BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

In the Matter of Black Hills/ Nebraska Gas Utility Company, LLC, d/b/a Black Hills Energy, Omaha, seeking a General Rate Increase for Black Hills Energy's Rate Areas One, Two and Three (Consolidated).	)	Application No. NG-0061 FINAL ORDER GRANTING APPLICATION IN PART Entered: August 17, 2010

BY THE COMMISSION:

On December 1, 2009, Black Hills/Nebraska Gas Utility Company, LLC, d/b/a Black Hills Energy, Omaha (Black Hills) filed an application seeking approval of a general rate increase pursuant to the State Natural Gas Regulation Act (the Act)[1]. Petitions for Formal Intervention were filed by the Public Advocate, Constellation New Energy Gas, NorthWestern Corporation d/b/a NorthWestern Energy, SourceGas Distribution LLC, and the City of Lincoln, Nebraska. An order granting interventions was entered on January 12, 2010. The City of Lincoln later withdrew its intervention on May 26, 2010.

In summary, Black Hills seeks a total revenue increase of approximately $12.1 million and a return on equity of 11.5 percent. Black Hills proposes increases in the fixed monthly customer charges for residential rate payers from $12.00 to $15.00 and for commercial ratepayers from $17.00 to $20.00. Furthermore, Black Hills proposed a declining block rate design with a two-tiered distribution rate schedule. Black Hills proposed a monthly volumetric rate of $.28200 for the first 20 therms used by residential rate payers and for the first 40 therms used by commercial rate payers. Both would be subject to a rate of $.16290 for remaining volumes.

Hearing on this matter was held on May 24 and 25, 2010. Live testimony was provided in support of the Application by Robert Livezey, Jeffrey Thomas, Dan Mechtenberg, Don Nordell, Richard Petersen, and Glenn Dee. Mr. Michael Arndt provided live testimony on behalf of the Public Advocate. In addition to live testimony, prefiled written and rebuttal testimony on behalf of the witnesses listed above and that of Thomas Sullivan, William Avera, Robert Hollibaugh, Larry Loos, Anthony Cleberg, Laura Patterson, and Richard Kinzley on behalf of Black Hills and William Marcus and Randall Woolridge on behalf of the Public Advocate were entered into the record. Various other documents were also entered into the record in this matter and will be specifically referenced when appropriate.

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[1] *Neb. Rev. Stat*. § 66-1801 et seq. (Reissue 2009).

O P I N I O N A N D F I N D I N G S

"Every rate made, demanded, or received by any natural gas public utility shall be just and reasonable. Rates shall not be unreasonably preferential or discriminatory and shall be reasonably consistent in application to a class of ratepayers."[2]

> The commission, in the exercise of its power and duty to determine just and reasonable rates for natural gas public utilities, shall give due consideration to the public need for adequate, efficient, and reasonable natural gas service and to the need of the jurisdictional utility for revenue sufficient to enable it to meet the cost of furnishing the service, including adequate provisions for depreciation of its utility property used and useful in rendering service to the public, and to earn a fair and reasonable return upon the investment in such property.[3]

"Cost of service shall include operating expenses and a fair and reasonable return on rate base, less appropriate credits."[4]

With the exception of the items specifically addressed herein, the Commission grants Black Hills' Application subject to the adjustments and limitations discussed below.

BURDEN OF PROOF

The burden of proof in demonstrating that proposed rates are just and reasonable rests with the utility. As stated previously by this Commission, in order to prove its case, a utility must not only meet the filing requirements but must provide substantive support for the elements of its rate application. Mere conclusory statements are insufficient.

> A prima facie case is that which is received or continues until the contrary is shown, and on which in the absence of explanation or contradiction constitutes an apparent case sufficient in the eyes of the law to establish the fact, and if not rebutted remains sufficient for that purpose.[5]

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[2] *Neb. Rev. Stat*. § 66-1825(1) (Reissue 2009).
[3] § 66-1825(3).
[4] § 66-1825(4).
[5] *In re Hoagland's Estate, Shotwell v. First Nat. Bank of Omaha, et al.,* 126 Neb. 377, 380, 253 N.W. 416, 419 (1934).

Just as conclusions are insufficient to satisfy the utility’s burden, neither the Public Advocate nor any other party can rely on mere conclusory statements to rebut a prima facie showing by the utility.

The application of the burden of proof continues to be a source of disagreement between utilities and the Public Advocate with respect to the production of evidence. The Public Advocate maintains that the utility must meet its burden of proof in its direct case and cannot rely on information provided in rebuttal.

The Commission agrees that the utility must provide evidence to support its rate application in its direct case. However, to expect a utility to anticipate every objection to its rate application and to proactively provide testimony and documentary evidence to address these anticipated objections is unreasonable. Infinite information exists that could be provided in infinite forms in support of an application. Likewise, it would be equally inappropriate for a utility to provide as little information as possible to frustrate the Public Advocate’s ability to conduct a reasonable review of its rate filing. The question of whether any particular evidence constitutes appropriate rebuttal must be examined on a case by case basis. Ultimately, the purpose of the entire process is to provide the Commission with sufficient information to establish just and reasonable rates, thereby balancing the interests of utilities and ratepayers.

Parties also expressed concern regarding the Commission staff’s request for additional information regarding allocation of common property and expenses and affiliate transactions. As previously stated in the Hearing Officer’s order entered on May 12, 2010, the Commission Rules of Procedure permit questioning of witnesses at hearing by Commissioners[6] and staff[7] and authorize the Hearing Officer to accept late-filed exhibits[8]. Allowing staff to submit written questions prior to hearing acknowledges the constraints of a 210- to 270-day time limit for the conduct of general rate cases, is consistent with requiring testimony of parties to be prefiled, and enables all parties an opportunity to address the issues raised.

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[6] Neb. Admin. Code, Title 291, Chapter 9, § 018.01F.
[7] § 002.04.
[8] § 016.09.

RATE BASE

Rate base is defined by the Act.

> The rate base of the jurisdictional utility shall consist of the utility's property, used and useful in providing utility service, including the applicable investment in utility plant, less accumulated depreciation and amortization, allowance for working capital, such other items as may be reasonably included and reasonable allocations of common property, less such investment as may be reasonably attributed to other than investor-supplied capital unless such deduction is otherwise prohibited by law.[9]

"The rate base shall ordinarily consist of those items which are used and useful in providing service to the public."[10]

> Post test year adjustments are permitted for known and measurable rate base adjustments to test year where the utility accounts for any related impacts on all aspects of the jurisdictional utility's operations. Related impacts are those that reasonably follow as a consequence of the post test year adjustment being proposed, including a related impact of another post test year adjustment.[11]

Average Rate Base

Black Hills proposes a historical test year for the twelve-month period ending on July 31, 2009, adjusted for known and measurable changes. The utility's proposed total jurisdictional rate base, as adjusted is $163,800,857.[12] Black Hills asserts its proposed rate base reflects values recorded at the end of the test year and adjusted for known and measurable changes.

The Public Advocate supports using an average rate base methodology.[13] According to Mr. Arndt,

> A year-end rate base results in a mismatch of test year investment, revenues and expenses. A year-end rate base requires corresponding year-end adjustments to revenues and expense to achieve the necessary and

[9] § 66-1825(6).
[10] § 005.06D
[11] § 005.06F
[12] Application for Rate Increase, Ex. 8 at Ex. III, Schedule B-1.
[13] Pre-filed Direct Testimony of Michael Arndt, Ex. 101 at 15:1-4.

> proper matching of investment, revenues and expenses. Such adjustments are complex and speculative.[14]

Furthermore, Mr. Arndt contends that the utility's actual rate base is declining.[15]

The Commission previously rejected use of the average rate base methodology.[16] Utilizing the average rate base method in this case would prevent the utility from earning a rate of return on actual investment. Without making any findings regarding the individual adjustments or components of the rate base proposed by the utility, the Commission finds that the use of actual rate base, relying on company records, adjusted for known and measurable changes is the appropriate method.

<u>Capital Additions and Construction Work In Progress</u>

In its application, Black Hills proposes adjustments to rate base related to capital additions for system integrity projects during the remainder of 2009 following the end of the test year and the first half of 2010 in the amount of $8,984,704.[17] An additional $3,512,198 is included in the proposed rate base and is labeled as Work in Progress. However, these projects were already completed at the time the application was filed.[18] The Public Advocate recommends that amounts for capital additions beyond the test year and amounts referred to as work in progress should be denied.[19]

Neb. Rev. Stat. § 66-1817 states, in part

> (1) Any jurisdictional utility property may be deemed to be completed and dedicated to commercial service if construction of the property will be commenced and completed in one year or less.

All of the capital additions proposed by Black Hills consist of projects commenced and completed within 12 months of the test year.

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[14] *Id.* at 15:5-10.
[15] *Id.* at 16:8-9.
[16] *See In the Matter of SourceGas Distribution, L.L.C.,* Application No. NG-0060, Order Granting Application, In Part (Mar. 9, 2010). [Hereafter "NG-0060 Order"]
[17] Ex.8 at Ex. VI Schedule A at ln. 1 and Ex. VI, Schedule B at pg. 1.
[18] Ex. 8 at Ex. III Schedule B-2 at line 3; Ex. 49 at Response to PA-302. The number reflected is the test year adjusted balance as of July 31, 2009. Some testimony refers to $3,185,128 which represents the base year ending balance. We believe the test year adjusted balance to be the appropriate number.
[19] *See* Ex. 101 at 22:10-16.

Post-test year adjustments related to capital additions and construction work in progress are entirely within the Commission's discretion.[20] The Commission has previously provided guidance regarding the nature of direct testimony that utilities should provide in support of adjustments for construction work in progress including but not limited to:

> a discussion of each project; why the utility has determined that the project is necessary to the provision of safe and reliable gas service; and how the project costs are being financed, whether through debt or internally generated cash. Additionally, the utility should describe why it is necessary for the project to be included in rates before it is complete and in service.[21]

The Commission further suggested that evidence should include:

> a list of all construction projects the utility is requesting to include in plant in service which should include a description of the project; location of the project; purpose of the project; date construction was begun; expected completion date; actual costs incurred as of the last day of the test year; and finally total expected cost of the project at completion.[22]

Black Hills provides testimony and multiple exhibits detailing the information the Commission previously requested.[23]

Mr. Nordell testifies that integrity projects include government-mandated relocation projects, replacing old service lines and replacing old mains.[24] Mr. Nordell further testifies regarding downward adjustments to the amount included for integrity projects due to changes in completion dates during their regular status meetings.

