues that these types of expenses do not benefit the ratepayers and therefore should be absorbed by shareholders. Alternatively, the shareholders should bear a high percentage of these expenses.<sup>154</sup>

140. We determine that, based on the facts and circumstances in this case, allowing recovery of this employee recognition expense is reasonable, providing balance between ratepayer and Company interests.<sup>155</sup> The \$69,208 for employee recognition expenses shall remain in the revenue requirement calculation.

**e. Rate Case Expenses**

141. Black Hills estimates it will incur rate case expenses of \$550,000 and seeks recovery of these costs over a three-year period.<sup>156</sup> The Company states that it concurs with Staff's proposal to reconcile actual incurred costs to the \$550,000 amount after the resolution of this case.<sup>157</sup>

142. Specifically, Staff proposes a method of cost recovery for rate case expenses that is similar to that used in Black Hills' prior rate case, Proceeding No. 14AL-0393E. Staff asserts actual, rather than estimated, costs should be used and that a separate GRSA should be

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<sup>153</sup> Black Hills SOP, pp. 43-44.

<sup>154</sup> Hearing Exhibit 31, Kahl Answer, pp. 13-14.

<sup>155</sup> Commissioner Frances A. Koncilja does not join in these findings and conclusions.

<sup>156</sup> Black Hills SOP, p. 44.

<sup>157</sup> Black Hills SOP, p. 44.

established after the conclusion of this Proceeding for the purpose of recovering actual rate case expenses.<sup>158</sup>

143. We are not inclined to adopt a process that could adjust further the GRSA resulting from this Proceeding for the purpose of reconciling actual incurred rate case expenses to the \$550,000 amount. We direct Black Hills to provide actual rate case costs to date as an input to its cost of service model for the upcoming Technical Conference described below. However, the input amount will be limited to no more than the Company's estimate of \$550,000 and shall be recovered over a three-year period.<sup>159</sup><sup>160</sup>

**f. Employee Incentive Compensation (AIP & STIP)**

144. Black Hills seeks cost recovery of two employee incentive programs—the Annual Incentive Plan (AIP) and the Short-Term Incentive Plan (STIP). Company witness Lopez describes these programs as an important component of the total pay package necessary to ensure that Black Hills is competitive with market practices to obtain and retain employees.<sup>161</sup> She notes other utilities provide incentive or variable pay as part of their compensation packages. The incentive pay offered to employees is tied to goals and measures that benefit customers such as safety, reliability, expense reductions, continuous improvement, and achievement of earnings per share targets. Further, with the exception of equity compensation, the Company's compensation levels and practices have not been raised in previous rate cases.

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<sup>158</sup> Hearing Exhibit 31, Kahl Answer, p. 17.

<sup>159</sup> At the Technical Conference on December 7, 2016, Black Hills stated that it had incurred rate case expenses in excess of \$550,000 and therefore the capped amount was used to derive the revenue requirement and associated GRSA. On December 7, 2016, the Company filed a notice that its actual rate case expenses booked as of November 30, 2016 were \$619,645.

<sup>160</sup> Commissioner Frances A. Koncilja does not join in these findings and conclusions.

<sup>161</sup> Hearing Exhibit 18, Lopez Direct, p. 9.

145. Staff recommends that the Commission make four adjustments to the Company's cost of service for these incentive programs. First, the Commission should limit recovery to no more than 15 percent of base salary, applied on a per-employee basis. Second, the Commission should reduce the cost of service by an amount equal to the pension impact of incentive payments above 15 percent of base salary. Third, the Commission should apply a 15 percent cap on incentive payments and associated pension impacts to the costs allocated to Colorado ratepayers for incentive payment expenses related to Black Hills Service Company (BHSC) and BHUH employees. Fourth, the Commission should reduce the cost of service to reflect the Plan Year 2016 AIP incentive payments per employee to the projected amount.<sup>162</sup>

146. Staff explains that these recommended changes to the Company's cost of service would limit, but not eliminate, the Company's recovery of incentive pay related expenses. Staff claims that its compromise approach balances the benefits of these types of expenses for both ratepayers and shareholders. Staff states it has presented recovery for incentive payment amounts that do not go beyond what is necessary to attract, retain, and motivate skilled workers, that are what is appropriate to include in just and reasonable rates, and what is in line with Commission approved decisions and settlements on recovery of incentive payment expenses for Public Service's gas and electric operations in Colorado.<sup>163</sup>

147. Further, Staff argues that it is important for the Commission to recognize that capping recovery of costs associated with incentive payments exceeding 15 percent of base earnings would not directly impact individual employees.<sup>164</sup> Black Hills may simply continue to pay those employees large incentive payments out of corporate resources. The only difference

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<sup>162</sup> Staff SOP, pp. 25-26.

<sup>163</sup> Hearing Exhibit 27, Peuquet Answer, p. 23.

<sup>164</sup> Hearing Exhibit 27, Peuquet Answer, p. 30.



would be that Black Hills would no longer be permitted to request recovery of those costs from ratepayers.

148. Staff clarifies that its recommendation is to apply the 15 percent cap on an individual employee basis and not to an aggregated sum of all base salaries. According to Staff, applying the 15 percent cap at the aggregate level rather than the individual level would allow the Company to pay more than 15 percent to some employees while paying less than 15 percent to others, an outcome that would favor executives and other high-salaried employees.<sup>165</sup> Additionally, Staff proposes that the same restrictions on reimbursement of certain incentive payment expenses and associated pension costs be applied to the costs allocated to Colorado ratepayers for incentive payment expenses related to BHSC and BHUH employees.

149. In response, Black Hills argues that Staff's recommendation to limit the recovery of incentive pay above 15 percent of base salary is based on rate cases of Public Service and therefore should not influence this proceeding because the facts and circumstances for the Company's compensation programs are different than those of other utility companies. Additionally, the Company argues that Staff's proposal to reduce the amount of incentive pay in the cost of service from 100 percent of the 2016 target to the projected incentive compensation for 2016 is without merit. Black Hills argues that an adjustment reflecting 100 percent of the target is representative of payout expectations going forward. Further, Black Hills contests the proposal to reduce the cost of service by an amount equal to the pension impact of incentive pay above the 15 percent cap. Black Hills argues that the information required to make such

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<sup>165</sup> Hearing Exhibit 27, Peuquet answer, p. 27.

an adjustment has not been required in other rate cases before this Commission and would require a special actuarial study.<sup>166</sup>

150. We find merit in Staff's recommendations, because they preserve a reasonable level of cost recovery and balance ratepayer and Company interests for these types of expenses. Incentive payment recovery will be capped at 15 percent of base salary applied on a per-employee basis. The Company will also make an adjustment to remove the pension expense impact of incentive payments above 15 percent of base salary. These modifications will also apply to the costs allocated to Colorado ratepayers for incentive payment expenses related to BHSC and BHUH employees. Finally, the Plan Year 2016 AIP incentive payments per employee will be reduced to the projected, rather than target, amount.

**g. Equity Compensation**

151. Black Hills makes an adjustment of \$512,246 to be included in its cost of service related to equity compensation. Company witness Lopez supports cost recovery of this program, which provides non-cash compensation to select employees responsible for various aspects of management and business results.<sup>167</sup> These long-term incentives include restricted stock grants and performance share awards, both of which award shares in BHC. As explained by the Company, restricted stock refers to stock that is awarded to certain eligible employees at all levels of BHC and which is not fully transferable until the expiration of a three-year vesting period. In addition to these two employee programs, BHC's Board of Directors compensation includes an equity component referred to as "Phantom Stock."<sup>168</sup>

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<sup>166</sup> Hearing Exhibit 19, Lopez Rebuttal, pp. 4-15,

<sup>167</sup> Hearing Exhibit 18, Lopez Direct, p. 14.

