# BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

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| **IN THE MATTER OF THE APPLICATION** | **)** | |
| **OF BLACK HILLS NEBRASKA GAS, LLC, D/B/A** | **)** | |
| **BLACK HILLS ENERGY, RAPID CITY, SOUTH** | **)** | **APPLICATION NO. NG-109** |
| **DAKOTA, SEEKING APPROVAL OF A** | **)** | |
| **GENERAL RATE INCREASE** | **)** | |

## DIRECT TESTIMONY OF MICHAEL C. CLEVINGER

**SR. REGULATORY MANAGER**

**ON BEHALF OF BLACK HILLS NEBRASKA GAS, LLC**

Date: June 1, 2020

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# DIRECT TESTIMONY OF MICHAEL C. CLEVINGER

## I. INTRODUCTION

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

A. My name is Michael C. Clevinger. My business address is 7001 Mount Rushmore Rd, Rapid City, South Dakota 57702.

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

A. I am employed by Black Hills Service Company, LLC ("BHSC")., d/b/a Black Hills Energy. My position is Sr. Regulatory Manager. I manage the BHSC Revenue Requirements Team, which prepares Revenue Requirement Studies and annual reports for the regulated utility subsidiaries of Black Hills Corporation ("BHC").

**Q. ON WHOSE BEHALF ARE YOU TESTIFYING?**

A. I am testifying on behalf of Black Hills Nebraska Gas, LLC ("BH Nebraska Gas" or "the Company"). BH Nebraska Gas is the natural gas utility resulting from the recent consolidation of the Nebraska gas utility assets and operations of BHC's two former Nebraska gas utility distribution subsidiaries, Black Hills/Nebraska Gas Utility Company, Inc. ("BH Gas Utility") and Black Hills Gas Distribution, LLC ("BH Gas Distribution").

## II. STATEMENT OF QUALIFICATIONS

**Q. WHAT ARE THE DUTIES AND RESPONSIBILITIES IN YOUR CURRENT POSITION?**

A. I am responsible for managing the Revenue Requirements Team which provides various financial analyses in support of BHC's utility subsidiaries and provides support of revenue requirement calculations in multiple states and jurisdictions.

My education, employment history and professional experience is provided in Exhibit No. MCC–1.

**Q. PLEASE DESCRIBE YOUR RESPONSIBILITIES RELATED TO BH NEBRASKA GAS OPERATIONS.**

A. I am indirectly involved in the oversight of the finance, accounting, regulatory, and reporting centralized functions within BHSC that provide support to BH Nebraska Gas.

**Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?**

A. No.

## III. <u>PURPOSE OF TESTIMONY</u>

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

A. The purpose of my testimony is to provide support for the following areas:

### A. Revenue Requirement Study.

My testimony presents the results of the Revenue Requirement Study prepared for BH Nebraska Gas.[1] The Revenue Requirement Study supports the required increase in base rate revenues that BH Nebraska Gas proposes in its Rate Review Application. The Revenue Requirements Study also establishes the cost basis for the Company's structure and design of its proposed base rates.

### B. Adjustments.

My testimony discusses the reasoning behind the various adjustments made within the Rate Review Application to (1) per-book investments and (2)

[1] See Exhibit No. MCC-2 for the completed Revenue Requirement Study.

expenses and revenues. The testimony explains how those adjustments are reflected within the Revenue Requirement Study.

**C. Lead Lag Study.**

I sponsor the Lead-Lag Study for the 12 months ending December 31, 2019 (Exhibit No. MCC-3).

**D. Cash Working Capital.**

I support the calculation of the Cash Working Capital ("CWC") allowance included in the Revenue Requirement Study.

**E. Depreciation Studies.**

My testimony adopts the depreciation studies provided with this testimony as Exhibit No. MCC-4 (Gas Plant Depreciation Study for BH Nebraska Gas) and Exhibit No. MCC-5 (Common Plant Depreciation Study for BHSC). The depreciation studies were prepared by Gannett Fleming Valuation and Rate Consultants, LLC. The depreciation rates recommended in the depreciation studies have been incorporated into the depreciation calculations in the Revenue Requirement Study.

**F. Affiliate Transactions.**

My testimony confirms that Shared Resources Affiliate (i.e., Black Hills Utility Holdings, Inc. ("BHUH") or BHSC) as well any other Affiliate transactions included in the Revenue Requirement Study complies with

Commission Rule 005.07.[2] Affiliate transactions are detailed in Application Exhibit No. 1, Section 2, Exhibit E.[3]

**G. Cost Allocation Manual.**

My testimony supports the costs allocated by BHSC to BH Nebraska Gas under the Cost Allocation Manual ("CAM"). The current BHSC CAM is provided with this testimony as Application Exhibit No. 1, Section 2, Exhibit F.

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

A. Yes. I am sponsoring several Rate Review Application exhibits required by Rule 004 of the Nebraska Public Service Commission ("Commission") Rules and Regulations.[4] Many of the Application Rate Review Exhibits required by the Commission Rule 004 are contained within the Revenue Requirement Study, which is identified as Exhibit No. MCC-2. With respect to Commission's Rule 004 requirements, I sponsor the following Rate Review Application Exhibits:

**Section 1, Exhibit C** – General Information – Financial Summary.[5]

**Section 1, Exhibit E –** Financial Statements.[6]

**Section 2, Exhibit A –** Rate Base Schedules.[7]

**Section 2, Exhibit A1 –** Utility Plant and Accumulated Depreciation.[8]

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[2] *291 Neb. Admin. Code. Ch. 9. Rule 005.07*.
[3] In accordance with the Commission Rules and Regulations, Resource Affiliate Transactions are not included within this Exhibit. Those transactions flow through the applicable CAM.
[4] *291 Neb. Admin. Code. Ch. 9, Rule 004 (General Rate Filings).*
[5] The Financial Summary satisfies Commission Rule 004.02C. See Exhibit No. MCC-2, Statement M.
[6] The Financial Statements satisfy Commission Rule 004.02E. See Exhibit No. MCC-2, Stmts. A and B.
[7] The Rate Base schedules satisfy Commission Rules 004.03. See Exhibit No. MCC-2, Stmts. D, E, F, and Schedule M-1.
[8] The Utility Plant and Accumulated Depreciation satisfies Commission Rule 004.03A1. See Exhibit MCC-2, Statement E.

**Section 2, Exhibit A2 –** Working Capital.[9]

**Section 2, Exhibit A3 –** Other Rate Base Components.[10]

**Section 2, Exhibit B** – Allocated Rate Base Schedules.[11]

**Section 2, Exhibit A –** Operating Expense Schedules.[12]

**Section 2, Exhibit B –** Legislative Advocacy.[13]

**Section 2, Exhibit C –** Political Candidate Schedules.[14]

**Section 2, Exhibit D** – Political or Religious Causes.[15]

**Section 2, Exhibit E** - Membership List.[16]

**Section 2, Exhibit F** – Affiliate Transactions.[17]

**Section 2, Exhibit G** – Cost Allocation Manual.[18]

I am also sponsoring the following Testimony Exhibit(s):

**Section 2, Exhibits 5A–** Rate of Return and Cost of Capital Schedules.[19]

**Section 2, Exhibit 5B –** Rate of Return and Cost of Capital Schedules.

**Exhibit No. MCC – 1** is a Statement of Qualifications**.**

**Exhibit No. MCC – 2** is the Revenue Requirement Study.[20]

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[9] The Working capital schedules satisfy Commission Rule 004.03A2. See Statement F and Lead Lag Study in Revenue Requirement Study.
[10] The Other Rate Base Components schedules satisfy Commission Rule and 004.03A3. Schedule M-1 of Revenue Requirement Study.
[11] The Allocated Rate Base schedule satisfies Commission Rule 004.03B. See Exhibit No. MCC-1, Stmts. D, E and Schedule M-1.
[12] The Operating Expense schedule satisfies Commission Rules 004.04A. See Exhibit No. MCC-1, Stmt. H.
[13] The Legislative Advocacy schedule satisfies Commission Rule 004.04B.
[14] The Political Candidates schedule satisfies Commission Rule 004.04C.
[15] The Political or Religious Causes schedule satisfies Commission Rule 004.04D.
[16] The Membership list satisfies Commission Rule 004.04E.
[17] The Affiliate Transactions list satisfies Commission Rule 004.04F.
[18] The Cost Allocation Manual satisfies Commission Rule 004.04G.
[19] The Rate of Return and Cost of Capital schedules satisfies Commission Rules 004.05A and 004.05B. See also Statement G and G1 of the Revenue Requirement Study in Exhibit No. MCC-1.