> … my original capital additions was close to $8.9 million for integrity projects that we had put in there. In my revised rebuttal testimony, it was 8.3.

[20] § 66-1817.
[21] *In the Matter of Aquila, Inc. d/b/a Aquila Networks (Aquila), Omaha, seeking individual rate increases for Aquila's Rate Area One, Rate Area Two, and Rate Area Three.,* Application No. NG-0041, Order Granting Application in Part, pg. 5 (July 24, 2007).
[22] *Id.*
[23] *See* Direct Testimony of Don Nordell and Exhibits, Ex. 23 at Ex. DJN-2.2; Rebuttal Testimony of Don Nordell and Exhibits, Ex. 24.
[24] Trans. at 249:6-17.

> So I -- you know, based on a clearer scope, clearer schedule and scope of the size of the projects, I, you know, adjust it downward.[25]

Mr. Nordell also states that "Black Hills Energy has made all of the other 'attendant' adjustments required in accordance with the Commission guidance in its prior orders."[26] Mr. Nordell testifies that of the adjusted amounts, $4,433,939 of capital improvements were completed as of March 31, 2010, and an additional $3,886,965 were expected to be completed by July 31, 2010.[27]

In support of the Public Advocate's recommendation to exclude the proposed adjustment, Mr. Arndt testifies:

> The Company's proposed CWIP and forecasted 2010 plant additions adjustments should be denied. CWIP adjustments require corresponding post test year adjustments to other rate base components, revenues and expenses to achieve the necessary and proper matching of investment, revenues and expenses. The Company has failed to identify, quantify and match the attendant impacts associated with its proposed CWIP and forecasted 2010 plant additions adjustments.[28]

Mr. Dee testifies, that:

> All of the Capital Additions were for "integrity" projects. Black Hills Energy did not include the investment related to projects related to "growth". In other words, the investment in the Capital Additions adjustment in this rate application is for projects related to relocations, line replacements, and other similar items that do not generate new revenue. Thus, there is no offset to make for that item.[29]

With respect to the amounts included in rate base as "work in progress", Mr. Dee also testifies that all of the projects included in CWIP … were completed with the exception of $3,854."[30]

The Company provides evidence in compliance with the requirements set forth in NG-0041 regarding all of the capital

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[25] Trans. at 264:23 – 265:6.
[26] Ex. 24 at 22:7-9.
[27] *Id.* at 22:2-13.
[28] Ex. 101 at 22:10-16.
[29] Rebuttal Testimony of Glenn Dee, Ex. 22 at 23:13-18.
[30] *Id.* at 21:12-14.

additions. The Commission remains concerned that adjustments may be required to ADIT by IRS regulations in order to avoid any normalization violations. However, the Commission does not find a sufficient record exists to require any such adjustment. The Commission finds that the adjustment for capital additions as amended in rebuttal testimony in the amount of $8,320,904 should be approved. Furthermore, the Commission finds that work in progress was properly included in rate base in the amount of $3,512,198.

Gas In Storage Inventory

Black Hills includes in rate base a gas storage inventory balance of $17,979,457, based on a 12-month average for the months of August 2008 to July 2009.[31]

The Public Advocate recommends "that the 13-month average balance for the test year ended July 31, 2009, be used. The average test year balance matches the other components of the average test year rate base and test year customer levels and should be used."[32]

The Commission previously stated in reference to Aquila's decision to include the value of its gas in storage based upon a single point in time, that

> an adjustment for gas in storage is appropriate as it is "used and useful" in the provision of natural gas service. However, we further find the Public Advocate's recommendation that a twelve-month average of historic data over the test-year period is a more appropriate method for determining a "known and measurable" adjustment in this context.[33]

The utility provides monthly balances and the 12-month average calculation.[34] The cost of natural gas peaked in August 2008 at $10.29 per Mcf, and as of December 2009, six months after the test period, the cost of gas was $3.38 per Mcf.[35]

The Commission recognizes the volatility of the natural gas market. However, such volatility only underscores the need for consistency in the regulatory process. The Commission previously approved the 12-month average as an appropriate method for determining gas in storage adjustments. Although the method

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[31] Ex. 101 at 22:18-21; Ex. 8 at Ex. III, Schedule B-2, ln. 30.
[32] Ex. 101 at 24:1-4.
[33] NG-0041 Order, *supra* note 21 at 7.
[34] *See* Ex. 11.
[35] Ex. 49 at Response to PA-309.

proposed by the Public Advocate may have merit, sufficient evidence was not provided to require Black Hills to deviate from the 12-month average method.

Once a particular method or approach is approved, it may be changed if warranted by the evidence. However, a change is not required under the present circumstances. Therefore, the Commission finds that the 12-month average provided by the utility should be approved.

Cash Working Capital

Black Hills includes in rate base cash working capital in the amount of $2,190,478.[36]

> Working capital is comprised of prudent inventories of materials and supplies, including gas storage inventories, prepayments and a cash working capital component. Accumulated Reserve for Deferred Income Taxes, Contributions in Aid of Construction, Rate Payer Deposits, and Customer Advances are all included as adjustments that offset the need for working capital.[37]

In support of its cash working capital calculation, Black Hills performed a lead/lag study.[38] Mr. Dee testifies that the study was conducted consistent with the method previously used by Aquila.[39] Mr. Dee further testifies that "The actual computation is explained more fully in the tab labeled 'Working Capital'."[40] Exhibit V, Schedules A through G set forth an explanation regarding the cash working capital calculation and the results of the calculations.[41]

The Public Advocate recommends cash working capital in the amount of $93,539.[42] Mr. Arndt testifies that the revenue lag be reduced from 41.40 days to 39.66 days[43]. He references higher collection lags during the early months of the test year[44] and states that

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[36] Ex. 8 at Ex. III, Schedule B-2 at ln. 28.
[37] Direct Testimony of Glenn Dee and Exhibits, Ex. 21 at 6:17-22.
[38] *Id.* at 7:3-7.
[39] *Id.* at 7:8-10.
[40] *Id.* at 7:7-8.
[41] Ex. 8 at Ex. V, Schedule A.
[42] Ex. 101 at MLA-1 at 4:8.
[43] *Id.* 27:3-9.
[44] *Id.* at 26:14-16.

> The Company recalculated the collection lag based on the most recent 12-month period. The Company's collection lag based on current data is 21.64 days rather than 23.06 days. [citation omitted] My recommendation is to use the more current collection lag.[45]

Mr. Arndt testifies that the expense lag for purchased gas should be increased to 40.20 days[46]. In making his recommendation, Mr. Arndt refers to the fact that the utility pays for purchased gas expenses by wire transfer on the 25th of the month and as a result the company's expense lag is too short.[47]

Mr. Dee provides rebuttal testimony addressing the recommendations proposed by the Public Advocate.[48]

No objections were raised with respect to the methods used in conducting the lead/lag study. The Public Advocate raises concerns only with the inputs used. With regard to the collection lag, we see no justification for relying on data from an updated period for only one portion of the study. Furthermore, we find Black Hills has adequately addressed the Public Advocate's concerns regarding the calculation of the purchase gas expense lag. The Commission finds that Black Hills met its burden with respect to its lead/lag study and the proposed cash working capital should be approved, adjusted as necessary consistent with the other findings within the order.

Prepayments

Black Hills includes in rate base prepayments in the amount of $573,454.[49]

The Public Advocate argues that the amount was not properly included in rate base. Mr. Arndt testifies:

> The Company's calculation of a 28.20 expense day lag for other operation and maintenance expenses includes prepaid expenses. The inclusion of an additional amount for prepayments in rate base would result in a double recovery of prepaid amounts.[50]

[45] *Id.* at 26:21-27:2.
[46] *Id.* at 28:3-6.
[47] *Id.* at 27:20-28:2.
[48] Ex. 22 at 25-29.
[49] Ex. 8 at Ex. III, Schedule B-2 at ln. 31.
[50] Ex. 101 at 29:15-18.

On rebuttal, Mr. Dee testifies that prepayments were not included in the lead lag study. Specifically, Mr. Dee testifies that:

> My use of the term “prepaid” was in reference to the 15.2 days for services provided on a monthly basis or more specifically payments involving subscription, memberships, local utility bills etc. The $573,454 prepayments included in rate base have no relation with, nor is it accounted for or included in, the Lead Lag computation.[51]

Based upon the testimony of Mr. Dee, inclusion of prepayments in rate base would not result in double-recovery.

The Commission finds that inclusion of prepayments in rate base in the amount of $573,454 is approved.

Accumulated Deferred Income Tax

Both the Company and the Public Advocate agree that Accumulated Deferred Income Tax (ADIT) should be deducted from rate base as cost-free capital. The Public Advocate and the Company disagree as to the amount of ADIT that should be properly deducted.

The acquisition of Aquila’s gas utility assets by Black Hills was structured as an asset purchase agreement. Richard Kinzley testifies regarding negotiations between Black Hills and Aquila. Mr. Kinzley states in his testimony, “The only opportunity made available to Black Hills with regard to the Nebraska jurisdictional assets was the opportunity to acquire the Nebraska assets – there was no entity to acquire in a merger.”[52] The $28,662,736 ADIT balance on Aquila’s books for the assets sold to Black Hills was removed from Aquila’s regulatory books. Black Hills took a new tax basis in the acquired assets that reflects the purchase price of the assets.

The Public Advocate estimates that the reduction in ADIT between the current rate case and the last rate case for Aquila in 2006 accounts for approximately 28.58 percent of the Company’s revenue deficiency in the current case.