<sup>168</sup> Hearing Exhibit 27, Peuquet Answer, p. 32.

152. Black Hills asserts equity compensation motivates employees to take a longer-term view of the utility's operations.<sup>169</sup> The Company views equity compensation as an operating expense associated with recruiting, compensating, and retaining employees similar to expenses for salaries and benefits. Further, Black Hills claims it will have difficulty attracting and retaining qualified employees unless it can recover each element of its employee compensation program.

153. Black Hills further argues that no party claims that the requested \$512,246 in equity compensation is excessive compared to similarly-situated utilities or against any other industry standard and that no party disputes the equity compensation calculation of \$512,246.<sup>170</sup> Finally, the Company notes that in the most recent rate case the Commission concluded, "[s]ince equity compensation benefits ratepayers it is necessary to include it in the test period."<sup>171</sup>

154. Staff recommends that the Commission limit the Company's recovery of the associated costs of the equity compensation program to 50 percent of the requested per book amount. Staff states it finds merit in the previous Commission rulings that equity compensation provides benefit to both shareholders and ratepayers and recommends that both shareholders and ratepayers should bear costs associated with equity grants to employees.<sup>172</sup>

155. OCC recommends that the Commission remove all equity compensation expenses from the Company's revenue requirement calculation. The OCC asserts equity compensation programs are designed to align management with stockholders, not ratepayers, and because shareholders benefit from these programs, the OCC argues that they should pay for them in their

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<sup>169</sup> Hearing Exhibit 18, Lopez Direct, p. 15.

<sup>170</sup> Black Hills SOP, p. 28.

<sup>171</sup> Decision No. R14-1298, issued October 28, 2014, Proceeding No. 14AL-0393E.

<sup>172</sup> Staff SOP, pp. 24-25.

entirety.<sup>173</sup> The OCC further contends that the compensation payout amounts are not known and measurable for regulatory purposes. The OCC points out that the vestings and payouts are typically greater than one year from the test period and that the larger equity base resulting from equity compensation programs further gives companies an opportunity to earn more profit.<sup>174</sup> In OCC's view, Company witness Lopez confirmed that the Black Hills 2016 proxy statement indicates that equity compensation and other bonus programs link the interests of management to its shareholders.<sup>175</sup> Additionally, the OCC notes that some of BHC's other jurisdictions have either allowed only partial recovery or excluded any recovery of executive incentive plans from rates.<sup>176</sup>

156. EOC also recommends an adjustment to remove all equity compensation expense from the revenue requirement.<sup>177</sup> EOC argues that there are no specific and clear ratepayer benefits from a higher Black Hills share price. The EOC also asserts that the economic hardship facing the Company's service area is another factor suggesting that its relatively low-income customers should not pay for a program to give money to a few highly paid executives without material benefits to customers that offset this spending.

157. Likewise, the Public Intervenors urge the Commission to deny forcing customers to pay the perks of highly compensated executives.<sup>178</sup> According to them, equity compensation programs are designed to align management with stockholders, not customers. They also agree with the OCC that compensation payout amounts are not known and measurable for

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<sup>173</sup> OCC SOP, p. 27.

<sup>174</sup> Hearing Exhibit 37, Fernandez Answer, p. 56.

<sup>175</sup> OCC SOP, p. 27.

<sup>176</sup> OCC SOP, pp. 27-28.

<sup>177</sup> EOC SOP, pp. 6-8.

<sup>178</sup> Public Intervenors SOP, p. 23.

regulatory purposes. Pueblo County also states it agrees with many intervenors that the Company's requested executive equity compensation should be rejected in its entirety.<sup>179</sup>

158. We direct Black Hills to remove from its cost of service the \$512,246 of costs associated with the equity compensation program. We find that the recovery of these equity compensation costs from the Company's ratepayers is not reasonable based on the arguments raised by the intervening parties in this case.<sup>180</sup>

#### **h. SourceGas Synergies Credit**

159. Black Hills reduces its 2015 Test Year cost of service by \$1.7 million to reflect cost savings from the acquisition of SourceGas by BHUH in February of this year.<sup>181</sup>

160. Staff contends that, since the SourceGas acquisition is not even a year old, it is difficult to assess the actual savings and the values calculated by Black Hills are only estimates. Staff states that it propounded discovery on this issue and determined that there is little analytical evidence to support the Company's proposed level of cost savings.<sup>182</sup> Staff states that a much larger synergies saving credit can be supported by the record and recommends that the Commission assume \$2.2 million in savings until the next rate case. Staff suggests that, in the interim, Black Hills be required to document baseline variances between pre- and post-acquisition budgets.<sup>183</sup>

161. The OCC also expresses concern that Black Hills' proposed \$1.7 million adjustment is based only on estimates and that there is no way to confirm that this is the

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<sup>179</sup> Pueblo County SOP, pp. 4-5.

<sup>180</sup> Commissioner Glenn A. Vaad voted in favor of including 50 percent of the equity compensation costs as recommended by Staff.

<sup>181</sup> Hearing Exhibit 22. Otto Direct, p. 12.

<sup>182</sup> Hearing Exhibit 34. Reis Answer, p. 26.

<sup>183</sup> Hearing Exhibit 34. Reis Answer, p. 28.

appropriate amount of cost savings that should be allocated to Black Hills. The OCC does not provide a specific amount, but suggests that the Commission should be aware that the actual savings could be much higher than \$1.7 million.<sup>184</sup>

162. Black Hills counters Staff's position, stating that Staff's calculations are based on incorrect allocations, and maintains that the Company has updated and affirmed its estimate of \$1.7 million.<sup>185</sup> Black Hills also rejects Staff's recommendations for additional reporting, stating that such reports are unnecessary and would be administratively burdensome. Black Hills maintains the savings will be allocated according to the Cost Assignment and Allocation Manuals and will be reported in the Company's Appendix A earnings reports in its annual reports. Additionally, Black Hills characterizes additional reporting as unnecessary because pursuant to Decision No. R16-0058-I in the acquisition proceeding, Proceeding No. 15A-0667G, BHUH agreed with parties to that proceeding, including Staff and OCC, what would be tracked. Black Hills also states that additional reporting would affect BHUH, Black Hills Gas Distribution LLC, Rocky Mountain Natural Gas LLC, and Black Hills/Colorado Gas Utility Company LP, none of which are parties to this proceeding.<sup>186</sup>

163. Given that the SourceGas acquisition is less than a year old, determining actual cost savings from the acquisition is not possible. In consideration of the Company's estimate of \$1.7 million of savings and Staff's recommendation of \$2.2 million of savings, we conclude that \$2.0 million in cost savings is a reasonable amount to be used in the calculation of revenue requirements and the associated GRSA.<sup>187</sup> We also find that Staff and others will have ample

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<sup>184</sup> Hearing Exhibit 36, England Answer, p. 27.

<sup>185</sup> Hearing Exhibit 23, Otto Rebuttal, p. 5.

<sup>186</sup> Hearing Exhibit 23, Otto Rebuttal, p. 6.

<sup>187</sup> Commissioner Frances A. Koncilja does not join in these findings and conclusions.

opportunity to track the SourceGas acquisition cost savings and allocations through Black Hills' Appendix A to its Annual Report filings and the reports ordered in Proceeding No. 15A-0667G.<sup>188</sup>

**i. Loss on Coal Reserves**

164. In compliance with the CACJA, Black Hills closed the W.N. Clark plant on December 31, 2012.<sup>189</sup> The Company proposes to amortize through a *pro forma* expense the loss on the sale of the coal pile that was no longer needed upon the discontinuance of the plant's operations.<sup>190</sup>

165. The OCC questioned Black Hills' inclusion of the \$1,568,506 loss in the Company's cost of service. The OCC maintains that the depletion of the coal was one of the assumptions in a study that led to the approval of the decommissioning of W.N. Clark.<sup>191</sup> The OCC alleges that Black Hills relied on its status as a regulated entity to close the plant early and take the loss on the coal, seeking to recover the loss from ratepayers.<sup>192</sup>

166. Black Hills counters that the economic analysis performed for early shut down of the plant indicated economic benefits of approximately \$3.4 million, so that the ratepayers realized a net benefit of \$1.8 million.<sup>193</sup> Black Hills maintains that it acted prudently by closing W.N. Clark one year before its approved CACJA emission reduction plan called for closure and that it disposed of the coal in an efficient single-buyer transaction. Black Hills states that by

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<sup>188</sup> Decision No. R16-0058, issued January 22, 2016, Proceeding No. 15A-0667G.

