

BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

**IN THE MATTER OF BLACK HILLS/)
NEBRASKA GAS UTILITY COMPANY, LLC)
D/B/A BLACK HILLS ENERGY, OMAHA,) DOCKET NO. NG ____
SEEKING A GENERAL RATE INCREASE FOR)
BLACK HILLS ENERGY'S RATE AREAS ONE,)
TWO AND THREE (CONSOLIDATED))**

Direct Testimony and Exhibits of Anthony S. Cleberg

Executive Vice President and Chief Financial Officer

Capital Structure, Accounting, Cost Allocation, Debt and Equity Cost

December 1, 2009

Anthony S. Cleberg
Exec.V.P. and C.F.O.
625 Ninth Street
Rapid City, SD 57701

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EXHIBITS

Exhibit No. ___ ASC - 1:	Service Agreement – (Black Hills Energy & Service Company)
Exhibit No. ___ ASC - 2:	Service Agreement – (Black Hills Energy & Black Hills Utility Holdings)
Exhibit No. ___ ASC - 3:	Cost Allocation Manual (CAM) –Service Company
Exhibit No. ___ ASC - 4:	Cost Allocation Manual (CAM) – Black Hills Utility Holdings
Exhibit No. ___ ASC - 5:	Black Hills Corporation Credit Ratings
Exhibit No. ___ ASC - 6:	Weighted Average Cost of Capital Calculation

1 **I. INTRODUCTION AND QUALIFICATIONS**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Anthony S. Cleberg. My business address is 625 9th Street, Rapid
4 City, South Dakota 57701.

5 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

6 A. I am currently employed by Black Hills Corporation as Executive Vice President
7 and Chief Financial Officer. I am also the Principal Accounting Officer for all of
8 Black Hills Corporation's subsidiaries, including Black Hills/Nebraska Gas
9 Utility Company, LLC d/b/a Black Hills Energy ("Black Hills Energy").

10 **Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS DOCKET?**

11 A. I am appearing on behalf of Black Hills/Nebraska Gas Utility Company, LLC, a
12 wholly owned subsidiary of Black Hills Utility Holdings, Inc. ("Black Hills Utility
13 Holdings"). Black Hills Utility Holdings is a wholly owned subsidiary of Black Hills
14 Corporation.

15 **Q. PLEASE OUTLINE YOUR EDUCATIONAL BACKGROUND.**

16 A. I have a Bachelor of Science degree in Accounting from the University of South
17 Dakota. I completed the Advanced Management Program at Harvard University.
18 I am a Certified Public Accountant and a Certified Management Accountant. I
19 am currently a member of the Board of Trustees for the University of South
20 Dakota.

21 **Q. PLEASE DESCRIBE YOUR WORK EXPERIENCE.**

22 A. I was appointed to my current position as Executive Vice President and Chief
23 Financial Officer effective July 16, 2008. Prior to joining Black Hills

1 Corporation, I served in a number of managerial accounting positions. From
2 2002 to my appointment as Executive Vice President and CFO for Black Hills
3 Corporation, I was an independent consultant and investor advising multiple
4 clients on accounting, tax, investment, and other finance matters.

5 In addition to that experience, I served as Executive Vice President and Chief
6 Financial Officer of Champion Enterprises Inc. from October 2000 to October
7 2002. Prior to that employment, I served as an Executive Vice President and
8 Chief Financial Officer of Washington Group International Inc. (formerly known
9 as Morrison Knudsen Corporation) from May 1997 to October 2000. Both of
10 those companies were publicly traded companies.

11 From July 1982 to April 1997, I held various financial positions for Honeywell,
12 Inc., including: Corporate Vice President of Business Development, Corporate
13 Vice President of Taxes and Vice President of Finance, Space and Aviation
14 Control. Prior to Honeywell, I worked eight years in public accounting at Deloitte
15 & Touche.

16 I have also been a Member of the Board of Directors of Venturian Corporation
17 from June 1996 to February 2001, and CNA Surety Corp. since April 23, 2007 to
18 present.

