

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

PROCEEDING NO. 14AL-0393E

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IN THE MATTER OF ADVICE LETTER NO. 680 FILED BY BLACK HILLS/COLORADO ELECTRIC UTILITY COMPANY, LP TO REVISE ITS COLORADO PUC NO. 9 ELECTRIC TARIFF TO IMPLEMENT A GENERAL RATE SCHEDULE ADJUSTMENT TO INCREASE RATES, A NEW RIDER PURSUANT TO THE CLEAN AIR-CLEAN JOBS ACT, AND OTHER CHANGES, PROPOSED TO BE EFFECTIVE ON MAY 31, 2014.

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**RECOMMENDED DECISION OF  
ADMINISTRATIVE LAW JUDGE  
ROBERT I. GARVEY  
PERMANENTLY SUSPENDING TARIFF SHEETS;  
REQUIRING FILING OF NEW TARIFFS,  
AND SHORTENING TIME FOR  
FILING RESPONSES TO EXCEPTIONS**

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Mailed Date: October 28, 2014

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**I. STATEMENT**

1. On April 30, 2014, Black Hills/Colorado Electric Utility Company, LP (Black Hills or Company) filed Advice Letter No. 680, a Phase I rate proceeding, proposed to be effective on May 31, 2014. Black Hills submitted the Advice Letter with supporting testimony and exhibits.

2. Black Hills stated the purpose of the filing is to increase the rates for all rate schedules contained in the Company's Colorado P.U.C. No. 9 Tariff, to become effective May 31, 2014. Black Hills seeks to implement a revised General Rate Schedule Adjustment (GRSA) of 5.051 percent to be applied to all base rate components under all schedules. The Company further seeks to add a Clean Air Clean Jobs (CACJA) Adjustment clause to provide for cost recovery, beginning January 1, 2015, associated with the construction work in progress for its new LM6000 generating unit approved by the Commission by Decision No. C14-0007 in Proceeding No. 13A-0445E issued January 6, 2014. Black Hills Energy also seeks to revise the energy and demand components of the base rates under all schedules to roll in the costs currently being recovered under the Transmission Cost Adjustment and the Purchased Capacity Cost Adjustment, which will be offset through a corresponding change to remove the costs from recovery under these current adjustments upon the effective date of the accompanying tariff pages.

3. By Decision No. C14-0522, issued May 16, 2014, the effective date of the Advice letter was suspended until September 28, 2014. The matter was also referred to an administrative law judge (ALJ) for disposition.

4. On May 30, 2014, Staff of the Colorado Public Utilities Commission (Staff) filed its Notice of Intervention as of Right, Entry of Appearance, Notice Pursuant to Rule 1007(a) and

Rule 1403(b), and Request for Hearing. As required by Rule 4 *Code of Colorado Regulations* (CCR) 723-1-1007(a) of the Commission's Rules of Practice and Procedure, in that filing Staff identified the Trial Advocacy (litigation) Staff and the Advisory Staff.

5. On June 6, 2014, Colorado Office of Consumer Counsel (OCC) filed its Notice of Intervention of Right, Entry of Appearance, and Request for Hearing.

6. On June 6, 2014, The Board of Water Works of Pueblo, Colorado and the Fountain Valley Authority (collectively The Board and Authority) timely filed their combined Petition to Intervene.

7. On June 12, 2014, Holcim (U.S.) Inc. (Holcim) timely filed a Petition to Intervene. Holcim indicated that it receives electric service from Black Hills and is also one of Black Hills' largest customers.

8. On June 13, 2014, the City of Pueblo, Colorado (The City or Pueblo) timely filed a Petition to Intervene. The City stated that it is a municipal governmental entity and obtains electricity from Black Hills.

9. On June 13, 2014, Western Resource Advocates (WRA) timely filed its Petition for Leave to Intervene. WRA described how the subject matter of this proceeding will directly affect the pecuniary or other tangible interests of WRA, and those it represents.

10. By Interim Decision No. R14-0549-I, issued May 22, 2014, a prehearing conference was scheduled for June 17, 2014.

11. By Interim Decision No. R14-0723-I, issued on June 26, 2014, the procedural schedule agreed to by the parties at the prehearing conference was adopted and the interventions of The Board and Authority, Holcim, and WRA were granted.

12. On June 27, 2014, The City filed its Motion for Permission to Withdraw its Petition to Intervene and Petition for Amicus Curiae.

13. By Interim Decision No. R14-0835-I, issued July 16, 2014, The City's Motion for Permission to Withdraw its Petition to Intervene and Petition for Amicus Curiae was granted.

14. On September 16, 2014, Black Hills filed its Motion to Strike Certain Portions of Corrected Answer Testimony of the Office of Consumer Counsel and Request for Shortened Response Time (Motion to Strike).

15. By Interim Decision R14-1142-I, issued September 17, 2014, response time to the Motion to Strike was shortened to September 19, 2014 at noon.

16. On September 19, 2014, the OCC filed its Response in Opposition to Black Hills Motion to Strike Certain Portions of Corrected Answer Testimony of the Office of Consumer Counsel.

17. On September 19, 2014, the undersigned ALJ advised the parties that the Motion to Strike had been denied. The undersigned ALJ also advised the parties that Black Hills would be allowed to supplement its rebuttal testimony in response to the corrected testimony of the OCC during the evidentiary hearing. The parties were further advised that a written decision concerning the Motion to Strike would be included in the Recommended Decision.

18. Public Comment Hearings were held in Pueblo, Colorado on September 4, 2014 and September 11, 2014.

19. The evidentiary hearing was held as scheduled on September 23 through 25, 2014. At the close of the hearing, the ALJ closed the evidentiary record.

20. The following parties filed a Statement of Position (SOP):<sup>1</sup> Black Hills, Holcim, The Board and Authority, OCC, and Staff. WRA did not file a Statement of Position. The City filed an *Amicus Curiae* brief.

21. On October 15, 2014, Black Hills filed its Motion to Strike a Portion of the Post Hearing Statement of Position of the Office of Consumer Counsel or in the Alternative for Leave to File Response, and Request for Shortened Response Time.

22. On October 17, 2014, the OCC filed its Response Motion to Strike a Portion of the Post Hearing Statement of Position of the Office of Consumer Counsel or in the Alternative for Leave to File Response.

23. In accordance with § 40-6-109, C.R.S., the undersigned ALJ now transmits to the Commission the record in this Proceeding along with a written recommended decision.

## **II. PRE AND POST HEARING MOTIONS**

### **A. Prehearing Motion to Strike**

24. On September 16, 2014, Black Hills filed its Motion to Strike Certain Portions of Corrected Answer Testimony of the Office of Consumer Counsel and Request for Shortened Response Time (Motion to Strike I).

25. In the Motion to Strike I, Black Hills argued that the corrected testimony of OCC witness Ronald Fernandez introduced new evidence. The correction filed by the OCC consisted of a \$2 million<sup>2</sup> adjustment to what Mr. Fernandez described as a placeholder adjustment in his Answer Testimony.

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<sup>1</sup> The ALJ allowed for a page limit of 40 pages for the SOPs. Black Hills filed an Unopposed Motion for Enlargement of Page Limit to 40 Pages for Statements of Position contemporaneously with their SOP.

<sup>2</sup> The amount of Black Hills' equity compensation.

26. Black Hills argues that there is not sufficient time to “investigate and respond” to this new evidence. Black Hills further argues that allowance of this corrected testimony is a violation of due process.

27. In the alternative, Black Hills requests the evidentiary hearing be vacated to allow for discovery and written sur-rebuttal testimony. Black Hills is not willing to extend the 210-day statutory deadline for Commission decision pursuant to § 40-6-111(1), C.R.S.

28. On September 19, 2014, the OCC filed its Response in Opposition of the Colorado Office of Consumer Counsel to Black Hills’ Motion to Strike Certain Portions of Corrected Answer Testimony (Response I).

29. The OCC argues the corrected testimony is not new evidence. The OCC states that the original Answer Testimony of Mr. Fernandez contained a “place holder” for the equity compensation adjustment due to the failure of Black Hills to respond to a discovery request for the equity compensation in a timely manner.

30. The OCC states that a discovery request was made on July 11, 2014 for the equity compensation information. On July 21, 2014, Black Hills requested and was granted an extension until July 23, 2014.<sup>3</sup>

31. The response to the discovery request was made on July 24, 2014. The discovery response was insufficient, and the OCC again requested the information on July 25, 2014.

32. On July 28, 2014, answer testimony was scheduled to be filed by all Intervenors, including the OCC. Without the equity compensation information, Mr. Fernandez stated in his

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<sup>3</sup> See Attachment 1 to Response.

answer testimony that there would be an equity compensation adjustment, but at the time of the filing of the testimony the amount was unknown.

33. On August 4, 2014, Black Hills provided the requested information concerning equity compensation to the OCC.

34. The OCC also argues that there is no due process violation due to the fact that the information alleged to be new evidence, was known to Black Hills.

35. Due process is a flexible concept that requires the use of orderly procedures that are balanced in a way to protect constitutional interests while also furthering legitimate governmental ends. *Chiappe v. State Personnel Board*, 622 P.2d 527, 532 (Colo. 1981); *People v. Taylor*, 618 P.2d 1127, 1135 (Colo. 1980). Due process calls for the procedural protections that the particular situation demands. *Chiappe*, at 732; *People v. Taylor*, at 1135. This means that the process due depends on the circumstances of a given case.

36. Procedural due process in administrative hearings requires notice and an opportunity to be heard. *Watson v. Board of Regents*, 512 P.2d 1162, 1165 (Colo. 1973) (“courts have recognized that procedural due process requires -- prior to imposition of the disciplinary action -- adequate notice of the charges, reasonable opportunity to prepare to meet the charges, an orderly administrative hearing adapted to the nature of the case, and a fair and impartial decision”); *Bourie*, at 22; *Shaball*, at 404; *People in Interest of D.G.*, at 1202.

37. Failure to give notice violates the most rudimentary demands of due process of law. *Peralta v. Heights Med. Ctr., Inc.*, 485 U.S. 80, 84 (1988). Indeed, the purpose of notice under the due process clause is to apprise the affected individual of, and permit adequate preparation for, an impending hearing. *Memphis Light, Gas & Water Division v. Craft*, 436 U.S. 1, 14 (1978). Due process is fundamentally the right to be heard, but that right has little

worth unless one is informed of the matters at issue. *Mullane v. Central Bank & Trust Co.*, 339 U.S. 306, 314 (1950).

38. In the instant case, Black Hills was made aware that this adjustment would be made by the OCC in the testimony filed by Mr. Fernandez on July 28, 2014. Black Hills was also aware that the amount of equity compensation was not known by the OCC until August 4, 2014. Finally the amount of equity compensation had been under control of Black Hills the entire time. This was not new information that they were informed of a week before the hearing but rather information in their control which they had reason to know would be added to Mr. Fernandez's testimony prior to the hearing. There is no due process violation.

39. The Motion to Strike is denied. Black Hills will have the opportunity to supplement their rebuttal testimony at the evidentiary hearing.<sup>4</sup>

40. The alternative relief is also denied. Without an agreement to extend the statutory deadline for a Commission Decision, a later date for the hearing will not allow sufficient time for a Commission Decision within the statutorily required 210 days.

**B. Post-Hearing Motion to Strike**

41. On October 15, 2014, Black Hills filed its Motion to Strike a Portion of the Post Hearing Statement of Position of the Office of Consumer Counsel or in the Alternative for Leave to File Response, and Request for Shortened Response Time (Motion to Strike II).

42. In its Motion to Strike II, Black Hills states that in its SOP the OCC raised a new substantive argument not previously developed in the record. Black Hills takes issue with a proposed \$200,000 adjustment to the revenue requirement based on an alleged over-recovery of

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<sup>4</sup> This ruling was made and told to the parties four days before the start of the hearing.

the \$100,000 incentive grant awarded by the Commission in Black Hills' last rate case.<sup>5</sup> Black Hills argues that it is legally and procedurally improper for the OCC to raise this type of issue in its SOP, after the evidentiary record is closed with no basis in the record for this position.

43. Specifically, Black Hills objects to the following two sentences in the OCC's SOP:

Given that the base rates stemming from the 2011 rate case went into effect on January 1, 2012 and those base rates are still in effect, the Company will have recovered about \$300,000 for this AMI Savings Incentive. The OCC believes that this is an inappropriate amount to recover from ratepayers and a negative adjustment should be made in the amount of \$200,000 to reflect the Commission's intent in Decision No. C11-1373.

44. In the alternative, Black Hills argues that due process requires that Black Hills be given the opportunity to respond to the OCC's new position.

45. On October 17, 2014, the OCC filed its Response Motion to Strike a Portion of the Post Hearing Statement of Position of the Office of Consumer Counsel or in the Alternative for Leave to File Response (Response II).

46. In their Response II the OCC argues that this adjustment was contained in Hearing Exhibit 24 the Second Corrected Answer Testimony of Cory Skluzak, and after given ample opportunity, Black Hills has failed to address the issue until the filing of the Motion to Strike II.

47. As an alternative, the OCC offers the following revision to the sentences objected to by Black Hills:

Given that the base rates stemming from the 2011 rate case went into effect on January 1, 2012 and those base rates are still in effect, the Company [may] have recovered about 300,000 for this AMI Savings Incentive. The OCC believes that this is an inappropriate amount [may have been recovered] from ratepayers and a

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<sup>5</sup> In Proceeding Nos. 11AL-382E and 11AL-387E this incentive concerned treatment of the American Reinvestment and Recovery Act of 2009 grant given to Black Hills.

negative adjustment [may be warranted] to reflect the Commission's intent in [¶ 139 of] Decision No. C11-1373.

48. The issue of potential over collection concerning the American Reinvestment and Recovery Act of 2009 (ARRA) grant was contained within the Answer Testimony of Mr. Skluzak.<sup>6</sup> The argument of over recovery concerning the ARRA grant is not a new argument that was not a part of the evidentiary hearing. There is no due process violation.

49. In the prefiled testimony and during the evidentiary hearing there was no evidence presented to establish that the amount of any over recovery concerning the ARRA grant or that there actually was an over recovery.

50. The OCC's proposed new language eliminates the dollar figures from the two sentences in question and rephrases the passage to only question if there was an over recovery. The proposed revision addresses the inaccuracies presented in the passage objected to by Black Hills.

51. Black Hills' Motion to Strike II shall be denied. The revisions suggested by the OCC shall be adopted.

### **III. PUBLIC COMMENTS**

52. According to its long-standing practice, the Commission invited public comment on the issues presented in this matter. The Commission believes that, although institutions such as the OCC represent the interests of certain consumers before the Commission, it is important to have a direct connection to interested and affected individuals and groups.

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<sup>6</sup> Hearing Exhibit 24, p. 38, l. 5- p.39 l. 4.

53. In this Proceeding, the Commission received 114 written comments. None of the comments supported Black Hill's proposed rate increase. Many comments expressed concern for policies and practices of Black Hills that are not at issue in this proceeding. Among those concerns are Black Hills' policy for discontinuation of service and deposits required to re-start service and the fund for the Low Income Assistance Program. None of the comments is evidence in this Proceeding.

54. On September 4, 2014 and September 11, 2014, the Commission held a hearing to take public comment.<sup>7</sup> At the hearing held on September 4, 2014, 32 individuals made presentations. At the hearing held on September 11, 2014, 28 individuals made presentations. Each person who spoke opposed the rate increase sought by Black Hills. Many comments were also made concerning Black Hills' policy for discontinuation of service, deposits required to re-start service, and the fund for the Low Income Assistance Program.

55. Generally speaking, the commenters that oppose the requested rate increase discussed the financially troubled times they and other ratepayers are facing. Given the current economic situation and what they describe as numerous and recent Black Hills rate increases, the commenters ask the Commission not to approve any rate increase at this time and many asked for a reduction and/or a rebate.

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<sup>7</sup> The transcript of the September 4, 2014 and September 11, 2014 hearing to take public comment is filed in this Proceeding.

56. As has been done in other proceedings, the ALJ gave Black Hills and Intervenors an opportunity to present testimony or otherwise to address the written and oral comments from members of the public.

57. As is the Commission's practice, the ALJ read and considered the written and oral comments from members of the public.

#### IV. EVIDENTIARY RECORD

58. In this Proceeding, Black Hills advocated for an increase in rates for the use of a Current Test Year (CTY) ending December 31, 2014. Black Hills presents its proposal and justification in direct testimony. In answer testimony, Intervenors respond to the arguments opposed for any rate increase and generally support the use of a historical test year (HTY). In rebuttal testimony, Black Hills addresses the Intervenors' answer testimony.

59. In this Proceeding, OCC advocates adoption of an HTY, ending December 31, 2013.<sup>8</sup> In its answer testimony, OCC presents its arguments in support of adoption of an HTY and presents its adjustments to the HTY cost of service study (*i.e.*, OCC's HTY cost of service study and HTY revenue requirement). In its rebuttal testimony, Black Hills responds to OCC's arguments in support of an HTY and to the OCC HTY cost of service and revenue requirement.

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<sup>8</sup> In this Decision, unless the context indicates otherwise, reference to an HTY means an HTY with: (a) accounting adjustments; (b) Commission-ordered adjustments; and (c) *pro forma* adjustments.

60. In this Proceeding, Staff did not take a position as to the adoption of a CTY or a HTY. In its answer testimony and during the hearing, Staff failed to present any argument concerning a CTY or an HTY. The revenue requirement presented by Staff utilized Black Hills' CTY model.

61. Black Hills, OCC, and Staff presented testimony in this Proceeding. Although it did not present testimony, the Board and Authority, Holcim and WRA participated in the evidentiary hearing held in September 2013. The City was present for the entire hearing. As used in this Decision and unless the context indicates otherwise, Parties refers to these entities that actively participated in the hearing: Black Hills, OCC, Board and Authority, Holcim, WRA, and Staff.

62. The evidentiary record contains testimony and exhibits from the three-day evidentiary hearing.<sup>9</sup> The ALJ heard the testimony of 18 witnesses.<sup>10</sup>

63. Black Hills presented the testimony of 11 witnesses: Mr. Fredric C. Stoffel,<sup>11</sup> Mr. Christopher Burke,<sup>12</sup> Mr. Bryan S. Owens,<sup>13</sup> Mr. Charles R. Gray,<sup>14</sup> Mr. Brian G. Iverson,<sup>15</sup>

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<sup>9</sup> A transcript of each day of the evidentiary hearing is filed in this Proceeding.