<sup>189</sup> Decision No. R12-1318, issued November 9, 2012, Proceeding No. 12A-763E.

<sup>190</sup> Hearing Exhibit 10, Clevinger Direct, p. 13.

<sup>191</sup> Hearing Exhibit 36, England Answer, Attachment SEE-7.

<sup>192</sup> Hearing Exhibit 36, England Answer, pp. 17-19.

<sup>193</sup> Hearing Exhibit Lux Rebuttal, p. 4.

not putting the coal out for a request for proposals, it was able to restrict the delivery method to “as is, where is” and thereby realize a greater gain on the sale.<sup>194</sup>

167. We find that although Black Hills possibly could have mitigated the coal sale loss, the early closure of Clark allowed an economic benefit to ratepayers and is consistent with the goals of the CACJA.<sup>195</sup> We therefore approve the Company’s request to amortize the loss through a *pro forma* expense adjustment in its cost of service study.

**j. Pueblo 5 and 6 Decommissioning Costs**

168. Black Hills seeks to recover the decommissioning costs associated with Pueblo 5 and 6 facilities through a *pro forma* expense adjustment in its cost of service model.<sup>196</sup> The proposed expense adjustment would also address decommissioning costs of the W.N. Clark Station. Black Hills proposes to devote the first two years of collections of the *pro forma* expense to cover the costs of the W.N. Clark project.<sup>197</sup>

169. The OCC counters that the demolition of Pueblo 5 and 6 has not yet been permitted by the City of Pueblo. Therefore, since the actual costs of decommissioning are not known, the OCC argues that it is premature to include \$4.3 million in the current cost of service.<sup>198</sup>

170. Because Black Hills has not yet received approval for the demolition of Pueblo 5 and 6, the *pro forma* expense to amortize such decommissioning costs should not be included in

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<sup>194</sup> Hearing Exhibit Lux Rebuttal, p. 10.

<sup>195</sup> Commissioner Frances A. Koncilja does not join in these findings and conclusions.

<sup>196</sup> Hearing Exhibit 11, Clevinger Rebuttal, Attachment MCC-5, Schedule J-1.

<sup>197</sup> Hearing Exhibit 10, Clevinger Direct, p. 31.

<sup>198</sup> OCC SOP, p. 35.



its cost of service used to set rates in this Proceeding. We further note that Black Hills currently has a regulatory asset which tracks these costs.<sup>199</sup> That accounting treatment shall continue.

**k. Deferred Accounting for Vegetation Management**

171. Beginning in 2012, Black Hills began transitioning its vegetation management program to new practices and procedures. The Company states that it previously employed a vegetation management program based on reactively spotting and solving problems in its rights of ways (ROWs). Black Hills' new program is based on "reclaiming" full ROWs in a systematic manner that decreases outages but requires more intensive work initially as the Company clears ROWs that might not have been trimmed for several years. Black Hills concedes that the applicable North American Electric Reliability Corporation Standard FAC-003-03 does not require the Company to convert to the new vegetation management program because the Company's lines fall below the 200kV requirement. Nevertheless, the Company has adopted the standard as a means of best practices.<sup>200</sup>

172. Due to the transition to reclaiming full ROWs, Black Hills proposes deferred accounting treatment for vegetation management expenses above or below \$2,309,790, the amount included in the Company's base rate cost of service.<sup>201</sup>

173. Staff recommends that the Commission reject the proposed deferred account for vegetation management, stating that Black Hills has failed to demonstrate a need for the deferred account, which is generally used in urgent circumstances.<sup>202</sup> Staff's position is that the change in vegetation management program is not an urgent need that requires funds above those allowed

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<sup>199</sup> Decision No. C15-1119, issued October 16, 2015, Proceeding No. 14A-1196E.

<sup>200</sup> Hearing Exhibit 20, Kline Direct, p. 10.

<sup>201</sup> Hearing Exhibit 10, Clevinger Direct, p. 43.

<sup>202</sup> Hearing Exhibit 34, Reis Answer, p. 37.

through established rates. Staff suggests that Black Hills has requested the deferred account simply because it does not want to make an adjustment to its revenue requirement, increasing the overall request for a rate increase. Staff recommends that the Company raise its spending level for vegetation management and include it, along with supporting data, in its next rate case.

174. The OCC also recommends that the Commission deny Black Hills' proposed deferred account for vegetation management, stating that if vegetation management costs exceed those in the current cost of service, Black Hills can file a rate case for recovery.<sup>203</sup> The OCC's position is that the deferred account will allow all expenses to be accrued for future recovery under the assumption that all of the expenses are prudently incurred, an assumption that might not hold. Furthermore, the OCC maintains that the deferred account shifts the risk of cost recovery from the Company to ratepayers.<sup>204</sup> The OCC states that a deferred account was authorized only once before by the Commission, in response to the need for immediate removal of Mountain Pine Beetle-infested trees.<sup>205</sup> The OCC sees no such emergency in the shift in the vegetation management practices of Black Hills and therefore no need to create the deferred account.

175. Black Hills counters that the Company is requesting deferred accounting only for the amount that is above or below the base level costs of \$2,309,790 through the transition period to the new vegetation management program.<sup>206</sup> The Company also rebuts the contention that the transition to a different vegetation management program is part of the Company's ordinary course of business, stating that the transition is a significant acceleration in expenses over a

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<sup>203</sup> Hearing Exhibit 36, England Answer, p. 35.

<sup>204</sup> Hearing Exhibit 36, England Answer, pp. 31-32.

<sup>205</sup> Decision No. C12-0494, issued May 9, 2012, Proceeding No. 11AL-947E.

<sup>206</sup> Hearing Exhibit 21, Kline Rebuttal, pp. 3 and 5.

limited time. For this reason, Black Hills maintains that a deferred account is appropriate since the Company knows what the costs will be and has proposed a method of tracking them. The Company rejects the idea that the costs could be captured through a future rate case, stating that Staff's recommendation could result in over-recovery because the Company intends to decrease its vegetation management spending after three years. Black Hills also rejects the OCC's argument that the costs in the deferred account would escape a prudence review because the Commission can review them when the Company requests recovery.

176. We acknowledge that vegetation management is an important practice for all utilities. However, we are not convinced that a deferred account for vegetation management expenses is necessary, in part because Black Hills' decision to change its vegetation management program does not rise to the level of unusual circumstances that might warrant deferred accounting. Therefore, we deny the Company's request for approval of deferred accounting treatment for vegetation management expenses above or below \$2,309,790.

### **3. Revenues**

#### **a. Weather Normalization Adjustment**

177. It is undisputed in this Proceeding that the summer of 2015 was warmer than normal summers. The intent of weather normalization is to adjust test year revenues to reflect normal temperatures.