19 **Q. PLEASE DESCRIBE YOUR DUTIES AND RESPONSIBILITIES IN**
20 **YOUR CURRENT POSITION.**

21 A. I am responsible for the Accounting, Finance, Tax and Supply Chain functions at
22 Black Hills Corporation and all of its subsidiaries. I oversee the managers and
23 other employees responsible to prepare all accounting, tax, finance, and

1 investment documents, to lead the supply chain and facility initiatives, and to
2 advise our senior leadership and the Board of Directors on decisions made for
3 Black Hills Corporation and all of its subsidiaries.

4 **II. PURPOSE OF TESTIMONY**

5 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

6 A. The purpose of my testimony is to support the following areas of the rate
7 application:

- 8 • Certify Books and Records of Black Hills Energy
- 9 • Certify Use of Federal Energy Regulatory Commission (“FERC”) Uniform
10 System of Accounts for Black Hills Energy
- 11 • Explain the structure of Black Hills Service Company (Service Company) and
12 Black Hills Utility Holdings, Inc.
- 13 • Describe Cost Allocation Procedures
- 14 • Discuss Corporate Finance Philosophy adopted for Black Hills Energy
- 15 • Support Proposed Capital Structure of Black Hills Energy
- 16 • Support Debt and Cost of Equity allocated to Black Hills Energy
- 17 • Discuss Debt Financing Activity
- 18 • Support Weighted Average Cost of Capital

19 I note that some of the areas described above are supported within the direct
20 testimony of other witnesses for Black Hills Energy, and my testimony below will
21 defer to the testimony of those witnesses as appropriate.

22 **Q. ARE YOU SPONSORING ANY EXHIBITS?**

1 A. Yes, I am. I am sponsoring Exhibit Nos. ASC-1 through ASC-6 which I will
2 describe and refer to in my testimony. The Exhibits attached to this testimony are
3 as follows:

- 4 • ASC-1: Service Agreement – (Black Hills Energy & Service Company)
- 5 • ASC-2: Service Agreement – (Black Hills Energy & Utility Holdings)
- 6 • ASC-3: Cost Allocation Manual (CAM) –Service Company
- 7 • ASC-4: Cost Allocation Manual (CAM) – Black Hills Utility Holdings
- 8 • ASC-5: Black Hills Corporation Credit Ratings
- 9 • ASC-6: Weighted Average Cost of Capital Calculation

10 **Q. HAVE THE TESTIMONY AND EXHIBITS WHICH YOU ARE**
11 **SPONSORING BEEN PREPARED BY YOU OR UNDER YOUR**
12 **SUPERVISION?**

13 A. Yes.

14 **III. ACCOUNTING RECORDS**

15 **Q. WOULD YOU BRIEFLY DESCRIBE YOUR DUTIES AND**
16 **RESPONSIBILITIES IN YOUR CURRENT POSITION?**

17 A. I am responsible for the consistent application of generally accepted accounting
18 principles (“GAAP”) and regulatory accounting principles and related financial
19 reporting of Black Hills Corporation and its subsidiaries, including Black Hills
20 Energy.

21 **Q. ARE YOU FAMILIAR WITH THE BOOKS AND RECORDS OF BLACK**
22 **HILLS ENERGY AND THE MANNER IN WHICH THEY ARE KEPT?**

1 A. Yes. The financial statements and records have been prepared on the accrual
2 basis in conformity with GAAP and in accordance with accounting requirements
3 of the Federal Energy Regulatory Commission as set forth in its applicable
4 Uniform System of Accounts.

5 **IV. FUNCTIONS OF THE SERVICE COMPANIES**

6 **Q. WHY WAS BLACK HILLS SERVICE COMPANY FORMED?**

7 A. In January 2005, Black Hills Corporation became a registered holding company
8 under the Public Utility Holding Company Act 1935 (“PUHCA 1935”). One of
9 the many requirements under PUHCA 1935 was to form a service company and
10 to transfer employees that perform common functions for Black Hills
11 Corporation’s subsidiaries to the Service Company. The Service Company was
12 formed on December 30, 2004 and became fully operational on January 1, 2006.
13 PUHCA 1935 was subsequently repealed, and the Energy Policy Act of 2005
14 created the Public Utility Holding Company Act of 2005 and moved the
15 jurisdiction of service companies to the FERC.