<sup>10</sup> This number includes witnesses who prefiled testimony but who did not present oral testimony at the hearing. When they testified, some witnesses modified or corrected their prefiled testimonies. The testimonies as modified or corrected were admitted as Hearing Exhibits.

<sup>11</sup> Mr. Stoffel is Director of Regulatory Services-Colorado for Black Hills Utility Holdings, Inc., a wholly owned subsidiary of Black Hills Corporation. Mr. Stoffel's direct testimony is Hearing Exhibit No. 2, his rebuttal testimony is Hearing Exhibit No. 3.

<sup>12</sup> Mr. Burke is Vice President of Electric Operations for Black Hills/Colorado Electric Utility, LP. Mr. Burke's direct testimony is Hearing Exhibit No. 4, and his rebuttal testimony is Hearing Exhibit No. 5.

<sup>13</sup> Mr. Owens is Manager-Colorado Electric Regulatory Affairs for Black Hills Utility Holdings, Inc., a wholly owned subsidiary of Black Hills Corporation. Mr. Owens' direct testimony is Hearing Exhibit No. 6, and his rebuttal testimony is Hearing Exhibit No. 7.

<sup>14</sup> Mr. Gray is Manager-Regulatory Affairs in the Regulatory Department for Black Hills Utility Holdings, Inc., a wholly owned subsidiary of Black Hills Corporation. Mr. Gray's direct testimony is Hearing Exhibit No. 8. Mr. Gray did not file rebuttal testimony.

<sup>15</sup> Mr. Iverson is Vice President and Treasurer of Black Hills Corporation. His direct testimony is Hearing Exhibit No. 9, and his rebuttal testimony is Hearing Exhibit No. 10.

Mr. William E. Avera,<sup>16</sup> Mr. Richard Kinzley,<sup>17</sup> Mr. Robert J. Hollibaugh<sup>18</sup> Mr. Mark L. Lux,<sup>19</sup> Ms. Laura Patterson,<sup>20</sup> and Ms. Jennifer Landis.<sup>21</sup>

64. The OCC presented the testimony of four witnesses: Cindy Z. Schonhaut,<sup>22</sup> Mr. Ronald Fernandez,<sup>23</sup> Mr. Frank Shafer,<sup>24</sup> and Mr. Cory W. Skluzak.<sup>25</sup>

65. Staff presented the testimony of three witnesses: Dr. Scott E. England,<sup>26</sup> Mr. Charles B. Hernandez,<sup>27</sup> and Ms. Bridget A. McGee.<sup>28</sup>

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<sup>16</sup> Mr. Avera is the President of FINCAP Inc., a financial, economic and policy consulting services firm. Mr. Avera's direct testimony is Hearing Exhibit No. 11, and his rebuttal testimony is Hearing Exhibit No. 12.

<sup>17</sup> Mr. Kinzley is Vice President-Corporate Controller for Black Hills Service Company a wholly owned subsidiary of Black Hills Corporation. Mr. Kinzley's direct testimony is Hearing Exhibit No. 13. Mr. Kinzley did not file rebuttal testimony. A portion of Ms. Kinzley's direct testimony is Confidential Hearing Exhibit No. 13A.

<sup>18</sup> Mr. Hollibaugh is the Director of Tax for Black Hills Service Company a wholly owned subsidiary of Black Hills Corporation. Mr. Hollibaugh's direct testimony is Hearing Exhibit No. 14, and his rebuttal testimony is Hearing Exhibit No. 15.

<sup>19</sup> Mr. Lux is Vice President and General Manager, Power Delivery, Regulated and Non-Regulated Generation for Black Hills Service Company a wholly owned subsidiary of Black Hills Corporation. Mr. Lux's direct testimony is Hearing Exhibit No. 16. Mr. Lux did not file rebuttal testimony. A portion of Ms. Lux's direct testimony is Confidential Hearing Exhibit No. 16A.

<sup>20</sup> Ms. Patterson is Director, Compensation, Benefits and Human Resources Information Systems for Black Hills Service Company a wholly owned subsidiary of Black Hills Corporation. Mr. Patterson's direct testimony is Hearing Exhibit No. 17. Ms. Patterson did not file rebuttal testimony.

<sup>21</sup> Ms. Landis is Director, Corporate Human Resources and Talent Management for Black Hills Service Company a wholly owned subsidiary of Black Hills Corporation. Ms. Landis's direct testimony is Hearing Exhibit No. 18, her rebuttal testimony is Hearing Exhibit No. 19.

<sup>22</sup> Ms. Schonhaut is the Director of the OCC. Ms. Schonhaut's answer testimony is Hearing Exhibit No. 23.

<sup>23</sup> Mr. Fernandez is a Financial Analyst and is employed by the OCC. Mr. Fernandez's answer testimony is Hearing Exhibit No. 26.

<sup>24</sup> Mr. Shafer is the Principal of KNARF, LLC a consulting company. Mr. Shafer's answer testimony is Hearing Exhibit No. 25.

<sup>25</sup> Mr. Skluzak is a Financial Analyst and is employed by the OCC. Mr. Skluzak's answer testimony is Hearing Exhibit No. 24.

<sup>26</sup> Dr. England is a Senior Economist and is employed by the Commission. Dr. England's answer testimony is Hearing Exhibit No. 22.

<sup>27</sup> Mr. Hernandez is Chief Economist and Financial Section Chief and is employed by the Commission. Mr. Hernandez's answer testimony is Hearing Exhibit No. 21.

<sup>28</sup> Ms. McGee is a Rate/Financial analyst and is employed by the Commission. Ms. McGee's answer testimony is Hearing Exhibit No. 20.

66. Including prefiled testimonies, Hearing Exhibits 1 through 51 were marked. Of the offered exhibits, Hearing Exhibits Nos. 1 through 32,<sup>29</sup> and Nos. 34 through 51 were admitted into evidence. Administrative Notice was taken of Decision No. C11-1373 in Proceeding No. 11AL-387E issued December 22, 2011.

67. At the conclusion of the September 2014 hearing, the ALJ closed the evidentiary record.

**V. GENERAL FINDINGS**

68. Black Hills is a public utility that, as pertinent here, provides regulated electric service to its ratepayers in Colorado. As a public utility, Black Hills provides regulated electric service pursuant to tariffs on file with the Commission.

69. Intervenor the Board is an independent municipal governmental entity created by virtue of the Home Rule Charter of The City. The Board provides raw and potable water service to customers inside and outside The City. The Board obtains its electricity service requirements from Black Hills.

70. Intervenor the Authority is an intergovernmental authority formed under Colorado law to operate a water pipeline, pumping stations, and a water treatment plant that delivers potable water to the communities of Security, Stratmoor Hills, Widefield, Fountain, and Colorado Springs.

71. Intervenor Holcim operates a cement manufacturing facility in Florence, Colorado. Holcim receives electric service from Black Hills at its facilities. Holcim is among Black Hills' largest electric customers.

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<sup>29</sup> Hearing Exhibit 34 was not offered.

72. Intervenor WRA is a non-profit regional environmental law and policy center serving states within the Interior West of the United States.

73. Intervenor OCC is a Colorado state agency established pursuant to § 40-6.5-102, C.R.S. Its charge is as set out in § 40-6.5-104, C.R.S.

74. Intervenor Staff is litigation Staff of the Commission as identified in the Rule 4 CCR 723-1-1007(a)<sup>30</sup> notices filed in this Proceeding.

75. Additional findings of fact are found throughout the remainder of the Decision.

## **VI. GENERAL OVERVIEW: DERIVATION OF REVENUE REQUIREMENT**

76. Section 40-3-101(1), C.R.S., requires rates and charges for utility service to be just and reasonable. Section 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.

Just and reasonable rates have two principal traits: (a) the rates reflect the costs of an efficient and prudent utility; and (b) the rates allow a prudent utility a reasonable opportunity to earn its authorized rate of return. To establish the just and reasonable rates that will permit a utility both to meet the requirements of § 40-3-101(2), C.R.S., and to maintain its financial integrity, and as pertinent in this Proceeding, the Commission engages in ratemaking.

77. The Commission must exercise reasoned judgment in setting rates. Ratemaking is a legislative function (*City and County of Denver v. Public Utilities Commission*, 129 Colo. 41, 226 P.2d 1105 (1954)) and not an exact science (*Public Utilities Commission v. Northwest Water*

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<sup>30</sup> This Rule is found in the Rules of Practice and Procedure, Part 1 of 4 *Code of Colorado Regulations* 723.

*Corporation*, 168 Colo. 154, 551 P.2d 266 (1963)). 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.” *Colorado Office of Consumer Counsel v. Colorado Public Utilities Commission*, 275 P.3d 656, 660 (Colo. 2012).

78. Under the just and reasonable standard, the Commission has the primary responsibility for balancing “the investor’s interest in avoiding confiscation and the consumer’s interest in prevention of exorbitant rates” (*Colorado Municipal League v. Public Utilities Commission*, 687 P.2d 416, 418 (Colo. 1984)) 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 to pay a rate which accurately reflects the cost of service rendered.

*Public Service Company of Colorado v. Public Utilities Commission*, 644 P.2d 933, 939 (Colo. 1982). The utility’s right to earn a reasonable return incorporates the principle that the Commission-authorized rate of return is a return that the utility has a reasonable opportunity to realize and is not a rate of return that the utility is guaranteed to realize.

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

80. The Commission establishes rates (or, in this case, the GRSA) 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. Thought of another way, the revenue requirement is the total costs (including the utility’s opportunity to earn a fair rate of return) to provide safe and reliable service to the utility’s customers.

81. The revenue requirement formula is well-known and is:

$$\text{Revenue requirement} = E + r(\text{RB})$$

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

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

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.” *CF&I Steel, L.P. v. Pub. Utils. Comm’n.*, 949 P.2d 577, 584 (Colo. 1997)[.] ... 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.” *CF&I Steel*, 949 P.2d at 584.

*Glustrom*, 280 P.3d at 669

**VII. BURDEN OF PROOF AND RELATED PRINCIPLES**

83. In the normal course of the proceeding, 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 preponderance of the evidence. Section 24-4-105(7), C.R.S.; § 13-25-127(1), C.R.S.; Rule 4 CCR 723-1-1500. The evidence must be “substantial evidence,” which the Colorado Supreme Court has defined as:

such relevant evidence as a reasonable person’s 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.

*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)). The preponderance standard requires the finder of fact to determine whether the existence of a *contested fact* is more probable than its non-existence. *Swain v. Colorado Department of Revenue*, 717 P.2d 507 (Colo. App. 1985). A party has met this burden of proof when the evidence, on the whole and however slightly, tips in favor of that party.

84. The preponderance of the evidence standard is understood and applied most easily in cases in which: (a) there are disputed facts; and (b) the resolution of the dispositive issue, or of an important issue, depends on the facts as determined by the decision-maker.<sup>31</sup>

85. The standard is understood and applied less easily in the context of a rate case because: (a) many of the thorniest and most controversial issues require policy-based decisions; (b) parties present facts to persuade the decision-maker to adopt a particular policy or approach (*i.e.*, regulatory principle) or to change an existing policy or approach (*i.e.*, regulatory principle)

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<sup>31</sup> A civil penalty assessment proceeding is an example of such a case.

and, generally speaking, do not dispute facts *per se*; and (c) 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.” *Colorado Office of Consumer Counsel*, 275 P.3d at 660. For these reasons, the ALJ principally applied the reasonable basis standard when resolving issues in this ratemaking proceeding.

86. Many, if not most, of the disputed issues in this ratemaking center on whether to maintain an existing Commission-adopted regulatory principle, method, or approach or to adopt a different regulatory principle, method, or approach.<sup>32</sup> In deciding these issues, the ALJ took the Commission-adopted principle or approach as the baseline or starting point and then assessed the evidence or policy rationale, or both, presented in support of the request to adopt a new or to change/modify a principle, method, or approach and that presented in support of applying the existing principle, method, or approach. In assessing a new/modified principle, method, or approach, the ALJ took into account the Commission’s rationale for initially adopting the principle, method, or approach. The ALJ preferred to maintain a Commission-adopted principle, method, or approach unless the ALJ determined that, on balance, the proposed new, proposed change, or proposed modification was the better regulatory principle, method, or approach in light of the circumstances taken as a whole.

87. Black Hills’ rates for electric service and related issues are matters of public interest. The Commission has an independent duty to determine matters that are within the public interest. *Caldwell v. Public Utilities Commission*, 692 P.2d 1085, 1089 (Colo. 1984).

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<sup>32</sup> The different regulatory principle, method, or approach could be a modification of the existing principle, method, or approach or could be a new principle, method, or approach.

As a result, the Commission is not bound by the Parties' proposals. The Commission may do what the Commission deems necessary to assure that the final result is just, is reasonable, and is in the public interest *provided* the record supports the result *and provided* the reasons for the choices made (*e.g.*, policy decisions) are stated.

88. In reaching his decision in this matter, the ALJ is mindful of these principles and of the Commission's duty. The ALJ has considered all arguments presented, including those arguments not specifically addressed in this Decision. Likewise, the ALJ has considered all evidence presented at the hearing, even if the evidence is not specifically addressed in this Decision.

### **VIII. TEST YEAR**

#### **A. Background**

89. A test year is a 12-month operating period used to evaluate the utility's cost of service. In a rate case proceeding, the test year is the time period used to evaluate and to adjust (as necessary) the interrelationships of revenue, expense, and capital investment to determine whether the utility has a revenue excess or deficiency. These interrelationships, which require that expenses be recorded and revenues recognized in the period in which they occur, is better known as the "matching principle."

90. The choice of a test year is one of the key elements of utility rate making. Through the test year the Commission determines the interrelationships of revenues, expenses, and rate base that will yield just and reasonable rates and will offer the utility a reasonable chance to earn its authorized rate of return. A test year attempts to develop rates that are representative of costs the utility faces when the new rates go into effect.

91. Importantly, a test year is defined by the interaction of its component parts; no single component stands alone. Built into the test year are inputs and outputs for the designated period and how they affect are affected by the utility's operations. Because the absolute quantities of input and output and the prices will change when the test year has ended and the new rate year arrives, the key to test year integrity is to make the interrelationship of revenue, expense, and capital investment as representative of future operations as possible.

92. An HTY uses revenues, expenses, and rate base from an identified historical period, as adjusted, to determine the utility's revenue requirement. A CTY is forward-looking and uses forecasts to estimate the revenues, expenses, and rate base for a current period that is in progress but not yet expired to determine the utility's revenue requirement.

## **B. Positions of the Parties**

### **1. Black Hills**

93. Black Hills, through the testimony of witness Fredric C. Stoffel, proposes the use of a CTY, based on the historical 12-month period ending December 31, 2013, which it refers to as the "Base Period." The base period is then adjusted for all changes in investments, expenses and revenues projected to occur during the 12-month period ending December 31, 2014, referred to as the "Test Period." For purposes of establishing the revenue requirement, the Company uses a rate base, cost of service, and capital structure based on December 31, 2014. Black Hills uses some actual data available in early 2014, and builds upon that data to develop its expectations for the remainder of the year.

94. Black Hills believes that its CTY proposal preserves the interrelationships of investments, expenses, and revenues that will occur during calendar year 2014. The Company argued that this approach reflects, as closely as possible, the actual cost of providing service

when rates become effective. Black Hills cites § 40-3-111(1) and § 40-6-111(2), C.R.S., to establish that the Commission may consider current, future, or past test periods or any reasonable combination thereof to determine rates. Black Hills refers to Public Service's 1981 rate case in Investigation and Suspension (I&S) Docket No. 1525 as an example of the adoption of a current test year similar to what is being proposed by Black Hills in this case.

## 2. The OCC

95. The OCC, through the answer testimony of witness Cory Skluzak, oppose Black Hills' CTY approach. The OCC recommends that the Commission adopt an HTY approach to develop the revenue requirement, and describe this method as the Commission's conventional and traditional approach. Like Black Hills, the OCC asserts that the Commission has broad discretion to determine a utility's appropriate test year to achieve just and reasonable rates. The OCC suggests the most important standard to consider when determining the appropriate test year is which method is the most reliable, verifiable, auditable, and which best matches revenues, expenses, and rate base investment.

96. The OCC asserts that the Commission has recently considered alternative test year proposals, including the Future Test Year (FTY) concept advanced by Public Service, and rejected them. The OCC cites Proceeding No. 93S-001EG, in which the Commission considered and rejected Public Service's request for an FTY and expressed its preference for the use of an HTY with *pro forma* adjustments for known and measurable changes that will occur within one year of the end of the test year. The OCC asserts that the Commission has never found that a full test year is an appropriate method for the determination of the revenue requirement. The OCC acknowledges the 1981 case cited by Black Hills, but argues the methodology approved was strictly to alleviate earnings attrition in that particular case.

### 3. Staff

97. Staff does not expressly state a position on the test year used in this proceeding.<sup>33</sup> Nonetheless, it introduced a revenue requirement sponsored by witness Bridget A. McGee. The revenue requirement is based on Ms. McGee's Exhibit BAM-1. Staff describes the development of its revenue requirement as utilizing Black Hills' Exhibit BSO-1, and making limited adjustments. There is no statement of opposition to the underlying premises of Black Hills' model.

### 4. Holcim

98. Holcim argues that the Commission should reject the Black Hills CTY and should adopt an HTY. Holcim cites Commission Decision No. C13-1568 in Proceeding No. 12AL-1268 issued December 23, 2013 at ¶8 which states that a company has a natural incentive to inflate forecasts if an HTY is not used. In addition, Holcim believes that Black Hills has failed to provide a sufficient reason for the Commission to deviate from the practice of using an HTY.