178. Black Hills proposes a weather normalization adjustment that reduces actual billed energy for the 2015 Test Year by 32,524,650 kWh, which translates to a \$1,668,767 reduction in revenue.<sup>207</sup> Black Hills explains that this adjustment derives from a

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<sup>207</sup> Hearing Exhibit 24, Gray Direct, p. 8.

weather normalization method created by Staff and accepted by the Commission in previous Phase I rate cases, Proceeding Nos. 10AL-008E and 11AL-387E.<sup>208</sup> The method applies data from the National Oceanic and Atmospheric Administration (NOAA) and customer usage data captured by the Company's Meter Data Management System in 2015. Black Hills calculates "sensitivity factors" that identify weather-driven usage as a percentage of customer loads by comparing the average customer load during the "shoulder" months of May and October against the customer load in the summer months of June through September.<sup>209</sup>

179. Staff challenges the method used by Black Hills and recommends that the Commission adopt a weather normalization adjustment that reduces billed energy by 9,312,462 kWh, which translates to a \$724,093 reduction in revenue.<sup>210</sup> Staff's proposed weather normalization adjustment to revenues is based on a different method for deriving a "sensitivity factor" that identifies weather-driven usage based on data for only the summer months June through September. Staff argues that it is appropriate to use only June through September data in the weather normalization process, because the Company is not adjusting revenues for the eight non-summer months.

180. Staff's proposed weather normalization method reduces the sensitivity factors for all customer classes in the Black Hills system, meaning that a smaller percentage of customer usage is related to hotter temperatures than indicated by the method the Company used.<sup>211</sup> At hearing, Staff witness Erin O'Neill explained the lower sensitivity factors that Staff derived for the Company's commercial rate classes, stating that: "for a store or a commercial enterprise,

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<sup>208</sup> Hearing Exhibit 24, Gray Direct, p. 9.

<sup>209</sup> Hearing Exhibit 25, Gray Rebuttal, p. 5.

<sup>210</sup> Hearing Exhibit 32, O'Neill Answer, p. 1.

<sup>211</sup> Hearing Exhibit 32, O'Neill Direct, p. 9.

they are basically running their air conditioning all the time whether the temperature goes up and down a couple of degrees. Given that it is summer and their air conditioning is on, they are not particularly sensitive to it being a little bit hotter or a little bit colder. That is what was supported by the data.”<sup>212</sup>

181. Staff used NOAA weather data for the Pueblo area similar to the Company. But in contrast to Black Hills’ weather normalization analysis, Staff analyzed 13 years of data on loads per customer, which includes 6 more years of recent data than in the Company’s analysis.<sup>213</sup> At the hearing, however, Ms. O’Neill acknowledged that her use of billing data was not ideal,<sup>214</sup> but that such data was what was provided by the Company. She explained that while use of metered data from the Company’s Advanced Meter Infrastructure (AMI) would have been preferable, there is only 2 years of AMI data available for analysis, compared to 13 years of billing data.<sup>215</sup>

182. Black Hills objects to Staff’s recommendations regarding its revised weather sensitivity factors, arguing that Staff’s proposal equates to a hotter summer temperature having a lower impact on customers’ summertime energy consumption than what has previously been accepted by the Commission.<sup>216</sup> Black Hills argues that Staff’s approach is based on a flawed comparison of data because Staff used data from billing cycles that do not conform to the calendar months of weather data. The Company further asserts there is no significant difference concerning its model and actual history.<sup>217</sup>

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<sup>212</sup> Transcript, October 21, 2016, pp. 149-150.

<sup>213</sup> Transcript, October 21, 2016, pp. 148-149.

<sup>214</sup> Transcript, October 21, 2016, pp. 138 and 152-153.

<sup>215</sup> Transcript, October 21, 2016, pp. 149-150.

<sup>216</sup> Black Hills SOP, p. 47.

<sup>217</sup> Hearing Exhibit 25, Gray Rebuttal, pp. 11-12.

183. We find Staff's weather normalization calculations based on lower sensitivity factors to be reasonable, despite the potential for some mismatch between the types of underlying data in Staff's analysis. We therefore direct the Company to adjust the 2015 Test Year revenues by \$724,093 as recommended by Staff.

**b. Year End Revenue Annualization**

184. Black Hills Witness Clevinger notes that the Company made an adjustment to year end revenues to account for additional customer usage, and argues that this revenue adjustment should be reversed if the Commission adopts a 13-month average test year.<sup>218</sup> The OCC agrees with that adjustment.<sup>219</sup>

185. Consistent with our decision to require the rate base for the 2015 Test Year to be calculated as a 13-month average, we agree with Black Hills that the \$641,874 revenue annualization adjustment in its year-end 2015 revenues should be removed when calculating the Company's final revenue requirement and the corresponding GRSA.

**K. Changes to Transmission Cost Adjustment (TCA) Cost Recovery**

186. Black Hills proposes modifications to its TCA tariff so that the rider would provide current recovery of transmission investments in the year that they are made. The proposed tariff changes are intended to address earnings attrition created by large transmission-related investments in the next couple of years.<sup>220</sup> Black Hills claims that its proposed method for current cost recovery is similar to the method recently authorized by the Commission for Public Service.<sup>221</sup> The Company also claims it is permitted to earn current

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<sup>218</sup> Hearing Exhibit 11, Clevinger Rebuttal, p. 9.

<sup>219</sup> OCC SOP, p. 15.

<sup>220</sup> Hearing Exhibit 3, Stoffel Direct, p. 38.

<sup>221</sup> Decision No. C15-0292, issued March 31, 2015, Proceeding No. 14AL-0660E.

recovery of TCA investments pursuant to § 40-5-101(4)(b), C.R.S. The new start date for inclusion of TCA assets will be January 1, 2017, and will be revised to include projected costs for 2017 on a 13-month average basis. Black Hills states that the corresponding transmission investments are approximately \$26.8 million for 2016 and \$16.1 million for 2017.<sup>222</sup>

187. Staff supports Black Hills' proposal, agreeing that the modified TCA language is authorized by statute and is very similar to that contained in Public Service's tariff as approved by Decision No. C15-0292.<sup>223</sup> Staff also concludes that the change proposed by Black Hills is not prohibited by statute.

188. The OCC recommends that the TCA methodology not be changed because the rider already guarantees the recovery of expenses in its current form and because any regulatory lag that exists is for the purpose of ensuring that expenses are accurate.<sup>224</sup> The OCC notes that the presence of the true-up mechanism in the TCA tariff will serve to collect all prudently incurred costs. Further, the OCC cautions that a prospective rider may have the effect of encouraging the utility to over-estimate costs, given the lag before any customer refund would be issued.

189. In response, Black Hills denies that its proposed modification to the TCA would encourage the Company to over-project its costs, in part because of the interest payment required on balances for true-ups.<sup>225</sup>

190. We are not persuaded to modify the TCA to allow for current cost recovery of transmission investments as proposed by Black Hills for the purpose of addressing alleged

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<sup>222</sup> Hearing Exhibit 3, Stoffel Direct, p. 38.

<sup>223</sup> Hearing Exhibit 30, Kunzie Answer, p. 41.

<sup>224</sup> OCC SOP, pp. 22-23.

<sup>225</sup> Black Hills SOP, p. 50.

earnings attrition. Furthermore, § 40-5-101(4), C.R.S., also does not require the adoption of the proposed changes to the tariff. We also note that the changes made to Public Service's TCA mechanism was a provision of a settlement that was not specifically addressed by any Commission decision.

