Decision No. C12-0143

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO

DOCKET NO. 11AL-382E

IN THE MATTER OF ADVICE LETTER NO. 642 FILED BY BLACK HILLS/COLORADO ELECTRIC UTILITY COMPANY, LP TO AMEND THE ENERGY COST ADJUSTMENT (ECA) TARIFFS AND ADD A MECHANISM TO INCLUDE INCENTIVE SHARING, DEFINED AS NET INCOME FROM ENERGY SALES TO BE EFFECTIVE ON MAY 28, 2011.

DOCKET NO. 11AL-387E

IN THE MATTER OF ADVICE LETTER NO. 643 FILED BY BLACK HILLS/COLORADO ELECTRIC UTILITY COMPANY, LP TO COMPLY WITH AN ORDER OF THE COMMISSION IN DECISION NO. C10-1119 IN DOCKET NO. 09AL-837E TO FILE A NEW ELECTRIC RATE CASE ON OR BEFORE APRIL 30, 2011 AND TO INCREASE THE RATES FOR ALL ELECTRIC SERVICES BY IMPLEMENTING A GENERAL RATE SCHEDULE ADJUSTMENT (GRSA) IN THE COMPANY'S COLORADO PUC NO. 8 ELECTRIC TARIFF TO BE EFFECTIVE MAY 29, 2011.

DECISION ADDRESSING APPLICATIONS FOR REHEARING, REARGUMENT, OR RECONSIDERATION

Mailed Date: February 10, 2012
Adopted Date: February 1, 2012

TABLE OF CONTENTS

I. BY THE COMMISSION

A. Statement

1. By Decision No. C11-1373 issued on December 22, 2011, the Commission authorized Black Hills/Colorado Electric Utility, LP (Black Hills or Company) to implement a General Rate Schedule Adjustment (GRSA) rate rider of 7.976 percent to generate an overall increase in revenues of $10,485,814. The Commission permanently suspended the tariff sheets filed with Advice Letter Nos. 642 and 643 and instructed the Company to submit an advice letter compliance filing, consistent with the decision, with new rates for effect on January 1, 2012.

2. Black Hills filed an application for rehearing, reargument, or reconsideration (RRR) to Decision No. C11-1373 on January 11, 2012. Black Hills requests the Commission modify several aspects of Decision No. C11-1373, including the authorized return on equity (ROE), the approved cost of long-term debt, and the adopted debt-to-equity capital structure used for establishing rates. The Colorado Office of Consumer Counsel (OCC) also filed an RRR on January 11, 2012.

3. Now being fully advised in the matter, the Commission grants, in part, and denies, in part, the RRR filed by Black Hills and denies the RRR filed by the OCC.

B. Black Hills' RRR

1. Authorized Return on Equity

4. When establishing an authorized ROE for Black Hills, the Commission considered the suggested ranges put forward by the expert witnesses in the proceeding and likewise adopted a range extending from 9.8 percent to 10.2 percent. The Commission explained in Decision No. C11-1373 that earnings within this range are fair, reasonable, and sufficient for the Company to maintain its financial integrity and to attract capital in today's market. The Commission further found that the range is commensurate with rates of return of other enterprises having corresponding risks, consistent with the *Hope* and *Bluefield* standards.

5. In its RRR, Black Hills argues that the Commission should reconsider adopting a range as the authorized ROE and instead set a single-point ROE at 10.0 percent, since 10 percent is the midpoint of the 9.8 percent to 10.2 percent "zone of reasonableness." Because the Commission instructed Black Hills to calculate rates using an ROE of 9.9 percent, a figure within our established range, the adoption of a 10 percent ROE would likely cause an additional increase in rates. Black Hills explains, however, that if the Commission adopts an authorized single-point ROE of 10 percent, "[it] will agree to forego the additional revenue requirement that would result from using [it] to calculate the rate of return on rate base and the revenue requirement."