### 5. Board and Authority

99. The Board and Authority also urges the Commission to reject Black Hills' CTY model and adopt an HTY. The Board and Authority articulate six specific reasons to reject Black Hills' CTY: 1) the utility and not intervenors have the upper hand in calculating and supporting the forecasts; 2) forecasts by their very nature involve speculation and it will be natural to assume the utility will speculate on the high end; 3) the use of an actual HTY with known and

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<sup>33</sup> Staff, during the hearing, did not state a preference for a CTY or HTY but did state that it did not oppose Black Hills' CTY approach, *see Hearing Transcript Vol. p. 175, l. 9-23*. In its SOP, Staff states the failure to "challenge" Black Hills' CTY approach was due to the failure of Black Hills to file "updates to its historical base period to presumably replace some of the forecasted test period numbers with actual book numbers." *Staff SOP p. 5*. Staff states that based upon these filings a determination was to be made by Staff as to the "reasonableness of the test period numbers." *Id.* Staff still fails to take a position on a proper test year in their SOP. Staff does not reject or endorse Black Hills' CTY concept, but appears to question Black Hills' approach to a CTY. "It may be that the Company's implementation of its concept falls short as a result." *Id. at 6*.

measurable adjustments serves to promote efficiency by encouraging cost-reducing behavior by the utility; 4) absent extenuating circumstances, rate cases will result in endless haggling over budgets; 5) using a CTY will inevitably present a “moving target” as the rate case is prosecuted; and 6) Black Hills was given an opportunity in this case to further update its actual results and it chose not to do so.

## 6. Discussion

100. The OCC cites certain reasons that it opposes the CTY proposed by Black Hills. First, Black Hills’ 2014 forecasts may not be accurate, reliable, and verifiable; the approach is inconsistent and biased; the proposed update is prejudicial (this update did not occur); the reliance on the 1981 Public Service decision is misplaced; and there is value afforded by regulatory lag.

101. Black Hills responded to the OCC’s criticism of its CTY that the use of an HTY fails to determine the Company’s actual cost of service when rates will be in effect in 2015 and 2016. Black Hills argues that the OCC’s objections to the CTY are based on theory, and utilizes the same arguments it made in past proceedings in opposition to the CTY. The use of an HTY in Black Hills’ estimation, predetermines the result and no projection could ever be utilized under such a standard. The use of an HTY is no better at predicting actual future costs than a fully forecasted test year. Black Hills asserts, however, that there is a significant difference between a fully forecasted test year and the proposed CTY in that the CTY includes over 15 months of actual historical data.

102. The ALJ will abide by the statutory direction provided in § 40-6-111(2)(a)(I), C.R.S., which directs that “[t]he commission shall consider the reasonableness of the test period revenue requirements presented by the utility.” The ALJ acknowledges § 40-3-111(1) and

§ 40-6-111(2), C.R.S., which allow the Commission to consider current, future, or past test periods or any reasonable combination thereof to determine rates.

103. Whether included in a fully forecasted test year or a partially forecasted test year similar to that proposed by Black Hills in this proceeding, the acceptance of forecasts is a central part of the consideration of what is the appropriate test year on which to develop the revenue requirement. The Commission has not, since 1981, accepted the use of forecasts in a fully litigated rate case. As described by the OCC, when a current form of test year was accepted, the Commission was clear that “such year will operate as an attrition alleviating tool.”<sup>34</sup> Attrition is a specific economic phenomenon that exists under certain conditions, for example, decreasing customer counts and increasing inflation. The ALJ observes that no testimony was introduced into the record by Black Hills in regard to earnings attrition; therefore earnings attrition is not a premise in support of Black Hills’ proposed CTY.

104. As the proponent of its Advice Letter, Black Hills has the burden to demonstrate why its use of a test year is just and reasonable. In this proceeding, much discussion centered around which methodology most closely matches revenues and expenses, and which method is most reliable and auditable, and which method is most representative of the costs of the Company going forward. Arguments made by both Black Hills and the OCC, on the whole, attempted to address these premises and champion their preferred test year method as superior to the other. Indeed, with a host of advantages and disadvantages to each approach, there may be no clear answer. However, the ALJ observed a noticeable lack of evidence introduced by the Company with respect to what factors, specific to this proceeding, give cause for the

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<sup>34</sup> I&S Docket No. 1525, Decision No. C81-1999, p. 21, ¶2.

Commission to deviate from the prevailing practice of approving the use of an HTY, with known and measurable *pro forma* adjustments, for purposes of developing the revenue requirement.

105. When Black Hills filed testimony in this proceeding, Company witness Stoffel made the statement that “the Company plans to update its Revenue Requirement Model to reflect actual per-book changes occurring in 2014 at an appropriate point in this proceeding.”<sup>35</sup> In Rebuttal, the Company chose not to make that update, citing “strong opposition” to this proposal and claiming that more parameters and procedures would need to be developed.<sup>36</sup> Black Hills had the option of whether to make this update, and chose not to. The ALJ finds the choice not to update the revenue requirement model very instructive in this proceeding. An update, presumed on actual per-book numbers, would have provided the Commission with a critical benchmark with respect to the quality of its forecasts. In the ALJ’s view, Black Hills had just as much chance to prove the quality of its CTY forecasting by performing the update, versus the risk of providing its opposition with facts to discount it. With respect to the need for parameters and procedures needed to make such an update, the ALJ questions this logic when the update would be made to a document already filed under the existing parameters and procedures.

106. The ALJ finds that based on the record in this proceeding, there is not sufficient cause to deviate from the Commission’s prevailing practice of using an HTY, adjusted for known and measurable *pro forma* adjustments extending 12 months from the date of the end of the test year. In this proceeding, the test year shall be an HTY ending December 31, 2013,

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<sup>35</sup> Hearing Exhibit No. 2, Corrected Direct Testimony and Exhibits of Fredric C. Stoffel, p. 16 lines 4-6. In addition, at the pre-hearing conference held on June 17, 2014, Black Hills was granted permission to update its Revenue Requirement Model over the objection of the OCC.

<sup>36</sup> Hearing Exhibit No. 3, Corrected Rebuttal Testimony and Exhibits of Fredric C. Stoffel, p. 22, lines 5-11.

including known and measurable *pro forma* adjustments extending 12 months from that date, through December 31, 2014.

**IX. RATE BASE**

107. Rate base represents the investor-supplied plant facilities and other investments required in providing utility service to customers. The utility is allowed a reasonable opportunity to earn a fair rate of return on the net jurisdictional rate base.

108. Rate base is:

- Plant in service
- less: accumulated depreciation
- less: customer deposits and advances
- plus/less: cash working capital
- plus: materials and supplies
- plus: fuel inventories
- plus: prepayments
- less: accumulated deferred income taxes
- plus/less: other deferred items

Construction Work In Progress (CWIP) is not included in rate base.

**A. Year End Rate Base or Average Year Rate Base**

109. The Year End rate base method uses the plant assets as they exist at year end as the rate base in the calculation of revenue requirement.

110. The Average Year rate base method weights each month of the year equally in terms of the inflow and outflow of plant assets and uses a 13-month average in the calculation of revenue requirement.

## 1. Black Hills

111. Black Hills states that it developed its rate base on a 13-month average using the base period plant balances ending in December, 2013. The 13-month average was adjusted to annualize the plant placed in service during the base period, and depreciation was adjusted to reflect additional test period depreciation expense projected to occur in 2014.

112. The rate base consists of additional components for working capital and other rate base reductions, such as deferred federal income taxes. Adjustments were made to add back \$8.3 million associated with the ARRA grant, reclassified plant that was placed in service prior to April 23, 2014, and projected plant expected to be placed in service by year-end 2014.

113. Black Hills also made an adjustment to remove plant balances for the W.N Clark Generating Station (W.N. Clark) and Pueblo 5 and 6 generating units, and an adjustment to recognize a full-year increase to the accumulated reserve for depreciation related to the base period plant balance, and 2013 annualization adjustments.

## 2. OCC

114. The OCC fundamentally agrees with Black Hills' 13-month average methodology, however, the OCC claims that its subsequent annualization adjustments to rate base "eviscerate" this approach and change its form to be more reflective of a year-end methodology, creating an imbalance between revenues, expenses, and investments. The one exception is working capital, which OCC agrees was developed using the correct data. The OCC advocates that the 13-month period used to determine the rate base should span the whole time period over which revenues were earned and expenses were incurred. Because the OCC advocates for an HTY using a 13-month average rate base methodology that does not utilize the adjustments made by Black Hills, it recommends a deduction to rate base that effectively "unwinds" Black Hills'

adjustments, bringing the rate base back to a 13-month average ending December 31, 2013. The OCC's total rate base adjustment of \$7,923,728 affects Plant in Service, Accumulated Depreciation, and Other Rate Base Deductions (Accumulated Deferred Income Taxes).

115. In rebuttal, Black Hills addresses the OCC's criticism that its annualization adjustments converted projects contained in CWIP to plant in service for the 2014 test period is based either on actual booked amounts or projected in-service dates.

116. Black Hills asserts that this was a proper adjustment that measures changes from December 31, 2013 through December 31, 2014 and applies that adjustment to the 2013 calculated 13-month average. The effect of the adjustment is to change the point in time of the average from mid-year 2013 to mid-year 2014, according to the convention for the test period.

### **3. Other Intervenors**

117. No other Intervenor stated a contrary position or opposition to Black Hills' proposal concerning rate base in prefiled testimony, in testimony during the evidentiary hearing, or in a filed SOP.<sup>37</sup>

### **4. Discussion**

118. In Decision No. R13-1307 in Proceeding No. 12AL-1268G issued October 22, 2013, Public Service's recent gas rate case, the ALJ addressed the rate base methodology as follows: "The ALJ observes that, in each instance, the Commission considered a particular set of facts and evidence when it made its ruling on rate base calculation. In determining the method of rate base calculation in this Proceeding, the ALJ looks at whether the record establishes the

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<sup>37</sup> In its SOP Staff states that the failure to oppose aspects of Black Hills' case is not an "affirmative endorsement" of Black Hills' position. *Staff SOP p. 6*. While not an endorsement, Staff failed at any point in the proceeding to provide opposition or alternatives to the position of Black Hills except where it is discussed in this Decision.

existence of special circumstances (in this case, earnings attrition) that warrant the use of Year End rate base.”<sup>38</sup>

119. Black Hills presents its rate base as a 13-month average, however, it acknowledges the use of annualizations incorporating the test period of 2014. By rolling its plant in service balance to the end of 2014, the OCC argues that this effectively results in a year-end rate base methodology.

120. Black Hills witness Owens cites to the Commission’s Decision No. C13-1568 addressing exceptions in Proceeding No. 12AL-1268G, in which the Commission overturned the ALJ’s recommendation to use average rate base, and approved the use of a year-end rate base. Black Hills uses this citation presumably to suggest that, if the OCC’s argument about effectively using a year-end rate base is true, the Commission has “regularly” approved the use of a year-end rate base.<sup>39</sup>

121. The ALJ observes that, in Decision No. C13-1568, the Commission stated that the decision to use year-end rate base was predicated on two factors: 1) a reduction in Public Service’s Return on Equity (ROE); and 2) the significant difference in investment apparent between the use of average and year-end rate base.<sup>40</sup> The ALJ distinguishes the instant case from the Public Service rate case because Black Hills did not advocate for the use of a year-end rate base; it advocated for a 13-month average rate base. As such, the record lacks any developed argument for year-end rate base that would include specific factors supporting its use.

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<sup>38</sup> Decision No. R13-1307, Proceeding No. 12AL-1268G, pp. 66-67, ¶189. The ALJ took administrative notice of this decision per Transcript Vol. 2, p. 48.

<sup>39</sup> Hearing Exhibit No. 7, p. 29, Corrected Rebuttal Testimony and Exhibits of Bryan S. Owens, lines 17-20.

<sup>40</sup> Decision No. C13-1568, Proceeding No. 12AL-1268G, p. 17 ¶50.

Indeed, the ALJ observed *supra* that no argument was made with respect to earnings attrition, which is a factor that could be used to support the use of year-end rate base.

122. The average included by Black Hills includes projections that involve estimated in-service dates that, as acknowledged by Black Hills witness Owens, in some cases may not yet have occurred.<sup>41</sup> Moreover, as illustrated at hearing by Black Hills witness Burke, changes still appear to be occurring to the Black Hills rate base as evidenced by the decline of capital expenditures in 2014 from \$54.6 million in the Company's initial filing to approximately \$39 million as updated at hearing.<sup>42</sup> The ALJ finds the existence of such factors to be problematic with respect to the methodology employed by Black Hills.

123. The ALJ will ascribe to the Commission's premise that, unless a special circumstance exists that warrants a change to the rate base methodology, a historic 13-month average rate base shall be used. The ALJ does not find that such special circumstances were argued by Black Hills in this proceeding, and will decline the methodology proposed by Black Hills.

124. Since the test year shall consist of an HTY ending December 31, 2013 with known and measurable *pro forma* adjustments extending 12 months, the rate base should therefore be calculated using a 13-month average convention over the span of the test year that has been approved, plus one month.

125. The rate base adjustment proposed by the OCC, converting Black Hills' proposed rate base to a 13-month average HTY, best adheres to the principles for rate base enumerated here. The OCC's total rate base adjustment of \$7,923,728 is therefore approved.

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<sup>41</sup> Transcript Vol.2, p. 85, lines 14-16.

<sup>42</sup> Transcript Vol. 1, p. 158, lines 1-6.

**B. ARRA Grant**

126. Black Hills received approximately \$8.3 million in tax-free grant money from the U.S. Treasury Department pursuant to the ARRA, and invested it in the Busch Ranch wind project.

**1. Black Hills**

127. Black Hills argues that the Busch Ranch Project qualified as a renewable resource under ARRA and was eligible for a grant equal to 30 percent of the total investment.

128. Black Hills witness Hollibaugh testified that under Treasury rules related to ratemaking, Black Hills is allowed to treat the unamortized balance through either an offset to rate base or a ratable amortization, but not both.

129. The Company had the option to elect an investment tax credit (ITC) or a production tax credit that would have otherwise been available, and due to quantitative and qualitative factors, elected to receive the grant. Because the grant was received in lieu of the ITC, Black Hills claims that the grant was subject to the ITC normalization rules, since it was in lieu of the ITC.

130. Black Hills argues that the selection of the grant was in the best interest of ratepayers, and included this amount in rate base as an adjustment. Notably, no corresponding depreciation expense adjustment was made based on the 25-year life of the Busch Ranch project.

**2. OCC**

131. The OCC opposes the tax normalization of the ARRA grant in rate base since it was not a cash outlay by either the shareholders or ratepayers, and therefore it would not be reasonable to allow the Company to earn a return on this amount.

132. The OCC claims that because the grant is not an ITC, it should not be treated the same with respect to normalization. The normalization treatment proposed by Black Hills is not mandated, and has been since been eliminated after its original enactment.

133. Finally, the OCC notes that Black Hills did not request the inclusion of ARRA grant money in its 2011 rate case for approximately \$3.8 million it received in ARRA grant money for its Advanced Meter Infrastructure (AMI) project. The OCC recommends that the Commission not accept the proposed normalization treatment, and remove the entire amount from rate base.

134. The OCC also questions whether Black Hills over recovered on the \$100,000 incentive that was included in Black Hills' last rate case. The OCC suggests that a "negative adjustment" may be necessary to address this possible over recovery.

### **3. Black Hills' Rebuttal**

135. In rebuttal, Black Hills argues that the ARRA grant should be tax normalized as requested, and that the OCC fails to consider that the Company's proposed rate base treatment is only one part of income tax normalization.

136. Black Hills explains that the cost of service is reduced as a result of the combination of reduced depreciation expense and reduced income tax expense, and thus normalization allows for the equitable sharing of the grant between customers and the Company. The reason the cash grant is offered in lieu of the ITC is that Section 1603 of the ARRA recognizes that a company may not be able to take immediate advantage of the ITC because of its Net Operating Loss (NOL) position. At the time of the grant selection, Black Hills was in a NOL position.

137. Further, the normalization treatment was mandated under the ARRA when the Company elected to take the grant. Black Hills argues that the Commission has commonly approved of this treatment for an ITC in rate base, even though it is not investor-supplied capital. To remove the grant from rate base would place the Company in a worse overall position than if it had never received the grant.

#### **4. Other Intervenors**

138. No other Intervenor stated a contrary position or opposition to Black Hills' proposal concerning the ARRA grant in prefiled testimony, in testimony during the evidentiary hearing or in a filed SOP.

#### **5. Discussion**

139. The purpose of the ARRA may be broadly described as an incentive for private industry to make investments in infrastructure. The intent was, in part, to enable and encourage companies to make the choice to proceed with certain investments, a choice that they might not otherwise make.

140. Black Hills cites Decision No. C93-1346 in Proceeding No. 93S-001EG issued October 27, 1993, in which the Commission stated that to deduct ITCs from rate base "may jeopardize the Company's ability to take advantage of State ITCs. This result would be detrimental to ratepayers."<sup>43</sup> Further, the Commission acknowledged that it had applied consistent regulatory treatment to both federal and Colorado ITCs utilized by Public Service for many years. More recently, as expressed in Black Hills' most recent electric rate case, the

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<sup>43</sup> Decision No. C93-1346, Proceeding No. 93S-001EG, as reproduced in Hearing Exhibit No. 15, Rebuttal Testimony and Exhibits of Robert J. Hollibaugh, p. 13 lines 32-34.

Commission stated that it had encouraged investor-owned utilities such as Black Hills to apply for and make use of ARRA funds in Proceeding No. 09R-158EG.<sup>44</sup>

141. In Decision No. C11-1373, in Proceeding Nos. 11AL-382E and 11AL-387E, Black Hills requested that the Commission provide an incentive payment associated with the reduced costs of AMI investments resulting from the Company obtaining ARRA grants in the amount of approximately \$3.8 million. The Company requested \$400,000 as an expense to the cost of service as an incentive. It did not request that the amount be included in rate base. The Commission acknowledged that the obtaining of ARRA funds was in the ordinary course of business, and because its actions in obtaining the funding were consistent with the directives in Proceeding No. 09R-158EG, the Commission allowed an incentive in the form of a \$100,000 expense.

142. Here, the Company seeks to place the ARRA grant in rate base thus earning the Weighted Average Cost of Capital (WACC), and reduce the depreciation expense by an amount of \$334,772 that otherwise could have been taken. Black Hills represents that this is the effective equivalent of amortizing the grant over a period of 25 years, which will accord customers a benefit over the entire life of the Busch Ranch wind facility.

143. The undersigned ALJ finds that because of this treatment, Black Hills is indeed affording customers a tangible benefit through the depreciation expense reduction. Further, to deny Black Hills a return on the grant would contravene the direction by the Commission that such investment be encouraged. Black Hills made a prudent choice to accept the grant versus the ITC, considering the existence of the NOL position. It is not necessary that the grant be classified as an ITC in order to afford it a certain regulatory treatment; the Commission has

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<sup>44</sup> Decision No. C11-1373, Proceeding Nos. 11AL-382E and 11AL-387E, pp. 47-48, ¶139.

broad discretion in this matter. The accounting normalization treatment proposed by Black Hills for the ARRA grant, being similar to that which would have been afforded to an ITC, is just, reasonable, and in the public interest.