**L. Roll-In of TCA and PCCA to Base Rates**

191. Black Hills proposes to “roll in” costs that would otherwise be recovered through its TCA and its PCCA by including the associated transmission investment and purchased capacity costs in the base rate cost of service. Black Hills explains that, inasmuch as the TCA and PCCA costs have been included in the base rate test period, subsequent TCA and PCCA tariff filings to become effective January 1, 2017, would exclude them.<sup>226</sup> The amount of TCA revenues to be rolled into the proposed GRSA is approximately \$1.6 million, and the amount of PCCA revenues to be rolled in is approximately \$770,000.<sup>227</sup>

192. EOC opposes the proposed roll-in of TCA and PCCA costs into the GRSA-collected revenue requirement.<sup>228</sup> EOC argues that the roll-in would have the effect of increasing the fixed Customer Charge, which, as explained above, is \$16.50 per month for residential customers. EOC points out that, unlike a GRSA, the TCA and PCCA collect costs either on an energy-only or a demand-only basis in accordance with cost functionalization, cost categorization, and rate class allocations.<sup>229</sup>

193. We will not approve the proposed roll-in of the TCA and PCCA costs and revenue requirements into the new GRSA. Consistent with our decision to retain the CACJA Adjustment

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<sup>226</sup> Black Hills SOP, pp. 51-52.

<sup>227</sup> Hearing Exhibit 11, Clevenger Rebuttal, p. 4, Table MCC-R1.

<sup>228</sup> EOC SOP, p. 28.

<sup>229</sup> EOC SOP, p. 13.



rider to preserve the benefits of class cost allocations and to alleviate GRSA impacts on the monthly fixed Customer Charge of \$16.50 in residential base rates, we will consider the roll-in of the TCA and PCCA revenues in the Phase II rate case, when costs are functionalized, categorized, and assigned or allocated to customer rate classes. While § 40-5-101(4)(b), C.R.S., allows for costs recovered through the TCA to instead be recovered in base rates as a result of a rate case, the statute does not require the Commission to order such transfer of costs from the rider to base rates.

194. Black Hills is authorized to continue to use TCA and PCCA to collect revenue requirements consistent with previous Commission decisions and the terms of the approved tariffs. Changes to the 2017 TCA and 2017 PCCA consistent with this Decision shall be filed on not less than 30 days' notice in separate advice letter filings.

#### **M. Technical Conference**

195. Pursuant to Decision No. C16-1093-I,<sup>230</sup> Black Hills filed on December 6, 2016, an updated cost of service model for the calculation of the base rate revenue requirement, a model deriving the corresponding change in the GRSA, a worksheet deriving a revenue requirement to be collected through the CACJA Adjustment rider for effect on January 1, 2017, and information on the bill impacts resulting from the increase in the GRSA and the change in the CACJA Adjustment rider rates. The calculations were based on our deliberations at the November 30, 2016, Commissioners' Weekly Meeting.

196. At the Technical Conference held on December 7, 2016, Black Hills presented the updated cost of service model reflecting the approved adjustments to the 2015 Test Year. Black Hills demonstrated that, based on our deliberations, the approved increase in electric base rate

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<sup>230</sup> Decision No. C16-1093-I, issued November 30, 2016, Proceeding No. 16AL-0326E.

revenues is \$636,267, and the corresponding GRSA is 0.4102 percent. This GRSA value would be combined with the Company's existing GRSA of 1.9450 percent for a new GRSA value of 2.3552 percent to be set forth in Black Hills' tariffs. The combined GRSA would take effect January 1, 2017.

197. In addition, Black Hills presented the calculation of the 2017 CACJA Adjustment rider revenue requirement and the CACJA Adjustment rider rates for effect on January 1, 2017. Black Hills demonstrated that, based on our November 30, 2016, deliberations, the CACJA Adjustment rider would collect \$6,438,585 on an annual basis, an increase from the annualized amount of revenues collected under the current CACJA Adjustment rider rates of \$5,910,552.

198. Black Hills showed that the combined increase in annual revenues would be \$1,164,301. In terms of bill impacts that are comparable to those estimated by the Company at the time of its filing of Advice Letter No. 721 in May 2016, the approved rate causes an increase of approximately \$0.90 per month in the average residential bill (assuming 600 kWh of usage).

#### **N. General Rate Schedule Adjustment (GRSA)**

199. We approve an increase of base rate revenues for Black Hills of \$636,267. Black Hills is authorized to implement a GRSA of 2.3552 percent to become effective January 1, 2017, in accordance with the compliance tariff filing procedures set forth in this Decision.

#### **O. Future Rate Case Filing Requirements**

200. As a general principle, rates for electric service should be redesigned based on cost functionalization, categorization, and class allocation whenever there is a significant change in the Company's overall revenue requirements.

201. In previous Phase I rate cases, the Commission has been in a position to conclude that the utility's proposed GRSA would result in just and reasonable rates at least until there is a

follow-on Phase II rate case. However, the adoption of a GRSA in a Phase I rate case has become an increasingly controversial matter, raising the question of whether the proposed proportional increase in base rate components alters rates to the extent they are no longer just and reasonable. For example, when recently approving the GRSA for Public Service's gas operations, the Commission specifically determined that the final GRSA would not cause an unreasonable distortion in rate design or bill impacts for residential customers.<sup>231</sup> The record in this particular rate case supports efforts to minimize the use of the GRSA because of its indiscreet effects on rates.

202. Black Hills is already subject to a Commission directive to file a Phase II rate case following this proceeding,<sup>232</sup> and the Company states that it intends to file a Phase II rate case in the mid-2017 time period including a class cost of service study.<sup>233</sup>

203. We direct Black Hills to file a Phase II rate case no later than July 7, 2017.

204. Aside from the pending Phase II rate case filing, Black Hills witness Stoffel suggested at hearing that the Company does not intend to file another electric rate case for approximately three years.<sup>234</sup> Until otherwise allowed by the Commission, Black Hills shall file combined Phase I and Phase II rate cases so that overall increases in revenue requirements can be examined in terms of class cost allocations and rate design. While such combined filings may be more complex, administrative efficiencies and the associated costs savings may be gained relative to the current practice of separate proceedings.

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<sup>231</sup> Decision No. C16-0123, issued February 16, 2016, Proceeding No. 15AL-0135G, p. 25, ¶92.

<sup>232</sup> Decision No. R15-0605, issued June 26, 2014, Proceeding No. 14V-1164E.

<sup>233</sup> Transcript, October 18, 2016, p. 69.

<sup>234</sup> Transcript, October 18, 2016, p. 164.

**P. Response to Dissent**

205. The Public Utilities Commission, a Constitutional created entity, has a unique role among all state agencies. The Commission has the responsibility of assuring that the activities of regulated utilities result in rates that are “fair, just, and reasonable,” and are based on decades of case law. The Commission’s decisions must protect the public interest and assure that the State of Colorado is attractive for operation of safe and reliable utility service. The Commission has performed this function for over 100 years. The hallmark of success is deciding cases based solely on the record and respecting prior Commission decisions while adjudicating a case based on current circumstances.

206. While the majority is cognizant of the Dissent’s emotional attachment to the City of Pueblo, that does not excuse the failure to follow Commission precedent. We are unaware of any time where a Commission has dramatically reduced an ROE, the WACC, or eliminated indirect costs, primarily for the purpose of sanctioning an individual company. The decisions of this Commission are foundational for the economic well-being of the State of Colorado, and an adherence to fundamental decision-making is paramount.

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

1. The effective date of the tariff sheets filed by Black Hills/Colorado Electric Utility Company, LP (Black Hills) on May 3, 2016, under Advice Letter No. 721 is permanently suspended and shall not be further amended.

2. The tariff sheets filed under Advice Letter No. 721 are permanently suspended and shall not be further amended.

3. Black Hills is authorized to increase base rate revenues by \$636,267, consistent with the discussion above.

4. Black Hills shall file a revised Sheet No. 78 in Colorado PUC No. 9 to implement a General Rate Schedule Adjustment of 2.3552 percent, effective January 1, 2017, consistent with the discussion above.

5. Black Hills is authorized to file modified tariff sheets for the Clean Air-Clean Jobs Act (CACJA) Adjustment rider tariff to implement the requirements of this Decision.

6. Black Hills shall file an advice letter compliance filing with the General Rate Schedule Adjustment and CACJA Adjustment rider tariff sheets in a separate proceeding and on not less than two business days' notice for effect no sooner than January 1, 2017.