The Public Advocate asserts that Black Hills acted imprudently in not structuring the acquisition of assets from Aquila as a merger instead of an asset purchase, thereby re-

[51] Ex. 22 at 28:23-29:5.
[52] Rebuttal Testimony of Richard Kinzley, Ex. 34 at 6:12-15.

taining the ADIT balance on Aquila's books for Nebraska ratepayers. In support of his recommendation, the Public Advocate offers examples of other utility acquisitions that were structured as mergers.

The Commission previously approved the structure of the acquisition.[53] Although the impacts of an acquisition on rates may be appropriately raised in a rate case depending on the circumstances, any challenge to the structure of the transaction should be raised in the docket regarding the acquisition. Therefore, we decline to find any imprudence on the part of Black Hills in the structuring of the transaction with Aquila.[54]

The Public Advocate, in the alternative, recommends the loss of ADIT be considered an acquisition premium and deducted from rate base. He points out that Black Hills stated it was not seeking any acquisition premiums from ratepayers.[55] If we find the loss of ADIT is an acquisition premium, the Public Advocate then urges the Commission to approve a return on equity for the Company at the lower range of the Public Advocate's recommendation.

Commission rules define acquisition adjustments as "the difference between the purchase price of an acquired operating unit or system and the depreciated original cost of the acquired property."[56] The loss of ADIT does not meet the definition of an "acquisition adjustment" and therefore should not be treated as such. Further, the Commission sees no direct link between the treatment of ADIT in an acquisition of a utility distribution system and the appropriate return on equity in a general rate increase filing.[57]

Black Hills conceded that because it seeks post-test year adjustments for capital additions and payroll adjustments, using the ADIT per book balance of $7,829,788 as of December 31, 2009

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[53] *In the Matter of the Joint Application of Aquila Inc. d/b/a Aquila Networks, Black Hills Corporation and Black Hills/Nebraska Gas Utility Company, LLC, Source Gas Holdings LLC for approval of the proposed transfer of Aquila's certificate of convenience and for a change of control of Aquila's Nebraska Jurisdictional assets*, Application No. NG-0044, Order Granting Application (October 16, 2007).
[54] This is consistent with our findings on a similar issue in the recently concluded SourceGas Distribution LLC rate case, *See* NG-0060 Order, *supra* note 16.
[55] Deposition of Robert Hollibaugh, Ex. 103 at 42:4-25, 126:18-22.
[56] § 005.06A4.
[57] This is consistent with our findings on a similar issue in the recently concluded SourceGas Distribution LLC rate case, *See* Application No. NG-0060 Order, *supra* note 16.

would be appropriate.[58] For the reasons stated above, the Commission finds that the ADIT balance as of the end of the test year, December 31, 2009, shall be utilized in this proceeding.

COST OF SERVICE

"Operating expenses shall consist of expenses prudently incurred to provide natural gas service including (a) a reasonable allocation of common expenses as authorized and limited by section 66-1819 and (b) the quantity and type of purchased services regulated by the Federal Energy Regulatory Commission."[59]

Due to the corporate structure encompassing Black Hills, a significant issue exists relating to the allocation of common expenses. Black Hills provides two cost allocation manuals (CAMs). One relates to the allocation of costs of the Service Company and the second relates to the allocation of costs of Black Hills Utility Holdings.[60] Mr. Cleberg provides general descriptions of the two CAMs.[61] However, upon reviewing the testimony and the CAMs, Commission staff propounded additional questions regarding the allocation process. In response, the utility provided testimony from Mr. Jeffrey Thomas along with several exhibits providing additional explanation regarding the allocation of common expenses.[62]

The Commission is satisfied, based upon the information provided in direct and rebuttal testimony as well as the specific responses to questions posed by Commission staff, that the methodology for allocating common expenses is reasonable. In the future the information provided in Mr. Thomas' testimony should be filed with a utility's direct case.

Weather Normalization

Black Hills proposes a 10-year average based on Optimum Climate Normals (OCN) provided and supported by Dr. Robert Livezey, a climatologist, former chief of the National Weather Service's climate services, and expert in climate variability, climate change, and climate prediction. Dr. Livezey testifies regarding his conclusions that the predictive value of 30-year normals has decreased due to a warming trend recorded since the

[58] *Comments of Black Hills Energy on the June 29, 2010 Advisory Report of GDS Associates, Inc.*, at 19 (July 12, 2010).
[59] § 66-1825(7).
[60] Direct Testimony of Anthony Cleberg and Exhibits, Ex. 27 at 7:17-19 and Ex. ASC-3; Ex. ASC-4.
[61] See Ex. 27 at 7-10.
[62] See Supplemental Testimony and Exhibits of Jeffrey O. Thomas, Ex. 68.

mid 1970's. Further, Dr. Livezey testifies that a 30-year normal is no longer the best indicator of weather.[63] The National Oceanographic and Atmospheric (NOAA) is no longer using 30-year normals in forecasting weather[64] and the National Weather Service's Climate Prediction Center (CPC) has utilized a 10-year period as the default climate normal for forecasting since 1995.[65] Dr. Livezey recommends, based on the data from Nebraska, the OCN method, or a 10-year running average, as the least biased and most accurate and reliable method.[66]

The Public Advocate urges us to use the traditional 30-year normal, but proposes using a 25-year average for the time period between 1984 and 2008, with the data at 5 year intervals for normalization purposes as an alternative approach.[67]

He asserts that weather patterns are similar in western and eastern Nebraska, and the Commission adopted a 30-year average for weather normalization in the last SourceGas rate case.[68] The Public Advocate states that the Commission should adhere to a consistent weather normalization method, unless and until a utility can, "present persuasive proof that there is a need to deviate from the established and accepted weather normalization applied by such commission."[69] The Public Advocate also argues that other regulatory Commissions have not adopted Dr. Livezey's methodology.

Proposed rates are based on gas usage or gas sales to calculate the revenue generated for the test year. Gas usage figures are then adjusted to reflect a "normal" year of usage. In prior rate cases the Commission has approved a 30-year average of the NOAA normals.[70] In the SourceGas rate case, the Commission declined to adopt a 5-year period for weather normalization proposed by the Company. We did not make any judgments regarding other methodologies for weather normalization.[71] The Public Advocate relies on the actions of other Commissions in support of his proposal. However, the action or inaction of other regulatory commissions and bodies, while possibly instructive, is neither authoritative nor determinative in this Commission's analysis of the evidence provided by Dr. Livezey.

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[63] Direct Testimony of Robert Livezey, Ex. 3 at 9:4-12.
[64] *Id.* at 8:3-8.
[65] *Id.* at 10:14-11:12.
[66] *Id.* at 37:12-17
[67] *See* Post-Hearing Brief of the Public Advocate, PA Brief at 48.
[68] *See* Id. at 48.
[69] *See* PA Brief at 46.
[70] *See* NG-0060 Order, *supra* note 16; NG-0041 Order, *supra* note 21.
[71] *See* NG-0060 Order, *supra* note 16.

We find in this particular case that Black Hills has presented sufficient evidence to support the use of its proposed weather normalization method. Therefore, the Commission, for the purposes of this rate case proceeding, finds that the OCN methodology proposed by Black Hills, using 10-year running averages, should be adopted.

Payroll Adjustments

Black Hills proposes a payroll expense increase totaling $2,035,691 consisting of an annualization adjustment of $1,524,254; merit increases for non-union employees of $456,724; and the addition of the GSS control department of $54,713.[72] Black Hills updates its payroll expense to reflect actual payroll and vacancies in addition to non-union merit increases as of April 5th.[73] Based upon the adjustment, total payroll and benefits as of May 7, 2010, would be $1,768,106.[74] Based upon the adjustment, the filed capitalized portion of the payroll adjustment is decreased by $2,261 and the overall revenue deficiency is decreased by $269,846.[75]

1. Payroll Annualization Adjustment

Black Hills proposes a payroll annualization adjustment of $1,524,254.[76]

On behalf of the Public Advocate, Mr. Arndt testifies:

> The Company proposed adjustment annualizes (1) Black Hills Utility Holdings, Inc. direct and allocable payroll expense based on September 15, 2009 payroll expense; and (2) Black Hills Service Company payroll expense based on July 2009 payroll expense. There has been no showing that BHUHC's September 2009 or BHSCO's July 2009 payroll expenses are representative of future Nebraska affiliate charges.
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> In addition, the Company has proposed no matching adjustment to recognize revenue growth related to increased customer levels during and after the test year.[77]

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[72] Rebuttal Testimony of Richard G. Petersen, Ex. 18 at 4:19-24.
[73] *Id.* at 4:17-18.
[74] *Id.* at 5:1.
[75] Ex. 18 at 5:4-7.
[76] Ex. 8 at Ex. VI, Schedule A, Adjustment No. 3; Ex. 18 at 4:17-20.
[77] Ex. 101 at 37:2-16.

The Commission finds that sufficient evidence has been provided to demonstrate that the updated annualization adjustment is appropriate and should be approved.

2. Non-union Merit Increases

Black Hills proposes an adjustment for merit increases for non-union employees in the amount of $456,724. The Public Advocate recommends that this adjustment be disallowed. Mr. Arndt testifies:

> The future merit increases for non-union employees are not guaranteed increases and are not known and measureable. In addition, the Company has proposed no matching adjustment to recognize revenue growth related to increased customer levels during and after the test year.[78]

Black Hills responds that as of April 5, 2010, the merit increase amounts are now established.[79] Black Hills references the Commission's prior order in Docket NG-0041 with respect to the Commission's findings on payroll increases stating that no matching issues existed.[80] Black Hills contends that the Commission should approve either the amount of payroll merit increase reflected in the original filing in Adjustment No. 5 on Exhibit No. VI, Schedule A in the amount of $456,824 or the adjusted amount updated as of May 7th.

The Commission finds that Black Hills produced sufficient evidence to demonstrate that the adjustment in the amount of $456,724 constitutes a known and measurable change and should be approved.

3. Gas Supply Services Department Adjustment

Black Hills proposes an adjustment in the amount of $54,713 for the establishment of a new Gas Supply Services Department.[81] Black Hills contends that the new department was created to increase efficiencies and avoid future pipeline penalties.[82] Mr. Petersen further testifies that the "jobs are all filled, those positions are located in Nebraska, the cost is known, the employees are monitoring the gas distribution systems, and the payroll cost is presently being incurred by Black Hills Energy.