144. Finally, the suggestion by the OCC that there may have been an over recovery of the \$100,000 incentive from Black Hills' rate case, and the belief that a negative adjustment may be warranted, is without merit. There has been little to no evidence to substantiate this claim. The record in this proceeding contains only allegations of an over recovery, no actual evidence.

145. In addition, the undersigned ALJ is not convinced that this proceeding is the proper place to request this relief. Based upon the very limited evidence presented in this proceeding concerning the potential for over recovery, it would appear that it may be proper to re-open and then commence an action in Proceeding Nos. 11AL-382E and 11AL-387E.

### **C. Prepayments**

#### **1. Black Hills**

146. Black Hills has included prepayments in rate base using a 13-month average for the months of December 2012 through December 2013. Black Hills argues that prepayments are a normal working capital rate base allowance as they represent an investment of funds made in advance of the future service period. The total prepayment amount is \$409,485.

#### **2. OCC**

147. The OCC raises the issue that prepayments are included in both the rate base in working capital, and as a separate component of cash working capital, and thus Black Hills is counting them twice. The OCC suggests that the Commission may decide to include the amount in the lead-lag study for cash working capital, or recognize the average balance in working

capital in rate base, but it should not do both. The OCC's suggestion is to remove the amount from cash working capital, and provides an adjustment.

148. In rebuttal, Black Hills clarifies that prepaid items are not counted twice, and the OCC confuses the underlying expense activity. Black Hills explains that when a prepaid item is originally paid, the prepaid asset account is debited and a cash account is credited. As expenses are realized or incurred, an expense account is debited and the prepaid asset is credited.

149. The "Other O&M" category includes expense activity which reduces the prepaid asset account. Black Hills argues that OCC is therefore mistaken in its assumptions. The cash working capital allowance captures the inputs and outputs related to the prepayment account, not the investment itself, and is a measure of cash flow timing. Black Hills recommends that OCC's adjustment be rejected.

### **3. Other Intervenors**

150. No other Intervenor stated a contrary position or opposition to Black Hills' proposal concerning prepayments in prefiled testimony, in testimony during the evidentiary hearing, or in a filed SOP.

### **4. Discussion**

151. The OCC acknowledged at hearing that Black Hills used a 13-month average for prepayments, and further, that that is the traditional approach of the Commission with respect to inventories.<sup>45</sup> The OCC provided the example at hearing that the Factory Group Mutual Insurance Premium decrease is a prime example of a normalization adjustment.

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<sup>45</sup> Transcript Vol. 3, p. 45, lines 24-25.

152. The ALJ agrees that normalization can be appropriate in certain circumstances; however, while the OCC makes reference to a large decrease in the Factory Group Mutual Insurance premium, it is only one prepaid expense of many.<sup>46</sup> The ALJ is satisfied that Black Hills did not double count prepayments; further, the OCC did not provide sufficient evidence in this case to overturn the Commission's practice of utilizing the 13-month average. The OCC's adjustment to prepayments is therefore denied.

**D. Materials and Supplies**

**1. Black Hills**

153. Black Hills states that materials and supplies (M&S) are considered working capital as these inventories must be on hand for the Company to perform its day-to-day operations and construction activities. The month-end balances were averaged for the months of December 2012 through December 2013, and included in rate base in the amount of \$7,360,365.

**2. OCC**

154. The OCC argues that the amount for M&S decreased significantly (22 percent) from \$7,519,596 in December, 2012, to \$5,863,803 in December, 2013. The OCC notes that Black Hills did not provide an explanation for the decrease, but assumes that it is due to the Company winding down its coal generation plant and steam plants (Pueblo 5 & 6) due to the implementation of the CACJA with an accompanying decrease in M&S.

155. The OCC recommends an adjustment to the test year averaged amount for M&S to reflect the conditions going forward in light of the transition from its coal generation facilities. This will adjust the test year data to a normal, ongoing level of operation for the test period.

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<sup>46</sup> Hearing Exhibit No. 7, Rebuttal Testimony and Exhibits of Bryan S. Owens, Exhibit BSO-6.

The OCC therefore recommends adjusting to the amount as of December 31, 2013, or \$5,863,803, by applying a negative adjustment of \$1,496,562.

156. In rebuttal, Black Hills replies that the OCC performed no study and requested no discovery to validate its assumption. Black Hills asserted in its SOP that M&S is an inventory account that experiences a wide degree of fluctuation from month to month. Therefore, it is improper to make an adjustment based on the OCC's unsupported assumption.

### **3. Other Intervenors**

157. No other Intervenor stated a contrary position or opposition to Black Hills' proposal concerning materials and supplies in prefiled testimony, in testimony during the evidentiary hearing, or in a filed SOP.

### **4. Discussion**

158. As with prepayments, the OCC's adjustment to M&S is a normalization adjustment designed to reflect what the OCC believes will be the conditions going forward. The ALJ must weigh the evidence on the record with regard to such an adjustment. Though there may be logic to the OCC's reasoning for the large decrease in M&S, the ALJ agrees with Black Hills that it is common for this account to fluctuate, and there is insufficient analysis on the record to draw a conclusion on this matter. The ALJ will therefore deny the OCC's adjustment with regard to M&S.

## **E. Fuel Stocks**

### **1. Black Hills**

159. Black Hills states that a 13-month average similar to that applied to other inventory accounts was used for fuel stock inventories. The month-end balances of Federal Energy Regulatory Commission (FERC) accounts 151 (Fuel Stocks) and 152 (Fuel Stock

Expenses Undistributed) were averaged for the months of December 2012 through December 2013. The total CTY rate base amount is \$868,651.

## 2. OCC

160. The OCC claims that the amount for fuel stocks decreased significantly (almost 48 percent) from \$985,800, in December, 2012, to \$513,550 in December 2013, most likely due to Black Hills selling off its coal inventory for plants such as W.N. Clark as a result of CACJA.

161. The OCC recommends that an adjustment to Black Hills' test year averaged amount for fuel stocks be made to reflect the conditions going forward for the Company in light of the transition from its coal generation facilities to natural gas. The OCC recommends adjusting the amount as of the end of the HTY on December 31, 2013 to \$513,550, and removing \$355,101, which represents the *pro forma* increase between the CTY year-end amount and the 13-month average.

162. In rebuttal, Black Hills asserts that the OCC does not recognize that the Company already removed the coal inventory from its 13-month average calculation. No study was performed to validate the OCC's assumptions. Thus, the proposed adjustment is improper.

## 3. Other Intervenors

163. No other Intervenor stated a contrary position or opposition to Black Hills' proposal concerning materials and supplies in prefiled testimony, in testimony during the evidentiary hearing, or in a filed SOP.

## 4. Discussion

164. The circumstances surrounding fuel stocks present a significantly different issue when compared to prepayments or M&S. Specifically, the OCC's adjustment contemplates the known event of the decommissioning of the W.N. Clark coal plant pursuant to CACJA.

165. Whereas it was established that both prepayments and M&S will fluctuate over time because their levels are driven by a variety of factors, fuel stocks are greatly impacted by the closing of a plant and are far more likely to only decrease as evidenced by the precipitous 48 percent decline between 2012 and 2013. The OCC cites the sale of approximately \$1.5 million in coal inventories in 2013 for W.N. Clark, discussed by Mr. Lux, as a major factor in this decline.<sup>47</sup> Further, the OCC rightly points to the fact that, unlike prepayments or M&S, the sale of coal related to CACJA is permanent.

166. On balance, the ALJ finds it to be a much more compelling argument to accept an adjustment that is based in known fact (the passing of CACJA), under a law that has been under implementation for a long time (since 2010), and the outcome of which (the permanent reduction of coal inventories due to the closure of plants) is a highly probable outcome. For the aforementioned reasons, the ALJ will approve the OCC's adjustment to reflect fuel stock inventories to the December 31, 2013 level of \$513,550.

#### **F. Cash Working Capital**

167. The cash working capital calculation by Black Hills in direct testimony used the 1/8 rule. The 1/8 rule and its applicability is cited by Black Hills in a common regulatory accounting reference, Hahne and Aliff's *Accounting for Public Utilities*, in Section 5.04. Black Hills recommends the Commission accept its Cash Working Capital adjustment in the amount of (\$5,035,614).

168. The OCC objected to the use of the 1/8 rule in Answer Testimony and presented a "placeholder adjustment" that was to be supplemented later. The OCC never supplemented this

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<sup>47</sup> Hearing Exhibit No. 16, Direct Testimony and Exhibits of Mark L. Lux.

placeholder adjustment and further failed to object to Black Hills' cash working calculation in its SOP.

169. No other intervenor addressed the cash working capital calculation presented by Black Hills.

170. Because the revenue requirement will be calculated on the 2013 HTY, the cash working capital balance as of the end of the base period, December 31, 2013, is appropriate. The cash working capital adjustment shall be \$(5,076,824).<sup>48</sup>

## **X. RETURN ON EQUITY**

### **A. Black Hills**

171. Black Hills sponsored the testimony of Dr. William Avera in regard to ROE. Black Hills' initial overall ROE recommendation was 10.3 percent, within a reasonable range of 9.64 percent to 11.64 percent that includes 14 basis points for flotation costs attributable to the issuance of stock in 2010. The range was derived from the collective results of the Discounted Cash Flow (DCF), Empirical Capital Asset Pricing Model (ECAPM), and Risk Premium models used to calculate the expected rates of return. Other ROE benchmarks utilized included the Capital Asset Pricing Model (CAPM), the Expected Earnings Approach, and Low Risk Non-Utility DCF.

172. Black Hills uses a combination utility/non-utility proxy group of 27 companies that the Company believes are comparable in their level of investment risk. Black Hills concludes that the recommended ROE of 10.3 percent represents a reasonable compromise between balancing the impact on customers and the need to provide the Company with an

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<sup>48</sup> Hearing Exhibit No. 6, Exhibit BSO-1, statement F, line 1 column (a).

opportunity to earn a return that is adequate to compensate its investors, maintain financial integrity, and attract capital.

173. At the start of the evidentiary hearing, Black Hills presented Exhibit 27<sup>49</sup> which lowered the requested ROE to 9.9 percent, Black Hills' current ROE. This resulted in a \$1,557,624 reduction in the revenue requirement, and a reduction in a WACC from 7.83 percent to 7.62 percent.

174. Black Hills asserts that its proxy group is comprised of companies that most closely represent Black Hills in terms of operating characteristics. In his criteria for analysis, Dr. Avera considered companies with a similar credit rating to the Better Business Bureau (BBB) designation currently held by Black Hills. He also considered published benchmarks that are typically relied on by credit agencies in the determination of risk relative to other similarly situated companies. Dr. Avera asserts that Black Hills has a higher level of risk than other companies in his selected proxy group, in part based on its smaller market capitalization in comparison to the other companies.

175. Black Hills produced a DCF model that is commonly known as the traditional or Constant Growth DCF, and incorporates a calculation based on the future flow of dividends utilizing the dividend yield divided by a single growth rate. Dr. Avera asserts that the DCF is the model most commonly relied upon to establish the cost of equity for regulated utilities. The calculation of the model involves determining an expected dividend yield, and an estimate of investors' long-term growth expectations for the firm. Dr. Avera's DCF results yielded an ROE range of 8.2 percent to 12.0 percent.

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<sup>49</sup> Black Hills Concessions.

176. Black Hills performed a CAPM analysis, but represented it only as a benchmark to its cost of equity. The results of its model yielded an estimate of 10.5 percent, adjusted to 11.6 percent after incorporating a size adjustment that corresponds to the market capitalization of comparative utilities. Staff also performed a CAPM analysis to provide a benchmark, but did not rely on its results. The overall result of Black Hills' analysis was a weighted CAPM of 9.90 percent, using a risk-free rate of 3.29 percent, a Beta of 0.78, and a market rate of return of 11.77 percent.

177. Black Hills developed an ECAPM model, which is a variant of the traditional CAPM that assumes that investors are fully diversified, and that the relevant risk of an individual asset is its volatility related to the market as a whole. The results of Black Hills' ECAPM model estimated an ROE of 11.0 percent; however, adjusted for the impact of firm size, the results increased to 12.1 percent. Staff also performed the ECAPM, recognizing that the CAPM may understate the cost of equity for low beta industries, and overstate it for high beta industries. Staff cautioned that the ECAPM is predicted to result in higher ROE recommendations because utilities are characterized as a low-volatility industry. The mean result of Staff's ECAPM study was an ROE of 10.37 percent.

178. Black Hills performed another model termed the Utility Risk Premium method, in which the cost of equity is estimated by determining the additional return investors require to forgo the safety of bonds in exchange for the risks of common stocks. Black Hills estimated a risk premium based on a forecasted yield for 2014 through 2018 that resulted in an implied cost of equity of approximately 11.14 percent.

179. Black Hills asserts that because of its relative smaller size in comparison to similarly situated electric utilities, its risk profile is higher. Because of its smaller size,

Black Hills added a size premium to the ECAPM model account for differences in the required rates of return that are not fully captured by the beta value, which is a numerical measure of relative risk. The Company also suggests that the risk of electric companies in general is higher than the risk of natural gas utilities.

180. Black Hills included unrecovered flotation costs for the sale of common stock in 2010. These unrecovered costs represent 3.7 percent of gross proceeds in connection with that sale. Using an expense percentage and a representative dividend yield, Black Hills calculated a flotation cost adjustment of 14 basis points. Black Hills believes that such costs are justified because they are legitimate unrecovered costs that are needed to compensate for past equity issues.

#### **B. OCC**

181. The OCC sponsored the testimony of Mr. Ronald A. Fernandez with respect to ROE. The OCC also performed financial analyses in support of its ROE recommendation including the DCF, CAPM, and a comparison of recent authorized returns in utility cases. The OCC recommended an ROE of 9.2 percent, which represents an average of the three methodologies.

182. As a basis for these models, the OCC created a proxy group of 20 companies by selecting electric-only utilities derived from the Value Line database.

183. Mr. Fernandez did not include a range for his recommended ROE and did not include a Multi-Stage DCF method in his calculations.

184. The OCC's proxy group was also derived from the Value Line database, and considered credit ratings and dividend payments as factors in its proxy group selection. In addition, the OCC eliminated a recent merger, acquisition, and divestiture activity, as well as

non-utility, non-regulated, or international subsidiaries. The OCC does not believe that Black Hills Corporation (BHC) should be included as part of the proxy group, in order to avoid circular logic.

185. The OCC's DCF analysis resulted in a range of 8.3 percent to 8.9 percent, with an average of 8.6 percent. Mr. Fernandez points to several differences in his model as compared to Black Hills, including differences in the growth rate, certain companies included in the proxy group, and alleged mathematical errors in Black Hills' model. In regard to the proxy group, OCC disagrees with the inclusion of non-utility companies, on the grounds that the dividend yields for these companies are significantly lower and the ROE estimates are higher than almost any ROE awarded to utilities in recent years.

186. OCC examines risk as part of its ROE analysis, and points to the CACJA rider as a factor that reduces Black Hills' overall risk. OCC believes that investors will recognize that the effect of the rider is to push costs to consumers, and that warrants a lower return. If the CACJA rider is approved, OCC recommends a reduction to the ROE of 25 basis points to compensate for guaranteed recovery of costs. OCC opposes an adjustment to the ROE based on Black Hills' relative size, citing a negative industry risk premium.

187. OCC opposes the inclusion of flotation costs, because they have no bearing on the price that an investor is willing to pay for a stock. OCC argues that the vast majority of trading in a Company's stock takes place in organized exchanges, and therefore the Company does not incur any costs in these trades. OCC believes that the costs incurred in 2010 are dated, and to include them would violate the matching principle.

**C. Staff**

188. Staff sponsored the testimony of Dr. Scott England with respect to its ROE recommendation. Based on his analysis, Dr. England recommends a reasonable range of 9.48 percent to 10.37 percent, and presents Staff's recommended ROE as the very bottom of its range at 9.48 percent.

189. In support of his ROE recommendation, Dr. England employed four generally accepted methodologies or models to calculate the earned rates of return: the DCF Method, the Multi-Stage DCF Method, the CAPM, and the ECAPM. Staff's proxy group is comprised of 12 electric utilities, with no non-utilities included.

190. Staff's proxy group utilities were derived from information listed in the Value Line database service and considered, among other things, market capitalization, earnings per share estimates, dividend payments, and credit ratings. Staff's proxy group did not include the parent company, BHC, to avoid issues related to circularity as also raised by OCC. Staff questions the inclusion of large-cap companies, which does not comport with the fact that Black Hills is a relatively smaller mid-cap company.

191. Staff prepared two DCF analyses using two separate approaches: the Constant Growth DCF as utilized by Black Hills, and the Multi-Stage DCF model. The cost of equity determined by Staff's Constant Growth DCF analysis resulted in a mean cost of equity of 9.48 percent. Staff asserts that a major difference in its DCF model compared to Black Hills is Black Hills' inclusion of growth rates above 13.3 percent, which results in an unfair upward bias in the ROE result.

192. The second DCF approach by Staff is the Multi-Stage DCF model, which is an extension of the Constant Growth DCF in that it incorporates additional stages of growth to

reflect a long-term relationship with the overall economy. Staff based this long-term growth rate on the nominal Gross Domestic Product (GDP). Based on three stages of growth, including the percentage change in real GDP, anticipated inflation rate, and long-term growth rate, Staff calculated a nominal GDP rate of 5.778 percent. For its Multi-Stage DCF analysis, Staff produced an overall mean cost of equity of 9.83 percent.

193. Staff makes reference to certain factors that reduce Black Hills' risk, and therefore apply downward pressure on its ROE. Because the proposed CACJA recovery rider guarantees the current return on CWIP at a more favorable rate than other projects not related to CACJA, the overall risk profile of the Company is reduced. Per § 40-3.2-207(3), C.R.S., Black Hills is permitted to recover CWIP for its CACJA investment with a return equal to its WACC. The effect of implementing the rider allows rates to fluctuate between rate cases, and therefore addresses any potential over or under recovery. Staff recommends that the Commission acknowledge that the Company's risk is reduced by authorizing an ROE at the lower end of Staff's range.