**Exhibit No. MCC – 3** is the Lead/Lag Study.

**Exhibit No. MCC – 4** is the Gas Plant Depreciation Study for BH Nebraska Gas.

**Exhibit No. MCC – 5** is the Common Plant Depreciation Study for BHSC.

**Exhibit No. MCC – 6** is the BHSC CAM as of December 31, 2018.

**Exhibit No. MCC – 7** is the BHSC CAM prior to December 31, 2018.

**Exhibit No. MCC – 8** is the BHUH CAM prior to December 31, 2018.

**Q. HAVE THE TESTIMONY AND EXHIBITS THAT YOU ARE SPONSORING BEEN PREPARED BY YOU OR UNDER YOUR SUPERVISION?**

A. Yes. However, Exhibits No. MCC-4 (Gas Plan Depreciation Study for BH Nebraska Gas) and Exhibit No. MCC-5 (Common Plant Depreciation Study for BHSC) were prepared by Gannett Fleming Valuation and Rate Consultants, LLC, a third-party expert engaged to prepare the studies.

Application Exhibit No. 1, Section 2, Exhibit F and Exhibit No. MCC–6 (2018 BHSC CAM), Exhibit No. MCC-7 (Prior to 2018 BHSC CAM), and Exhibit No. MCC-8 (2018 CAM) are the product of a multifunctional committee of Subject Matter Experts (SMEs) from BHC subsidiaries. I was a member of that multifunctional committee that reviews and updates the CAM.

[20] Exhibit No. MCC-2 contains many of the statements and schedules that are required under Commission Rule 004 – General Rate Filings. Exhibit No MCC-2 is also referred to within testimony in this Rate Review Application as Application Exhibit 1, Section 2

## IV. THE REVENUE REQUIREMENT STUDY

**Q. WHERE DOES BH NEBRASKA GAS PROVIDE THE REVENUE REQUIREMENT STUDY WITHIN THE RATE REVIEW APPLICATION?**

A. The Revenue Requirement Study is designated as either Application Exhibit No. 1, Section 2 or Exhibit No. MCC-2. In compliance with the Commission's Rules and Regulations, various statements or schedules from the Revenue Requirement Study by BH Nebraska Gas are duplicated or otherwise referenced in Application Exhibits to provide the information required by the Commission's General Rate Filing Rules and Regulations.[21]

**Q. WHAT IS THE PURPOSE OF A REVENUE REQUIREMENT STUDY?**

A. A revenue requirement study, also sometimes referred to as a cost of service study, is the financial analysis used to determine the level of revenues required to recover the costs incurred by a jurisdictional utility providing service to its customers. The Revenue Requirement Study revenues must also allow the jurisdictional utility an opportunity to earn a fair and reasonable return on its investments in its property dedicated to the provision of adequate, efficient and reasonable natural gas service. The costs included in a cost of service study include the expenses incurred by the jurisdictional utility to operate and maintain facilities. Such costs include, but are not limited to, depreciation and taxes), administrative costs to oversee the operations, and capital costs

[21] *291 Neb. Admin. Code. Ch. 9, Rule 004.*

necessary to service the utility's debt and to provide investors a fair return. At a basic level, the revenue requirement equation is as follows:

Revenue Requirement = Expenses + Return on Rate Base

Expenses refer to all expenses incurred by the Company in its regulated utility business and include operating expense, maintenance expense, depreciation and amortization, property tax, sales tax, payroll tax, federal income tax, and state income tax. The return on rate base is calculated using the Weighted Average Cost of Capital ("WACC"), the components of which are long-term debt and equity weighted by ratio and cost. The WACC is then multiplied by the calculated rate base to yield the total amount of earnings. As the name implies, the Revenue Requirement Study indicates the overall level of revenues necessary for the Company to earn its authorized return, which is then used in setting the Company's base rates for service.

**Q. HOW WAS THE REVENUE REQUIREMENT STUDY DEVELOPED FOR THIS RATE REVIEW?**

A. The Revenue Requirement Study starts with the Company's per book, or unadjusted, financial statements for the 12 months ending December 31, 2019 ("Base Year"), as reflected in Statements A, B, and C of the Revenue Requirement Study, prepared in accordance with the Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts.

Because the consolidation of BH Gas Utility and BH Gas Distribution under BH Nebraska Gas became effective on January 1, 2020, and that BH Nebraska Gas will operate as one legal entity going forward, the Company combined the books and records of BH Gas Distribution and BH Gas Utility for the purpose of the revenue requirement analysis provided in this rate review application.

Exhibit No. MCC-2 represents the consolidated books and records of BH Nebraska Gas as it will exist going forward. The Revenue Requirement Study adjusts the consolidated Base Year data to include pro forma adjustments to calculate the proposed revenue requirement for the 12 months ending December 31, 2020 ("Test Year") in this proceeding.

Table MCC-1 below shows each statement supplied within the Revenue Requirement Study (Exhibit No. MCC-2):

| **Table MCC-1** | |
|---|---|
| **Revenue Requirement Study Statements** | |
| Statement A | Balance Sheet |
| Statement B | Income Statement |
| Statement C | Statement of Retained Earnings |
| Statement D | Plant in Service |
| Statement E | Accumulated Provision for Depreciation |
| Statement F | Working Capital |
| Statement G | Cost of Capital |
| Statement H | Operating and Maintenance Expenses |
| Statement I | Operating Revenue |
| Statement J | Depreciation Expense |
| Statement K | Computation of Federal Income Tax |
| Statement L | Taxes Other Than Income |

| | |
|---|---|
| Statement M | Overall Revenue Requirement |
| Statement N | Detailed Calculation of the Revenue Deficiency |

**Q. PLEASE EXPLAIN HOW THE STATEMENTS AND SCHEDULES INCLUDED IN THE REVENUE REQUIREMENT STUDY SUPPORT THE PROPOSED REVENUE REQUIREMENT.**

A. Statements A through L within the Revenue Requirement Study support the revenue requirement summary in Statement M. Statement N of the Revenue Requirement Study calculates the revenue deficiency based upon inputs from the previous statements.

The schedules within the Revenue Requirement Study provide detailed information and are used to support the statements throughout the Revenue Requirement Study. For example, Statement H of the Revenue Requirement Study summarizes a list of adjustments to the revenue requirement. Each adjustment is referenced by a corresponding schedule and explained separately in my direct testimony.

Other Revenue Requirement Study schedules, such as Schedule D-1, present detailed information necessary for use in the Class Cost of Service Study.

Revenue Requirement Study Statement N summarizes the detailed schedules to present the detail that Mr. Hyatt uses to calculate the Class Cost of Service Study presented in his direct testimony.[22]

[22] *See* Testimony of Mr. Hyatt Exhibit Nos. DNH-8 and DNH-9.

The Class Cost of Service Study determines the jurisdictional revenue deficiency at issue in this proceeding. The results of the jurisdictional revenue deficiency from the Class Cost of Service Study is summarized on Statement M page 2.

## V. RATE BASE

**Q. PLEASE DESCRIBE THE RATE BASE USED IN THE REVENUE REQUIREMENT STUDY.**

A. Rate base is the value of invested capital, including all items used to provide utility service. Rate base represents the investor financed plant facilities and other investments required in providing utility service to customers. A regulated utility is allowed and should have a reasonable opportunity to earn a fair rate of return on rate base.[23] As summarized on Statement M of the Revenue Requirement Study, rate base includes Plant in Service, Accumulated Depreciation, Working Capital, and Other Rate Base Items which include Accumulated Deferred Income Taxes ("ADIT"), Customer Advances, Regulatory Assets, and Regulatory Liabilities.