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[78] *Id.* at 38:11-14.
[79] Ex. 18 at 12:8-9.
[80] *Id.* at 14:18-20.
[81] Ex. 8 at Ex. VI, Schedule A, Adjustment 4; See Direct Testimony of Richard G. Petersen, Ex. 17.
[82] Ex. 18 at 17:2-6; Ex. 55 at Response to PA-393.

The cost for this area must be recovered by Black Hills Energy as it provides useful benefits to Nebraska's rate payers."[83]

The Public Advocate recommends that this adjustment be disallowed. Mr. Arndt testifies that the adjustment fails to (a) recognize that two of the four positions were filled by existing Black Hills employees; (b) fails to include any matching adjustments to recognize future savings from avoiding pipeline penalties and increased efficiencies; and does not include any matching adjustment to recognize revenue growth related to increased customer levels during and after the test year.[84]

Black Hills responds in its rebuttal that "Those prior job positions vacated by the Gas Control Department employees did not disappear. Instead, other people were hired to replace those vacated positions."[85]

Based upon the evidence provided, a net increase in employees resulted from the addition of the new department and sufficient evidence was produced to support the adjustment. Future efficiencies and savings would be speculative at this time.

The Commission finds that the adjustment in the amount of $54,713 should be approved.

4. Union Payroll Increase

Black Hills originally proposed an increase for union employees in the amount of 224,503.[86] However, the utility provides an updated amount of $187,085.

The Public Advocate has recommended that this adjustment be disallowed. Mr. Arndt testifies:

> The projected union increase expected to be effective January 1, 2010, has not been finalized. The projected union increase expected to be effective April 28, 2010, has not been negotiated and voting on any increase was not expected until April 2010.
>
> In addition, the Company has proposed no matching adjustment to recognize revenue growth related to

[83] Ex. 18 at 18:14-18.
[84] Ex. 101 at 37:21-38:6.
[85] Ex. 18 at 16:11-15.
[86] Ex. 8 at Ex. VI, Schedule A, Adjustment No. 6; *See* Ex. 17.

> increased customer levels during and after the test year.[87]

The Commission finds that Black Hills produced sufficient evidence to demonstrate that the adjustment in the amount of $187,085 constitutes a known and measurable change and should be approved.

5. Payroll Taxes

Based upon all of the adjustments to payroll, Black Hills had proposed payroll taxes in the amount of $118,183.[88] However, based upon the updated numbers, payroll taxes would total $100,873.[89]

Based upon the above recommendations to accept the updated payroll adjustments, the Commission should approve the adjustment in the amount of $100,873.

Variable Compensation

Initially, Black Hills proposes inclusion of $766,930 as variable compensation.[90] In his direct testimony, Mr. Petersen testifies that:

> variable compensation amounts are accrued monthly to reflect expected payments in March 2010 for completion of employee objectives. … The amount accrued reflects variable compensation payments at the midpoint of the variable compensation payout schedule applicable to each employee.[91]

Mr. Arndt testifies on behalf of the Public Advocate that the company did not provide support in its direct testimony for the proposed amount; and that it should therefore be denied.[92]

Black Hills provides an updated amount reflecting actual payouts as of March 5, 2010, in the amount of $708,217.[93] The updated amount represents the actual payout made during 2010.[94] In response to Mr. Arndt's testimony, the utility filed rebuttal

[87] Ex. 101 at 38:20-39:5.
[88] Ex. 18 at 27:7-12.
[89] *Id.* at 27:13-14.
[90] *Id.* at 26:18-20.
[91] Ex. 17 at 7:17-21.
[92] Ex. 101 at 40:15-41:5.
[93] Ex. 18 at 26:15-22.
[94] *Id.* at 25:3-7.

testimony of Ms. Patterson which gives a detailed description of the variable compensation program.[95]

Previously, Aquila sought an adjustment in its variable compensation expense representing an increase of 150 percent in the program.[96] No direct testimony was offered to support the need for the increase in the program or the amount previously paid to employees.[97] On rebuttal the company provided the amount previously paid but no further detail.[98] In that matter, the Commission found it appropriate to grant an amount consistent with the actual payout in 2007[99], stating:

> The Commission finds that consideration of the actual amount paid in March 2007 is proper under these circumstances in order to achieve the most accurate adjustment possible. No matching issues exist as the amounts do not relate to the number of ratepayers or volumes sold. Because the amount is based on actual amounts paid, it constitutes a "known and measurable" adjustment.[100]

Black Hills is not seeking any increase or adjustment in the program but instead provides an initial amount based upon actual amounts accrued at the time the rate case was filed and updated the amount with actual payouts made for the 2010 program year. Furthermore, unlike Aquila, Black Hills provides detail regarding the program, including but not limited to the metrics used to calculate compensation for employees. Consistent with its finding in Aquila, the Commission finds that consideration of the actual amounts paid is the most accurate method for determining the appropriate expense.

Therefore, based upon the additional detail provided by Ms. Patterson, the Commission finds that the updated variable compensation costs in the amount of $708,217 should be approved. In its next rate filing, the utility must file in its direct case the type of information provided in Ms. Patterson's testimony and additional historic information regarding the annual payouts of variable compensation between rate cases.

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[95] Rebuttal Testimony of Laura Patterson, Ex. 33 at 6:6 – 14:14.
[96] NG-0041 Order, *supra* note 21 at 13.
[97] *Id.*
[98] *Id.*
[99] *Id.* at 13 finding that "the nature of the objectives appear to benefit both ratepayers and shareholders and it would be improper for the ratepayers to bear the full cost of this benefit."
[100] *Id.*

Rebranding Costs

Black Hills has included $190,552 in expenses related to the costs of placing company identification on vehicles and other items. The Public Advocate recommends that these expenses be eliminated.

The labeling of this expense as “rebranding” is somewhat misleading as it is not solely a one-time expense related to the acquisition of Aquila by Black Hills. Mr. Petersen testifies that:

> Black Hills Energy’s customers need to be able to identify Company operations via phone numbers, vehicle logos, building signs, warehouse identification, uniforms etc. These items do wear out and do need to be replaced from time to time as a normal business cost. To eliminate all of these types of costs, and simply refer to them as rebranding (and related to the purchase of Aquila properties) is inappropriate.[101]

The Utility acknowledges that all changes necessitated by the acquisition of Aquila are complete.[102] In the alternative to full recovery, the Company proposes allowing recovery of half of the original amount, which would reduce the proposed amount to $95,276.[103]

The utility is entitled to a presumption that costs incurred are prudent and has demonstrated such identification costs existed; however, it is clear from the record that the test year expenses are extraordinary and unlikely to reoccur at the proposed level. The test year must be adjusted for known and measurable changes, and it is anticipated that from the close of the test year, branding expenses will decrease. Therefore, some adjustment should have been made to account for the decrease.

The Commission recognizes that some level of expense related to this item exists. However, in the absence of evidence from the company detailing what would be a more appropriate amount, the Commission finds that it is unable to determine the appropriate amount; and therefore must deny this adjustment.

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[101] Ex. 18 at 30:25-31:5.
[102] Trans. at 307:14-20.
[103] Ex. 18 at 31:11-14.

The Commission finds that $190,055 of the proposed re-branding expenses should be denied.

Affiliate Costs

Transactions between a utility and its affiliates are subject to close scrutiny due to the potential for overpayment for goods or services inherent in the relationship. Such transactions do not enjoy the same presumption of prudency available to a utility with respect to arms length transactions.

> The jurisdictional utility has the burden to demonstrate that any cost paid to an affiliate for any goods or services are prudent. The jurisdictional utility has the burden to demonstrate all of the following before any amount paid to an affiliate either, as a capital cost or an expense, is included in rates except as provided in *Neb. Rev. Stat*. § 66-1825(8):
>
> > 005.07A Each payment is prudently incurred for each item or class of items at the time incurred.
> >
> > 005.07B The costs charged by an affiliate reasonably approximate the market value of service to it. [104]

On behalf of Black Hills, Mr. Cleberg testifies that Black Hills Service Company (Service Company) provides “various support services, both administrative and management, to all of Black Hills Corporation’s subsidiaries….”[105]

> Black Hills obtains services from Service Company through a service agreement providing support services. This avoids the duplication of these business functions by each of the regulated and non-regulated business units of Black Hills Corporation. By providing support services on a centralized basis, efficiencies are created when compared to stand-alone business functions.[106]

Black Hills Energy obtains services “related to customer service, billing and information technology from Black Hills Utility Holdings through a service agreement.”[107] Mr. Cleberg

[104] § 005.07.
[105] Ex. 27 at 5:16-18.
[106] *Id.* at 5:14-18 and at Ex. ASC-1.
[107] *Id.* at 5:21-6:1 and at Ex. ASC-2.

further testifies that all services provided by Service Company and Black Hills Utility Holdings are provided at cost.[108]

Mr. Arndt testifies on behalf of the Public Advocate that "57.04% of Black Hills Energy's Nebraska test year O&M expenses related to charges from affiliate companies."[109]

> In response to questions regarding costs incurred from affiliate transactions are market based, Mr. Petersen testified, "We have operations in a number of states. So we have to be sure that they are reasonable as assigned between states. We are privy to a lot of other company data where you compare costs from your company to their company. They seem reasonable based on those comparisons.[110]

Additionally, Ms. Patterson testifies that in order to ensure that non-executive salaries are competitive with market rates; they have conducted and relied upon multiple market surveys, including a market review of Black Hills' positions in 2009 and that the salaries are reviewed annually.[111]

The Public Advocate further argues that amounts related to executive compensation should be excluded. Mr. Arndt testifies that the utility was unable to provide information regarding executive compensation for the test year as its accounting records do not track executive compensation by person and that no justification has been offered for the amounts.[112]

Ms. Patterson testifies that market analysis of executive salaries is conducted by an independent contractor.[113]

The Commission finds that the affiliate costs as proposed should be approved. However, in future rate cases the Commission expects more specific evidence in the company's direct case regarding the methods used by the company to ensure that affiliate costs approximate market value. Furthermore, the Commission finds that in future rate cases, information related to executive compensation should be provided for each executive position.