194. Staff also raises the issue of Black Hills' inclusion of an acquisition premium related to the assets of Aquila, Inc. (Aquila). Staff asserts that the acquisition premium is booked as additional paid-in capital, and therefore is included in the Company's capital structure. Without such inclusion, the percentage of equity would be lower. The result is that ratepayers bear a greater cost than would otherwise be the case. Staff cites this as another factor in its proposal to award an ROE on the lower end of Staff's range.

195. Staff, like OCC, opposes Black Hills' inclusion of flotation costs in its ROE determination on the grounds that they are simply sunk costs, and do not recur. The flotation costs are related to stock issued in 2010, which is considerably dated. In Black Hills' most recent

electric rate case, Proceeding Nos. 11AL-382E and 11AL-387E, the Commission denied the inclusion of flotation costs with the implication that such costs would only be considered for new stock issuance; therefore, Staff asserts that the flotation costs relative to this sale should not be considered.

**D. Other Intervenors**

196. No other Intervenor sponsored testimony in regards to ROE. The following Intervenors provide argument in support of a proposed ROE from another party.

197. In its SOP, Holcim endorses the conclusions of Dr. England in regards to ROE. Holcim agrees with Dr. England's objections to Black Hills' adjustments for floatation costs, size premium, and inconsistent adjustments for DCF growth rates that are too low or too high. Holcim also stresses the lack of risk to investors due to the CACJA and the associated rider.

198. The Board and Authority endorse the position taken by Staff and the OCC and urge the Commission to set an ROE between 9.2 percent and 9.5 percent.<sup>50</sup> The Board and Authority base their argument upon the low level of business risk faced by Black Hills. The Board and Authority cite four separate risk reduction factors, including: 1) virtually no generation risk; 2) no risk to recover fuel costs due to their Energy Cost Adjustment tariff; 3) the CACJA rider allowance; and 4) rates that essentially guarantee revenue recovery.

199. The City urges the Commission reduce the ROE to "substantially less" than 9.9 percent due to the CACJA rider. The City supports the testimony of both Dr. England and Mr. Fernandez.

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<sup>50</sup> The OCC recommendation was 9.2 and the Staff recommendation was 9.48.

**E. Discussion**

200. First, the ALJ notes that at hearing, Black Hills witness Stoffel introduced Hearing Exhibit No. 27, titled “Black Hills’ Rate Case Concessions,” in which he conveyed the Company’s willingness to reduce its requested ROE from 10.3 percent to 9.9 percent, resulting in a reduction to the revenue requirement of approximately \$1.6 million. Dr. Avera acknowledged at hearing that although the reduction was considerably below his recommendation, it was still above the 9.64 percent at the bottom of his range.<sup>51</sup> Although not fully supportive of the reduction, he indicated his concurrence with the Company’s position that the reduction was made in consideration of its relationship with its customers. This concession effectively resets the Company’s direct case ROE recommendation, reducing it to 9.9 percent and coinciding with its current authorized return.

201. The ALJ acknowledges that the Commission has abided by the standard created by the *Hope* and *Bluefield* Supreme Court cases with respect to the establishment of a fair rate of return.<sup>52</sup> These cases establish that the ROE should be: 1) similar to that of other financially sound businesses having similar or comparable risks; 2) sufficient to ensure investor confidence in the financial integrity of the utility; and 3) adequate to maintain and support the credit of the utility, enabling it to attract the funds necessary to satisfy its capital requirement so that it can meet the obligation to provide adequate and reliable service to the public.

202. All of the equity models presented by the parties qualify as generally accepted methodologies for determining an appropriate rate of return. In Black Hills’ most recent electric rate case, the Commission expressed its preference for the DCF model as an acceptable approach

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<sup>51</sup> Transcript Volume 2, p. 19, lines 7-15.

<sup>52</sup> *Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923); and *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 391 (1944).

for determining ROE.<sup>53</sup> The ALJ does not interpret this preference to equate to an elimination of other methodologies, which may be of use in supporting an ROE decision. It does, however, serve as a guideline when focusing on final results.

203. In Public Service's most recent natural gas rate case, Proceeding No. 12AL-1268G, the Commission narrowed its preference further, approving the use of the Multi-Stage DCF model. In her Decision, ALJ Mana L. Jennings-Fader stated that the Multi-Stage DCF model is: (a) a refinement on the premises of the Constant Growth DCF model, and cited the model's ability to specify near-term, intermediate, and long-term growth rates which is an improvement over the Constant Growth DCF method's basic assumption that a company will grow at the same rate in the future; (b) the model's ability to account for increases and decreases in capital spending or changes in dividend payout levels; and (c) as a result of its greater input flexibility, the model's ability to produce results that are closer to the realities of the changing capital markets and, therefore, that are a more representative estimation of the cost of equity.<sup>54</sup> The ALJ reiterates that while this ruling does not eliminate consideration of other ROE models, it similarly serves as guidance.

204. The testimony filed in this case presented a divergence of positions in terms of the calculated results of ROE models, and a divergence of opinions with respect to factors that may impact the risk level of Black Hills and put either upward or downward pressure on the determination of the ROE. The ALJ observes that certain aspects of the analyses that were presented were repetitive in nature to those positions that were advanced and ruled on in Black Hills' last rate case in Proceeding Nos. 11AL-382E and 11AL-387E. Specifically, these relate to

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<sup>53</sup> Proceeding Nos. 11AL-382E and 11AL-387E, Decision No. C11-1373, p.30, ¶86.

<sup>54</sup> Proceeding No. 12AL-1268G, Decision No. R13-1307, p. 97, ¶298.

the use of non-utility companies in Black Hills' proxy group, and the inclusion of flotation costs related to stock sales in 2010 in the determination of the ROE range. The ALJ declines to reconsider the rulings already made in relation to these positions. The inclusion of non-utility companies in Black Hills' proxy group will not be accepted in the ROE analysis in this proceeding. Likewise, the inclusion of flotation costs will not be accepted; removing the 14-basis point addition to the ROE range of Black Hills' results in an adjusted range of 9.5 percent to 11.5 percent.

205. An ROE based on the market cost of equity not only incents the utility to operate safely, reliably, and efficiently, it also impacts its ability to attract the capital necessary to support ongoing operations. At hearing, Dr. Avera was questioned as to his thoughts with respect to the downward revision of the ROE from 10.3 percent to 9.9 percent. Dr. Avera testified, among other things, that in regard to the ROE "as long as it's in the range of reasonableness and there is an expectation on the part of investors that this is an accommodation to a special situation of the customer's concerns, I think it would allow the company to attract capital and maintain its financial integrity and be barely competitive with other returns."<sup>55</sup> The ALJ concludes from this statement that Dr. Avera concedes that an ROE within his recommended range of 9.64 percent to 11.64 percent, while not necessarily desirable, would be sufficient to allow the Company to attract capital and maintain its financial integrity.

206. Black Hills' level of risk is influenced by many factors as raised in testimony by the parties. The ALJ is persuaded by the Company's argument that electric utilities are generally more risky than natural gas utilities, as measured by their comparative beta values. Less compelling, however, is the Company's adjustment for size. The OCC makes a convincing

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<sup>55</sup> Transcript vol. 2, p.8, lines 7-13.

argument that Black Hills' addition of over 100 basis points to the estimated returns based on size is flawed because there is no corresponding adjustment for the decreasing risk experienced by the industry as a whole. At hearing, Dr. Avera alluded to the recent bond rating upgrade by the Moody's reporting agency, which supports OCC's contention;<sup>56</sup> indeed, Black Hills' bond rating itself has improved to BBB since its last rate case based on the upgrade.

207. Staff argues that Dr. Avera's use of a size premium is counterintuitive given that many companies in his proxy group have more than double the market capitalization of BHS. The Commission previously articulated in Proceeding No. 12AL-1268G that the proxy group should most closely reflect the operations of the parent company, in order to reflect investor expectations.<sup>57</sup> In the application of this principle to Xcel Energy in that proceeding, Staff notes that no such premium was implemented, and if it had been, it would have resulted in a perverse outcome.

208. The testimony of both the OCC and Staff present compelling arguments as to the stabilizing effect of riders, which results in guaranteed revenue that has the effect of lowering the company's risk. Staff's reference to the higher rate of return of the WACC earned on the CACJA rider, compared to the AFUDC rate, supports the conclusion that Black Hills will benefit from improved cash flow as a result of the implementation of the rider. Staff asserts that, ultimately, the rider will recover approximately \$70 million in rate base additions or approximately 15 percent of Black Hills' rate base. OCC concurs with Staff, stating that Black Hills will have essentially guaranteed recovery on a dollar-for-dollar basis of these costs from ratepayers,

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<sup>56</sup> Transcript vol. 2, p. 10, lines 21-24.

<sup>57</sup> Decision No. R13-1307, 12AL-1268G, p. 94 ¶ 287.

making the recovery virtually risk-free. The ALJ finds these arguments to be persuasive, and concludes that the approval of the CACJA rider will reduce Black Hills' overall risk profile.

209. Certain facts introduced to the record in this proceeding as to the overall financial health of the Company were not controverted; these include: 1) Black Hills was recently upgraded to a BBB credit rating; 2) the Company has declared a dividend in each year for the past 44 years; and 3) in 2013, the Company's stock price was up 44.5 percent.<sup>58</sup> These statistics exist as independent barometers of the economic environment in which the Company operates.

210. The determination of the allowed ROE incorporates a range of analyses that often conflict, and involves a considerable amount of judgment with regard to factors that are not easily quantified. The ALJ finds that the best approach in the determination of ROE is one that is model-based, and incorporates principles that have been articulated by the Commission.

211. The Commission has stated its preference in prior decisions for the results produced by the DCF methodology, and most recently, the Multi-Stage DCF methodology. The expression of a preference for a certain methodology does not discount or dismiss the validity of other models; rather, they provide valuable benchmarks that contribute to the overall decision. The selection of one ROE methodology over another does not constitute a precedent for future proceedings.

212. The ALJ finds that based on the weight of the evidence introduced in this proceeding, the Multi-Stage DCF methodology best reflects a realistic relationship to the marketplace, and will produce the most just and reasonable result. The ALJ agrees with the reasoning articulated by the Commission in Decision No. R13-1307 in Proceeding

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<sup>58</sup> Transcript Vol. 1, p. 96 lines 24-25, p. 97 lines 1-17.

No. 12AL-1268G that the Multi-Stage DCF methodology provides a degree of flexibility that may address the limiting assumptions of the Constant Growth DCF methodology, and the incorporation of the short-term, transitional, and long-term growth rates, as opposed to a single growth rate, is a superior method for estimating growth.

213. The ALJ now turns to the establishment of a range of reasonableness for the ROE. The range presented by the Company, 9.64 percent to 11.64 percent, is modified to 9.5 percent to 11.5 percent accounting for the removal of 14 basis points related to flotation costs. Staff, both in its testimony and at hearing, repeatedly advocates that an ROE be set at the “lower end” of Staff’s range of 9.48 percent to 10.37 percent.<sup>59</sup> In its summary of recommendations, however, Staff advocates that the ROE be set at the very bottom of its range, which is 9.48 percent. At hearing, it was established that based on a simple division of its range, the lower end of Staff’s range would constitute the 45 basis points from 9.48 percent to 9.93 percent.<sup>60</sup> The ALJ will therefore presume that this constitutes the lower end of Staff’s range.

214. The OCC presented a single ROE recommendation of 9.2 percent, which is the average of the outcomes of its methodologies. It did not expressly present a range of reasonableness as part of its recommendation. The ALJ observes the OCC’s Table RAF-5 in Mr. Fernandez’ Answer Testimony, which summarizes the outcomes of his ROE methodologies, and concludes that the lowest outcome is 8.3 percent, and the highest outcome is 9.9 percent.

215. As discussed *supra*, the Black Hills concession effectively re-established its direct case ROE at 9.9 percent, equivalent to its currently established ROE. Based on the evidence presented in this proceeding, numerous factors lead the ALJ to conclude that an increase to the

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<sup>59</sup> Hearing Exhibit No. 22, Answer Testimony of Dr. Scott England, p. 11 lines 1-3.

<sup>60</sup> Transcript Vol. 2, p. 197 lines 24-25, p. 198 lines 1-3.

ROE is unwarranted. The ALJ finds that an ROE range of 9.6 percent to 9.9 percent provides a just and reasonable result, and will maintain Black Hills' financial integrity and ability to attract capital. For purposes of establishing the allowed rate of return on equity, the ALJ authorizes an ROE equivalent to the mean results of Staff's Multi-Stage DCF methodology, at 9.83 percent.

216. As part of its overall recommendation, the OCC proposed an earnings sharing plan that was based on a similar earnings sharing plan in Public Service's Phase I rate case in Proceeding No. 11AL-947E. The structure of the OCC's proposed plan is that no sharing would occur for earnings below the authorized ROE. For an actual ROE that falls within the first 50 basis points above the authorized ROE, overearnings would be shared on a 50 percent /50 percent basis between customers and the Company. For an actual ROE that occurs above 50 basis points above the authorized ROE, the OCC recommends that customers retain 100 percent of those overearnings.

217. Black Hill opposes the OCC's recommendation based on the fact that it will be filing a general rate proceeding in 2016 for the purposes of incorporating costs related to the LM6000 plant. Black Hills argues that timing is a factor related to the appropriateness of an earnings sharing plan, and whereas such a plan may be justified if there is a prolonged period of time between rate cases, that is not the situation here. Further, the plan agreed to in the Public Service rate case was pursuant to a settlement, and was therefore not litigated.

218. The ALJ appreciates the OCC's arguments with respect to the goodwill and customer benefits that may accrue by the approval of such a plan; however, when the Commission carefully considers the appropriate level of ROE, it becomes less likely that such benefits would ever accrue. Second, the ALJ is mindful of the relatively short period of time until the next proposed rate case, as referenced by Black Hills. During that time, parties

including the OCC, may avail themselves of the existing formal complaint process in which such overearnings may be addressed. The ALJ will therefore deny the proposed sharing plan.

## **XI. CAPITAL STRUCTURE AND COST OF DEBT**

### **A. Black Hills**

219. Black Hills' capital structure and cost of debt are sponsored by witness Brian G. Iverson. Mr. Iverson recommends a capital structure of 49.46 percent debt and 50.54 percent equity, which is derived from the use of Black Hills' actual 2013 year-end capital structure, with a *pro forma* adjustment to reflect earnings for calendar year 2014. Black Hills calculated its long-term cost of debt at 5.29 percent, which includes several assignments of debt at varying interest rates.

220. In rebuttal, Black Hills criticizes the OCC's capital structure position because it is a departure from the position it has taken in the prior to rate cases filed by Black Hills, specifically that only the holding company's capital structure has a realistic relationship to the marketplace. Black Hills generally argues for the use of forecasts because of its use of the CTY rate base methodology. Black Hills responds to Staff's position that its use of a capital structure at the end of the first quarter of 2014 is inconsistent with the presumed acceptance of the CTY test period in the determination of its revenue requirement. In addition, Black Hills points to the inconsistency of using a long-term cost of debt that is also based on the end of the test period. Black Hills states that Staff ignores the corporate goals of establishing and maintaining the Company's capital structure in the targeted range of between 50 to 52 percent equity. Black Hills also states that Staff ignores the Company's taking assignment of \$350 million of low cost, long-term financing, and the fact that BHC consists of several diverse subsidiaries and business segments with very different equity and debt ratios.

**B. OCC**

221. The OCC recommends a capital structure of 50.17 percent debt and 49.83 percent equity, as proposed by OCC witness Fernandez. In keeping with its position to use the HTY, the OCC recommends that the appropriate capital structure is the actual capital structure of the Company at the end of 2013. OCC argues that the use of the Company's actual capital structure is the historic policy of the Commission.

222. The OCC objects to any capital structure calculation that includes projections, consistent with its position that rates should be based on the 2013 HTY. Specifically, the OCC points to the speculative calculation of net income that has the effect of increasing the equity in the capital structure. This increases the overall cost of capital, and therefore the cost to ratepayers. The OCC states that the Commission's historic policy has been to use the Company's actual capital structure based on an HTY.

223. In regard to the long-term cost of debt, the OCC recommends, for this proceeding only, the use of the 5.29 percent proposed by Black Hills. OCC makes this recommendation contingent on the Commission's review of a securities application anticipated to be filed by Black Hills. OCC envisions that such review will determine the appropriate amount of debt to be assigned to Black Hills, which would then be trued up to the approved rate in this proceeding.

**C. Staff**

224. Staff's positions on capital structure and the cost of debt were developed and sponsored by Staff witness Dr. England. Dr. England recommends a capital structure of 51.07 percent debt and 48.93 percent equity, which represents the capitalization of Black Hills Holdings (BKH), a wholly-owned subsidiary of BHC, at the end of the first quarter of 2014.

225. Staff objects to Black Hills' use of a capital structure that consists of an allocation of debt that is not reflective of the operating company. Staff contends that since the obligation to pay off debt lies with the parent organization, the allocation is simply a calculation and can be changed at any time. Staff asserts that the capital structure for Black Hills should reflect that of its parent company, BKH, because that is the entity responsible for repaying debt. Further, because the allocation is determined by BKH, the level of allocation is solely at its discretion. Staff selected a capital structure based on BKH's balance sheet for the first quarter of 2014.

226. Staff recommends a cost of debt of 5.29 percent, which is identical to the cost of debt proposed by Black Hills. Staff states that its practice has been to accept the Company's actual long-term cost of debt in rate cases unless the utility is requesting a change in the methodology of how it is determined.

**D. Other Intervenors**

227. Holcim and The City do not address capital structure or cost of debt.

228. The Board and Authority urge the Commission to reject Black Hills' capital structure and adopt the capital structure presented by the OCC.<sup>61</sup> The Board and Authority instruct the Commission to look to Decision No. C11-1373 in the last Black Hills rate case for guidance. In that case Black Hills endorsed the same position and it was rejected by the Commission. Although the Commission is not bound by the doctrine of *stare decisis*, the Board and Authority urge the Commission to give controlling weight to Commission Decision No. C11-1373.

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<sup>61</sup> The Board and Authority in the alternative urge the Commission to adopt the capital structure as presented by Staff.