6. Black Hills argues that there is nothing in the record that warrants deviation from past practice where the Commission established a range based upon the evidence in the record and then selected the midpoint of that range as the single-point authorized ROE.

The Company also requests that the Commission take administrative notice of certain prior Commission decisions that establish an authorized single-point ROE at 10.0 percent or above.

7. Black Hills further takes the position that, because the Commission has adopted a range instead of a single-point ROE, the Company will have difficulty maintaining its financial position and attracting capital as required under the *Hope* and *Bluefield* standards, implying that the financial community is struggling to understand the authorized range and is instead focusing on the 9.9 percent used to calculate the GRSA.

8. We deny RRR on this point, primarily because Black Hills raises no new argument in its RRR that we had not considered before. The authorized range from 9.8 percent to 10.2 percent signifies that, absent changed circumstances, the Company has the opportunity to earn no more than the high end and no less than the low end. Furthermore, the authorized range recognizes that the evidence presented in this proceeding does not lend itself to the establishment of a precise single-point estimate. The expert witnesses themselves presented ranges for the Commission to consider and we conclude that it is appropriate for the Commission to adopt a range as well. The range adopted in Decision No. C11-1373 also acknowledges that the Commission approved an ROE for Black Hills of 10.5 percent in August 2010 in Docket No. 10AL-008E, and that a measured move in the authorized ROE is warranted.

2. Cost of Long-Term Debt

9. By Decision No. C11-1373, at ¶ 98, the Commission found that the embedded cost of long-term debt for Black Hills should be 7.22 percent, based on the entire $675 million of the senior unsecured notes held by Black Hills Corporation (BHC).

10. Black Hills requests that the Commission instead adopt the Company's "actual" cost of long-term debt of 7.41 percent. Black Hills states that the Commission erred by relying on the OCC's analysis in favor of using the entire $675 million. The Company argues that all of BHC's senior unsecured notes are not equally fungible. For example, Black Hills contends that considering all of the $675 million is contrary to the ring-fencing conditions ordered by the Commission in Decision No C08-0204 in Docket No. 07A-108EG issued February 29, 2008. Black Hills further contends that common cost causation principles require that only half of the recently acquired $200 million of senior unsecured notes be used to calculate the Company's cost of debt, because the other half was acquired specifically to fund the construction of its unregulated affiliate's generation units at the Pueblo Airport Generating Station (PAGS). When considering only half of this debt issue with its relatively low cost, Black Hills concludes the appropriate cost of debt for the regulated utility is higher at 7.41 percent instead of 7.22 percent.

11. We disagree with Black Hills that the ring-fencing provisions established in Docket No. 07A-108EG are relevant to establishing the cost of long-term debt for the Company in this rate proceeding. We are further concerned that the Company's arguments about ring-fencing protections as they relate to the BHC's debt acquisitions are being raised for the first time in the RRR, and that the result is a higher cost of debt being assigned to regulated utility operations traditionally viewed as less risky than unregulated independent power producers (IPPs).

12. Putting such concerns aside, however, we find Black Hills' arguments unpersuasive. Black Hills made a series of calculations based on professional judgments to arrive at an overall cost of debt. In some instances, the OCC and the Public Intervenors[1] disagreed with those calculations and judgment calls. Being fully apprised of the matter, we rejected Black Hills' proposal to assign $100 million of the senior unsecured notes specifically to the Company's affiliate IPP and agreed with the OCC's suggestion to adopt a cost of 7.22 percent. We conclude this cost appropriately reflects the sources and costs of debt funds used to provide service to Colorado ratepayers and thus deny RRR on this point.

3. Capital Structure

13. Black Hills requests that the Commission set aside the capital structure of 50.9 percent debt and 49.1 percent equity adopted in Decision No. C11-1373, and instead approve the capital structure the Company put forward in its case-in-chief of 48 percent long-term debt and 52 percent equity.