16 **Q. WHAT IS THE PURPOSE OF BLACK HILLS SERVICE COMPANY?**

17 A. The purpose of Service Company is to provide various support services, both
18 administrative and management, to all of Black Hills Corporation’s subsidiaries in
19 an efficient and economical way and to ensure these support costs are allocated
20 among Black Hills Corporation and its subsidiaries in a fair and equitable
21 manner.

22 **Q. WHY WAS BLACK HILLS UTILITY HOLDINGS FORMED?**

1 A. Black Hills Corporation formed Black Hills Utility Holdings to accommodate
2 Black Hills Corporation's utility operations through the Aquila utility asset
3 purchase. Black Hills Utility Holdings is a subsidiary of Black Hills Corporation,
4 and is designed to focus on Black Hills Corporation's regulated utility operations.
5 Black Hills Utility Holdings was formed to hold and clearly separate the newly
6 acquired regulated utility holdings (i.e., former Aquila assets) of Black Hills
7 Corporation from the non-regulated holdings of Black Hills Corporation.
8 Subsidiaries of Black Hills Corporation and its Black Hills Utility Holdings
9 subsidiary are set forth on Exhibit No. ___ DJM-1 included with the testimony of
10 Black Hills Witness, Dan Mechtenberg, Vice President of Black Hills/Nebraska
11 Gas Utility Company d/b/a Black Hills Energy.

12 **Q. DOES BLACK HILLS ENERGY OBTAIN SERVICES FROM BLACK**
13 **HILLS SERVICE COMPANY?**

14 A. Yes. Black Hills Energy obtains services from Service Company through a
15 service agreement providing for support services. This avoids the duplication of
16 these business functions by each of the regulated and non-regulated business units
17 of Black Hills Corporation. By providing support services on a centralized basis,
18 efficiencies are created when compared to stand-alone business functions.

19 **Q. DOES BLACK HILLS ENERGY OBTAIN SERVICES FROM BLACK**
20 **HILLS UTILITY HOLDINGS?**

21 A. Yes. Black Hills Energy obtains services primarily related to customer service,
22 billing and information technology from Black Hills Utility Holdings through a

1 service agreement. Black Hills Energy is a separate subsidiary of Black Hills
2 Utility Holdings.

3 **Q. ARE THESE SERVICES PROVIDED UNDER A WRITTEN**
4 **AGREEMENT?**

5 A. Yes, Black Hills Energy has Service Agreements with Service Company and
6 Black Hills Utility Holdings. Both Service Company and Black Hills Utility
7 Holdings provide their services at cost to Black Hills Energy and other Black
8 Hills Corporation affiliates through direct charges and indirect charges. Expenses
9 for support services are charged to Black Hills Energy on a monthly basis
10 pursuant to the Service Agreements. A copy of the Service Company Service
11 Agreement is attached to my testimony as Exhibit No. ___ ASC-1. A copy of the
12 Black Hills Utility Holdings Service Agreement is attached as Exhibit No. ___
13 ASC-2.

14 **V. DESCRIPTION OF COST ALLOCATION MANUAL**

15 **Q. DOES THE COST ALLOCATION MANUAL DESCRIBE THE**
16 **METHODOLOGIES USED FOR ALLOCATION?**

17 A. Yes. The methodologies are described on pages 14-17 for the Service Company
18 Cost Allocation Manual (CAM) and pages 10-19 for the Black Hills Utility
19 Holdings CAM. The departments and services provided by Service Company
20 and Black Hills Utility Holdings are different. The Service Company provides
21 support services, including administrative and management, to all regulated and
22 non-regulated business units of Black Hills Corporation. Conversely, Black Hills
23 Utility Holdings provides services primarily related to customer service, billing

1 and information technology, and provides those services only to the regulated
2 business holdings of Black Hills Corporation. In addition, Black Hills Energy
3 does not receive services from every department of the Service Company. A copy
4 the Cost Allocation Manual (CAM) for Service Company is attached as Exhibit
5 No. ___ ASC-3. A copy the Cost Allocation Manual for Black Hills Utility
6 Holdings is attached as Exhibit No. ___ ASC-4.