### A. Rate Base Components

**Q. PLEASE EXPLAIN GENERALLY HOW RATE BASE IS CALCULATED IN A REVENUE REQUIREMENT STUDY.**

A. Rate base represents the net investment by a utility necessary to operate the business and serve customers. Rate base is made up of two general components.

[23] *Neb. Rev. Stat. § 66-1825.*

**1. Property, Plant and Equipment.**

The primary component of rate base are the costs related to property plant and equipment, which includes the initial investment such as Gross Plant in Service, but also any related offset that the Company has received. Offsets to the rate base cost component include Accumulated Depreciation, ADIT, and Contributions in Aid of Construction.

**2. Working Capital.**

The other component used in calculating rate base is the investment necessary for a company to pay its bills and meet financial obligations necessary to operate the business. This component is referred to as Working Capital.

The total investment is determined by summing the items listed above. Goodwill or acquisition adjustments are generally not included in rate base unless otherwise approved by the Commission. BH Nebraska Gas did not include acquisition premium in the Revenue Requirement.

**Q. WHAT ITEMS ARE INCLUDED IN OTHER RATE BASE ITEMS?**

A. Schedule M-1 within the Revenue Requirement Study shows each item that is included in the Revenue Requirement Study. Schedule M-1 includes Deferred Income Tax Assets, Regulatory Liabilities for Excess Deferred Income Tax ("EDIT"), Deferred Income Tax Liabilities (categorized as Property and Other), State Tax Items, Other Utility Plant Deferred Income Tax (the ADIT associated with Allocated plant from BHSC), Customer Deposits, and Customer Advances.

Mr. Klapperich explains the derivation of the tax related items in his direct testimony.

**Q. WHAT METHOD OF CALCULATING RATE BASE IS THE COMPANY PROPOSING FOR THE REVENUE REQUIREMENT STUDY PRESENTED IN THIS REVIEW?**

A. The Company uses a Base Year ending on December 31, 2019 and then adjusted the year-end rate base as permitted under the Commission's Rules and Regulations through December 31, 2020 as the basis of its rate base calculation.[24] The Base Year is used as the anchor of the data and uses known and measurable adjustments to calculate the rate base included in the Test Year. Allocated plant recorded in FERC Accounts 118 and 119 are included as rate base and are shown on the Revenue Requirement Study on Schedule D-1 lines 61 to 65 by the method of allocation rather than by account.

## B. Adjustments

**Q. PLEASE DESCRIBE THE ADJUSTMENTS MADE TO REFLECT THE CHANGES FROM THE END OF THE BASE YEAR TO THE END OF THE TEST YEAR.**

A. The adjustments are as follows:

1. Roll forward the existing plant to December 31, 2020
2. Include plant additions occurring during calendar year 2020
3. Remove planned plant retirements during calendar year 2020

[24] *291 Neb. Admin. Code, Ch. 9, Rule 005.06.*

4. Adjust allocated plant for changes of input to the factors used in the Cost Allocation Manual

**1. Roll Forward Existing Plant.**

The first adjustment to rate base is to roll forward the Accumulated Depreciation associated with the plant in service as of December 31, 2019 to reflect the balance as of December 31, 2020. This roll forward is shown on Revenue Requirement Study, Exhibit No. MCC-1, Statement E, Schedule E-1. This schedule shows (a) the results of the calculation of the depreciation expense under the existing depreciation rates through August 31, 2020 (or 8 months) and (b) also calculates new depreciation rates consistent with the depreciation studies presented within Exhibit No. MCC-4 (i.e., depreciation for BH Nebraska Gas) for the remainder of 2020 (or 4 months). An associated adjustment on Schedule M-3, Lines 2 and 5 moves the Accumulated Deferred Income Tax ("ADIT") to the projected December 31, 2020 balance.

**2. 2020 Capital Additions.**[25]

The second adjustment to rate base included in the Revenue Requirement Study is to include plant that is planned to go into service during calendar year 2020. The list of Capital Additions projects included as plant additions in calendar year 2020 is presented and discussed by Mr. Jarosz in his direct testimony. As discussed below, the Company will update both the list of Capital Additions and the Revenue Requirement Study in its rebuttal testimony

[25] BH Nebraska Gas refers to the 2020 rate base investment permitted by Commission Rule 005.06D as "Capital Additions."

to reflect the status of the projects at that time. The adjustment to gross plant, accumulated depreciation, calculated ADIT, and depreciation expense is shown on Revenue Requirement Study, Schedule M-2. The accumulated depreciation associated with the Capital Additions is calculated to be the annual depreciation expense calculated using the new depreciation rates, because all Capital Additions will have an in-service date during 2020.

**3. Planned Retirements.**

The third adjustment to rate base is to account for any known plant retirements that will occur in calendar year 2020. The Planned Retirements adjustment is summarized on Revenue Requirement Study, Schedule M-3, Line 11 with the gross plant detailed on Schedule D-3.

**4. CAM Allocation Adjustments.**

The fourth adjustment is summarized on Revenue Requirement Study, Schedule M-3, Line 8 and detailed on Schedule D-1 Column (c) and Statement E Column (c). This rate base adjustment accounts for CAM allocation percentages annual updates. The adjustments reflect the changes in the inputs to BHSC CAM allocation factors. The CAM is designed to allocate costs based on the relative size of the company to which it is allocating costs. One of those inputs is the amount of net plant by BHC subsidiary. In this case, the Company is proposing to include $101.8 million of plant additions. This level of investment in rate base would have an impact on relative size of BH Nebraska Gas compared to other BH Nebraska Gas affiliates at the same time other utilities are also investing in their systems. BH Nebraska Gas has made an adjustment to the allocation factors to reflect the allocation percentages that are forecasted to be used when final rates go into effect.

**Q. WHAT SPECIFIC PRO FORMA PLANT ADJUSTMENTS WERE MADE TO RATE BASE?**

A. The Company proposes to include $101.8 million of plant additions that BH Nebraska Gas will place into service before December 31, 2020.

**Q. WHAT IS THE NATURE OF THE PRO FORMA PLANT ADDITIONS THAT ARE PROPOSED?**

A. The pro forma plant additions are primarily related to replacing existing plant. Of the approximately $102 million of plant to be placed in service before December 31, 2020, (1) approximately $86 million is related to replacing or repairing existing facilities, (2) approximately $12.1 million is related to growing the customer base, and (3) approximately $3.9 million is related to allocated BHSC plant additions. Mr. Jarosz discusses BH Nebraska system growth and system repair or replacement projects in his testimony.

**Q. DOES BH NEBRASKA GAS ACCOUNT FOR NEW CUSTOMERS ASSOCIATED WITH GROWING THE CUSTOMER BASE?**

A. Yes. The Company has included an adjustment to its revenues for incremental growth on Statement I, column (i) to reflect the expected additional customers associated with adding growth capital in its revenue requirement. Mr. Hyatt discusses this adjustment further in his direct testimony.

**Q. WERE ANY ASSUMPTIONS MADE IN THE INCLUSION OF THE CAPITAL ADDITIONS TO THE DETAILED PLANT ACCOUNTS IN EXHIBIT NO. MCC-2, SCHEDULE D-2?**

A. Yes, the Company considered each project and determined that for the projects with the highest cost it could estimate which plant FERC account the total project dollars would be allocated based on the specifics of that project. The remaining projects would rely on a historical review of similar types of projects. For instance, blanket work orders which are set up on an annual basis for routine projects less than $5,000 used the same ratio experienced in 2019 for similar blanket work orders. The ratio was calculated as the amount of dollars that were recorded in the plant account as compared to the total projects.

**Q. IF A HISTORIC RATIO IS USED AND ESTIMATES ARE USED, ARE THE DOLLARS REPRESENTED IN THE PLANT ACCOUNTS REASONABLE?**

A. The dollars in the plant accounts are reasonable. While the actual dollars recorded for these projects may fluctuate, the methods described above provide a reasonable representation of the plant that will be placed in service.