14. Black Hills argues that the Commission should adopt a 48-52 ratio because it reflects the balance of debt-to-equity that BHC intends to use to operate its regulated utility divisions. Black Hills further argues that the BHC's capital structure, as adopted by the Commission, is contrary to *Peoples Natural Gas Div. Pub. Utils. Comm'n*, 567 P.2d 377 (Colo. 1977), because it inappropriately includes debt and equity used to support the non-regulated businesses of BHC.

[1] The Public Intervenors are the Board of Water Works of Pueblo, Fountain Valley Authority, and the City of Pueblo.

15. We deny RRR on this point. While Black Hills is correct that *Peoples Natural Gas* arose out of the need to protect ratepayers from a holding company's non-regulated activities, the Commission took such protections fully into account when adopting a debt-to-equity ratio of 50.9 percent debt and 49.1 percent equity. Specifically, we adopted the 50.9 to 49.1 ratio as proposed by Staff of the Colorado Public Utilities Commission (Staff), because it more closely reflects the capitalization of other *regulated* electric utilities.

16. Furthermore, we remain convinced that BHC's consolidated capital structure is appropriate for Black Hills, because that capital structure has a real relationship to the marketplace and because the Company's credit rating is a function of the financial profile of its parent company. In contrast, the 48-52 ratio proposed by the Company comprises hypothetical percentages that the BHC merely aspires to achieve.

4. Construction Savings Bonus

17. At ¶ 41 of Decision No. C11-1373, the Commission affirmed that Black Hills is entitled to recover a customer cost-savings bonus for the construction of the new generation units at PAGS. However, the Commission concluded it is not appropriate for the Company to recover this bonus until after the final costs of the facilities are known and reviewed in a future base rate case. Once the ultimate level of the cost-savings bonus is established, it would be collected from ratepayers through Black Hills' Energy Cost Adjustment (ECA) rate rider over three years.

18. Black Hills argues that waiting until after its next rate base will unreasonably delay the length of time for recovery, because the Company may not complete its next electric rate case for more than two years. The Company thus asks the Commission to allow it to recover the bonus through the ECA with collections beginning with its next semi-annual ECA filing in April 2012, to be effective in May 2012.

19. According to Black Hills, it is not necessary to delay verification of actual construction cost savings until completion of the next rate case, because the Company has a high degree of certainty that the cost of the two LMS100s and associated facilities investment will be $226 million. Black Hills states that the LMS100 units commenced commercial operations on January 1, 2012, and the amount of actual construction costs and calculation of customer and Company cost savings should soon be known. The Company therefore proposes that the amount of the Company's share of the cost savings not already recovered could be verified by Staff and then collected through future ECA filings.

20. We agree with Black Hills that waiting until after the completion of the Company's next base rate proceeding may unreasonably delay the recovery of the construction savings bonus. Therefore, we will grant the RRR on this matter, in part.

21. Black Hills may file an application whose sole purpose will be to review the exact calculation of the savings bonus that will be recovered from ratepayers based on the final actual construction costs for PAGS. Upon completion of that application proceeding, Black Hills may begin recovery of the bonus over three years through semi-annual ECA filings. We conclude that this approach will expedite cost recovery of the bonus authorized in Docket No. 09A-415E.

5. Property Taxes Related to PAGS

22. By Decision No. C11-1373, the Commission denied the Company's proposed adjustment to its property tax expense related to the new plant installed at PAGS and required the cost of service instead to reflect actual mill levy rates during the 2010 test year. In reaching its decision, the Commission was persuaded by Staff that, as a result of property taxes actually being paid more than a year in arrears, the Company will not have a tax payment due on the PAGS site until April 2013.

23. Black Hills states that by adopting Staff's position on this matter, the Commission has misapprehended the record on this issue, has misapplied the law, and has erred in its conclusion with respect to the Company's property tax expenses. Black Hills thus requests the Commission instead adopt its proposed adjustment to the property tax mill rate to reflect the in-service date of all applicable plant additions (*i.e.*, January 1, 2012) including the estimated effects of the property tax abatements based on the agreements negotiated and executed with Pueblo County and the City of Pueblo. The Company asserts these estimates are reliable, are known and measurable, and must be allowed.