7 **Q. HAS BLACK HILLS SERVICE COMPANY PROVIDED ITS CAM TO**
8 **ANY REGULATORY COMMISSION?**

9 **A.** Yes. The Service Company CAM has been made available to several
10 Commissions in states where Black Hills Corporation operates its regulated utility
11 businesses. The Service Company CAM has not been filed with the Nebraska
12 Public Service Commission, but would be provided upon request of the
13 Commission or its staff. Exhibit No. ___ ASC-3 is an updated version to the one
14 previously used prior to Black Hills Corporation's acquisition of Aquila assets.
15 There are no material changes to the methodologies of the Service Company
16 CAM. The Service Company CAM was updated to reflect the acquisition and
17 divestiture of assets in July 2008.

18 **Q. IS IT NORMAL PRACTICE FOR DIVERSIFIED UTILITIES TO USE**
19 **CAMS FOR COMMON BUSINESS COSTS?**

20 **A.** Yes. The CAM was designed equitably to distribute support costs to subsidiaries.

21 **Q. HAS THE BLACK HILLS UTILITY HOLDINGS CAM PREVIOUSLY**
22 **BEEN PROVIDED?**

1 A. No, it has not previously been provided to the Nebraska Commission. The BHUH
2 CAM is available and will be provided to all Commissions in which Black Hills
3 Energy provides service.

4 **Q. CAN YOU EXPLAIN THE DIFFERENCE BETWEEN DIRECT AND**
5 **INDIRECT CHARGES?**

6 A. Yes. Direct charges are those costs specifically associated with providing support
7 to an identified subsidiary or group of identified subsidiaries. Indirect costs are
8 incurred to support processes and administrative functions that benefit some or all
9 subsidiaries and are charged to the subsidiaries based on methods outlined in the
10 CAM because maintaining a system to charge directly would not be cost
11 effective. The Cost Allocation Manuals provide a more detailed explanation of the
12 treatment of direct and indirect costs.

13 **Q. HOW ARE THESE SERVICES BILLED TO BLACK HILLS**
14 **CORPORATION'S DIFFERENT SUBSIDIARIES?**

15 A. The cost of services that can be directly assigned to a subsidiary are billed directly
16 to that business unit. This is true for all of Black Hills Corporation's subsidiaries.
17 The indirect costs that are attributable to more than one business unit are allocated
18 based on a formula that is designed to result in a fair and reasonable allocation for
19 those costs.

20 **Q. DO THESE ALLOCATIONS OF INDIRECT COSTS RESULT IN A FAIR**
21 **COST BEING BILLED TO BLACK HILLS ENERGY?**

22 A. Yes. The methods used by the Service Company and Black Hills Utility Holdings
23 were established by reviewing relevant cost factors and are consistent with

1 industry practice in allocating common costs. In addition, services that are
2 identified to a specific project or company are directly billed to that project or
3 company. The combination of assigning direct costs for identifiable expenses and
4 allocation of indirect costs fairly and accurately represents Black Hills Energy's
5 share of the costs of Service Company and Black Hills Utility Holdings in the
6 provision of services to Black Hills Energy.

7 **Q. ARE THERE ANY OTHER FACTORS AFFECTING THE COSTS**
8 **CHARGED BY EITHER THE SERVICE COMPANY OR BLACK HILLS**
9 **UTILITY HOLDINGS?**

10 A. Yes. Other factors that have and will continue to impact the costs of providing
11 utility service include significant increases in health care and other benefit costs.
12 These costs continue to increase year to year and as appropriate are directly
13 charged or allocated to the affiliate receiving the benefit of the services using the
14 methodologies discussed above.

15 **VI. FINANCIAL INTEGRITY OF BLACK HILLS ENERGY**

16 **Q. PLEASE EXPLAIN THE CORPORATE FINANCE PHILOSOPHY OF**
17 **BLACK HILLS ENERGY.**

18 A. The corporate philosophy of Black Hills Energy is the same philosophy
19 established by Black Hills Corporation. That corporate philosophy is that Black
20 Hills Energy must maintain financial integrity and its ability to access capital as
21 needed at a reasonable cost. Financial integrity is critical to Black Hills Energy's
22 ability to satisfy its obligation to supply safe and reliable natural gas services.
23 Black Hills Energy defines financial integrity as the financial stability necessary