**Q. PLEASE DESCRIBE THE PRO FORMA PLANT ADDITIONS ASSOCIATED WITH THE ALLOCATED SERVICE COMPANY ASSETS?**

A. The allocated Service Company asset additions of $3,906,857 represent BH Nebraska Gas' portion of allocated capital expenditures in Information Technology software and hardware as well as fleet expenditures.

**Q. WHAT IS CAUSING CAPITAL EXPENDITURE IN INFORMATION TECHNOLOGY HARDWARE ASSETS?**

A. Business processes and systems depend on reliable systems to run our business effectively. Hardware is refreshed when certain equipment reaches the following age:

- Network hardware - 7 years
- Printers – 7 years
- Enterprise Storage - 5 years
- Servers – 4 years
- Laptop/Tablets/iPads/Toughbooks/Thin Clients – 4 years

The hardware refresh schedule is based on vendor supportability and hardware failure rate. Failure to refresh hardware, increases risk of system downtime, deteriorates the quality of service to customers, and decreases employee productivity.

## C. Information Technology

**Q. WHAT IS CAUSING CAPITAL EXPENDITURE IN INFORMATION TECHNOLOGY FOR SOFTWARE ASSETS?**

A. Like many other businesses, data growth at Black Hills continues to increase exponentially. The capital investment in information systems software requires BHSC to acquire (i) more information storage and licensing and (ii) more backup software to store and backup new data through organic growth. The continued investment in information technology is needed to prudently and safely manage business operations.

For example, the Company invests in the following software platforms:

**1. <u>Digital As-Built Mapping</u>.**

Digital As-Built Mapping is a platform system which will directly translate to the safety of our customers through GPS accurate data. The system is built to provide the following capabilities:

- the platform to create geospatially correct As-Built drawings directly on the ESRI map using an IOS device;
- a solution to comply with new rules regarding tracking and traceability;
- a platform to submit the As-Built drawing back to the server as part of the capital work order completion that is then accessible by the Black Hills GIS Team to perform QA/QC and update the ESRI system; and
- a platform for capturing data related to the installation or retirements.

**2. <u>Gas GIS Unification</u>.**

The Gas GIS Unification phase 2 project integrates the Gas GIS at the database level so that all GIS database management, workflows, and enterprise integration is done in a standardized fashion across BHC subsidiaries.

**3. <u>Microsoft Products</u>.**

The Microsoft Enterprise Agreement provides Microsoft products to our employees and the systems needed to run many of our automated business processes each day. This includes a required upgrade to Microsoft Office 365 which is necessary to ensure the security framework remains intact.

**4. Utilities International (UI) Financial Planning and Analysis.**

The Utilities International Financial Planning and Analysis is single system that integrates regulatory, financial planning and analysis across the organization. This software is designed to enhance business processes to provide timely forecasts, more time to focus on analytics, and to create a platform for a regulatory module to assist in preparing rate reviews.

**5. Customer Web Additions.**

The Customer Web Additions software improves the digital customer experience. This software uses an integrated solution that supports the customer and prioritizing features and functionality that support improved usability, promote self-service, streamlined transactions, implement personalization, and increase program enrollment.

**6. Customer Center Technology Enhancements.**

The Customer Center Technology Enhancements are similar to the Customer Web Additions but focus on the Company to Customer personal interactions. This software provides options for customers to interact and conduct business with BH Nebraska Gas through multiple channels. This process encourages customers to choose lower cost of contact options such as email, chat, Integrated Voice Response, and website platforms to provide a better and more cost-effective customer experience. These software enhancements also improve workforce scheduling to ensure the right staffing levels to provide consistent call availability and optimize agent hours.

Enhancements to the Customer Information System increase system reliability, security and expand functionality. The expanded functionality is to improve reporting and data gathering for primarily regulatory reporting needs.

**7. Cyber Top 20 ("CT20").**

The CT20 is a security initiative adopted to respond to heightened cyber threats. It includes safeguards, known as "controls," that leading information technology security professionals and governing bodies recognize as best practices. These 20 critical controls were created by National Security Agency (NSA) Red and Blue teams, the US Department of Energy nuclear energy labs, law enforcement organizations and some of the nation's top forensics and incident response organizations including McAfee and Lockheed. These best practices are the same as what is referred to by cybersecurity professionals as CIS Top 20. The Company refers to these practices as CT20 to remove confusion with its Customer Information System which uses the same acronym of CIS. The return on investment comes from being better able to avoid, detect, counteract or minimize security risks to property, information, computer systems and other assets.

**8. Data Infrastructure Improvement Program ("DIIP").**

The Data Infrastructure Improvement Program constitutes the investment in improving infrastructure system data for system safety as set forth in the testimony of Mr. Lewis. These projects represent BH Nebraska Gas' portion of the software necessary to store track and analyze the data gathered in BH Nebraska Gas and its affiliates.

**Q. ARE THE CAPITAL ADDITIONS COMPLETE?**

A. No. However, all the Capital Additions are expected to be completed throughout calendar year 2020, and before December 31, 2020. The Company will update its plant additions in rebuttal to reflect any updates to the projects and costs presented.

**Q. IS THE COMPANY SEEKING RECOVERY FOR ANY PORTION OF THE ACQUISITION PREMIUMS ASSOCIATED WITH THE AQUILA OR SOURCEGAS ACQUISITIONS IN THIS PROCEEDING?**

A. No. The acquisition premiums associated with the Aquila and SourceGas acquisitions, sometimes referred to as "Goodwill," are recorded in FERC account 114. The amounts recorded in FERC Account 114 are not included in the Company's calculation of Rate Base. Additionally, the Company does not propose an amortization of the acquisition premiums related to the Aquila acquisition or the SourceGas acquisition, and the Company has not included any amortizations of the acquisition premiums.

**Q. IS CONSTRUCTION WORK IN PROGRESS ("CWIP") INCLUDED IN RATE BASE?**

A. No. The Company assumes that all CWIP will be placed in service prior to December 31, 2020 as part of the Capital Additions.

## VI. WORKING CAPITAL

**Q. WHAT IS WORKING CAPITAL?**

A. Working capital is the capital necessary to operate the business and is made up of Cash Working Capital ("CWC"), materials and supplies, and prepaid expenses. The working capital components are shown on Statement F of the

Revenue Requirement Study. CWC is determined by a lead-lag study.[26] The other items - materials and supplies and prepaid expenses - use the Base Year 13-month average balance. The final adjusted working capital total is used in the calculation of rate base.

**Q. PLEASE DESCRIBE CWC.**

A. CWC is the amount of investor-supplied capital required to fund the day-to-day operations of a utility after accounting for the timing differences between the occurrence of the transaction and the actual receipt of, or payment of, cash.

**Q. PLEASE DESCRIBE HOW THE CWC AMOUNT WAS CALCULATED.**

A. The per book and adjusted CWC amounts were determined based on the results of a Lead-Lag Study.[27] The Company prepared both per book and adjusted CWC amounts for this rate review. The per book CWC is located on Schedule F-2, page 1, and the adjusted CWC is on Schedule F-2, page 2. The adjusted CWC amount is included in rate base within the Revenue Requirement Study on Statement M, line 24.

**Q. HOW DOES A LEAD-LAG STUDY MEASURE THE AMOUNT OF CASH REQUIRED FOR BUSINESS OPERATIONS?**

A. A lead-lag study measures the difference between: (1) the time that goods or services are obtained or used and the time expenditures for those goods or services are made ("lead") and (2) the time a service is rendered and the time revenues for that service are received ("lag"). The applicable lead period for each major category of expense is compared to the revenue lag period. The

[26] The Lead-Lag Study in this Rate Application can be found in Exhibit No. MCC-3.
[27] See Exhibit No. MCC-3.

difference between those periods, expressed in days, multiplied by the average daily operating expense, yields the amount of CWC required for a company to meet its normal business obligations.