24. If the timing of recovery is the Commission's main concern, Black Hills requests that the Commission allow the difference in property tax expense for a plant in the City of Pueblo and Pueblo County to be passed on through the ECA (or a revised GRSA) after the property taxes have been assessed, and not disallow the remainder of the validly incurred property tax assessment based on Staff's "miscalculation."

25. We fully considered Black Hills' position regarding PAGS property taxes when finding that the Company should apply the actual mill levy rates during the test year. Decision No. C11-1373 fairly balances ratepayer interests with the Company's need to satisfy its tax burdens during the period when rates will be in effect. We therefore deny RRR on this matter.

6. Recovery of Fixed Operations and Maintenance Escalating Costs

26. Black Hills proposed in its case-in-chief to recover, through its ECA rate rider, the escalating fixed operations and maintenance (O&M) costs that it will incur pursuant to the purchased power agreement (PPA) that the Company entered into with its affiliate. Pursuant to the Stipulation as to Certain Disputed Issues (Stipulation) filed on October 27, 2011, Black Hills and Staff agreed that the Company would no longer pursue the recovery of these costs through

the ECA but would instead either modify the language of its Purchased Capacity Cost Adjustment (PCCA) rate rider to allow for the recovery of these fixed O&M costs or pursue "a similar mechanism." (The OCC and the Public Intervenors objected to this provision of the Stipulation.)

27. At ¶ 215 of Decision No. C11-1373, we found it to be inappropriate for Black Hills to recover fixed O&M costs through the ECA. We instead concluded that if Black Hills wanted to recover the fixed O&M costs through another rate rider, such as the Company's PCCA, the Company may file an advice letter requesting such relief and the merits of such request will be determined in that future proceeding.

28. In its RRR, Black Hills argues that a new docket will unnecessarily result in another lengthy and expensive proceeding. The Company contends that since the required Commission approvals to enter into the PPA have already been obtained in Docket No. 08A-346E, examining the merits in a second docket will be redundant. Black Hills instead suggests that the Commission approve the provisions of the Stipulation as agreed to by the Company and Staff and grant Black Hills the authority to recover these increased O&M costs through the Company's PCCA tariff.

29. We deny RRR on this matter. Decision No. C11-1373 established the correct process for implementing the agreement reached by Black Hills and Staff as set forth in the Stipulation. Advice Letter No. 643 contained no PCCA tariff. Both the Company's notice in the advice letter filing and its Direct Testimony suggested that the PCCA would be "phased out." No specific tariff language or rate mechanism has been agreed to by the Company and Staff pursuant to the Stipulation and then presented to the Commission for approval.

A new proceeding is thus necessary to resolve the recovery of the escalating fixed O&M costs as contemplated in the Stipulation.

7. Phase II Rate Case

30. By Decision No. C11-1373, the Commission directed Black Hills to submit a Phase II rate case for the purpose of recalibrating the base rate components set forth on the Company's tariff sheets according to an updated functionalized, customer-allocated cost of service analysis premised on the revenue requirements established in this Phase I proceeding. The Commission established a deadline for this Phase II advice letter filing of March 1, 2012.

31. The Commission also directed Black Hills to file an application for approval of an ECA redesign on or before December 1, 2012. The primary purpose of the redesign is to cause the ECA to recover all of the Company's fuel and purchased energy costs rather than achieving such cost recovery through a combination of base rates and the ECA.

32. In its RRR, Black Hills explains that it has never filed an electric Phase II rate case in Colorado and is concerned that Decision No. C11-1373 provides too little time to prepare and file such a case. The Company also explains the redesign of the ECA will impact class cost of service and the design of base rates to some degree. The Company therefore requests that it be allowed to file the Phase II rate case on or before October 1, 2012 and to combine that proceeding with the redesign of the ECA mechanism.