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[108] *Id.* at 7:7.
[109] Ex. 101 at 14:7-8.
[110] Trans. at 312:15-21.
[111] Ex. 33 at 4:19-6:5.
[112] Ex. 101 at 40:1-9.
[113] Ex. 33 at 14:18-21.

Relocation and Severance Costs

The Public Advocate recommends that $340,153 for relocation costs and $17,214 in severance costs should be disallowed.[114]

The company responded by providing relocation costs for the previous 5 years as follows: $28,241 in 2005; $73,894 in 2006; $92,500 in 2007; $114,387 in 2008; and $296,717 in 2009.[115] Black Hills then proposes if the actual cost included in the test year is not approved, that the Commission use an average cost.[116]

Black Hills recognizes that “the test year may contain some of the cost for relocation and severances due to the establishing jobs in Nebraska and relocating employees from Kansas City back to Nebraska and elsewhere after the transfer of assets from Aquila to Black Hills Corporation….”[117]

Black Hills agrees with Mr. Arndt’s recommendation that the $17,214 in severance costs should be eliminated as they were non-recurring.[118]

The Commission finds that the relocation costs reflected in the test year were unusual due to the merger and if included in rates would result in over-collection. The Commission finds that the average of actual relocation costs over the 5-year period in the amount of $121,184 is more appropriate. Consistent with the position of Black Hills and the Public Advocate, the Commission further finds that the $17,214 in severance costs must be eliminated.

Advertising

The Company has proposed an adjustment to eliminate $156,568 of total state advertising costs which are not associated with informational or safety issues.[119]

The Public Advocate makes no specific recommendation but instead states it is the company’s burden to show the amounts are reasonable.[120]

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[114] Ex. 101 at 47:10-11.
[115] Ex. 33 at 28:12-19.
[116] Ex. 18 at 28:22-29:3.
[117] *Id.* at 29:8-12.
[118] *Id.* at 12-17.
[119] Ex. 101 at 47:13-15 referencing Ex. 8 at Ex. VI, Schedule A, Work Paper, pg. 1.
[120] *Id.* at 47:16-22.

The Commission finds that the advertising expense as proposed by the Utility should be approved.

Dues

The Company proposes recovering (1) 100 percent of trade association (e.g., American Gas Association) and Chamber of Commerce dues; and (2) 50 percent of other business-related organizations. The Company's adjustment to eliminate 50 percent of "other business-related organizations" dues reduces total state expenses by $8,913.[121] In spite of the fact that the company seeks 100 percent of its trade association dues, it states that "No lobbying or legislative advocacy costs were included."[122]

The Public Advocate makes no recommendation but instead states it is the company's burden to show the amounts are reasonable.[123]

The utility states that the Commission approved costs related to these trade organizations were previously approved by the Commission. However, the Commission did not approve all of the trade association and chamber of commerce dues. We approved only the 50 percent sought by Aquila stating,

> As a matter of public policy, the Commission specifically finds that no expenses related to lobbying or legislative advocacy activity will be allowed. It is our understanding that any amounts attributable to lobbying and legislative advocacy activity have been excluded as part of the fifty percent factor adopted by Aquila.[124]

It is common knowledge that trade organizations represent their industry in a lobbying or legislative advocacy role. The fact that Black Hills seeks 100 percent of the trade association and chamber of commerce dues seems to conflict with its assertion that it removed all lobbying and legislative advocacy expenses. A breakdown of the dues paid was provided in response to the Public Advocate's data request No. PA-78.[125]

Therefore, consistent with our previous ruling in NG-0041, the Commission finds that expenses for dues paid to trade associations and chambers of commerce should be reduced by 50

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[121] *Id.* at 48:2-8 referencing Ex. 8 at Ex. VI, Schedule A, Work Paper, pg. 1.
[122] Ex. 18 at 47:8-12.
[123] Ex. 101 at 48:9-15.
[124] NG-0041 Order, *supra* note 21 at 10.
[125] Ex. 40.

percent to ensure that no costs associated with lobbying or legislative activity are included. The remaining request for 50 percent of the other business organizations should be approved. Therefore, the total of the requested amount should be reduced by $36,581. In the future, all utilities seeking dues and contributions must provide a list of the organizations and the corresponding amounts paid and any amounts excluded as lobbying expense with their direct testimony.

Rate Case Expenses

Black Hills proposes to recover rate case expenses totaling $1,692,420. The figure proposed by the Company includes $942,420 in costs from the 2006 Aquila rate case, Docket No. NG-0041[126], and the Company's estimate of $750,000 for costs of the current rate case.

In the 2006 Aquila rate case, the company estimated $500,000 for rate case expenses, the amount ultimately approved by the Commission.[127] Black Hills states that actual costs for that case totaled $1,197,050.[128] Black Hills seeks to recover the remaining costs for the 2006 rate case.

The Company also proposes two methods of recovering the costs of the rate cases rather than including the rate case expenses in rates. The methods the Company proposes are, 1) a one-time surcharge on customers of approximately $8.64 per customer; or 2) a Rate Case Rider of $0.36 per customer, per month, for 2 years.

The Public Advocate objects to Black Hills recovering former Aquila costs and recommends the Commission not allow recovery of the $942,420 in unrecovered rate case expense from the 2006 Aquila rate case. In support of his recommendation the Public Advocate states that Aquila no longer owns the Nebraska gas operations and disputes that Black Hills should be allowed to recover Aquila rate case costs. Further, the Public Advocate argues the Company underestimated the cost of 2006 rate case and has not offered evidence to support the reasonableness or prudency of recovering an additional $942,420 in expenses for the 2006 rate case.

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[126] *See* NG-0041 Order, *supra* note 21.
[127] *Id.*
[128] Ex. 21 at 7:19-22. The Commission notes that in his oral testimony offered at the hearing on the above-captioned docket, Mr. Glenn referred to the cost of the 2006 Aquila rate case as $1.9 million. The Company later corrected that statement and confirmed that the figure included in Mr. Glenn's pre-file direct testimony was correct, *See* Ex. 112.

The Public Advocate further recommends the estimated rate case expense of $750,000 for the current Black Hills rate case be included in the Company’s rates with a three year amortization period, or $250,000 per year for three years.[129] The Base Year proposed by the Company includes $399,026 in rate case expense; therefore the Public Advocate recommends a reduction to the company’s proposed rate case expense of $149,026.[130]

The Act[131] allows for the costs of the Public Advocate and the Commission to be recovered through an assessment on the utility which is recovered from ratepayers as a surcharge. The pertinent statute reads:

> On and after June 1, 2007, the commission by general rule and regulation shall authorize the recovery of the amount of any assessments or charges paid to the commission pursuant to this section and section 66-1840 in a general rate filing or through a special surcharge which may be billed on the monthly statements for up to a twelve-month period immediately following their payment by the jurisdictional utility.[132]

In prior rate cases before this Commission, rate case expenses have been recovered through a utility’s rates. The Company proposed two new methods for recovery of rate case expenses, a one-time surcharge or a two year rider on customer bills. The Company cited the above statutory reference in support for the two alternative recovery methods it proposed, and pointed out that the Public Advocate and the Commission recover their rate case expenses through surcharges.

The Commission has only allowed jurisdictional utilities to use surcharges to recover costs when specifically allowed under statute.[133] Every cost incurred by a utility could potentially be directly surcharged to customers, but the appropriate mechanism contemplated by SNGRA for Black Hills to recover its costs, including rate case expenses, is to recover them through its rates. Further, including costs in rates encourages the Company to find efficiencies and economies when operating its business, policy goals the Commission promotes. We therefore, reject the two alternative methods proposed by the Company to recover the rate case expenses.

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[129] Ex. 101 at 50:4-13.
[130] *Id.*
[131] *See Neb. Rev. Stat*. § 66-1801 et seq.
[132] § 66-1841(6)(b).
[133] *See* § 66-1854; § 66-1865.

The Company proposed a two year amortization period of its estimated rate case expenses. The Company and its predecessor in interest, Aquila, have averaged three years between general rate cases, with cases filed in 2003, 2006, and now the current rate case filed in 2009. The Company now proposes a two year amortization period.

It is true if the Company initiates a general rate case in less than three years from this current proceeding, it will not recover the entire amount of the cost it estimates for this rate case proceeding; however, if Black Hills follows its own past pattern of three years between rate cases, a two year amortization period would allow the company to over-recover from ratepayers. Consistent with the history of rate filings for this company's predecessor, a three year amortization period for rate case expenses is appropriate in this case.

Black Hills also proposes to recover expenses from the 2006 Aquila rate case that it alleged were not recovered. The Commission understands that a utility must forecast its expenses for a rate case and will not know the actual costs of a rate case until much later. However, the Commission wants to promote accurate and reasonable estimating in rate case expenses. The circumstances that the Company cited as justification for recovery of additional expenses related to the 2006 rate case do not warrant reopening the issue of 2006 rate case costs in the present proceeding. Therefore, we reject Black Hills' proposal to recover expenses for the 2006 rate case over and above the $500,000 estimated and included in that case.

Black Hills further states that it has recovered only $254,630 of the $500,000 rate case expense included by the Commission in the 2006 rate case. The Company's witness, Mr. Dee, provided testimony and exhibits regarding the calculations of the company regarding prior rate case expenses and recovery.[134] In Exhibit No. GWD-1 attached to his direct testimony, Mr. Dee provided the calculations for the amount that it proposes to include for both the expenses of the 2006 rate case and the current rate case.[135] However, the exhibit contains inconsistencies.[136] The company stated it has only recovered approximately half of the estimated $500,000 cost of the 2006 case; however, in arriving at that figure the Company only included the months from April 2008 to July 2009.[137] Ratepayers have paid for the 2006 rate case expenses from February 2007,

[134] Ex. 21.
[135] *Id.* at Ex. GWD-1.
[136] In line five, the explanation for the calculation erroneously states it is line 3 of the exhibit divided by 36. It should read line 4 divided by 36.
[137] Ex. 21 at Ex. GWD-1 at ln. 5.

when the interim rates in NG-0041 went into effect, to February of 2010, when the interim rates in the current proceeding were implemented, or approximately 3 years. The $500,000 cost of the 2006 rate case was amortized over three years and included in rates. Therefore, virtually all of the $500,000 rate case expense has been recovered from ratepayers. For these reasons, no amount of the cost of the 2006 rate case may be included in the rates of this current rate case.