1 to weather the peaks and valleys of business cycles, volatility in financial markets
2 and interest rates, and unanticipated changes in operational requirements, all of
3 which may strain an organization's ability to finance expenditures and provide
4 quality service. A strong financial position provides the financial flexibility
5 necessary to meet the ongoing demand for utility services. Black Hills Energy is
6 conservative in its financial philosophy and only takes on risk where appropriate
7 and reasonable. Even with a conservative corporate finance philosophy, no
8 corporation is insulated from market forces, credit crunches, and other financing
9 difficulties that cannot be foreseen or avoided. In those situations, Black Hills
10 Corporation follows the guidelines of prudence and reasonableness in evaluating
11 its credit and financing options.

12 **Q. WHAT IS BLACK HILLS ENERGY'S TARGETED CAPITAL**
13 **STRUCTURE?**

14 A. Black Hills Energy's witness, Dr. William Avera, provides a detailed analysis in
15 support of the recommended capital structure in his testimony. However, my
16 testimony supports the rate application's capital structure for Black Hills Energy
17 of 52 percent equity and 48 percent debt.

18 **Q. HOW DO INVESTORS EVALUATE A COMPANY'S FINANCIAL**
19 **INTEGRITY?**

20 A. Dr. Avera will cover this topic in greater detail; however, investors generally rely
21 on nationally recognized credit rating services to evaluate a company's financial
22 integrity and to inform them of the company's current financial position. Three
23 nationally recognized credit rating services are Moody's Investors Service

1 (“Moody’s”), Standard and Poor’s (“S&P”), and Fitch Ratings (“Fitch”). As of
2 June 30, 2009, Black Hills Corporation’s senior unsecured debt is respectively
3 rated Baa3 by Moody’s, BBB- by S&P, and BBB by Fitch. Each credit rating
4 agency rates Black Hills Corporation with a “stable” outlook.

5 **Q. HOW DO RATING AGENCIES PERFORM THIS FUNCTION?**

6 A. The credit rating services issue guidelines that all companies must follow. Those
7 credit rating services generally require a company to provide detailed financial
8 and operational information to rating agencies for their analysis before issuing
9 credit ratings for the company’s securities. As noted below, these credit rating
10 agencies compare quantitative measures of a company’s financial performance, as
11 well as a qualitative assessment of the company’s risks, (such as management,
12 forecasts, and regulatory climate) to their guidelines to rate the company and
13 determine the investment attributes of its debt securities. The credit ratings given
14 by these agencies provide important information to creditors, investors, vendors
15 and counterparties regarding Black Hills Corporation’s creditworthiness.

16 **Q. WHAT CRITERIA DO RATING AGENCIES USE IN EVALUATING A**
17 **UTILITY?**

18 A. The ratings evaluation process includes an analysis of both qualitative and
19 quantitative factors. There are several steps in the ratings evaluation process. For
20 example, one step is to assess the extent of a “regulated” company’s exposure to
21 unregulated businesses. The strongest position is enjoyed by those companies
22 operating in a wholly regulated business. Another step in the methodology is to
23 assess the credit support that is gained from operating within a particular

1 regulatory framework. The rating agencies also consider the exact level of risk
2 posed by the business. These criteria and others established by the credit rating
3 agencies then lead to an overall assessment of the qualitative business risk of the
4 company's activities.

5 As part of the quantitative assessment of a given entity, the rating agencies will
6 review numerous financial ratios of a given entity. Such ratios will be used to
7 review trends over various periods of time within a given entity, as well as to
8 provide comparisons among other companies in a given industry, or among
9 various industry averages.

10 For example, Moody's has identified four areas that are considered most useful in
11 completing analysis for electric utility companies. They are as follows: (1)
12 Regulated Framework, (2) Ability to Recover Costs and Earn Returns, (3)
13 Diversification and (4) Financial Strength and Liquidity. By maintaining good
14 credit ratings, Black Hills Energy achieves better credit terms and lower cost of
15 debt which directly benefits our customers.