33. We find good cause to grant Black Hills' request and therefore modify Decision No. C11-1373 to require the filing of a Phase II rate case with a redesigned ECA on or before October 1, 2012.

8. Customer Notice of ECA Price Changes

34. The OCC suggested in testimony and briefs that the Commission require Black Hills to print the customer notice regarding price changes in the ECA as a display ad in the main body of a print newspaper. The Commission declined to adopt this suggestion, but stated at ¶ 226 of Decision No. C11-1373 that it will consider the issues surrounding customer notice in a future proceeding to address a redesign of the Company's ECA. The Commission further recognized the matter may be appropriately addressed in a rulemaking proceeding, as suggested by Black Hills.

35. Black Hills requests that the Commission reconsider its finding that issues surrounding customer notice for ECA price changes can be considered in a redesigned ECA application proceeding. Black Hills wants the Commission to conclude it is only appropriate to address this matter in a rulemaking proceeding.

36. We deny Black Hills' RRR on this point. Instead, the Commission will consider the arguments regarding whether a particular proposal is more appropriate for a rulemaking or for an adjudicatory docket in the context of an actual ECA redesign proposal, rather than in the abstract.

C. The OCC's RRR

1. Transmission Plant in Service

37. The OCC asserts the Commission should revise ¶ 44 of Decision No. C11-1373 "to accurately describe the OCC's position regarding 2011 transmission projects." The OCC proposes additional language for ¶ 44 but provides no citation to the record in support of its professed position.

38. We have reviewed the record in this case and conclude that the language in the decision accurately reflects the OCC's position as described in the OCC's filings and in oral testimony at hearing. We therefore deny the RRR filed by the OCC on this ground.

2. Electric Resource Plan Costs

39. At ¶ 120 of Decision No. C11-1373, the Commission directed Black Hills to remove from its cost of service analysis the costs it expects to incur when developing and litigating it's next electric resource plan (ERP). Nonetheless, the Commission allowed the Company to record the costs associated with its upcoming ERP filing in a deferred asset account so that the recovery of these costs could be addressed in a future base rate proceeding.

40. The OCC requests the Commission confirm that Black Hills will be allowed to recover no earnings associated with the deferred account for ERP costs. The OCC argues that the past Commission practice of not allowing earnings associated with deferred asset account balances is a fair approach and should be continued.

41. We deny RRR on this matter. Although the OCC is correct that, as a general practice, the Commission does not allow earnings on deferred account balances for certain expenses, we find it unnecessary to determine at this time whether earnings on the deferred ERP costs will be authorized. As indicated in Decision No. C11-1373, all matters regarding the treatment of the balances in the deferred account for ERP costs are deferred until a future rate proceeding.

3. Interest Synchronization

42. The OCC argued through testimony and briefs that Black Hills' cost of service should be reduced to reflect additional interest synchronization, premised upon the notion that

the amount of interest the utility deducts for determining its income taxes should match the amount of debt in the utility's capital structure.

43. At ¶ 128 of Decision No. C11-1373, the Commission found that interest synchronization is proper, since this is simply the process by which the amount of interest expense is calculated consistent with the dollar value of rate base and the approved capital structure. However, the Commission also determined that the OCC had suggested a different, recalculated capital structure for interest synchronization related only to tax expenses. The Commission rejected the OCC's tax-related proposal, suggesting that it might also violate ring-fencing provisions of Decision No. C08-0204 in Docket No. 07A-108EG.

44. In its RRR, the OCC asks the Commission to reconsider its proposed interest synchronization adjustment for tax expenses. The OCC argues that this form of interest synchronization does not violate the ring-fencing provisions of Decision No. C08-0204. The OCC also renews its argument that, because Black Hills' capital structure is skewed due to the goodwill associated with the acquisition of Aquila, Inc., a departure from the more traditional method of calculating interest synchronization is warranted.