**E. Discussion**

229. The OCC is correct that the Commission has historically utilized the actual level of long-term debt and equity of the subject utility to establish its capital structure. Indeed, in Proceeding No. 12AL-1268G, Public Service's most recent gas rate case, ALJ Mana L. Jennings-Fader stated that "The Colorado Supreme Court has held that, unless it is demonstrated by a substantial showing that ratepayers are materially prejudiced by the actual capital structure that finances utility operations, the Commission should use that actual utility capital structure in calculating rates. *Peoples Natural Gas v. Public Utilities Commission*, 567 P2d 377 (Colo. 1977)."<sup>62</sup> (Emphasis in original) Based on the *Peoples Natural Gas* decision, the ALJ observes that Staff's proposed use of the parent company BKH's capital structure as of 2014 would require a substantial showing that ratepayers would be prejudiced by use of the Company's actual capital structure. The ALJ notes Black Hills' arguments regarding the variable characteristics of the parent company's debt structure, as well as the use of the first quarter 2014 data, which make the application of the parent company's capital structure problematic. However, the prevailing direction concerning this matter originates from the ruling made in the *Peoples Natural Gas* decision. Based on the weight of the evidence, the ALJ does not find that ratepayers would be prejudiced by use of the Company's actual capital structure, and will adopt the OCC's actual 2013 capital structure of 50.17 percent debt and 49.83 percent equity.

230. In regard to the cost of long-term debt, the OCC expresses concern that Black Hills has assigned its highest cost debt to the Black Hills Electric subsidiary, which results in the greatest amount of impact to the Company's ratepayers. The OCC suggests that if the cost of debt had been spread equitably, each subsidiary's cost of debt would be over one point lower.

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<sup>62</sup> Decision No. R13-1307, Proceeding No. 12AL-1268G, p. 105, ¶329.

The OCC recommends approving the cost of long term debt proposed by Black Hills, but only with reservations. OCC notes Black Hills' upcoming security filing in which the Commission will determine if \$350 million in debt should be permanently assigned to Black Hills Electric. OCC recommends that, as part of that proposed filing, the Commission should order a method to retroactively true up the cost of debt.

231. The ALJ observes that, as a practical matter, no party opposed Black Hills' proposed cost of long-term debt; further, no party introduced an alternative cost of long-term debt to the record. The ALJ will accept 5.29 percent as the long-term cost of debt for year-end 2013, which coincides with the HTY in this proceeding. Therefore, incorporating the authorized ROE of 9.83 percent, the capital structure consisting of 49.83 percent equity and 50.17 percent debt, and the approved long-term cost of debt of 5.29 percent, the WACC in this proceeding is calculated at 7.55 percent.

## **XII. INCOME STATEMENT (HTY REVENUES AND EXPENSES)**

### **A. Shared Facility Fee**

232. Black Hills has included a revenue credit of \$828,356 as it relates to the shared facility agreement between the Company and Black Hills' IPP (BHIPP) for the use of facilities at the Pueblo Airport Generating Station.

#### **1. Black Hills**

233. Black Hills argues the shared facilities fee charged to BHIPP and received by Black Hills as revenue is pursuant to an inter-company contract, and is determined based on the year-end net book value (NBV) of the shared assets in accordance with a formula approved by the Commission in Proceeding No. 11AL-387E. Since the NBV of the underlying asset declines over time, the principal on which the Shared Facility Fee is based also declines.

Therefore Black Hills has determined the amount for the Shared Facility Fee adjustment based on the NBV of the underlying asset as of December 31, 2014. Black Hills argues that under either a CTY or HTY analysis, its adjustment should be accepted.

## 2. The OCC

234. The OCC objects to Black Hills' calculation of the Shared Facility Fee because it is based on the projected value of the facility as of December 31, 2014. The OCC contended that the calculation of the Shared Facility Fee should be based on the December 31, 2013 value—the ending point of the OCC's proposed test year. The OCC adjustment indicated that the Black Hills Independent Power Plant affiliate was charged \$1,477,542 for the Shared Facility Fee during calendar year 2013. However, it believes it should be charged the \$2,268,416 amount. Therefore, the OCC adjustment is the difference between what it believes the affiliate should be charged and what it was charged. This amount is \$790,874.

## 3. Other Intervenors

235. No other Intervenor stated a contrary position or opposition to Black Hills' proposal concerning the Shared Facility Fee in prefiled testimony, in testimony during the evidentiary hearing, or in a filed SOP.<sup>63</sup>

## 4. Discussion

236. The standard when using an HTY is that it is adjusted for known and measurable changes during the test period. This is the most accurate method upon which to base adjustments to revenue items such as shared facility fees.

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<sup>63</sup> In its SOP Staff states that the failure to oppose aspects of Black Hills' case is not an "affirmative endorsement" of Black Hills' position. *Staff Statement of Position p. 6*. While not an endorsement, Staff failed at any point in the proceeding to provide opposition or alternatives to the positions of Black Hills except where noted.

237. The shared facility charge received by Black Hills Energy from its non-regulated BHIPP is based upon a year end NBV of the shared facility. This NBV is formulaic in nature and is known to Black Hills' staff. This formula can therefore produce a known and measurable adjustment to shared facility fees that is reflected in the Company's adjustment.

238. The adjustment proposed of \$828,356 to Miscellaneous Revenues as it relates to the Shared Facility Fee by Black Hills is known and measurable and shall be accepted.

**B. Open Positions Salary and Wages**

239. Black Hills proposes \$1,246,971 in merit pay increases for non-union employees and wage increases for union employees. No party takes issue with the inclusion of this expense in general, but the OCC takes issue with the amount due to vacant positions.

240. On December 31, 2013, there were 12 vacant positions. At the time of the filing of the Advice letter there were 14 vacant positions. By the time of the evidentiary hearing the 14 vacant positions had been filled, although 5 new positions had become vacant.

**1. Black Hills**

241. Black Hills states it is appropriate to increase the amount of salaries and wages by \$1,246,971 in order to reflect payroll annualization. Black Hills states that the recovery for the wages should not be denied since this was a prudently incurred expense that is just and reasonable.

242. In its SOP, Black Hills stated it is willing to concede the recovery of the five vacant positions as of August 2014.

**2. The OCC**

243. The OCC opposes Black Hills inclusion of salaries and wages for the 14 positions which were vacant at the time Black Hills filed its direct case. The OCC argues it is likely that

Black Hills will have vacant positions during the course of any year and having ratepayers pay for 100 percent of all salaries will lead to a windfall for Black Hills. The OCC encourages the Commission to remove \$969,747 worth of salaries and wages for the 14 vacant positions.

244. In the alternative, in its SOP, the OCC proposes the amount be adjusted to the average of the amount of vacancies stated in the direct case (14), the amount as of December 31, 2013 (12), and the amount as of August 2014 (5) or an average of 10 vacancies. The amount of the adjustment is calculated by dividing the proposed \$969,747 by 14, which equals \$69,268 and multiplying this number by 10 which equals \$692,676.

### **3. Other Intervenors**

245. No other Intervenor stated a contrary position or opposition to Black Hills' proposal concerning the open positions salary and wages in prefiled testimony, in testimony during the evidentiary hearing, or in a filed SOP.

### **4. Discussion**

246. During the proceedings, through the testimony of Black Hills Witness Bryan Owens, it was determined that the 14 positions contained in Black Hills' direct testimony were filled. This adjustment by Black Hills, therefore, represents a known and measurable change to this expense item.

247. Mr. Owens also testified to five current vacant positions as of August 2014. This new vacancy number is a known and measurable change.<sup>64</sup>

248. The ALJ will adjust the open positions, salary, and wages to the five vacancies as of August 2014. This adjustment will be made by applying the average salary amount reflected in

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<sup>64</sup> Transcript vol.2, p. 128, lines 18-19

the OCC's SOP of \$69,268, and multiplying it by five. This calculation reduces Black Hills' proposed adjustment of the amount of \$969,747 by \$346,340. The accepted adjustment, therefore, is \$623,407

**C. Holding Company Charges**

**1. Black Hills**

249. Black Hills' direct case includes an increase in the amount of intercompany charges from BBH/Black Hills Utility Holdings by \$345,967 in order to reflect changes in the anticipated costs and applicable allocation factors after December 31, 2013.

**2. The OCC**

250. The OCC opposed the inclusion of these additional operating costs because they are anticipated to occur after the calendar year 2013 HTY. They further maintain that because this adjustment is based on anticipated costs, it is not known and measurable.

251. The OCC contends that it is good regulatory practice to maintain the matching principle of revenues, expenses, and investments within a test year. Therefore, it proposed to remove the entire \$345,967 adjustment for this item.

**3. Other Intervenors**

252. No other Intervenor stated a contrary position or opposition to Black Hills' proposal concerning the holding company charges in prefiled testimony, in testimony during the evidentiary hearing, or in a filed SOP.

**4. Discussion**

253. When using an HTY, it is adjusted for known and measurable changes during the test period. This is the most accurate method upon which to base adjustments to revenue items such as shared facility fees.

254. Black Hills did not supplement their original filing to show that known and measurable changes beyond December 31, 2013 have occurred in this expense item. The adjustment made by the OCC in the amount of \$345,967 related to holding company charges shall be adopted.

255. It is also noted that the same expense item was determined not to be known and measurable in Black Hills' previous electric rate case Proceeding No. 11AL-387E and was removed.<sup>65</sup>

#### **D. Service Company Charges**

##### **1. Black Hills**

256. Black Hills states it anticipates a decrease in the amount of intercompany charges from Black Hills' Service Company by \$438,166 after December 31, 2013.

257. Black Hills maintains that this adjustment, made in its proposed CTY approach, is an anticipated change that is as reliable as adjustments allowed when using an HTY.

##### **2. The OCC**

258. The OCC opposed the inclusion of these operating costs because they are anticipated to occur after the calendar year 2013 HTY. The OCC argues this adjustment is based on anticipated costs and it is not known and measurable.

259. The OCC contends that it is good regulatory practice to maintain the matching principle of revenues, expenses, and investments within a test year. The OCC proposes to remove the entire \$438,166 adjustment for this item.

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<sup>65</sup> Proceeding Nos. 11AL-382E and 11AL-387E Decision No. C11-1373, p 37

### 3. Other Intervenors

260. No other Intervenor stated a contrary position or opposition to Black Hills' proposal concerning the service company charges in prefiled testimony, in testimony during the evidentiary hearing, or in a filed SOP.

### 4. Discussion

261. The standard when using an HTY is that it is adjusted for known and measurable changes during the test period. This is the most accurate method upon which to base adjustments to revenue items such as Service Company Charges.

262. Black Hills did not supplement their original filing to show that known and measurable changes beyond December 31, 2013 have occurred in this expense item.

263. The adjustment made by the OCC in the amount of \$438,166 related to Service Company Charges shall be adopted.

264. It is also noted that the same expense item was determined not to be known and measurable in Black Hills' previous electric rate case Proceeding No. 11AL-387E and was removed.<sup>66</sup>

265. This decreases this item made by Black Hills in the direct case.

## E. Generation Dispatch Costs

### 1. Black Hills

266. Black Hills states it is appropriate to increase the amount it will be charged for power generation dispatch and scheduling by \$20,801 to reflect changes in the anticipated costs in the calendar year 2014.

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<sup>66</sup> Proceeding Nos. 11AL-382E and 11AL-387E Decision No. C11-1373, p37

## 2. The OCC

267. The OCC opposes the inclusion of an increase to general dispatch costs since they will occur after the calendar year 2013 HTY. The OCC argues that because this adjustment is based on anticipated costs, it is not known and measurable.

268. The OCC believes that it is good regulatory practice to maintain the matching principle of revenues, expenses, and investments within a test year and propose to remove the entire \$20,801 allocated by Black Hills.

## 3. Other Intervenors

269. No other Intervenor stated a contrary position or opposition to Black Hills' proposal concerning generation dispatch costs in prefiled testimony, in testimony during the evidentiary hearing, or in a filed SOP.

## 4. Discussion

270. The standard when using an HTY is that it is adjusted for known and measurable changes during the test period. This is the most accurate method upon which to base adjustments to revenue items such as Generation Dispatch Costs.

271. Black Hills did not supplement their original filing to show that known and measurable changes beyond December 31, 2013 have occurred in this expense item.

272. The adjustment made by the OCC in the amount of \$20,801 related to Generation Dispatch Costs shall be adopted.

## F. Bad Debt Expense

273. Black Hills proposes to increase the amount of bad debt expense it expects to incur by \$145,434. This figure is the difference between its Per Book amount of \$929,501 in bad debts for calendar year 2013 and the expected amount of Bad Debts in 2014 of \$1,074,935.

**1. Black Hills**

274. Black Hills states it is appropriate to increase this amount by \$145,434 in order to reflect changes in the anticipated costs in the calendar year 2014.

**2. The OCC**

275. The OCC disagreed with Black Hills' calculation of bad debt expense because its calculation is forward looking in nature.

276. The OCC supports Black Hills' proposal of using a three-year average to develop its proposed adjustment to its bad debt expense. The OCC believes a three-year historic average will mitigate the variability in setting the expected level of an operating expense on a going forward basis.

277. The OCC recommends that Black Hills' bad debt expense be increased by \$101,357. This results in a reduction in operating costs for Black Hills of \$44,077 (\$145,434 - \$101,357).

**3. Other Intervenors**

278. No other Intervenor stated a contrary position or opposition to Black Hills' proposal concerning bad debt expense in prefiled testimony, in testimony during the evidentiary hearing, or in a filed SOP.

**4. Discussion**

279. The standard when using an HTY is that it is adjusted for known and measurable changes during the test period. This is the most accurate method upon which to base adjustments to revenue items such as Generation Dispatch Costs.

280. Black Hills did not supplement their original filing to show that known and measurable changes beyond December 31, 2013 have occurred in this expense item.

281. The ALJ will accept the adjustment made by the OCC in the amount of an increase of \$101,357 to bad debt expense versus the amount proposed by Black Hills of \$145,434.

**G. Phase I Rate Case Consulting Expense**

282. Black Hills proposes to amortize \$830,750 worth of outside consulting costs related to the instant rate case over a two-year period. The \$830,750 figure is the sum of: \$15,000 for a Depreciation Consultant; \$65,000 for a Capital Structure Consultant; \$700,000 for outside legal counsel; and \$50,750 for Other/Miscellaneous.

**1. Black Hills**

283. Black Hills requests \$830,750 (amortized over two years) arguing that legal costs should be treated similarly to other operating expenses. Black Hills states it has incurred significant legal costs in the review of this filing, preparation of testimony, responding to over 500 discovery requests and in preparation for hearings, that these are real costs and should not be deferred longer than two years.

**2. The OCC**

284. The OCC argues that amounts requested by Black Hills are estimated costs and not actual costs. In addition, the OCC states there is a noticeable increase in outside legal counsel costs as compared to Black Hills' last electric rate case.

285. The OCC points out that Black Hills is requesting an amount in outside legal consultant costs that is over 11 percent faster than inflation and 3.5 percent faster than A&G expense, since its last Phase I electric rate case in 2011.

286. The OCC contends that a utility should only collect actual prudently incurred rate case costs. OCC proposes a reduction in rate case expenses of \$415,375, which is one-half of the

\$830,750 cost estimate. The costs to be recovered after actual amounts are known and measureable.

### **3. Other Intervenors**

287. No other Intervenor stated a contrary position or opposition to Black Hills' proposal concerning Phase I rate case consulting expenses in prefiled testimony, in testimony during the evidentiary hearing, or in a filed SOP.

### **4. Discussion**

288. In past rate case proceedings, the Commission has recognized rate case costs to be legitimate expenses that are appropriate for rate recovery. At issue is whether it's appropriate to accept projections as a basis for adjustments to such an expense item.

289. In past proceedings, the Commission has directed a utility to file GRSA tariffs, upon the conclusion of rate case proceedings that allow for collection of actual incurred rate case expenses. This course of action would address the OCC's concerns that cost recovery should be deferred until amounts are actually known and measurable and can be reviewed by Staff and the OCC

290. Black Hills did not, during the course of the proceeding, update their initial filing to show that known and measurable changes beyond December 31, 2013 occurred concerning Phase I rate case expenses.

291. The ALJ finds that the \$830,750 proposed by Black Hills is a reasonable initial input as revenue requirement for Phase I Rate Case consulting expenses and that a two-year amortization period is also appropriate.

292. Black Hills shall meet no later than February 28, 2015, with the OCC and Staff to review the final rate case expenditures. Black Hills shall then file no later than April 1, 2015, a GRSA tariff that adjusts the final rate case expenses to actuals.

#### **H. Phase II Rate Case Consulting Expense**

293. Black Hills proposes to amortize \$323,097 worth of costs from its prior Phase II Electric Rate Case, Proceeding No. 12AL-1052E, over a two-year period.

##### **1. Black Hills**

294. Black Hills argues that during 2012 and 2013, Black Hills incurred substantial legal and consulting costs to amend its base rate design. Changes to the rate design were approved and became effective in July 2013.

295. Black Hills would prefer that the costs of these deferred regulatory expenses be fully amortized before the next Phase I case that will be filed in 2016. Phase II costs from the last rate case are fully known and measurable. Black Hills has responded to the OCC's opposition, which argues for a longer amortization (five years) stating that it is inappropriate for the Company to have to wait until 2019 in order to collect costs that have been prudently incurred over the last two years

##### **2. OCC**

296. The OCC contends that the \$323,097 worth of costs for its last Phase II Electric Rate Case should be amortized over five years. The dollar value of the OCC's adjustment was developed as follows:  $\$323,097 / 2 \text{ years} = \$161,549$  and  $\$323,097 / 5 \text{ years} = \$64,619$ . The difference between \$161,549 and \$64,619 is a \$96,930 reduction in operating expenses for Black Hills.

### 3. Other Intervenors

297. No other Intervenor stated a contrary position or opposition to Black Hills' proposal concerning Phase II rate case consulting expenses in prefiled testimony, in testimony during the evidentiary hearing, or in a filed SOP.

### 4. Discussion

298. In past rate proceedings, the Commission has recognized rate case costs to be legitimate expenses that are appropriate for rate recovery.<sup>67</sup> The question with this issue, is what is the appropriate amortization period for the recovery of known and measurable cost? These Phase II costs were incurred in 2012 and 2013.

299. The time between when costs are incurred and when they are recovered should be reasonable. The proposal of the OCC would delay known, recoverable rate case costs until 2019 at which time the recovery of up to four Phase I or Phase II<sup>68</sup> rate case costs could conceivably be recovered from ratepayers.