7. Black Hills may file an advice letter to revise its Transmission Cost Adjustment consistent with this Decision on not less than 30 days' notice.

8. Black Hills may file an advice letter to revise its Purchased Capacity Cost Adjustment consistent with this Decision on not less than 30-days' notice.

9. Consistent with the discussion above, Black Hills shall file a Phase II electric rate proceeding no later than July 7, 2017.

10. Unless otherwise ordered by the Commission, Black Hills shall not file separate Phase I and Phase II electric base rate proceedings, consistent with the discussion above.

11. 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.

12. This Decision is effective upon its Mailed Date.

**B. ADOPTED IN COMMISSIONERS' WEEKLY MEETING  
November 30, 2016.**

(S E A L)



THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF COLORADO

JOSHUA B. EPEL

GLENN A. VAAD

Commissioners

ATTEST: A TRUE COPY

Doug Dean,  
Director

COMMISSIONER FRANCES A. KONCILJA  
CONCURRING IN PART AND DISSENTING IN  
PART.

**III. COMMISSIONER FRANCES A. KONCILJA CONCURRING IN PART AND  
DISSENTING IN PART**

1. The 94,000 electric ratepayers in Southern Colorado pay some of the highest electric rates in Colorado - actually some of the highest in the nation - in spite of the fact that the Black Hills Colorado Electric (BHCE) customer footprint includes some of the poorest counties in Colorado.<sup>235</sup> While I am appreciative of the Commission's decisions to substantially reduce this latest increase sought by BHCE, and am appreciative of the three-hour frank, open and thoughtful discussion that the Commissioners engaged in on November 30, 2016, many substantial financial issues remain and it is these issues that have contributed to and will continue to contribute to these inordinately high electric rates. As a result, I cannot put a completely

<sup>235</sup> BHCE serves Pueblo and Fremont Counties, as well as portions of Custer, Otero, Teller, and El Paso Counties,

happy face on this outcome because I believe the Commission either failed to address and or incorrectly addressed these important remaining problems.

2. The reductions in the requested increase do not go far enough. The rates in Southern Colorado are still too high because:

1. The Commission has allowed \$854,361 dollars of indirect costs and cost sharing, allocated by the parent to BHCE as part of the cost of service.<sup>236</sup>
2. The cost of debt at 5.29 percent is still too high, ignores the much lower rates that BHCE's parent allocates to other affiliates and ignores the historical evidence that BHCE has failed to use the low interest rates of the last eight years to benefit Colorado ratepayers. This rate rewards BHCE for doing a poor job of using this low interest environment.
3. The return on equity (ROE) while a reduction from the BHCE request, is still too high, ignores the real world financial analysis of the witnesses presented by Staff and OCC, and instead relies on a formulaic "analysis" from the BHCE expert that is essentially an echo chamber of a continuous feedback loop as opposed to a rigorous financial analysis of markets and economic reality.<sup>237</sup>
4. The Commission should have removed from the cost of service, the \$573,000 annual amortization of the Aquila pension expense, as well as crediting the probably \$4 million that BHCE has already collected from ratepayers, as opposed to kicking the can down the road. BHCE failed to establish that the Commission has knowingly ever approved this expense in the past and therefore the Commission should have removed this expense
5. The Commission should have removed the \$1,568,506 the loss on sale of the coal pile at W.N. Clark because BHCE produced no evidence of the market price at the time or what efforts it made to sell the coal at a higher price. Their attitude was why bother when the ratepayers will pay for the loss.
6. The Commission should have used the capital structure of the parent which is 48.98 percent equity and 56.02 percent debt because BHCE has no capital structure. It is allocated to BHCE by the parent, as convenient

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<sup>236</sup> BHCE asserts that the direct costs of operating the LM6000 will be \$676,326. Thus the indirect costs exceed the direct costs by 126 percent. This is unreasonable.

<sup>237</sup> It is ironic that the BHCE, as a regulated monopoly, chooses to ignore market based realities and analyses when it makes these requests for rate increases. The Black Hills group would never get away with these actions if they had to compete in the market.

and beneficial to the parent and the, unregulated entities that are part of the Black Hills group.

7. The Commission should have reduced by 50 percent the request for attorney fees and costs for this rate case because the \$500,000 is simply too high for a utility that serves 94,000 ratepayers, is too high compared to what Public Service has sought in other cases and BHCE should not be rewarded for making many of its hyper aggressive, and or frivolous arguments. Simply put, Colorado ratepayers should not pay for BHCE's desire to roll the dice once more.

**A. Indirect Costs**

3. The Black Hills parent group, including the holding company and the service company, has an inherent conflict of interest with BHCE. The allocation of \$854,361 of indirect costs to Colorado ratepayers in this case is an example of that conflict of interest and demonstrates why this Commission must scrutinize these types of allocations and cost sharings. Put another way, BHCE has demonstrated again and again that it will favor its unregulated affiliates and the holding and service companies over Colorado ratepayers. Attachments MCC-6<sup>238</sup> and MCC-1<sup>239</sup> demonstrate the problem and also establish why the Commission may not have been aware of these huge indirect costs in the past. Attachment MCC-6<sup>240</sup> establishes that the incremental direct costs of operating the LM6000 are \$676,326 but the indirect allocations are \$854,361.

4. Attachments CMO-5 and CMO-6<sup>241</sup> list the types of indirect costs that the parent group, the holding company and the service company allocate to BHCE: Board of director fees and expenses, general office rent, depreciation of Black Hills Service Company assets, directors and officers insurance, investor relation expenses, shareholder expenses, and intercompany

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<sup>238</sup> Hearing Exhibit 10, Clevinger Rebuttal, Attachment MCC-6.

<sup>239</sup> Hearing Exhibit 10, Clevinger Direct, Attachment MCC-1.

<sup>240</sup> Hearing Exhibit 10, Clevinger Rebuttal, Attachment MCC-6.

<sup>241</sup> Hearing Exhibit 22, Otto Direct, Attachments CMO-5 and CMO-6



interest expenses. These allocations are based on the value of the property. *See* CMO-10.<sup>242</sup> Because the LM6000 is a brand new plant which cost \$62.9 million, the Black Hills corporate group shoves much of its cost of doing business to Colorado ratepayers through these allocations. Even if the allocation of \$854,361 indirect costs is appropriate, which it is not, the parent group should have reduced the costs by 99.715 percent, the ratio of 351 days to 352 days because the LM6000 will only be used one day a year. This allocation of \$854,361 is outrageous given that the LM6000 will be used one or two days a year.

5. The irony of this \$854,361 allocation is that BHCE used a different method with respect to calculating fuel costs. They reduced the fuel costs from an annualized \$718,164 to \$9,930 to reflect the operation of the LM6000 for only one or two days a year.<sup>243</sup>

6. Assuming that the Black Hills corporate group has done the same thing in the past, I estimate that Colorado ratepayers have likely paid over \$5 million a year for inclusion of indirect costs based on the construction costs of the units at the Pueblo Airport Generating Station. It is difficult to determine the actual number, because BHCE folds these indirect costs into other accounts and merely drops in a footnote to indicate that the account includes both direct and indirect costs. By way of example, *see* Corrected Attachment MCC-10, Schedules H-13 and H-15.<sup>244</sup>

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<sup>242</sup> Hearing Exhibit 22, Otto Direct, Attachments CMO-10

<sup>243</sup> The irony of this 100 percent allocation based on the cost manual is that when BHCE realized that allocating a full year of fuel costs (\$718,164) would lead to triggering the 5 percent limit on costs that the Commission had earlier imposed in Decision No C10-1330 in Proceeding No 10M-254E on December 15, 2010, BHCE reduced the fuel cost to \$9,930. For a full explanation of this creative dance by BHCE, see pages 30-33 of Staff witness Kunzie's answer testimony. If the numbers were not so high and the damage to rate payers so great, this would be comic.