**Q. HOW WAS THE EXPENSE LEAD CALCULATED FOR THIS RATE REVIEW?**

A. The expense lead days were determined by analyzing the actual data from the Base Year for the expense categories. The categories and the associated lead days are shown on Revenue Requirement Study, Schedule F-2 of the Revenue Requirement Study. The Lead-Lag Study steps through the calculation of the expense lead. The expense lead days are the actual days between when a good or a service is received (a midpoint is used where the service is received over a period of time) and when payment is made for that good or service. The expense per day is calculated by taking the total expense per category divided by the number of days in the year. Finally, that expense per day for each category is multiplied by the expense lead days for that category to determine the expense dollar days for each category.

The Company reviewed all recorded costs for the following expense categories: Federal Income Tax Withheld, State Income Tax Withheld, FICA Taxes, Net Payroll, Gas Purchases for BH Nebraska Gas, Payments to Gas suppliers for the Choice Gas program, Property Taxes, Unemployment Taxes, City Franchise Taxes, Sales Taxes and Current Income Taxes Federal, and Current Income Taxes State. The Company then determined from each category when cash was paid and compared the payment date to the midpoint of the service period to determine the expense lead day. The operations and maintenance (“O&M”) expense category used the method approved in previous rate reviews, which incorporated a standard lead time of one eighth of a year, or 45.625 lead days.

**Q. HOW ARE THE REVENUE LAG DAYS CALCULATED?**

A. The service lag for each revenue month during the Base Year was calculated by dividing the total days of the year by 12 and then by two to determine the mid-point of the month. The billing process lag is the number of days between when the meter is read and when the customer is billed. This is calculated by using the Company’s Customer Information System + (“CIS+”) data. The monthly results are averaged to arrive at an annual weighted average. Next, the receipt lag is the weighted average number of days between billing and receipt of payment. This is also calculated using the Company’s CIS+ data. Finally, the results obtained are added together to determine the total revenue lag days of 37.6996, as shown on Schedule F-2 of the Revenue Requirement Study.

**Q. WHAT WERE THE RESULTS OF THE LEAD-LAG STUDY?**

A. The Lead-Lag Study results in a reduction of rate base, which means that the Company typically sees a benefit in its cash received versus what is necessary to pay out at a given time. The individual results of the Lead and Lag for each category are summarized in Table MCC-2 below:

**Table MCC-2**
**Lead and Lag**

| Line No. | **Account Description** | **Revenue Lag (Days)** | **Expense Lead (Days)** |
|---|---|---|---|
| | | | |
| 1 | **Operations & Maintenance Expense** | | |
| 2 | Federal Income Tax Withheld | 37.6996 | 14.0000 |

| | | | |
|---|---|---|---|
| 3 | FICA Taxes Withheld - Employee | 37.6996 | 14.0000 |
| 4 | Net Payroll | 37.6996 | 14.0000 |
| 5 | Gas Purchases - GCA - BH Gas Utility | 38.8566 | 32.6530 |
| 6 | Other O & M | 37.6996 | 45.6250 |
| 7 | Gas Purchases (Choice Gas Supplier Payments) | 36.1261 | 35.0634 |
| 8 | Property Taxes | 37.6996 | 335.8070 |
| 9 | FICA Taxes - Employer's | 37.6996 | 14.0000 |
| 10 | Unemployment Taxes (FUTA & SUTA) | 37.6996 | 14.0000 |
| 11 | City Franchise Taxes | 37.6996 | 65.7954 |
| 12 | Sales Taxes | 37.6996 | 35.2000 |
| 13 | Current Income Taxes-Federal and State | 37.6996 | 38.5000 |

**Q. WAS CONSIDERATION GIVEN IN THE LEAD-LAG STUDY TO THE FACT THAT THERE WERE TWO SEPARATE OPERATING UTILITIES DURING THE BASE YEAR?**

A. Yes. The Lead-Lag Study incorporated the information from both BH Gas Distribution and BH Gas Utility. Exhibit No. MCC-3 represents the Lead-Lag Study of the combined company as if the operations had been combined during the entire Base Year. This reflects the on-going operations when rates will be in effect and is a reasonable representation of the CWC necessary to operate the combined business.

**Q. WHY DO THE GAS PURCHASES FOR THE CHOICE GAS PROGRAM AND GAS PURCHASES FOR THE GCA HAVE DIFFERENT REVENUE LAG FACTORS THAN THE REST OF THE ITEMS?**

A. The revenue lag factors for the BH Gas Utility and BH Gas Distribution were used for those items found on Exhibit No. MCC-2, Schedule F-2 lines 5 and 9. This change was chosen because the cash flow for the Gas Cost Adjustment (“GCA”) used by BH Gas Utility (Rate Areas One, Two, and Three) and the Choice Gas Program offered by BH Gas Distribution (Rate Area Five) are different. The gas purchases are accounted for using different accounting methods.

GCA revenues and costs are recorded on the income statement with the payment of GCA costs occurring at various times throughout the month. On the other hand, Choice Gas Program receipts and payments are recorded on the balance sheet as a liability and payment of a liability to GCA Suppliers that occurs each month on the 20th of each month unless the 20th falls on Saturday or Sunday. Using the separate accounting methods in this case more accurately depicts the Company's CWC needs.

**Q. DOES THE COMPANY PROPOSE TO CONTINUE THIS TREATMENT IN FUTURE RATE REVIEWS?**

A. No. The intent in this case is to recognize that there is a difference between the two programs and not have a precedent set in this rate review. The Company is in the process of determining whether it will modify the Choice Gas Program. Thus, if a modification is made to the Choice Gas Program in the future, BH Nebraska Gas will then make any changes required to CWC associated with gas purchases in a future rate review application.

**Q. AS TO THE OTHER ELEMENTS OF WORKING CAPITAL, WHAT ADJUSTMENTS WERE MADE TO PREPAID EXPENSES AND MATERIALS AND SUPPLIES?**

A. Prepaid Expenses and Materials and Supplies were adjusted to reflect the 13-month average balances for the Base Year. Using the 13-month average method represents the ongoing level of investment necessary to serve customers throughout the year. This method avoids using a snapshot of investment that could be either a peak or valley of investment based upon timing. This differs from Property, Plant, and Equipment investment because Materials and Supplies and Prepaid expenses are expected to be used or consumed in less than a year while Property, Plant, and Equipment are expected to have a useful life of multiple years. These balances are shown on Exhibit No. MCC-2, Schedule F-1.

**Q. WHAT MATERIALS AND SUPPLIES ARE INCLUDED IN RATE BASE?**

A. The inventory of materials and supplies used for construction, operation, and maintenance purposes are included in the Materials and Supplies accounts.

**Q. DOES THE COMPANY ANTICIPATE ANY CHANGES TO THE LEVEL OF INVENTORY?**

A. No. While inventory levels fluctuate month by month, the Company believes the Base Year 13-month average is representative of normal inventory levels going forward.