Black Hills is estimating the cost of the current proceeding at $750,000, and the Public Advocate did not challenge this item. The Commission hereby adopts the $750,000 estimate and finds the company shall amortize that cost over three years.

Property Taxes

Black Hills seeks to include all Ad Valorem taxes paid to the State of Nebraska on its Nebraska utility assets. The amount is a significant increase due to the acquisition of assets by Black Hills from Aquila and the revised Nebraska net taxable value reflecting the purchase price of those assets.[138] The Public Advocate argues the Company's proposed adjustment is a forecasted future expense and speculative. He recommends that the Ad Valorem tax adjustment included in rates be rejected.[139]

While it is true the Ad Valorem taxes owed by Black Hills to the State of Nebraska increased after the purchase from Aquila, the taxes are assessed by the State, and are due and payable on Black Hills' public utility property used and useful in providing service to its customers.

The State of Nebraska determines the value of the utility assets and assesses taxes accordingly. Ad Valorem taxes are prudent cost and should be recoverable by Black Hills in its rates. Therefore, the Commission adopts the property taxes figure proposed by the Company.

Income Taxes

Black Hills seeks recovery of income taxes calculated at the federal corporate income tax rate of 34 percent and the Nebraska state corporate income tax rate of 7.81 percent.[140]

The Public Advocate argues Black Hills as a limited liability company does not pay federal or state income taxes,

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[138] Ex. 17 at 8:3-6.
[139] *See* PA Brief at 115.
[140] Ex. 8 at Exhibit I, Schedule A, and Exhibit III, Schedule D.

and is not entitled to include any cost of income taxes in its rates. Further, the Public Advocate argues if Black Hills is treated as part of a consolidated corporation filing a consolidated tax return with its parent corporation, then an adjustment must be made to recognize the consolidated tax savings achieved by filing a consolidated tax return. The Company did not compute the consolidated tax savings that would flow to Black Hills if the company filed on a consolidated basis. The Public Advocate recommends that the Commission not allow any recovery for federal or state income taxes in light of no adjustment being made by the Company for consolidated tax savings.[141]

Income taxes paid by a utility are a prudent cost and should be included in Black Hills' rates. Based on the final rate of return determined in this proceeding as outlined in this order, the applicable federal income tax rate should be 34 percent[142] and state corporate income tax rate should be 7.81 percent.[143] The adjustment to the revenue requirement shall be made pursuant to the applicable federal and state tax rate.

The Public Advocate recommends the Commission direct Black Hills to provide sufficient information through a compliance filing to permit the Commission to compute the applicable level of consolidated tax savings Black Hills would achieve by filing a consolidated tax return for federal and state income tax purposes.[144] The Commission declines to adopt the Public Advocate's recommendation regarding a compliance filing on consolidated tax savings.

The Commission will estimate the taxable income the Company would report if it filed federal and state income taxes on its own and apply the appropriate tax levy to that amount to determine the fair and reasonable amount of income taxes to be included in the revenue requirement by Black Hills. In the absence of income tax returns filed by the Company, we find this is the most reasonable way of determining the appropriate income tax expense.[145]

[141] *See* PA Brief at 118.
[142] 26 U.S.C. § 11 (West 2010).
[143] § 77-2734.02.
[144] *See* PA Brief at 119.
[145] This is consistent with our findings on the same issue in the recently concluded SourceGas Distribution LLC rate case, *See* NG-0060 Order, *supra* note 16.

Depreciation Expense

The depreciation expense sought by the Company is based on all of the items proposed by Black Hills to be included in its rate base. The Public Advocate argues the Company should adopt an average rate base using actual test year balances.

Depreciation expense should be adjusted to reflect only those items determined to be correctly included in rate base in this proceeding as outlined in this order. The depreciation expenses reflected by the Company for the items included in rate base are reasonable. Therefore, the expenses shall be adjusted to include only those items the Commission approved to be included in rate base in this proceeding.

RATE OF RETURN

"In determining a fair and reasonable return on the rate base of a jurisdictional utility, a rate-of-return percentage shall be employed that is representative of the utility's weighted average cost of capital including, but not limited to, long-term debt, preferred stock, and common equity capital."[146]

"The Commission must allow each utility a reasonable opportunity to earn a reasonable rate of return, which is expressed as a percentage of invested capital, and must fix the rate of return in accordance with *Neb. Rev. Stat*. §§ 66-1825(3) and (5)."[147] In evaluating each case, the Commission "must consider the utility's cost of capital, which is the weighted average of the cost of the various classes of capital used by the utility."[148]

The classes of capital include debt and equity. "The cost of debt capital is the actual cost of debt."[149] "The cost of equity capital must be based upon a fair return on its value."[150]

Capital Structure

Black Hills proposes a capital structure of "52 percent common stock equity and 48 percent debt."[151] Comparing the common equity ratios for his proxy group as of fiscal year-end 2008, Dr. Avera found "common equity ratios … ranged between 42.4 and 66.1 percent and averaged 52.9 percent of long-term

146 § 66-1825(5).
147 § 005.05A.
148 § 005.05A2.
149 § 005.05A2(a).
150 § 005.05A2(b).
151 Ex. 27 at 11:16-17; Ex. 8 at Ex. II, Schedule A.

capital. Meanwhile, Value Line expects an average common equity ratio for the Gas Utility Proxy Group of 56.2 percent for its three-to-five forecast horizon."[152]

Debt consists of two financings including $250 million of financing at an effective rate of 9.18 percent and another $225 million at an effective rate of 6.77 percent.[153]

Dr. Woolridge, on behalf of the Public Advocate, criticizes the utility's capital structure testifying,

> the capital structure has no short-term debt …, the capitalization of the Company and Black Hills Utility Holdings are in transition since the acquisition, and the two financings used in the development of the capitalization and debt cost rate of the company are … unrelated to the assets of Black Hills.[154]

Black Hills provides rebuttal testimony in response to the concerns raised by Dr. Woolridge. First, Mr. Cleberg states that the utility's assets are predominantly long-lived and should be financed through long-term debt and that short-term debt should be used to meet seasonal working capital needs and for plant construction until its completion.[155] Secondly, Mr. Cleberg testifies that the permanent financing and capitalization of Black Hills following the acquisition of Aquila is complete.[156] Finally, he testifies that the $250 million holding company debt issue was a direct financing for the acquisition of Aquila and the $225 million was assigned to Aquila assets to achieve a lower blended debt rate.[157]

Given the evidence presented, Black Hills' proposed capital structure of 52 percent common equity and 48 percent debt is reasonable.

<u>Cost of Debt</u>

Black Hills' application reflects an average cost of debt for Black Hills Energy of 8.04 percent.[158] Mr. Cleberg states

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[152] Direct Testimony of William Avera and Exhibits, Ex. 25 at 59:5-9.
[153] See Ex. 27; Ex. 8 at Ex. II, Schedule A.
[154] Pre-filed Direct Testimony of L. Randall Woolridge and Exhibits, Ex. 100 at 13:7-16.
[155] See Rebuttal Testimony of Anthony Cleberg, Ex. 28 at 14:20-15:2 and 15:3-8.
[156] See *Id.*
[157] See *Id.* at 16:13-23.
[158] *See* Ex. 27 at 17:4.

> Black Hills Corporation has advanced $475 million of existing long-term debt to Black Hills Utility Holdings as short-term debt. As part of this rate application, in accordance with Nebraska law, Black Hills Utility Holdings allocates $130,096,976 of that amount to Black Hills/Nebraska Gas Utility Company, LLC. The 8.04% cost of debt is the average of the actual debt assigned to Black Hills Energy.[159]

The Public Advocate's witness, Dr. Woolridge objects to the proposed cost of debt, testifying that the two financings reflect risk associated with the parent companies and that the interest rates are higher because the bond issues are unsecured.[160] Dr. Woolridge further testifies that the credit ratings for Black Hills Energy were "strictly a function of the riskiness of the Company's parent … and the weakness in BHC's credit rating attributable to BHC's riskier unregulated operations…."[161] Dr. Woolridge recommends an average cost of debt of 6.0 percent.[162]

Mr. Cleberg provides rebuttal testimony in response to Dr. Woolridge. Mr. Cleberg testifies that "the ring-fencing provisions in each state of jurisdiction of the acquired Aquila utilities do not allow for the assets of the individual utility to secure the obligations of other utilities or entities. Thus, a combined secured financing of all of the BHUH legal entities could not be implemented."[163] Mr. Cleberg further states that the rate is a function of the timing and the credit crisis, not BHC's credit rating, which is investment grade.[164]

We find that the appropriate cost of debt is 8.04 percent.

Cost of Equity Capital

Both Black Hills and the Public Advocate develop a set of comparable companies and use the discounted cash flow (DCF) model[165] and the capital asset pricing model (CAPM)[166], to estimate a cost of equity capital for Black Hills.

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[159] *Id.* at 17:7-12.
[160] *See* Ex. 100 14:6-8.
[161] Ex. 100 at 14:10-14.
[162] *Id.* at 16:15-16.
[163] Ex. 28 at 17:14-19.
[164] *See Id.* at 17:1-5.
[165] Described in Ex. 25 at 27-28 and Pre-filed Direct Testimony of L. Randall Woolridge and Exhibits, Ex. 100 at 24:18-27:16.
[166] Described in Ex. 22 at 42:1-43:11 and Ex. 100 at 39:2-40:19.