16 **Q. WHAT IS THE FINANCIAL SOUNDNESS OF BLACK HILLS ENERGY?**

17 A. The financial integrity of Black Hills Energy is protected by the assignment of
18 capital and debt from Black Hills Corporation to Black Hills Utility Holdings.
19 Then within Black Hills Utility Holdings, capital and debt are allocated to each of
20 the Black Hills Utility Holdings subsidiaries, including Black Hills/Nebraska Gas
21 Utility Company, LLC d/b/a Black Hills Energy. The financial integrity of Black
22 Hills Energy in Nebraska is sound. The goal of Black Hills Corporation, is to
23 maintain and, if possible, improve its credit metrics and credit ratings.

1 If Black Hills Corporation’s credit rating is downgraded, that will impact its
2 ability to obtain short and long-term financing, the cost of such financing, and
3 vendor payment terms, including collateral requirements.

4 As a means of protecting its credit ratings, Black Hills Corporation will maintain
5 separate money pools, retain the Black Hills Utility Holdings legal entity structure
6 for “ring fencing” protection, and assign equity and debt to Black Hills Utility
7 Holdings for further allocation to Black Hills Energy. To that end, Black Hills
8 Energy will continue to target a capitalization level (GAAP basis) of
9 approximately 40—50% debt and expects to continue this level of capitalization
10 in the future. Exhibit No. ___ ASC-5 shows Black Hills Corporation’s key credit
11 ratings. These ratings flow down from Black Hills Corporation to Black Hills
12 Energy.

13 **Q. HOW DOES THIS FINANCE PHILOSOPHY AFFECT THE RETURNS**
14 **THAT EQUITY INVESTORS EXPECT?**

15 A. For any company to attract equity capital, the potential investor must believe that
16 the company will earn a return that exceeds the cost of capital. If Black Hills
17 Energy earns less than its allocated cost of capital, value is destroyed for the
18 shareholders, and consequently, the ability to raise additional capital by Black
19 Hills Corporation for future projects declines. The components of cost of capital
20 include both cost of debt and the cost of equity. The cost of equity is impacted by
21 a number of factors, including the risk premium investors expect above the long-
22 term U.S. Treasury Rates, the market risk of the company, the industry risk
23 premium, the size of market capitalization, and the ratio of debt to total

1 capitalization. The market meltdown in the fourth quarter of 2008 increased both
2 risk and premium investors need to attract capital, which increased the cost of
3 equity for all companies, including Black Hills Corporation on behalf of its
4 business units. As presented in the testimony of Dr. Avera, Black Hills Energy's
5 cost of equity capital is within a range of fair returns for regulated natural gas
6 utilities, and therefore Black Hills Energy is requesting a rate increase providing a
7 return on equity within that range of fair returns. Black Hills Energy seeks a
8 proposed return on equity of 11.50%. If Black Hills Energy earns less than
9 11.50% on its equity capital component, the Black Hills Corporation shareholders
10 will not meet their return expectations, and consequently, access to capital
11 markets will be diminished. The philosophy of Black Hills Corporation, on
12 behalf of Black Hills Energy, is supported by and consistent with the opinion of
13 Dr. Avera.

14 **Q. HOW DO THE CREDIT RATING AGENCIES AFFECT THE**
15 **COMPANY'S ABILITY TO ISSUE DEBT?**

16 A. The ratings of credit agencies affect a company's ability to issue debt in a couple
17 of ways. First, the lower the rating, the greater the risk premium required from
18 those willing to invest in a company. Second, a low rating also limits the number
19 of potential investors interested in a company's debt, which reduces the market
20 for the company's debt. Both of these circumstances tend to increase the overall
21 cost of debt to a company.

22 **Q. WHY IS THIS IMPORTANT TO BLACK HILLS ENERGY?**

1 A. Access to capital is important to refinancing and to provide additional funds for
2 operations, expansion of plant, and the potential acquisition of additional
3 generation for Black Hills Energy. In addition, as noted above, credit ratings
4 impact vendor payments, including collateral requirements.

5 **Q. DOES BLACK HILLS ENERGY INTEND TO ISSUE BONDS?**

6 A. No. Black Hills Energy is advanced short-term its debt from Black Hills
7 Corporation through Black Hills Utility Holdings. Black Hills Corporation does
8 not plan on seeking new bonds to be allocated to Black Hills Energy for Nebraska
9 operations in the near future. As discussed in more detail below, the average cost
10 of debt for Black Hills Energy is 8.04 %. The terms of the debt issuances
11 allocated to Nebraska are included on Exhibit No. __ ASC-6.