**Q. IS GAS STORAGE INVENTORY INCLUDED IN RATE BASE?**

A. No. Please see Mr. Bennett's testimony regarding the treatment of Gas Storage Inventory.

## VII. COST OF CAPITAL

**Q. WHAT IS THE PROPOSED CAPITAL STRUCTURE AND RATE OF RETURN INCLUDED IN THE COST OF SERVICE CALCULATION?**

A. The proposed capital structure included in the cost of service calculation is 50.00% equity and 50.00% debt. Based on the proposed return on equity of 10.00%, as supported by Mr. McKenzie, and the cost of long-term debt of

4.11%, as sponsored by Mr. Amdor, the requested Weighted Average Cost of Capital ("WACC") is 7.06%.[28] This is shown in Table MCC-3 below:

**Table MCC-3**
**WACC**

| Description | Amount | Percent of Total | Cost | Weighted Cost |
|---|---|---|---|---|
| | | | | |
| Long-Term Debt | $325,000,000 | 50.00% | 4.11% | 2.06% |
| Common Equity | $325,000,000 | 50.00% | 10.00% | 5.00% |
| | $650,000,000 | 100.00% | | 7.06% |

## VIII. OPERATING EXPENSES

**Q. PLEASE EXPLAIN HOW THE STATEMENTS AND SCHEDULES CONTAINED IN THE REVENUE REQUIREMENT STUDY SUPPORT THE EXPENSE AMOUNTS PRESENTED IN THIS CASE.**

A. Statement B of Exhibit No. MCC-2 (i.e., Revenue Requirement Study) shows the income statement as of December 31, 2019. Exhibit No. MCC-2, Statement H details the per book O&M expenses provided on Exhibit No. MCC-2, Statement B by FERC account and provides a summary of the adjustments and adjusted totals to show the amounts used to calculate the revenue requirement on Exhibit No. MCC-2, Statement M. Depreciation and amortization expenses are detailed on Statement J which shows the pro forma adjustments along with the adjusted totals used to calculate revenue requirements on Exhibit No. MCC-2, Statement M. Taxes other than income are detailed on Exhibit No. MCC-2, Statement L, which shows the adjustments along with the adjusted totals used to

[28] See also Exhibit No. MCC-2, Statement G and Schedule G-1.

calculate revenue requirements on Exhibit No. MCC-2, Statement M. Income tax calculations are shown on Exhibit No. MCC-2, Statement K, which details the income tax expense along with the timing differences and associated deferred income tax expense. Exhibit No. MCC-2, Statement K also shows the pro forma adjustments along with the adjusted totals used to calculate revenue requirements on Exhibit No. MCC-2, Statement M.

**A. <u>Lobbying, Political Promotion and Religious Contributions</u>**

Q. **DOES THE COMPANY SEEK RECOVERY OF ANY LOBBYING, POLITICAL PROMOTION, OR CONTRIBUTIONS TO RELIGIOUS ORGANIZATIONS IN ITS REVENUE REQUIREMENT?**

A. No. Those costs are booked below the line, or in Non-Utility Operating Income and Expense[i] and reported on Exhibit No. MCC-2, Statement B line 24. These costs are not included in the O&M accounts or as any component of the Revenue Requirement Study. Mr. Bennett discusses the accounting for these costs in his direct testimony.

**B. <u>Operation & Maintenance Adjustments</u>**

**Q. PLEASE LIST THE ADJUSTMENTS MADE TO THE PER BOOK O&M EXPENSES.**

A. See Table MCC-4 below for the listing of the O&M adjustments:

| **<u>Table MCC-4</u>**<br>**O & M Adjustments** | |
|---|---|
| Schedule H - 1 | Removal of Out of Period and Abnormal Expenses |
| Schedule H - 2 | Removal of Expenses not Appropriate for Recovery |
| Schedule H - 3 | Removal of Gas Costs |
| Schedule H - 4 | Wages and Salaries Annualization of Direct Employees |
| Schedule H - 5 | Employee Benefits Adjustment to a 3-year average |

| | |
|---|---|
| Schedule H - 6 | Intercompany charges from Black Hills Service Company |
| Schedule H - 7 | Bad Debt Expense Adjustment |
| Schedule H - 8 | Alternative Forms of Payment Adjustment |
| Schedule H - 9 | Acquisition Severance Cost Adjustment |
| Schedule H - 10 | Research and Development Adjustment |
| Schedule H - 11 | Line Locate Cost Adjustment |
| Schedule H - 12 | Fleet Depreciation Expense Adjustment |

**Q. EXPLAIN THE PURPOSE OF THE REMOVAL OF OUT OF PERIOD AND ABNORMAL EXPENSES ON EXHIBIT NO. MCC-2, SCHEDULE H-1?**

A. The purpose of the adjustment is to remove the costs recorded in the Base Year that are one-time occurrences or costs not expected to occur each year going forward. The amounts have been segregated into columns with each column representing costs for the occurrences to be removed from the Base Year so that the Test Year will reflect the appropriate level of on-going expenses.

**Q. PLEASE EXPLAIN EACH OCCURRENCE REPRESENTED IN THE COLUMNS SHOWN ON SCHEDULE H-1.**

A. Column (a) represents the costs booked in the Base Year that were associated with the work specifically related to the statewide flooding that occurred in 2019. The Company used work orders to track these costs and is removing the material costs, call out pay, and overtime pay recorded in the work orders. Normal labor was not removed because the Company would still be paying its employees if the flooding had not occurred, but not the direct costs to be called out for flooding or to work overtime because of the flooding.

Column (b) represents the costs booked in the Base Year that were related to damages to a pipeline caused by a third-party contractor which caused an outage. This occurrence is not considered a normal operating expense and the costs were removed.

Column (c) represents expenses to dispose of odorant tanks no longer in use.

Column (d) represents the expenses incurred to physically move offices associated with the consolidation of facilities. Mr. Jarosz discusses the consolidation. These costs do not occur every year and were removed.

Column (e) represents the costs associated with painting town border stations. This expense is removed because it does not occur each year and would not be considered a normal on-going expense.

**Q. EXPLAIN THE PURPOSE OF THE REMOVAL OF EXPENSES NOT ALLOWED FOR RECOVERY ON EXHIBIT NO. MCC-2, SCHEDULE H-2.**

A. This adjustment removes certain advertising, dues, charitable contributions, promotional items and sponsorships not allowed for recovery in prior Nebraska rate reviews. See below for a summary of the items removed:

a) Advertising expenses that are not associated with safety or hiring. Safety advertising is a public service and is directed at promoting public awareness and preventing damage to the system. Advertising associated with hiring is a necessary business expense to obtain applicants for any open positions.

b) All out of state dues and 50% of in state Fraternal organizations. Confidential Application Exhibit No. 1, Section 2, Exhibit E is provided to show dues requested by category and organization.

c) Charitable contributions that are coded above the line.

d) Costs of Promotional items.

e) Sponsorships of various community and charitable events.

### C. Safety and Hiring Advertising

**Q. HOW MUCH RECOVERY OF SAFETY AND HIRING ADVERTISING IS THE COMPANY REQUESTING IN THIS PROCEEDING?**

A. The Company is requesting $67,912 of advertising costs specifically for hiring and safety advertising.

### D. Gas Costs

**Q. PLEASE EXPLAIN THE REMOVAL OF GAS COSTS ON EXHIBIT NO. MCC-2, SCHEDULE H-3?**

A. Gas costs are only incurred for the territories previously served by BH Gas Utility and are currently recovered through the GCA. While the Company proposes minor changes to the GCA, the Company continues to propose to recover the gas costs recorded in Accounts 804 through 813 through the GCA.

**Q. DO THE CUSTOMERS PREVIOUSLY SERVED BY BH GAS DISTRIBUTION HAVE GAS COSTS?**

A. The customers in Rate Area Five (i.e., formerly BH Gas Distribution) obtain gas supplies under the Choice Gas Program where individual customers choose their own supplier and purchase gas directly from a Choice Gas Program Supplier according to the terms of a Supplier Participation Agreement. The cost of the gas commodity is charged to the customer by BH Nebraska Gas in accordance with the price agreed to between the Customer and the Choice Gas

Program Supplier. Although the gas cost charges to the customers are collected by the Company, as previously explained, the gas cost charges are not recorded as revenues or expenses by BH Nebraska Gas. Therefore, those Choice Gas Program Customer gas costs are not included in the Base Year or Test Year calculation of revenue requirements.

**E. <u>Annualized Wages, Salaries, and Benefits</u>**

**Q. PLEASE EXPLAIN THE ADJUSTMENT TO ANNUALIZE WAGES, SALARIES, AND BENEFITS FOR THE DIRECT EMPLOYEES ON EXHIBIT NO. MCC-2, SCHEDULE H-4?**

A. The Company has calculated the ongoing annual expenses of 377 direct employees of BH Nebraska Gas. The results of that calculation are used to set the basis of the labor costs reflected in the Test Year.