Black Hills develops three groups of comparable companies: 1) a gas utility proxy group that included "twelve publicly traded firms included by Value Line in their Natural Gas Utility industry group;"[167] 2) a combined utility proxy group that include both gas and electric utilities meeting certain criteria outlined in the testimony of Dr. William Avera;[168] and 3) a non-utility proxy group meeting certain criteria outlined in Dr. Avera's testimony.[169]

The Public Advocate develops "a proxy group of publicly-held gas distribution companies" meeting criteria outlined in the testimony of Dr. J. Randall Woolridge, totaling nine companies.[170]

The nine companies in the Public Advocate's comparable group are a subset of the 12 companies in Black Hills' gas utility proxy group. The Public Advocate excludes three companies because they "receive a low percentage of revenues from regulated gas operations and/or they are listed as combined electric and gas companies...."

The Commission finds that Black Hills' gas utility proxy group is reasonably comparable to Black Hills and that DCF and CAPM results for this group should be accorded more weight than results for other groups.

For the gas utility proxy group, Black Hills produces DCF estimates of the return on equity in the range of 8.9 to 10.2, using four factors and relying upon four different sets of analysts' earning growth rate projections.[171] Using the "sustainable growth rate estimate", Black Hills' estimates a return of 10.6;[172] using a "price appreciation growth rate" and stock price generated an expected return on equity for the gas utility proxy group of 11.5 percent.[173]

The Public Advocate's approach produces a DCF-based cost of equity estimate equal to 9.1 percent.[174] Dr. Woolridge used averages of historical and projected growth rate indicators, ultimately "giving more weight to the projected growth rate

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[167] Ex. 25 at 22:19-20.
[168] *Id.* at 22: 3-7.
[169] *Id.* at 24:8-14.
[170] Ex. 100 at 11:20-21.
[171] Ex. 25 at 29:6-33:11, Ex. WEA-2.
[172] *Id.* 35:3-36:16 and Ex. WEA-2.
[173] *Id.* at Ex. WEA-2
[174] Ex. 100 at JRW-10

indicators and to prospective internal growth" in his calculations.[175]

Black Hills' CAPM analysis for the utility proxy group results in an implied cost of equity capital equal to 9.5 percent.[176] The Public Advocate generates CAPM results of 7.6 percent[177], which was extensively criticized by Black Hills' witness.[178] Excluding the Public Advocate's "building blocks" approach and using his average premium of 4.5 percent yields a result of 7.7 percent. When comparing DCF to CAPM results, the Public Advocate's witness gives the CAPM results "less weight because I believe that risk premium studies, of which the CAPM is one form, provide a less reliable indication of equity costs rates for public utilities."[179]

The results of the analyses of Black Hills and the Public Advocate suggest a reasonable range for the cost of equity estimate between 7.7 and 11.5 percent. In examining all analyses by the parties and critiques of each approach, the Commission finds that a rate of return on equity of 10.1 percent should be allowed. A return of 10.1 percent should allow Black Hills Energy to fairly compensate its investors, offer a return adequate to attract new capital and maintain its financial integrity.

BASE RATE REVENUE REQUIREMENT

Based upon the above, the Commission finds that Black Hills is entitled to a base rate jurisdictional revenue requirement of $193,031,728. Rates are designed to recover this amount, annually.

Black Hills has presented sufficient evidence to establish that the average cost of debt is 8.04 percent and that such a rate is reasonable.

ALLOCATED COST OF SERVICE

Determining the cost of serving each customer class is key in setting revenue levels by customer class. To the extent that the Commission approves any cost of service study, such study is used to allocate cost between unregulated or large volume customers and the regulated (residential and commercial) customers and to avoid subsidization between classes. However, the

[175] *Id.* at 28:15 to 38:7-9
[176] Ex. 25 at 43:12-44:2, Ex. WEA-8.
[177] Ex. 100 at JRW-11
[178] Ex. 26 at 33:16-37:10.
[179] Ex. 100 at 24: 14-16.

study is not the sole factor in determining final rates and rate design. Adjustments in rate design between classes of ratepayers may still be necessary.

Cost of service studies can be developed using a variety of methodologies. Some level of subjectivity is inherent in the process. Since the cost of service is the primary consideration in determining customer class revenue levels and rate levels, it is important that the study be as accurate as possible.

Thomas Sullivan presented the Company's proposed cost of service study.[180] Mr. Sullivan testified that two changes were made to the cost of service study presented in Aquila's prior case.[181] First, the previous three jurisdictional classes have been consolidated into one.[182] Mr. Sullivan further testifies that Exhibit TJS-5 "presents the functional classification of Total Nebraska rate base and cost of service (revenue requirement). Exhibit TJS-6 shows the allocation of the total Nebraska rate base and cost of service to jurisdictional customer classes."[183] He testified that the current study is "less complex and more straightforward than the class cost of service study … sponsored in Docket No. NG-0041."[184] He further asserts that the approach used in the present rate case is the same as used in NG-0041.[185]

On behalf of the Public Advocate, Mr. Marcus prepared a cost of service study utilizing a zero intercept method.[186] He states that the primary objection relates to the allocation of mains by Black Hills.[187] However, other issues raised by the Public Advocate relate to the allocation of compressor stations, allocation of uncollectibles, allocation of administrative and general expenses, allocation of other revenue and the distribution of the revenue increase.

Mr. Sullivan and Mr. Loos provide rebuttal testimony in response to Mr. Marcus' testimony.[188]

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[180] Direct Testimony of Thomas J. Sullivan and Exhibits, Ex. 19 at 18-24.
[181] *Id.* at 18:7-9.
[182] *Id.* at 18:12-16.
[183] *Id.* at 19:1-3.
[184] *Id.* at 19:5-6.
[185] *Id.* at 6:10-14.
[186] Pre-filed Direct Testimony of William B. Marcus, Ex. 102 at 18:2-4, 24-26, and Ex. WBM-5.
[187] *Id.* at 18:4-5.
[188] Rebuttal Testimony of Thomas J. Sullivan and Exhibits, Ex. 20 at 5-22; Rebuttal Testimony of Larry Loos and Exhibits, Ex. 32 at 13-24.

Allocation of Mains

Mr. Sullivan testified that costs related to mains were classified as 32.93 percent Distribution-Demand; 5.99 percent Distribution – Commodity; and 61.08 percent Distribution – Customer.[189]

The Public Advocate states that the issue of allocation of mains "affects the jurisdictional revenue requirement by $2,184,000."[190] He further argues that the method employed by Black Hills for the allocation of mains "substantially overstates the revenue assigned to jurisdictional customers and substantially understates the level of cost of mains assigned to non-jurisdictional customers.[191]

In response to Mr. Marcus, Mr. Sullivan refers to the prior case in which the Public Advocate's witnesses utilized the same classification of mains-related costs.[192]

Mr. Sullivan also addresses the Commission's previous statement that the direct assignment of costs to customers or customer classes is preferable if adequate accounting information is available to support direct assignments by stating,

> To the extent possible, I maintained the direct assignment of plant where it was supported by the accounting information. However, much of the plant (and mains, specifically) that I directly assigned in Docket No. NG-0041 was directly assigned to rate areas rather than specific customers or groups of customers.[193]

Based upon the evidence presented, the utility has attempted to remain consistent with a previously approved method for the allocation of mains. As stated earlier, circumstances and evidence may dictate that a previously approved method is no longer appropriate. However, under the facts of this case and in consideration of the Commission's prior decision in NG-0041, the Commission finds that the allocation of mains proposed by the utility should be adopted.

[189] Ex. 20 at 6:3-9.
[190] PA Brief at 54.
[191] *Id.* at 58.
[192] Ex. 20 at 6:15-22.
[193] *Id.* at 9:2-5.

Allocation of Compressor Station

Black Hills initially allocated its compressor stations on the same basis that it allocated mains. The Public Advocate recommends allocating 50 percent of the compressor station using a commodity based allocation factor and 50 percent using a demand based allocation factor.[194] On rebuttal, the utility agreed with the Public Advocate’s recommendation.[195]

The Commission finds that the Public Advocate’s recommendation should be adopted and an adjustment to gross plant in the amount of $1,668.00 be made.

Allocation of Uncollectibles

The utility relies on its “customer accounts” allocator to assign the uncollectible expenses to the various jurisdictions and customer classes.[196]

The Public Advocate asserts that those costs should be allocated based upon the average annual uncollectibles attributable to each customer class over a five-year period due to the variance in the uncollectible expense from year to year.[197]

In response, Mr. Sullivan testified that Mr. Marcus’ recommendation would include a significant write-off related to a non-jurisdictional ratepayer in the amount of $195,929.83.[198] Mr. Sullivan further states that the write-off occurred after the test year and is therefore not included in the test year operation and maintenance expenses.[199] Finally, Mr. Sullivan states that the:

> write-off is an outlier that occurred due to a special situation that is not likely to ever occur again. … The ethanol plant went bankrupt and the write-off represents the present value of the future revenue stream that the Company would have received based on the contract.[200]

The Commission finds that the allocation proposed by Black Hills should be approved.

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[194] Ex. 102 at 31.
[195] Ex. 20 at 15:20-16:2.
[196] Ex. 102 at 31:24-26.
[197] *Id.* at 32:3-12.
[198] Ex. 20 at 16:8-11.
[199] *Id.* at 16:13-17.
[200] *Id.* at 16:18-23.

Allocation of Administrative and General Expenses

Black Hills relied upon the allocation factor for all operation and maintenance expenses in allocating the administrative and general expenses. Mr. Sullivan testified that a portion of the non administrative and general expenses or other operation and maintenance expenses were assigned to the commodity function and therefore some of the administrative and general expenses were assigned to the transportation service and throughput customers.[201]

The Public Advocate asserts that $83,000 in administrative and general expenses is not related to gas delivery or distribution and should be removed.

In response, Mr. Sullivan testified that the $83,000 was already included in the $1 million in administrative and general costs allocated to the non-jurisdictional class, stating that the “adjustment ($83,000) is essentially ‘double dipping’ on costs already reflected in my class cost of service study”.[202]

The Commission finds that the allocation proposed by the utility should be approved.