12 **VII. CAPITAL STRUCTURE**

13 **Q. WHAT IS THE CAPITAL STRUCTURE PROPOSED FOR BLACK**
14 **HILLS ENERGY?**

15 A. The Company proposes a capital structure of 52 percent common stock equity and
16 48 percent debt.

17 **Q. WHY IS THIS CAPITAL STRUCTURE APPROPRIATE FOR BLACK**
18 **HILLS ENERGY?**

19 A. As Dr. Avera testifies, this capital structure is appropriate because of the financial
20 position and relative size of Black Hills Energy to support utility operations, to
21 serve its customers with the appropriate capacity, for replacement and expansion
22 of assets used to provide energy, to maintain liquidity, and to attract cost effective
23 sources of capital for refinancing plant improvement and growth.

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VIII. COST OF DEBT

Q. WHAT IS THE COST OF DEBT FOR BLACK HILLS ENERGY?

A. As noted above, the average cost of debt for Black Hills Energy is 8.04 percent.

Q. HOW DID YOU DETERMINE THE COST OF DEBT FOR BLACK HILLS ENERGY?

A. 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.

The average cost of long-term debt is determined by taking the weighted average of the amount of the individual debt issue components and their respective interest rates (adjusted for issuance costs). Reference is made to Application Exhibit II, Schedule A.

The debt advanced by Black Hills Corporation to Black Hills Utility Holdings is permanent.

In turn, the debt advanced from Black Hills Utility Holdings to Black Hills Energy is a short-term placement of debt. In other words, the level of the debt advanced to Black Hills Utility Holdings and thereafter to Black Hills Energy will be there for the life of that debt (i.e., 2013 and 2014). The level, type, or term of

1 the debt is not variable. The level of debt allocated to Black Hills Energy is fair
2 and reasonable.

3 **Q. WHAT IS THE WEIGHTED AVERAGE COST OF CAPITAL**
4 **REQUESTED FOR BLACK HILLS ENERGY?**

5 A. The weighted average cost of capital requested for Black Hills Energy
6 incorporates the cost of equity of 11.50 percent, the weighted average embedded
7 cost of debt of 8.04 percent, and a capital structure of 52.00 percent equity and
8 48.00 percent debt financing. This calculation results in a weighted average cost
9 of capital of 9.84 percent. The result is presented in Exhibit No. ___ ASC-6.

10 **Q. DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?**

11 A. Yes.

12

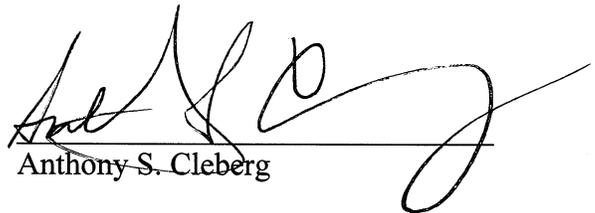
BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

IN THE MATTER OF BLACK HILLS/)
NEBRASKA GAS UTILITY COMPANY, LLC)
D/B/A BLACK HILLS ENERGY, OMAHA,) APPLICATION NO. NG____
SEEKING A GENERAL RATE INCREASE FOR)
BLACK HILLS ENERGY'S RATE AREAS ONE)
TWO AND THREE (CONSOLIDATED))

VERIFICATION

STATE OF SOUTH DAKOTA)
) ss.
COUNTY OF PENNINGTON)

Anthony S. Cleberg, of lawful age, being first duly sworn, deposes and says that he is the Executive Vice President and Chief Financial Officer for Black Hills Corporation, that he has read the foregoing testimony on behalf of Black Hills/Nebraska Gas Utility Company, LLC d/b/a Black Hills Energy, knows the contents thereof, and that the statements and allegations therein contained, including the information provided herewith pursuant to the State Natural Gas Regulation Act, are true to the best of his information, knowledge, and belief.


Anthony S. Cleberg

SUBSCRIBED AND SWORN TO before me this 23rd day of November, 2009.


Notary Public
My Commission Expires 6-27-2012