**Q. HOW DID THE COMPANY CALCULATE THE ONGOING ANNUAL EXPENSES OF THE 377 DIRECT EMPLOYEES?**

A. The Company gathered the gross pay, merit increase, premium pay, incentive pay, 401k contributions, retirement contributions, health, life, dental, and AD&D insurance costs from the Human Resource department to determine the ongoing annual pay and benefits received by each employee. Since some of these costs are recorded to the balance sheet as a component of capital, depending upon the time coding of the employees, the Company conducted a study using 2019 time data to determine the ratio of costs that are included in the Operations and Maintenance ("O&M") expense accounts compared to the total labor costs. The results of the study summarized the results by job type.

Each matching job type was applied to the total labor costs to determine the amount of expense.

### F. Premium Pay

**Q. PLEASE DEFINE PREMIUM PAY.**

A. "Premium Pay" is comprised of Overtime, Stand-by, and Call Out pay which are paid to hourly employees at a premium of 1.5 or 2 times the hourly rate and paid above the normal 40-hour work week. Employees receive 1.5 times their standard hourly rate if they work Overtime (above 40 hours in a week) or are Called Out to work during their Stand-by hours. Stand-by hours are paid at the employees' hourly rate over and above their normal work week of 40 hours. Former BH Gas Distribution Union employees who are called out to work on Sunday receive premium pay of 2 times their normal hourly rate.

**Q. WHAT ADJUSTMENTS WERE MADE TO PREMIUM PAY?**

A. The Company used the number of hours recorded for all Premium Pay incurred in 2019 as the normal Premium Pay hours to be incurred annually. The Company adjusted the Premium Pay hours to remove the hours associated with the flooding work orders noted in Exhibit No. MCC-2, Schedule H-1 as an abnormal occurrence. Those adjusted Premium Pay hours were used to determine an average amount of Premium Pay per job type so that a standard premium is applied across the employees that comprise that job type. For example, the Field Service job type incurred 31,394 overtime hours for 179 average employees during the Base Year. For the Labor calculation, there are 183 employees going forward or, on average, 175.4 hours per employee. The

Company used an average of 171.6 hours per employee or (31,394 / 183) in its calculation of overtime with a total of the original adjusted 31,394 overtime hours included in the calculation of overtime.

**Q. WOULD THE AMOUNT OF PREMIUM PAY BE THE SAME IN THE BASE PERIOD AND THE TEST PERIOD SINCE THE SAME NUMBER OF HOURS WERE USED?**

A. No. Although the premium pay hours from 2019 are used, the hourly rates when new rates go into effect will change. To incorporate that hourly rate change, the Company calculated a percentage factor over and above employees' base pay which is calculated as a normal working week of 40 hours or 2,080 hours per year. In the example above, that percentage factor was calculated by multiplying the Premium Pay hours by the Premium Pay rate of 1.5 to determine the additional annual hours of regular pay of 257.33 hours (or 171.6 x 1.5). The additional annual hours of regular pay can then be compared to the standard hours used to calculate base pay. The comparison is the Premium Pay hours paid at regular time (257.33) divided by annual base pay hours of 2,080 to determine the percentage of overtime received above base pay of 12.37% (or 257.33 / 2,080). In summary, if an employee's hourly rate was $20.00 their base pay would be $41,600 (2,080 x 20) and if they received 171.6 hours of overtime paid at time and a half they would have received $5,148 ($20 x 1.5 x 171.6, which is 12.37% ($5,148 / $41,600) of their base pay.

**Q. WAS THIS SAME PROCESS USED TO CALCULATE ALL PREMIUM PAY?**

A. Yes. Overtime was used as an example for all Premium Pay. Workpapers are provided for each of the studies used in the development of Premium Pay.

**Q. WOULD THIS PROCESS HAVE AN IMPACT ON OTHER ITEMS WITHIN THE LABOR EXPENSE CALCULATION?**

A. Yes. Incentive includes Base Pay and Premium pay to calculate the amount of incentive pay an employee will receive. Additionally, retirement costs (both 401K and retirement contributions) use Base Pay, Premium Pay and Incentive pay to calculate the amount of retirement contributions and 401K the employee will receive.

### G. <u>Incentive Payment</u>

**Q. WHAT ASSUMPTIONS WERE MADE REGARDING INCENTIVES?**

A. The Company assumed the incentive pay for non-union employees to be at 100% target. Union employees' incentive pay is contractually set without variation.

**Q. DOES THE COMPANY TYPICALLY PAY 100% OF TARGET?**

A. No. Incentive pay for non-union employees is based upon performance targets that pay out as a percentage of the incentive calculation from 0% to 150% of the target.[29] In the last four years the performance target for BH Nebraska employees was paid out as follows: 2019 was 97.66%; 2018 was 124.41%;

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[29] The testimony of Mr. Amdor further supports the employee compensation and benefits for both BH Nebraska Gas and BHSC included in the Revenue Requirement Study.

2017 was 73.30%; and 2016 was 109.51%. While the results of the performance targets do vary from year to year the Company proposes the ongoing expectation of 100% of target is reasonable.

### H. Labor Costs

**Q. PLEASE EXPLAIN THE STUDY USED TO DETERMINE THE EXPENSE AS OPPOSED TO THE TOTAL LABOR COSTS.**

A. The study uses the time coding of all employees for 2019 as its basis. This data was then used to identify to which accounts the labor costs were coded, by what ratio, and by employee job type. The Company made two adjustments to the data to reflect business changes beginning January 1, 2020. Those two business changes were the update to the capitalization of Administrative and General ("A&G") expenses and the change in scope of non-utility work.

### I. Capitalization of A & G Expenses

**Q. PLEASE EXPLAIN THE UPDATE TO THE CAPITALIZATION OF A&G EXPENSES.**

A. The Company's annual update to its capitalization rates for A&G beginning January 1, 2020 (primarily account 920 and for purposes of this proceeding is limited to the VP of Operations) the Company substituted the capital loading rate used in 2020 of 20% instead of the loading rate of 17% in 2019. The loading rate change is further explained below in my testimony.

### J. Non-Regulated Private Business Services

**Q. PLEASE EXPLAIN THE CHANGE IN SCOPE OF NON-REGULATED WORK.**

A. Some of the Company's Service Technicians service the needs of the Utility and its customers but also provide non-regulated private business services. Section 66-1819 of the State Natural Gas Regulation Act of Nebraska permits BH Nebraska Gas to conduct non-regulated private enterprise such as Customer appliance services or repair provided BH Nebraska Gas completely separates the accounts for its revenues and expenses for such nonregulated activities from the Company's regulated activities and accounts.[30] The Company's nonregulated private enterprise encompasses repairs made behind the meter.

In 2019, if a Service Technician engaged in nonregulated private business activities under the Company's previous appliance protection service program, then it would record time and expenses to a non-utility account. Under the original appliance protection program, a Customer could request repairs for nearly all of the appliances within the home.

As of 2020 the Company has changed its appliance protection program offering of services to only include Air Conditioning, Furnace, Stove, Range, or Fireplace protection. This contract limitation will exclude service calls that were completed in 2019 for washers, dryers, gas grills, and other appliances not in the listing of offered services. Accordingly, BH Nebraska Gas does not anticipate that its non-regulated private business activity will be as high as it has

[30] *Neb. Rev. Stat. § 66-1819*.

been historically since not as much non-regulated work will be performed by BH Nebraska Gas Service Technicians.

**Q. WILL THERE NEED TO BE A HEADCOUNT ADJUSTMENT TO REFLECT THE REDUCTION IN WORK ACTIVITY?**

A. No. The employees outside of Lincoln, Nebraska will now have the additional responsibility to do line locates. The line locate function was performed by contractors in 2019. The Company has made an adjustment for the removal of line locate costs recorded in 2019 in Exhibit No. MCC-2, Schedule H-11 to account for the change in expenses going forward.

**Q. DOES BH NEBRASKA GAS ANTICIPATE THAT THE ENTIRE CHANGE IN SCOPE FOR NON-UTILITY WORK WILL BE CHARGED TO EXPENSE?**

A. No. The Company assumes the time coded for the appliance repairs that the Company will no longer service, will be split between O&M and other activities. The percentage of that time assumed to be recorded to O&M is 45% for the South, Central and West regions and 65% recorded to O&M for the North region.