<sup>244</sup> Hearing Exhibit 10, Clevinger Direct, Attachment MCC-1.

7. Colorado ratepayers and this Commission should be outraged that BHCE, a regulated monopoly, is turning this regulatory process into a game of finding the needle in the haystack, which is exactly what they have done over the years and to the detriment of ratepayers in Southern Colorado.<sup>245</sup>

8. There may be legitimate reasons to allocate some indirect costs to Colorado ratepayers, but not \$854,367 a year. BHCE has provided absolutely no evidence as to the benefit to the Colorado ratepayers from the allocation of this amount of indirect costs and these costs should be disallowed and an investigation commenced to determine the amount of these costs in the past.

#### **B. Cost of Debt**

9. Staff of the Commission (Staff), in a well-reasoned and analytically strong presentation, proposed a cost of debt of 4.88 percent. This Commission has decided to use a cost of debt of 5.29 percent, based primarily on the assignment to BHCE of debt from the parent, approved by this Commission on January 28, 2015. This approval was granted as part of the consent calendar, which means there was no discussion of the issues. *See* Hearing Exhibits 51 and 52.<sup>246</sup> As I stated at the hearing and emphasize in this dissent, that allocation of \$350,000,000 of debt, with an annual payment of \$18,520,000, (soon to go to \$20,283,000 with the addition of the \$40 million) for the construction of the LM6000, with a term that expires in 2020 and 2023, is a ticking time bomb for the ratepayers in Southern Colorado.

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<sup>245</sup> Staff witnesses Reis and Sigalla both addressed in their answer testimony the refusal of BHCE to provide transparent and adequate data in a timely fashion. See p. 12 of Richard Reis Answer testimony and p. 1 of Fiona Sigalla Answer testimony. This behavior of BHCE is not acceptable and another reason for reducing their request for attorney fees and costs.

<sup>246</sup> Proceeding No. 15A-0023SE: Application of Black Hills/Colorado Electric Company for Approval to Assume Long-Term Debt and Decision No. C15-0096 issued January 29, 2015, Approving Application.

10. BHCE failed to disclose to the Commission in Exhibit 51 that the debt was interest only and that the debt instruments included a \$61 million prepayment or “make whole” payment in the event that the debt is refinanced. These two facts were not included in the BHCE Application and one cannot determine these facts from the attachments to the Application.<sup>247</sup> In fact, Staff was required to pose a question to BHCE during discovery in this proceeding and BHCE finally came clean in its response to discovery request at Attachment FDS-26.<sup>248</sup> As a result of the defects in this Application, this Commission should place no credibility whatsoever on the so called “cost” of long-term debt that BHCE proposed of 5.29 percent and as I stated at the hearing, either the Office of Consumer Counsel (OCC) or the City of Pueblo (Pueblo) should consider filing a complaint to reverse this action so that the Commission can conduct a complete review of the facts and determine how to protect the ratepayers in Southern Colorado from BHCE’s seemingly complete failure to use the low interest environment over the last eight years to benefits ratepayers in Southern Colorado.<sup>249</sup>

11. Further, an examination of the rate of interest on long-term debt for other affiliates of BHCE, establishes that when it wants to BHCE can obtain much better rates than 5.29 percent. BHCE asserts confidentiality over these rates claiming, falsely I believe, that it was required to maintain these interest rates as confidential because other regulators ordered that. What is far more likely is that BHCE requested that other regulators treat the information as confidential and those regulators entered orders of confidentiality. That is certainly the case with the SourceGas acquisition which was and is subject to the jurisdiction of this Commission.

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<sup>247</sup> Application in Proceeding No. 15A-0023SE.

<sup>248</sup> Hearing Exhibit 28, Sigalla Answer, Attachment FDS-26.

<sup>249</sup> This is one more example of BHCE acting in the best interest of its affiliates as opposed to the best interests of the Colorado ratepayers.

BHCE asserts that the rate of interest they are paying for the SourceGas acquisition is confidential which makes it more difficult for me to make this argument in this dissent.

12. Reviewing the various rates of interest that were available in the past, I believe this Commission should have ordered that the rate of interest be 4.42 percent. The evidence establishes that the 4.88 percent proposed by Staff was probably overly generous.

### **C. Return on Equity**

13. With absolutely no basis and no analysis, this Commission rejects the analysis done by Staff in this case and does it in a very demeaning and pejorative fashion, stating “The decreases in the authorized ROEs advocated by Staff and the OCC are unprecedented and unsound and will not be adopted here.”<sup>250</sup> The majority instead prefers to rely on the formulaic echo chamber that Mr. McKenzie, the BHCE expert, uses. Mr. McKenzie uses several high sounding formulas and models. The problem with the discounted cash flow models is that they rely on so called proxy groups. Relying on so called proxy groups can lead to absurd results based on an echo chamber and feedback loop that has no relationship to economic reality. Models are tools to be used, if they make economic sense. Models such as these are not written in stone and must be analyzed to determine if they lead to absurd results. These models have led to absurd results in the rate-setting history of BHCE. I understand the position of the other two Commissioners, that we must be cautious in setting an ROE because our actions could lead to concerns by the rating agencies that could affect other utilities in this state, most notably Public Service Company of Colorado (Public Service Company or PSCO). Let me be clear - my concerns and analysis here are not directed to Public Service Company. I believe that the evidence establishes that BHCE has been profligate with their charges to Colorado ratepayers,

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<sup>250</sup> See paragraph 65 of this Decision.

that the Commission has been too generous in the past to BHCE and that we must adjust that generosity in the rate of return on equity. Public Service Company, on the other hand, seems to take seriously its obligations to Colorado ratepayers and so my comments and conclusions should not be interpreted to affect other utilities in this state.<sup>251</sup>

14. If the evidence establishes that BHCE has received too generous rulings from this Commission in the past, we should not be bullied by the chicken little argument of BHCE that if we reduce the rate of return on equity by 100 basis points in this request, the rating agencies will recommend higher interest rates for BHCE. There is no requirement that this Commission pass onto Colorado ratepayers all increases in interest rates. If an increase in interest rates is the result of imprudent actions by the parent group of BHCE, those increased costs can be borne by the shareholders.

15. Staff, on the other hand performed several different analyses and used analyses and projections from the Office of Budget. In addition, the credential and experience of Staff witnesses on this issue is much more impressive and germane than that of Mr. McKenzie.<sup>252</sup>

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<sup>251</sup> It is also ironic to me that when it benefits BHCE, they want the same or higher rate of return that the Commission has given Public Service in the past. On the other hand, when comparisons are raised such as the costs of electricity, BHCE complains that the two utilities cannot be compared because BHCE has only 94,000 ratepayers and Public Service has close to 1.5 million ratepayers. The comments from ratepayers in Southern Colorado at the public hearing in August 2016, indicate that most of them would prefer to have Public Service Company as their electric provider, because the rates are lower and because Public Service has a large renewable portfolio. I also note that BHCE spends almost as much in attorney fees and costs on its rate cases as PSCO spends even though PSCO's requests are much more complicated. Once again, BHCE cherry picks facts, models, and analysis to benefit BHCE to the detriment of Colorado ratepayers.

<sup>252</sup> My other concern about these demeaning comments and out of hand dismissal of analytic work performed by both Staff and the OCC, is that they could likely lead to a belief by Staff and or the OCC that their opinions will be discounted so why bother. If one looks at the background of BHCE regulatory proceedings, rate payers would be far better off if the Commission had adopted the positions of Staff starting in 2008 with the BHCE acquisition of Aquila.