300. The adoption of such a long amortization period for costs that were prudently incurred as far back as two years ago is, as admitted to by Mr. Skluzak, "is a bit like kicking the can down the road<sup>69</sup>" and it does not allow for cost recovery in a timely manner.

301. The ratepayers do not deserve to be misled about reducing rates and then be hit with a huge rate increase after the next Phase I rate case, and Black Hills should be allowed recovery of legitimate expenses in a timely manner. A two-year amortization period is appropriate for the recovery of \$323,097 worth of Phase II rate case consulting costs.

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<sup>67</sup> Proceeding Nos. 11AL-382E and 11AL-387E, Decision No. C11-1373, p.40

<sup>68</sup> Black Hills, SOP, p. 37

<sup>69</sup> *Hearing Transcript Vol. 3, p. 79, l.16-23.*

**I. Electric Resource Plan Expense**

302. Black Hills proposed to amortize \$1,296,853 worth of Electric Resource Plan (ERP) costs over a two-year period. This figure is the sum of its 2013 ERP Regulatory Asset of \$846,853 and the estimated cost for its 2014 Phase II ERP of \$450,000.

**1. Black Hills**

303. Black Hills states that it is not following the four-year ERP cycle. The Company argued that next year it will begin to incur significant costs related to its 2015 ERP. Black Hills believes applying a four-year amortization advocated by the OCC would mean that 2013 ERP costs would carry forward into the next rate case cycle. The Company states that it believes a two-year amortization period would provide recovery in a timely manner and is fair and reasonable.

**2. OCC**

304. The OCC expresses two concerns with Black Hills' proposal on this issue. The first concern is the inclusion of the estimated \$450,000 amount for 2014 Phase II ERP costs. OCC's argument that a utility should only collect actual and prudently incurred rate case costs also extends to ERP costs.

305. The OCC recommends that the \$450,000 in estimated cost for Black Hills' 2014 Phase II ERP should not be collected at this time. Instead, the cost recovery for Black Hills' 2014 Phase II ERP should be deferred until an actual amount is known and has been reviewed by the OCC and Staff. The dollar value of this OCC adjustment is a reduction in operating expenses of \$225,000, which is one-half of the \$450,000 cost estimate. The one-half factor is because Black Hills proposes to amortize this \$450,000 cost estimate over a two-year period.

306. The second concern of the OCC is the proposed two-year amortization period for the \$846,853 worth of 2013 ERP costs. Under Commission Rule 4 CCR 723-3-3603(a), Rules Regulating Electric Utilities, each jurisdictional electric utility is required to file an ERP every four years. As a result, the OCC recommended that the ERP costs should be amortized on a four-year period because ERPs are due every four years.

307. The dollar values of the OCC adjustment were developed as follows:  $\$846,853 / 2 \text{ years} = \$423,427$  and  $\$846,853 / 4 \text{ years} = \$211,713$ . The difference between  $\$423,427$  and  $\$211,713$  is a  $\$211,714$  reduction in operating expenses for Black Hills.

### 3. Other Intervenors

308. No other Intervenor stated a contrary position or opposition to Black Hills' proposal concerning ERP expenses in prefiled testimony, in testimony during the evidentiary hearing, or in a filed SOP.

### 4. Discussion

309. The Commission has recognized ERP costs to be legitimate expenses that are appropriate for rate recovery.<sup>70</sup> The main question at issue once again, is what is the appropriate amortization period for the recovery of known and measurable costs? In addition, Black Hills has also made a proposal to include the projected costs of its 2014 ERP.

310. It is appropriate to use the standard for an HTY, which is adjusted for known and measurable changes during the test period. The ALJ further notes that in its previous Phase I electric case, Black Hills was directed by the Commission to remove, in its entirety, projected ERP costs.<sup>71</sup>

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<sup>70</sup> Proceeding Nos. 11AL-382E and 11AL-387E Decision No. C11-1373, p.42¶120

<sup>71</sup> Proceeding Nos. 11AL-382E and 11AL-387E Decision No. C11-1373, p.42¶120

311. As was the case in Proceeding No. 11AL-387E, it is appropriate to allow Black Hills to record the costs associated with its 2014 ERP in a deferred asset account and to address the recovery of these costs in a future rate proceeding.

312. There should be a reasonable time between when costs are incurred and when they are recovered. These are known and measurable ERP costs which were incurred in 2013. To delay recovery until 2018 is yet another effort to only “kick the can down the road” and is unfair to both Black Hills and the ratepayers. A two-year amortization period is appropriate for the recovery of \$846,853 worth of 2013 ERP costs.

**J. Renewable Energy Standard Plan Consulting Expense**

313. Black Hills proposes to amortize \$350,000 worth of 2014 Renewable Energy Standard (RES) Plan costs over a two-year period

**1. Black Hills**

314. This expense item is of a similar type to other projected adjustments made by Black Hills in this proceeding. This expense is a projection by Black Hills.

**2. OCC**

315. The OCC does not, in general, object to recovery for RES Plan consulting expenses. The OCC opposed the inclusion of these costs because they are anticipated to occur after the calendar year 2013 HTY and, therefore, represent estimated costs.

316. The OCC further maintains that because this adjustment is based on anticipated costs, it is not known and measurable. The OCC reiterates that a utility should also only collect actual and prudently incurred RES costs. As a result, the OCC recommended that the \$350,000 in estimated costs for Black Hills’ 2014 RES Plan should not be collected at this time.

317. The OCC believes that the cost recovery for Black Hills' 2014 RES Plan should be deferred until an actual amount is known and has been reviewed by the OCC and Staff and the actual amount should be amortized over a four-year period in the same manner as the ERP costs.

318. The dollar value of this OCC adjustment is a reduction in operating expenses of \$175,000, which is one-half of the \$350,000 cost estimate

### **3. Other Intervenors**

319. No other Intervenor stated a contrary position or opposition to Black Hills' proposal concerning RES Plan expenses in prefiled testimony, in testimony during the evidentiary hearing, or in a filed SOP.

### **4. Discussion**

320. The RES plan costs must be viewed under an HTY that is adjusted for known and measurable changes during the test period.

321. Black Hills did not augment the record to show that known and measurable changes beyond December 31, 2013 have occurred in this expense item. Mr. Owens testified that he was not aware of the current status of actual cost levels versus budgeted levels for individual expense issues during the evidentiary hearing.

322. It is appropriate to allow Black Hills to record the costs associated with its 2014 RES planning costs in a deferred asset account and to address the recovery of these costs in a future rate proceeding.

323. A two-year amortization period for the cost recovery for the RES plan expenses is appropriate once these costs become known and measurable. The ALJ finds the arguments made by the OCC for a four-year amortization period to be unpersuasive. The undersigned ALJ will

accept the adjustment made by the OCC in the amount of \$175,000 related to 2014 RES planning costs.

**K. FutureTrack Expense**

324. FutureTrack is a program envisioned by Black Hills to recruit talent within critical areas and to complete the advanced training necessary to fill the highly skilled positions upon retirement of existing employees. Most of the training will occur on the job and under very close supervision. Some positions will require bookwork, classroom-based training, and examinations.<sup>72</sup>

325. Potential candidates may be offered a scholarship covering tuition, books, and tools, to a Colorado vocational school to receive training necessary to meet minimum qualifications for FutureTrack positions.<sup>73</sup>

326. The program would include the following positions: line mechanics, electricians, estimators, meter technicians, relay technicians, technical communication analysts, and information technology developers.<sup>74</sup>

327. Black Hills will strive to recruit local candidates that have or intend to put down roots in Black Hills' communities.<sup>75</sup>

328. Black Hills will offer technical school scholarships which will include tuition, books, tools, and college scholarships to support the last year of the degree. If the recipient decides not to work for Black Hills for at least two years following graduation, the recipient must repay Black Hills the sum of their scholarship.<sup>76</sup>

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<sup>72</sup> *Exhibit 19, Direct Testimony of Jennifer Landis, p. 5, l. 10-15.*

<sup>73</sup> *Id. at l. 16-18.*

<sup>74</sup> *Id. at p. 7, l. 17-9.*

<sup>75</sup> *Id. at p.8, l. 14-15.*

<sup>76</sup> *Id at p. 9, l. 7-15.*

329. The program is expected to annually cost Black Hills \$632,708 for each of the next eight years. The allocation of these funds is as follows:

Labor & Benefits	\$592,101
Relocation	\$9,691
Scholarships	\$9,912
Training	\$21,004
TOTAL	\$632,708 <sup>77</sup>

**1. Black Hills**

330. Black Hills argues that the number of employees expected to retire in the next eight years represents nearly 54 percent of total years of experience with Black Hills and many of the roles most critical to Black Hills’s operations have a particularly high retirement risk.

331. Black Hills views the FutureTrack program as one which will “defray or obviate the need for costs in the future of hiring lateral employees to fill retirements at market rather than training and growing them within the Company at decreased cost”.<sup>78</sup>

332. At the start of the evidentiary hearing, Black Hills presented Exhibit 27 through Mr. Stoffel. Exhibit 27 removed forecasted FutureTrack program costs from its revenue requirement but requested deferred accounting authority for the costs of FutureTrack. This new proposal would create a regulatory asset account to track the costs of the program.

**2. OCC**

333. The OCC objects to a FutureTrack adjustment from both a conceptual standpoint and from a practical standpoint. The OCC believes cost adjustment clauses are a special type of cost recovery mechanism and they should be used in limited circumstances.

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<sup>77</sup> *Id* at p. 11, l. 1-7.

<sup>78</sup> *Black Hills’ SOP*, p. 35-36.

334. The OCC believes the Commission has defined the following criteria for adjustment clauses: (1) to permit rapid recovery of increased costs over which the utility has no control; (2) fuel expenses were significant; (3) fuel expenses were volatile; and (4) the rate of increase in the cost of fuel has been greater than the general inflation rate in other expense levels. The OCC believes FutureTrack does not meet these criteria

335. The OCC also argues that Black Hills has been able to fill retired positions over the last few years easily without any special cost recovery treatment and due to the nature of the work performed in the FutureTrack program, a portion of their labor costs will be captured in the ratemaking process and charged to customers when it is capitalized and eventually captured in Black Hills' depreciation expense. It was argued that this will be done regardless of whether there is a FutureTrack program.

336. OCC believes that there is no incentive for a supervisor to reduce the amount of money being allocate/charged to the regulatory cost account. Essentially, the subjective percentage in the fixed labor cost design of the FutureTrack program is to the benefit of the Company and to the detriment of ratepayers.

### **3. Staff**

337. Staff argues Black Hills has an obligation as a regulated utility to provide safe and reliable service under the doctrine of regulated monopoly in the State of Colorado. Staff believes that Black Hills has not provided sufficient evidence to support its claim that it needs a special revenue stream to fulfill its obligation as a regulated utility, and Black Hills did not demonstrate a unique need for this program.

338. Staff maintains that all utilities face the continuing need to hire, train, and employ competent personnel. Black Hills has the authority to hire, train, and manage employees as

Black Hills sees fit in its day-to-day management of its business. The Company does not need Commission approval to manage its business and any costs associated with hiring and training employees should be recovered as a cost in the normal course of business. Staff believes that the FutureTrack program has been absorbed by the normal course of business, which Staff believes is the appropriate way to handle any expenses related to hiring and training employees

339. Staff also argues that since there are no provisions for true-up of the base amount to be established in rates, it believes that Black Hills' requests, if granted, would literally give Black Hills a blank check to incur costs without any incentive to control and or evaluate the necessity of those costs. If Black Hills were accountable for the costs of implementing such a program, it would have an incentive to control and or evaluate those costs.

#### **4. Holcim**

340. Holcim urges the Commission to reject the FutureTrack program due to the speculative nature of the "catastrophic scenario" described by Black Hills. Holcim believes that the "market for labor tends to sort through these types of issues"<sup>79</sup> making this program unnecessary.

#### **5. Board and Authority**

341. The Board and Authority also encourages the Commission to reject the FutureTrack program. The Board and Authority argue that if this program is considered a regulatory asset that there would possibly be a presumption of prudence to all costs from the program.

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<sup>79</sup> *Holcim Statement of Position, p. 6.*

342. In addition, the Board and Authority agree with Staff and believe that costs associated with the replacement of retiring workers should be included as labor costs in a future case.

## 6. The City

343. The City believes that the FutureTrack program should be addressed *ab initio* in the planned 2016 Phase I rate case.

## 7. Discussion

344. The undersigned ALJ does not find the argument of Black Hills persuasive that the hiring and recruitment issues facing the Company are so unique and special to warrant the creation of a regulatory asset requiring cost recovery outside of the recovery of normal labor costs in a rate case.

345. FutureTrack has not had all the details settled concerning the labor capitalization of FutureTrack employees. Mr. Stoffel acknowledges that: "...with respect to capitalization of employee labor of those employees who are part of the FutureTrack program over time need some additional attention...",<sup>80</sup> and "With our concession, we can ensure that over the next year we can refine those [labor capitalization] aspects of it."<sup>81</sup>

346. Every utility must replace employees who retire with new employees capable of helping the utility provide safe and reliable service and where the Company has seemed to have succeeded in doing so in the past without a special program or a special regulatory asset. Ratepayer funded scholarships and on the job training program cannot be justified at this time and neither can an individualized approach to an industry-wide potential issue.

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<sup>80</sup> Transcript vol.1, p86, lines 14-16

<sup>81</sup> Transcript vol.1, p87, line 22

347. Finally, it was apparent to all present at the Public Hearings that Black Hills has some fences to mend with the Pueblo community. One of the main concerns of the community is the lack of jobs. It was alarming that Black Hills allocated almost an equal amount in relocation costs as scholarship costs. It is hoped that Black Hills would have looked at this as a program to help the community as well as helping Black Hills. The idea of reaching out to the Pueblo community with scholarships is a great idea, placing the cost of these scholarships on the backs of the ratepayers or using this program to import workers to an area with high unemployment is not a good idea.

348. Mr. Burke states in his testimony that \$174,000 was given to 188 charitable organizations in 2013.<sup>82</sup> Black Hills is to be commended for these contributions. Yet, rather than create a new regulatory asset and burden the already overburdened ratepayers, if Black Hills used 6 percent of the amount contributed to charitable organizations in 2013 to set up scholarships for students, it would pay for the yearly amount requested for scholarships in the FutureTrack program.<sup>83</sup> The program, if funded in this manner, would help the Pueblo community, help Black Hills, and not further burden the ratepayers. It would be a great way for Black Hills to invest in Pueblo.

349. The establishment of a regulatory asset designed for the future collection of costs designated to be related to FutureTrack expenses is denied.

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<sup>82</sup> *Exhibit 4, Testimony of Christopher Burke, p. 16, l. 16-17.*

<sup>83</sup> In addition, if an additional \$21,004 or 18 percent of the \$174,000 was reallocated, it could be used to fund the amount projected for scholarships and training.

**L. Depreciation Expense****1. Black Hills**

350. Black Hills bases this adjustment by taking the actual 2013 book depreciation expense of \$23,926,448 and decreasing this amount by \$2,485,425 through a depreciation adjustment. This adjustment is to account for the expected annual depreciation associated with the as-adjusted plant in service.

**2. OCC**

351. The OCC recommends that the depreciation adjustment be reversed. It recommends this change because it made an adjustment to reverse Black Hills' adjustments to Plant In Service, and therefore, the associated depreciation expense adjustment should also be reversed.

352. The OCC maintains the depreciation expense adjustment is a projection or expectation. This adjustment should be rejected since it is anticipated to occur after the calendar year 2013 HTY. Since this adjustment is based on anticipated costs, it is not known and measurable. The OCC argues that it is good regulatory practice to maintain the matching principle of revenues, expenses, and investments within a test year. The OCC proposes to reverse the adjustment of \$2,485,425 for this item.

353. The OCC is aware that the recommended adjustment would reverse Black Hill's depreciation adjustment, and would have the effect of increasing depreciation expense for the cost of service. This, in turn, would have the effect of increasing Black Hills' revenue requirement.

### 3. Other Intervenors

354. No other Intervenor stated a contrary position or opposition to Black Hills' proposal concerning depreciation expenses in prefiled testimony, in testimony during the evidentiary hearing, or in a filed SOP.

### 4. Discussion

355. Depreciation expenses must be viewed under an HTY that is adjusted for known and measurable changes during the test period.

356. Black Hills did not augment the record to show that known and measurable changes beyond December 31, 2013 have occurred in this expense item.

357. The adjustments proposed by the OCC regarding Plant-In-Service are appropriate based upon the methods the Commission has consistently used. Specifically, this is the 13-month average. The acceptance of this methodology has the effect of reversing Black Hills' proposed adjustment to Plant-In-Service. Therefore, the ALJ finds that a similar approach to depreciation expense is required.

358. The adjustment made by the OCC in the amount of \$2,485,425 related to depreciation expense shall be accepted. This adjustment reverses the proposed increase to this expense item made by Black Hills in the direct case.

### M. Amortization of W.N. Clark Coal Plant

359. In Proceeding No. 12A-763E, the Commission authorized Black Hills to decommission W.N. Clark as part of the Company's CACJA compliance plan.

360. W.N. Clark was formally retired on December 31, 2013, at which time it had a negative net book cost.

361. Decommissioning of W.N. Clark is currently underway and a site-specific study was conducted by the winning bidder performing the demolition project. The study estimated the cost of decommissioning costs at \$5.76 million.<sup>84</sup>

### **1. Black Hills**

362. In its direct case, the Company proposed to completely amortize and recover this unrecovered cost as a regulatory asset through amortization expense over two years and to include one-half of the amount of this regulatory asset in rate base.

363. At the start of the hearing Black Hills proposed to spread the recovery over four years instead of two years, which amounts to an approximate \$1 million reduction in its revenue requirement.<sup>85</sup>

### **2. OCC**

364. The OCC does not oppose the W.N. Clark decommissioning and removal costs being placed into a regulatory asset nor is the OCC proposing that prudent costs be disallowed in the future. The OCC recommends that the costs be disallowed for inclusion in base rates in the instant case.

365. The OCC argues for a regulatory asset to be created which would allow the Company to propose cost recovery in its imminent 2016 rate case. The OCC would agree to a four-year amortization of these approved costs in a future case.