Allocation of Other Revenue

Black Hills credits other operating revenues which include forfeited discounts, miscellaneous service revenues, and Rents from Gas Property to the cost of service.[203]

The Public Advocate raises objections to Black Hills’ allocation of other revenue. Specifically, Mr. Marcus raised concerns regarding the treatment of late payment revenues asserting that too much was allocated to residential customers and with other tariffed revenues in which Mr. Marcus stated that too little was allocated to residential customers.[204] Mr. Marcus recommended “directly assigning tariffed revenues to the classes who pay them (94 percent residential, 6 percent non-residential regulated).”[205] This change would result in a reduction to the jurisdictional revenue requirement in the amount of $85,000.[206] With respect to late payment revenue, Mr. Marcus testified that although the company correctly directly assigned those revenues to the jurisdictional class it incorrectly allocated all of them

[201] *Id.* at 17-18.
[202] *Id.* at 18:1-2.
[203] Ex. 19 at 23:14-18.
[204] Ex. 102 at 33:1-4.
[205] *Id.* at 33:17-18.
[206] *Id.* at 33:19-20.

to the residential class in spite of the fact that residential ratepayers paid 82.47 percent of late payment charges during the test year.[207] Therefore, the Public Advocate recommends that the allocation be adjusted to reflect the 82.47 percent actually paid by residential ratepayers.[208]

On rebuttal, the utility concedes that an adjustment is necessary but asserted that the appropriate adjustment is to directly assign $30,857 of Account 487 (forfeited discounts) to non-jurisdictional ratepayers and to adopt Mr. Marcus' recommendation to assign 100 percent of Account 488 (miscellaneous service revenues) to jurisdictional ratepayers.[209]

The Commission finds that the adjustments proposed on rebuttal by the utility should be adopted. It should be noted that the testimony reflects a small addition error as two adjustments made to Account 487 total $30,859 and the corrected number should be used.[210]

<u>Distribution of Revenue Increase</u>

Black Hills has proposed that all jurisdictional customer classes' revenue levels should be increased to equal their allocated cost of service.[211] This results in the highest revenue increase in the amount of 26.26 percent being imposed on residential ratepayers.

The Public Advocate recommended an overall rate revenue decrease.[212]

The Commission finds that a higher distribution of the revenue increase should be made to residential ratepayers to avoid the subsidization of residential costs by commercial ratepayers. However, the actual distribution between the classes is addressed below with respect to rate design.

RATE DESIGN

Black Hills designs its rates based upon an increase in revenues of approximately $12.1 million and moving toward "recognizing the fixed nature of the Company's non-gas costs."[213]

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[207] *Id.* at 33:25-27.
[208] *Id.* at 34:1-3.
[209] Ex. 20 at 18:23-19:3.
[210] *See Id.* at 18:18-20 showing a $27,995 adjustment and a $2,864 adjustment for a total adjustment of $30,859.
[211] Ex. 19 at 30-31.
[212] Ex. 102 at 44-45.
[213] Ex. 19 at 25:4-5, 9-10.

The utility proposed a declining block rate design with respect to its volumetric charges.[214]

Specifically, Black Hills increases fixed monthly customer charges to $15.00 for residential ratepayers and $20.00 for commercial ratepayers.[215] The proposed rates also include a monthly volumetric rate of $.28200 for the first 20 therms used by residential rate payers and for the first 40 therms used by commercial rate payers. Both classes of ratepayers would be subject to a rate of $.16290 for remaining volumes.

In support of the proposed fixed charges, Mr. Sullivan testifies that the rates "represent a balance between … [t]he primarily fixed nature of cost of service … existing relationships between the Residential, Commercial, and Energy Options – Firm customer charges … [and] Customer related cost of service."[216] He further testifies that the increase "will eliminate the current subsidization of the residential customers by the commercial customers."[217] In order to eliminate this purported subsidization, Mr. Sullivan testifies that the rates proposed result in "an 8.5 percent increase to Residential customers, 1.1 percent increase to the Commercial customers, and a 0.4 percent increase to the Energy Option-Firm."[218]

With respect to the declining block rate for the volumetric charges, Mr. Sullivan testifies,

> First, a declining block rate structure can be established that recognizes the fixed nature of some of the Company's costs that are not recovered fully by the customer charge. Second, a declining block rate structure can also be effectively used to establish rate levels in the second block that are more competitive with electric rates that target heat-sensitive usage.[219]

Mr. Marcus testifies on behalf of the Public Advocate in opposition to Black Hills' proposed rate design.[220] Mr. Marcus states that the proposed increase in fixed charges, including the first tier of the declining block rate, "reduces shareholder risk significantly"[221] and affects the customers' ability to

[214] *Id.* at 25:11-12.
[215] *Id.* at 26:1-5.
[216] *Id.* at 26:7-11.
[217] Ex. 19 at 27:7-8.
[218] *Id.* at 30:14-16, Ex. TJS-7.
[219] *Id.* at 27:18-22.
[220] *See* Ex. 102 at 35-44.
[221] *See Id.* at 36:1-3, 6.

control their bills and conserve energy.[222] Furthermore, Mr. Marcus asserts that “on the average, lower income people as a whole use less gas than higher income people.”[223] In support of his assertion, he provides various statistics.[224] Finally, Mr. Marcus discounts Mr. Sullivan’s testimony that the proposed rate structure would address the disparity in rates between electricity and natural gas.[225] Mr. Marcus also proposes two alternate rate designs eliminating the declining block rate.[226]

Black Hills provides the rebuttal testimony of Mr. Sullivan in response to the objections raised by the Public Advocate.[227]

In determining fair and reasonable rates, the Commission must strike the appropriate balance between ensuring that the utility has a reasonable opportunity to earn a fair rate of return and protecting ratepayers from unreasonable impacts of dramatic increases in fixed rates. Sending proper price signals to ratepayers is significant in encouraging conservation. However, proper price signals to utilities are equally important in encouraging efficiency in the provision of natural gas service.

The Commission recognizes that declining block rates are used by other jurisdictional utilities. However, in light of the decreased volumetric rate in the second tier, this rate design does not send proper price signals to encourage conservation. Also, declining block rates are confusing for ratepayers.

The Commission finds that a traditional rate design including a fixed charge and single tiered volumetric charge should be implemented and will result in more accurate price signaling to ratepayers and utilities.

The Commission acknowledges the primarily fixed nature of many of the utility’s costs. However, we must balance the utility’s need for a reasonable opportunity to earn a fair rate of return and the ratepayers’ interest in avoiding any unreasonable impacts of dramatic increases in fixed rates. Furthermore, the utility’s decision to establish consistent volumetric charges for all classes was a valid approach in the prior rate case. However, with the Commission’s decision not to adopt a declining block rate design and the need to ensure gradualism in the increase of the customer charges, the

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[222] *See Id.* at 36:23-37:4.
[223] *Id.* at 37:7-8.
[224] *Id.* at 37-39.
[225] *See Id.* at 42:1-43:6.
[226] *See Id.* at 44:3-4.
[227] *See* Ex. 20 at 23-30.

Commission finds it necessary to establish different volumetric charges for residential ratepayers in order to avoid the subsidization by the commercial and Energy Option-Firm classes. The rate design below results in residential ratepayers bearing a higher portion of the rate increase. Therefore, the Commission finds that rates shall be established as follows:

	Residential	Commercial	Energy Option - Firm
Customer Charge	$13.50	$18.50	$18.50
Volumetric Charge	$0.19747 per therm	$0.17345 per therm	$0.17345 per therm

COMPLIANCE

The Commission finds that final rates set forth in this order shall be **effective September 1, 2010,** and refunds shall be calculated as required by *Neb. Rev. Stat*. § 66-1838(10)(b). The Commission recognizes the complexity involved in computation of rates and the creation of schedules attached hereto. Should any party determine that a particular figure is not properly re-flected, requests for a correction should be made in the context of a Motion for Clarification with specific references to where the correct number is included in the record.

Schedules

The following schedules are attached hereto and incur-porated herein by this reference.

Schedule A: Summary of Commission Adjustments
Schedule B: Revenue Requirement
Schedule C: Rate Base
Schedule D: Cash Working Capital
Schedule E: Cost of Capital

Interim Rate Refund Plan

As permitted by law, Black Hills implemented interim rates pending the consideration of its rate application.[228] Black Hills implemented the full amount of its proposed rate. As a result of the Commission's decision herein, ratepayers are entitled to a refund of any amounts paid over and above the rates approved herein.

Black Hills must file a Refund Plan within thirty (30) days from the date of this order. That Refund Plan shall include a proposal for refunding the difference between the interim rate

[228] § 66-1838(10)(b).

revenue collected and its final rates and documentation supporting the calculations made. The Commission reserves the ability to receive evidence regarding such Refund Plan and to enter a subsequent order regarding such Refund Plan as hereafter provided in this order.

Proration of Rate Changes

The Company shall prorate the application of the final rates to reflect the estimated customer gas usage that occurred before and after the effective date of the new rates. The Compliance Filing shall include detailed description of the proration method utilized by the Company to implement the final rates as contained in this order.

Tariff Sheets

Finally, no later than thirty (30) days after the effective date of rates, Black Hills shall file any necessary all tariffs, schedules, and classifications, and all terms or conditions of service with the Commission as required by *Neb. Rev. Stat*. § 66-1838(16).

O R D E R

IT IS THEREFORE ORDERED by the Nebraska Public Service Commission that the Application for Approval of a General Rate Increase is granted in part as set forth herein.

IT IS FURTHER ORDERED that rates set forth herein shall become effective on September 2, 2010.

MADE AND ENTERED at Lincoln, Nebraska this 17th day of August, 2010.

NEBRASKA PUBLIC SERVICE COMMISSION

COMMISSIONERS CONCURRING:

Chairman

ATTEST:

Executive Director

MADE AND ENTERED at Lincoln, Nebraska this 17th day of August, 2010.

NEBRASKA PUBLIC SERVICE COMMISSION

COMMISSIONERS CONCURRING:

Rod Johnson

Anne C. Boyle

Tim Schram

//s// Frank E. Landis
//s// Gerald L. Vap

Chairman Gerald L. Vap

ATTEST:

Executive Director