**D. Capital Structure**

16. BHCE does not have its own capital structure and any statement to the contrary is not based on real evidence. The parent determines the capital structure and appears to make the allocations based on what is in the best interests of the unregulated oil and gas exploration company. BHCE witness, Nooney testified that Black Hills Corporation manages the capital structure, but then failed to explain what criteria it used. Assigning a number or percent is not managing a capital structure. The capital structure that BHCE proposed is a hypothetical allocation and should not be given any deference by this Commission. It is also suspicious to me that the “management” of the capital structure, meaning the increase of equity and the reduction of debt seemed to occur when BHCE knew that it would be filing a request for rate increase.<sup>253</sup>

**E. Coal Pile**

17. The loss on the sale of the coal pile should be rejected and not included as a cost of service, because BHCE presented no evidence that it had attempted to sell the coal at a higher price or what the market was at the time. BHCE presented no evidence that it had attempted to sell the coal before it took delivery of the coal. Instead BHCE merely stated the loss of \$1,568,506 was the best price that it could obtain. This lack of evidence as to price of coal at the time is especially troubling because BHCE has a subsidiary that mines and sells coal. Mere statements, especially statements that prejudice the ratepayers should not be relied upon by the Commission. Instead the Commission should have removed this item from the cost of service.

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<sup>253</sup> The mix of debt and equity in the capital structure is significant because utilities earn more on their equity investment than they earn on their debt. The spread is usually 1 percent to 1.5 percent, so this Commission must determine the rate of return on equity, the cost of debt and the proper amount of debt and equity. Those determinations are much more problematic in this case, because BHCE for some inexplicable reason does not issue its own debt but is assigned debt by the parent and that is where the games are played by the BH group to benefit the unregulated entities to the prejudice of the Colorado ratepayers.

**F. Pension**

18. BHCE could have easily produced a reference to documents that established it had informed the Commission in the past that it was including the annual amount of \$573,000 for the pension amortization and that the Commission had accepted it. Because BHCE did not produce any such documentation, the Commission should conclude that BHCE failed to meet its burden of proof with respect to this amount of \$573,000 and remove it from rates and should have removed the amounts charged Colorado ratepayers over the last eight years, an amount that probably reaches almost \$4 million. This is another example of BHCE hiding the needle in the haystack. Staff was only made aware of this sizeable pension cost as the result of reading the BHC parent 10-K filing with the Securities and Exchange Commission.<sup>254</sup>

**G. Course of Conduct**

19. BHCE has established a course of conduct since 2008 that it will ignore the best interests of ratepayers as well as orders from this Commission. In Decision No C08-0204 in Proceeding No. 07A-108EG issued February 29, 2008, the Commission gave BHCE the benefit of the doubt when it paid a 30 percent premium to purchase the assets of Aquila which BHCE knew at the time needed huge amounts of infrastructure repair and or replacement. The Commission rejected almost all of the positions and requests of Staff and the OCC and gave BHCE the benefit of the doubt. Although BHCE promised in the proceeding that it would file its electric resource plan (ERP) within a few months (and used that promise to persuade the Commission to reject the requests of Staff and OCC) BHCE failed to timely file the ERP.

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<sup>254</sup> I suggested at the hearing and still believe that the Commission should have imposed a 50 basis point penalty against BHCE for at least three years because of BHCE's continual refusal to provide timely information and their preference to hide the ball and make this case more expensive for all parties.

20. BHCE then used its failure to timely file its ERP to essentially force the Commission to expedite and reduce the requirements of competitive bidding. *See* Decision No. C09-0184 in Proceeding No. 08A-346E issued February 24, 2009.

21. BHCE then feigned surprise that the Aquila power purchase agreement (PPA) would expire by its own terms and used that as an excuse to acquire and build generation. One wonders how BHCE decided to purchase the assets of Aquila, at a 30 percent premium, when it did not perform the due diligence to allow it to know that it would have no way to service most of its ratepayers if this PPA expired. *See* Decision No. C08-0929 in Proceeding No. 07A-447E issued September 19, 2008. So, once again, BHCE played its brinksmanship game and was rewarded with the opportunity to build assets for which the Colorado ratepayers would pay.

22. I believe that in the two rate cases, Proceeding Nos. 11AL-387E and 14Al-0393E, this Commission was too generous in awarding an ROE, cost of debt, and the capital structure and that the Commission should have corrected those generosities in this rate case

23. The proceedings and filings in these cases are lengthy and voluminous. However, a review of them establishes that BHCE ignores this Commission, and has little to no concern for Colorado ratepayers, regarding Colorado ratepayers as pigeons to be plucked.

24. Between 400 and 600 people attended the public comment hearing on August 16, 2016 which the Commission conducted in Pueblo, Colorado at the Convention Center (*See* Paragraphs 33 through 37 of this Decision). State Representative Daneya Esgar and State Senator Leroy Garcia put together the community outreach for this hearing. The Commission heard from business owners, residents, people using walkers and or wheel chairs, people on oxygen, nuns, reverends, Republicans and Democrats--all of whom



(with the exception of two individuals) were furious with BHCE. These citizens shared their stories with the Commission--how those on fixed income could not afford the electric rates, how businesses were suffering because of the high electric rates, that Pueblo was having a hard time attracting new businesses, in part, because the electric rates were so high, how low-income citizens were treated by BHCE with termination policies, including the high costs of reconnecting and the deposits required. There were many thoughtful citizens who presented comments, but I want to make reference to Beth Gladney, who shared the story of closing her small tea room of 600 square feet because the cost of electricity made the store unprofitable and the story of her husband's multi generation business -- Pueblo Bearing Service -- that was suffering from high electric rates, used the BHCE "analysis" for which they paid BHCE over \$7000, implemented all of the suggestions and their bills went up. Beth Gladney ended her comments by stating that she had appeared before an administrative law judge several years ago and made similar comments which she believed fell on deaf ears, but she hoped for some relief this time.

25. No service company, other than a regulated monopoly, could stay in business with these types of customer complaints, outrage, and fury. Many of the citizens asked the Commission to allow them to purchase electricity from Public Service Company, because rates were lower and the renewable mix was better. This Commission, unfortunately, does not have that authority.

26. I will raise again the issue of having a Special Master appointed under Colorado Rule of Civil Procedure 53 to determine how to fix the BHCE low-income program which seems to be an abysmal failure.

## H. Conclusion

27. I believe that the Commission should regulate a utility with a light hand, until the utility takes steps to injure rate payers and to enrich itself. BHCE has, by its course of conduct over eight years, established that it has no respect for the regulatory compact. It has no concern for ratepayers. BHCE has no respect for this Commission, flaunting orders, playing brinksmanship with the Commission, threatening to sue the Commission, taking advantage of any ambiguity and then blaming the Commission for the high rates the residents of Southern Colorado are paying. No one held a gun to BHCE's head and told them they had to build the LM6000. In fact, there were other much less expensive ways BHCE could have met its peaking needs.<sup>255</sup> BHCE has no concern for the ratepayer. BHCE is not appreciative of the benefits they receive from the regulatory compact. Instead BHCE acts like a colonial power that can loot the citizens of Southern Colorado. Those days are over.

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<sup>255</sup> The Statement of Position of the Public Intervenors, filed in Proceeding Nos. 13A-0445E, 13A-0446E and 13A-0447E is worth reading, because the Public Intervenors, who did not join in the settlement, got it right and predicted the problems that would occur with the approval of the LM6000. This Statement of Position also summarizes the arrogance of BHCE in its insistence on building this \$62 million peaking plant and the total lack of concern of BHCE for ratepayers. It is unfortunate that the Public Intervenors did not appeal the decision of the Commission; however, it is difficult to overturn decisions of the Commission because of the deference given to the Commission and appeals are costly.

28. For these reasons, I concur in much of the decision of the majority, but dissent from other portions of the decision as set forth above.

THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF COLORADO

FRANCES A. KONCILJA

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Commissioner