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<sup>84</sup> The estimated unrecovered cost reflected in the regulatory asset for W.N. Clark as of December 31, 2014 is \$4,081,096, including a loss on the sale of the coal pile of \$1,568,506.

<sup>85</sup>Hearing Exhibit No. 27.

### **3. Holcim**

366. Holcim supports Black Hills' revised proposal to extend the amortization period to four years. Holcim believes that this is a good mechanism to lower current rates without a much larger increase after the planned 2016 rate case.

### **4. Other Intervenors**

367. No other Intervenor stated a contrary position or opposition to Black Hills' proposal concerning extending the amortization period in prefiled testimony, in testimony during the evidentiary hearing, or in a filed SOP.

### **5. Discussion**

368. The standard of allowing adjustments to a December 31, 2013 test year, if these adjustments can be viewed as being known and measurable into the test period, is the best course for this expense. Black Hills has entered into a contract for decommissioning/demolition with specific payment terms and obligations for both parties. These terms are known and measurable adjustments to the balances in this account.

369. No party opposes the recovery of the decommissioning costs of the W.N. Clark. The only point of contention is the timeframe of the recovery.

370. Once again, the OCC appears to be "kicking the can down the road" to give the appearance of lower rates. While this may look fine in the short-term, following the OCC recommendation will set the ratepayers up for what likely will be a very large rate increase in the proposed 2016 rate case.

371. The “concession proposal”<sup>86</sup> by Black Hills balances timely recovery with minimal impact to the ratepayers. Since no party objects to the recovery, W.N. Clark decommissioning and removal costs shall be placed in the rate base and amortized over four years.

#### **N. Equity Compensation**

372. Equity compensation is a non-cash compensation that represents a form of ownership interest in a company. Equity compensation is directly tied to, or based upon, the company’s equity. Equity grants are typically awarded to employees as part of their compensation package.

373. Equity grants include, but are not limited to, stock options, restricted stock, and performance shares. Companies, such as Black Hills, can award equity grants to employees.

374. The estimated cost is booked into the company’s income statement as a non-cash expense. This non-cash cost of the grants is either booked at the time of the grant, or over the life of the grant, depending on which accounting rules apply. When grants are exercised or vested, most companies issue shares of their stock to cover the grants

375. Black Hills pays equity compensation in BHC stock. In 2013 Black Hills “booked” \$2,040,927.59 in total equity compensation.<sup>87</sup> In 2013 Black Hills “paid” \$163,823.58 in equity compensation.<sup>88</sup>

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<sup>86</sup> Hearing Exhibit No. 27.

<sup>87</sup> Hearing Exhibit 27, p.1.

<sup>88</sup> *Id. at p. 3.*

376. Through July 25, 2014, Black Hills has “booked” \$986,823.61 in total equity compensation.<sup>89</sup> Through July 25, 2014, Black Hills has “paid” \$201,423.54 in total equity compensation.<sup>90</sup>

### 1. Black Hills

377. Black Hills argues that ratepayers “directly benefit from the employee’s activities that are being compensated which are directed toward providing safe, reliable and efficient electric service.”<sup>91</sup>

378. Black Hills also argues that there has been no showing that the overall level of compensation is excessive, compared to similarly situated utilities.

379. Concerning the difference between “booked” amounts and “paid” amounts, Black Hills states that the Commission has previously relied upon the Generally Accepted Accounting Principles (GAAP) accounting method or “booked” amounts. Black Hills does not believe sufficient evidence was presented for the Commission to deviate from the GAAP or “booked” amount approach and urge that the \$2,040,928 be accepted.

### 2. OCC

380. In prefiled testimony, the OCC argued that equity compensation primarily benefits investors over ratepayers and urged the Commission to remove all equity compensation from the test period.

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<sup>89</sup> *Id at p. 1*

<sup>90</sup> *Id at p. 1*

<sup>91</sup> Black Hills’ SOP p. 31.

381. In addition, the OCC stated that failure to remove equity compensation could lead to a huge windfall for Black Hills since the actual amounts paid are less than the expense booked each year.

382. Finally, the OCC argued that the tremendous growth in the equity compensation is unreasonable. The OCC believes that the growth of equity compensation should, at the very least, be capped and have suggested \$577,937 or the total allocated to Black Hills for equity compensation in 2011.<sup>92</sup>

### **3. The Board and Authority**

383. The Board and Authority also urge the Commission to remove all equity compensation from the test period. The Board and Authority argue that equity compensation enhances the profitability of the Company and primarily benefits shareholders and also that the payouts are speculative and not known and measurable.

### **4. Other Intervenors**

384. No other Intervenor stated a contrary position or opposition to Black Hills' proposal concerning equity compensation in prefiled testimony, in testimony during the evidentiary hearing, or in a filed SOP.

### **5. Discussion**

385. The first issue to be decided concerning equity compensation is whether it benefits ratepayers and if it does not benefit ratepayers should it be included in the test period.

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<sup>92</sup> Hearing Exhibit 29, p.1.

386. Both intervenors who address this issue appear to see at least some benefit to the ratepayers. The OCC states in its SOP:

[t]hat equity compensation aligns management interests with investors and *primarily* benefits investors. (emphasis added)

*OCC Statement of Position p.28.*

387. The Board and Authority use the same language in their SOP:

[P]erformance rewards enhance the value and profitability of the Company and *primarily* benefit investors. (emphasis added)

*Board and Authority Statement of Position p.10.*

388. Neither of these parties make a definitive statement claiming that there is no benefit to ratepayers. They only argue that investors *primarily* receive the benefits from equity compensation, not that they are the only beneficiaries from equity compensation.

389. In addition, the Commission addressed whether equity compensation benefited rate payers in Proceeding Nos. 11AL-382E and 11AL-387E.

We agree with Black Hills that this expense represents a reasonable amount that directly benefits the Company's customers. Decision No. C11-1373, ¶131.

390. Since equity compensation benefits ratepayers it is necessary to include it in the test period.

391. By establishing an HTY approach, the amount of equity compensation from 2013 is used and adjusted for known and measurable changes during the test period. In the instant case it appears that two very different amounts can possibly be viewed as the amount of equity compensation in 2013 either \$2,040,927.59 or \$163,823.58.

392. Black Hills argues that the Commission has accepted the "booked" value in the past and sufficient evidence has not been presented to deviate from this practice. While it is true that the "booked" value was used in the last Black Hills rate case, it is not clear that the

Commission addressed the “booked” versus “paid” question. From the Commission decision in that proceeding, the only question about equity compensation concerned whether Black Hills “failed to clearly demonstrate the direct benefit to ratepayers of this type of financial incentive compensation.”<sup>93</sup> The correct amount or how the correct amount is determined was not in question, only if any amount should be included.

393. The introduction of Hearing Exhibit 29 brought into question what is the proper amount to include in the test period for equity compensation. Contrary to the contention of Black Hills, the introduction of Hearing Exhibit 29 provides sufficient evidence to call into question if it is best to use a known and measurable amount based on “book” value or “paid” value.

394. Through testimony and Hearing Exhibit 29, the following facts were brought to light. The book value is an allocated amount determined by BHC. The amount actual paid has been a small percentage of the amount booked.

	<sup>94</sup> Tot. Book Equity Comp.	Tot. Paid Equity Comp.	%
2011	\$577,937	\$19,796	3%
2012	\$1,163,508	\$48,762	4%
2013	\$2,040,927	\$163,823	8%
2014 <sup>95</sup>	\$986,823	\$201,423	20%

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<sup>93</sup> Decision No. C11-1373, ¶129.

<sup>94</sup> Exhibit 29

<sup>95</sup> Through July 25, 2014.

395. Based upon these figures it cannot be said that the amount requested by Black Hills is reasonable. The “booked” amount has never been remotely close to the actual paid number. It is unclear why there is such a great discrepancy and no explanation was given. In addition, the amount of equity compensation, both “booked” and “paid” has doubled each year. Again, no explanation as to why the amount of equity compensation has grown by such levels.

396. There is merit to the argument of the OCC that, if left unchecked, at this rate of growth it can be expected that equity compensation may more than double again by the next rate case to over \$4,000,000. The ALJ finds that \$2,040,927.59 for equity compensation is not a reasonable amount.

397. While there was much testimony during the evidentiary hearing concerning equity compensation and detailing the difference between the “booked” amount and “paid” amount, little to no evidence was presented as to why one method was superior to the other to use in a test year.

398. Since no party provided sufficient evidence to determine the proper method, the undersigned ALJ has determined a compromise position which includes known and measurable amounts is the best way to determine the proper value for equity compensation.

399. The known and measurable amounts for 2013 are \$2,040,927.59 “booked” amount and \$163,823.58 “paid” amount. As stated earlier, the \$2,040,927.59 amount is not a reasonable amount. According to Hearing Exhibit 29, Black Hills has paid \$201,423.54 in 2014 through July 24 and therefore the total \$163,823.58 is known to be insufficient.

400. As shown above, the percentage of “paid” compared to “booked” has increased greatly in 2014.<sup>96</sup> One solution to determine the proper amount is to take 20 percent of Black Hills’ proposed “booked” amount (\$2,040,927.59) or \$408,185.40.

401. An additional compromise solution is to double the amount Black Hills has paid in equity compensation as of July 24, 2014. Doubling the total results in a final amount of \$402,847.08.

402. While neither of these methods is perfect, each addresses known and measurable payments from 2014. Therefore, based on these alternative methods the compromise amount for equity compensation shall be \$408,185.40.

#### **O. Staff Operations and Maintenance Adjustment**

403. Staff Witness, Mr. Charles Hernandez proposed an adjustment to the revenue requirement model presented by Black Hills. The amount of Mr. Hernandez’s adjustment was \$2,605,715. This adjustment was made with the purpose of producing a result of a zero dollar revenue requirement deficiency.

##### **1. Staff**

404. Staff supports this position by stating that this type of adjustment is not arbitrary. Staff argues that Black Hills requested an acquisition premium at the time they purchased the assets of Aquila. At that time Black Hills stated that “they would produce the savings that would support the acquisition premium.”<sup>97</sup>

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<sup>96</sup> It constituted only 8 percent in 2013 but has risen to 20 percent so far in 2014.

<sup>97</sup> Hearing Transcript Vol. II, p. 188, 1.2-4

405. Mr. Hernandez testified that he hoped this adjustment would create a “debate<sup>98</sup>” and the amount chosen for the adjustment was based only upon a desire to bring the revenue requirement to zero.<sup>99</sup>

## 2. Black Hills

406. Black Hills states that there is no factual basis for this adjustment. It considers Staff’s proposal to be arbitrary. The Company’s significant investments and related Operations and Maintenance (O&M) costs that have occurred since the acquisition show that the Company’s costs have increased. Black Hills points out that Mr. Hernandez never suggests that any expense sought to be recovered by Black Hills is unreasonable, nor does he suggest that any investment is imprudent.

407. Black Hills, in fact, points out in a response to a discovery request posed by the Company to Staff, where it asked for a breakdown by FERC account of the \$2,605,715 adjustment that no such breakdown existed. Staff replies by stating that the dollar amount was derived so that it could be inserted into the model to set the requested revenue increase to \$0.

## 3. Discussion

408. The proposed O&M adjustment by Staff has no merit. Mr. Hernandez could not point to any specific requested revenue requirement that was not justified.<sup>100</sup> This adjustment is the very definition of arbitrary and is denied.<sup>101</sup>

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<sup>98</sup> *Id. at* l. 5-11

<sup>99</sup> *Id at p.* 189, l. 16-24.

<sup>100</sup> *Id. at p.* 187, l.14-18.

<sup>101</sup> Staff failed to even mention this adjustment in its SOP.

**XIII. CACJA RIDER**

409. In combined Proceeding Nos. 13A-0445E, 13A-0446E, and 13A-0447E, the Commission granted Black Hills a Certificate of Public Convenience and Necessity to build the LM6000 combined cycle plant to replace the W.N. Clark coal plant in Colorado Springs. By the CACJA statute § 40-3.2-207(3), C.R.S., a utility is permitted to recover a return on its CWIP associated with the construction of replacement capacity at its WACC.

410. Black Hills is proposing to implement an interim cost tracking mechanism to provide for current recovery of a return on CWIP for the LM6000 at its WACC. The Company is proposing to implement the new tracking mechanism to recover these costs beginning on January 1, 2015. Black Hills plans for the LM6000 to begin commercial operation on or about January 2, 2017. Black Hills has calculated that the CACJA adjustment will recover approximately \$1.73 million in 2015, and approximately \$4.78 million in 2016.

411. OCC also does not challenge the implementation of the CACJA rider. The OCC recommends two changes in how Black Hills' CACJA rider will be calculated in the future. The first recommendation is that the most recent capitalization percentages of equity and debt should be used in the calculation of the rider. The second recommendation is that the most recent cost of long-term debt should also be used in the calculation. The OCC reasons that, over time, Black Hills may issue or be assigned more long-term debt.

412. Staff does not challenge Black Hills' proposal for a CACJA tracking adjustment. Staff acknowledges that by statute, Black Hills is entitled to recovery on CWIP for CACJA investments at the utility's WACC.

413. Black Hills contends that both OCC recommendations are directly contrary to the statute.

414. The CACJA rider was impacted by the introduction of Hearing Exhibit No. 27, Black Hills' Rate Case Concessions. Because Black Hills conceded a reduction in its ROE to 9.9 percent, it had a corresponding effect on the WACC, reducing it to 7.62 percent as calculated according to Black Hills' proposed capital structure and cost of debt. The impact of this change was a reduction of \$1,145,508 for 2015. Hearing Exhibit No. 27 also demonstrated a residential rate impact in the amount of \$0.39 for 2015, based on an estimated usage of 600 kWh, and an impact of \$1.86 for small commercial customers based on an estimated usage of 2,300 kWh.

415. Neither party opposed the implementation of the CACJA rider or the costs to be recovered.

416. There remains, however, a request by the OCC to use the most recent cost of long-term debt in the calculation of the rider. As presented by Black Hills witness Stoffel in rebuttal testimony, § 40-3.2-207(3), C.R.S., expressly states that “[c]urrent recovery shall be allowed on construction work in progress at the utility’s weighted average cost of capital, including its most recently authorized rate of return on equity, for expenditures on projects associated with the plan during the construction, startup, and preservice implementation phases of the projects.” Black Hills posits that the OCC’s recommendation would run counter to the statutory language.

417. The ALJ agrees with Black Hills, and will not adopt the recommendation of the OCC.

418. As a final matter related to the CACJA adjustment, the ALJ acknowledges that the approval of the capital structure, ROE, and cost of long-term debt, have an impact on the CACJA adjustment that requires a recalculation based on the new WACC. Therefore, the ALJ will require Black Hills to make a compliance filing, no later than ten days after the issuance of this

Decision, detailing the effect of the change in the WACC on the CACJA rider to include but not be limited to the calculation of the rider, a calculation of the revenues and billing determinants, and a final CACJA adjustment tariff for the approved rate to go into effect January 1, 2015. The ALJ will therefore approve the proposed CACJA rider with the exception of the application of the WACC. The CACJA rider shall be effective January 1, 2015.

#### **XIV. ORDER**

##### **A. The Commission Orders That:**

1. The effective date of the tariff sheets filed with Advice Letter No. 680 on April 30, 2014 is permanently suspended and shall not be further amended.

2. Within ten days of the date on which this Recommended Decision becomes a decision of the Commission, Black Hills/Colorado Electric Utility Company, LP (Black Hills) shall file a revised Historical Test Year study calculated using an executable version of Hearing Exhibit No. 6 at Exhibit BSO-1 as adjusted in accordance with this Decision (the as-adjusted Historical Test Year), and an accompanying study calculating the Clean Air Clean Jobs Act adjustment, also using an executable version. In the same filing, Black Hills shall calculate a General Rate Schedule Adjustment (GRSA) based on the revenue requirement that is calculated using the as-adjusted Historical Test Year and shall file proposed tariffs that contain the appropriate changes as a result of this Recommended Decision. Such tariffs shall be filed in a separate advice letter proceeding and shall be effective on not less than 14 days' notice.

3. Black Hills shall meet, no later than February 28, 2015 with the Colorado Office of Consumer Counsel (OCC) and Staff of the Colorado Public Utilities Commission to review the final rate case expenditures. Black Hills shall file, no later than April 1, 2015, a GRSA tariff that adjusts the final rate case expenses to actuals.

4. The Motion to Strike Certain Portions of Corrected Answer Testimony of the Office of Consumer Counsel and Request for Shortened Response Time filed by Black Hills on September 16, 2014 is denied.

5. The Motion to Strike a Portion of the Post Hearing Statement of Position of the Office of Consumer Counsel or in the Alternative for Leave to File Response filed by Black Hills on October 15, 2014 is denied.

6. The Request by the OCC to revise the last two sentences of its Statement of Position as discussed above is granted.

7. This Recommended Decision shall be effective on the day it becomes the Decision of the Commission, if that is the case, and is entered as of the date above.

8. As provided by § 40-6-109, C.R.S., copies of this Recommended Decision shall be served upon the parties, who may file exceptions to it.

9. If no exceptions are filed within 20 days after service or within any extended period of time authorized, or unless the recommended decision is stayed by the Commission upon its own motion, the recommended decision shall become the decision of the Commission and subject to the provisions of § 40-6-114, C.R.S.

10. If exceptions to this Recommended Decision are filed, they shall not exceed 30 pages in length, unless the Commission for good cause shown permits this limit to be exceeded. If any party files exceptions to this Recommended Decision they shall file concurrently an executable copy of their revenue requirement model containing their exceptions adjustments, an executable copy of their revenue requirement model containing all adjustments consistent with this Recommended Decision, and an executable CACJA rider impact adjustment model.

11. If a party seeks to amend, modify, annul, or reverse a basic finding of fact in its exceptions, that party must request and pay for a transcript to be filed, or the parties may stipulate to portions of the transcript according to the procedure stated in § 40-6-113, C.R.S. If no transcript or stipulation is filed, the Commission is bound by the facts set out by the administrative law judge; and the parties cannot challenge these facts. This will limit what the Commission can review if exceptions are filed.

12. Responses to exceptions shall be due within seven calendar days from the filing of exceptions.

(S E A L)



THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF COLORADO

ROBERT I. GARVEY

Administrative Law Judge

ATTEST: A TRUE COPY

A handwritten signature in cursive script that reads "Doug Dean".

Doug Dean,  
Director