45. We deny the OCC's RRR on this matter. The OCC makes the same arguments in its Application for RRR as it did through the Answer Testimony of its witness Basil Copeland and in its Statement of Position. We fully considered the OCC's proposed adjustment and concluded in Decision No. C11-1373 that, while interest synchronization is appropriate, the OCC's approach would not properly apply the correct steps and inputs in achieving interest synchronization. We recognize, however, that we rejected the OCC's proposed interest synchronization adjustment due to the method of its calculation and not due to any ring-fencing provisions. We therefore strike the statement in ¶ 128 of Decision No. C11-1373:

"We also share Black Hills' concern that the OCC's proposed capital structure percentages, after its interest synchronization adjustment, may violate "ring fencing" provisions of Decision No. C08-0204."

4. AMI Customer Savings Incentive

46. Various filings submitted in relation to the Stipulation indicate that Black Hills proposed to include in its cost of service an expense of approximately $176,000 to account for a customer savings incentive stemming from the Company's success in securing funds from the federal government for its advanced metering infrastructure (AMI) project.

47. At ¶ 139 of Decision No. C11-1373, the Commission authorized Black Hills to recover through base rates an incentive in the form of a $100,000 expense instead of a $176,000 expense.

48. The OCC requests the Commission reconsider base rate recovery of the incentive amount and instead allow for the recovery of the $100,000 through the ECA.

49. We deny RRR on this matter. We significantly reduced the incentive but retained the Company's proposed approach for recovery as a base rate expense item. We were fully aware of other rate mechanisms that could be employed for cost recovery, including the ECA, when authorizing the $100,000 expense. We further expect Black Hills to file an electric base rate proceeding within a reasonable timeframe such that the collection of the expense will terminate and the Company will have recovered from ratepayers an appropriate total amount.

5. Weather Normalization

50. At ¶ 158 of Decision No. C11-1373, the Commission found it reasonable to allow for the weather normalization of billing units in this rate proceeding, recognizing that variations

in weather conditions can impact customer electricity usage and the corresponding revenues received by the Company. The Commission also agreed with Staff that the most recent weather data from the National Oceanic and Atmospheric Administration should be used in determining such normal weather conditions.

51. The OCC requests the Commission maintain its "long-standing policy" of not allowing weather normalization adjustments for billing determinants for electric utilities.

52. We deny RRR on this matter. The Commission found that the specific facts and circumstances of this case warranted the adoption of a weather normalization adjustment. The Commission further explained that the specific weather normalization adjustments approved in this proceeding properly account for weather-related impacts on ratepayers' electric bills.

53. Moreover, the Commission fully considered the argument that the Commission's long-standing policy has been to reject weather normalization adjustments in electric rate case proceedings. The OCC's analysis of past Commission decisions was not compelling. For instance, the OCC fails to explain specifically why the Commission may have rejected weather normalization adjustments in past electric rate proceedings and why those previous findings should hold in this case as well. It also appears that parties to previous electric rate cases have settled the issue. We therefore disagree with the OCC's characterization of past Commission decisions as a "long standing policy" of not allowing weather normalization adjustments. For the foregoing reasons, we deny the RRR filed by the OCC on this issue.

D. All Other Requests Denied

54. All requests made by Black Hills or the OCC in their Applications for RRR not addressed by this Order are hereby denied.

II. ORDER

A. The Commission Orders That:

1. The Application for Rehearing, Reargument, or Reconsideration (RRR) filed by Black Hills/Colorado Electric Utility, LP on January 11, 2012 is granted, in part, and denied, in part, consistent with the discussion above.

2. The RRR filed by the Colorado Office of Consumer Counsel on January 11, 2012 is denied, consistent with the discussion above.

3. This Order is effective upon its Mailed Date.

B. ADOPTED IN COMMISSIONERS' WEEKLY MEETING Feburary 1, 2012.

(S E A L)

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

JOSHUA B. EPEL

JAMES K. TARPEY

MATT BAKER

Commissioners

ATTEST: A TRUE COPY

Doug Dean,
Director