### K. Labor Cost Expense Study

**Q. WHAT ARE THE RESULTS OF THE LABOR COST EXPENSE STUDY?**

A. See Table MCC-5 below for the results of the study by Job type.

| **Table MCC-5**<br>**Labor Cost Expense** | | |
|---|---|---|
| **Line No.** | **Job Type** | **O&M Expense Percent** |
| 1 | (F) - Cathodic Protection/Corrosion/Leak | 98.48% |
| 2 | (F) - Field Measurement | 86.18% |
| 3 | (F) - Meter Reader | 96.94% |
| 4 | (F) - Operations/Maintenance | 45.03% |
| 5 | (F) - Service | 69.34% |
| 6 | (F) - Welder | 19.10% |
| 7 | (O) - Construction Planner | 5.41% |
| 8 | (O) - Dir Business Operations | 83.00% |
| 9 | (O) - FSA/CSA | 96.30% |
| 10 | (O) - Mgr. Gas Operations | 61.93% |
| 11 | (O) - Mgr. Special Projects | 100.00% |
| 12 | (O) - Operations Analyst | 100.00% |
| 13 | (O) - Operations Support Specialist | 72.57% |
| 14 | (O) - Rep Customer Solutions | 97.62% |
| 15 | (O) - Storekeeper | 0.74% |
| 16 | (O) - Sup Gas Operations | 63.33% |
| 17 | (O) - Utility Construction Spec | 3.68% |
| 18 | (O) - VP Gas Operations | 83.00% |
| 19 | (O) - Intern | 100.00% |
| 20 | (F) - Construction Inspector | 5.41% |

**Q. ARE ALL OF THE POSITIONS USED TO CALCULATE THE LABOR ACTUALLY HIRED AS OF THE DATE OF THIS FILING?**

A. No. The calculation of the labor costs includes twenty-two open positions for BH Nebraska Gas. Nine of those positions are vacant due to attrition with an additional thirteen positions would represent new headcount.

**Q. WHAT IS THE RESULT OF THE CALCULATION AND THE ADJUSTMENT ON SCHEDULE H-4?**

A. The calculation shows that there will be $23,487,986 of labor expenses recorded to O&M Expense accounts on an on-going basis. This is compared to the dollar amount recorded in the Base Year for labor expenses of $20,514,558. The adjustment of $2,973,428 is to bridge the Base Year labor expenses to the Test Year labor expenses.

### L. <u>Employee Benefits Adjustment</u>

**Q. PLEASE EXPLAIN THE ADJUSTMENT TO EMPLOYEE BENEFITS ON SCHEDULE H-5?**

A. The employee benefits adjustment is related to the expenses of the Black Hills Corporation Pension Plan (“Pension Plan”) and the Retiree Medical benefit plan offered by the Company. These expenses are calculated each year by an outside actuarial expert and can change materially from year to year based on updating the inputs or assumptions to that study. The Company proposes to adjust the Base Year costs for both the Pension Plan and Retiree Medical benefits to reflect a four-year average (2018 to 2020 inclusive) for the Test Year.

**Q. WHAT ARE THE ANNUAL COSTS USED TO CALCULATE THE THREE-YEAR AVERAGE?**

A. See Table MCC-6 for the calculation of the three-year average for each component of the adjustment.

**<u>Table MCC-6</u>**
**Three-Year Average**

| Line No. | Description | 2018 | 2019 | 2020 | Average |
|---|---|---|---|---|---|
| 1 | Retiree Healthcare Net Periodic Expense and Administrative Costs | $906,207 | $835,847 | $719,049 | $820,368 |
| 2 | Retiree Healthcare Plan Costs (amortization of Regulated Assets) | 280,337 | 287,461 | 37,959 | 201,919 |
| 3 | Pension Plan Net Periodic Expense and Administrative Costs | 1,642,006 | 782,086 | 1,229,476 | 1,217,856 |
| 4 | Pension Plan Costs (amortization of Regulated Assets) | 613,395 | 639,254 | 646,992 | 633,214 |
| 5 | Total | | | | |

| | | | | | |
|---|---|---|---|---|---|
| | | $3,441,945 | $2,544,648 | $2,633,476 | $2,873,356 |

**Q. WHAT IS THE RESULT OF THE ADJUSTMENT?**

A. As shown on Exhibit No. MCC-2, Schedule H-5, the total expenses booked during the Base Year was $2,544,648. The total of the three-year average is $2,873,356. The Company adjusted the Base Year expense by an additional $328,708 to reflect the Test Year expense proposed.

**M. <u>Centralized Shared Service Adjustment</u>**

**Q. PLEASE EXPLAIN THE ADJUSTMENT MADE FOR CENTRALIZED SHARED SERVICE CHARGES FROM BLACK HILLS SERVICE COMPANY SHOWN ON EXHIBIT NO. MCC-2, SCHEDULE H-6?**

A. As BHC continues to focus on the long-term ownership and provision of utility service, there are necessary changes in activities to be made, to continue to provide customers with safe and reliable service and to comply with regulatory and operational initiatives. During the Base Year, shared service costs are not reflective of the normal ongoing operating expenses chargeable to BH Nebraska Gas. Changes in the normalized annual costs charged to BH Nebraska Gas are expected to occur in the Test Year.

**Q. GENERALLY, WHAT ARE THE DRIVERS OF THE INCREASED OPERATING COSTS?**

A. BH Nebraska Gas has and continues to make investments in its system which impacts the inputs to the factors described in the Cost Allocation Manual ("CAM") which allocate costs to BHC's affiliates, including BH Nebraska Gas. Also, labor costs continue to rise through both annual compensation merit increases as well as increased staffing. Additionally, several corporate-level initiatives that benefit all utility subsidiary customers, including those of BH Nebraska Gas, are being included in the Test Year outside the Base Year. The costs, however, are matched with required levels of service. Specifically, BHSC is: (i) enhancing cyber security and information systems; (ii) expanding its gas engineering, regulatory and finance, accounting and information technology functions to enhance safety and compliance and to comply with evolving federal and state regulatory and reporting requirements; and (iii) relocation of facilities. Pro forma adjustments are necessary to reflect the costs of these important and necessary programs.

**N. <u>CAM Factors Adjustment</u>**

**Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT FOR THE IMPACT OF 2020 CAM FACTORS.**

A. The 2019 Test Year costs indirectly allocated to the BH Nebraska Gas entities were based on the allocation factors as of September 30, 2018. BHC performs an annual review and update of allocation factors September 30 of each year to go into effect as of January 1 of the following year. Based on BHC's practice of updating the allocation factors, new factors and resulting allocation percentages were calculated as of September 30, 2019 to be used beginning January 1, 2020, the beginning of the Test Year. The updated allocation rates were applied to the Base Year 2019 total pool of indirect costs which resulted in an estimated increase of costs to BH Nebraska Gas. This application was completed so that the CAM calculations applied on the date new rates for BH Nebraska Gas are effective match the shared service expenses in the underlying revenue requirements. The net effect of the changes increased the shared service costs chargeable to BH Nebraska Gas by $2,499,451.

**O. <u>Administrative and General Transfer Credit</u>**

**Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT FOR THE ADMINISTRATIVE AND GENERAL TRANSFER CREDIT.**

A. BHC follows a common practice among utilities to load administrative and general costs to capital projects based upon a percentage of effort in managing the capital projects. This is often referred to as a transfer credit, as it reduces or transfers costs from the income statement or cost service to the balance sheet. A calculated rate is applied to costs resulting from identified Administrative and General departments that typically do not code directly to capital projects. BHC applies a three-year historical average of hours reported to capital projects versus operating and maintenance costs. The transfer credit rate increased from 17% used in the Base Year to 20% used in the Test Year. As a result of the increased transfer credit rate, a decrease of $397,271 was included in the revenue requirement.

**P. <u>Merit Increase Adjustment</u>**

**Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT FOR ANNUAL MERIT INCREASES TO BHSC STAFF COMPENSATION.**

A. Exhibit No. MCC-2, Schedule H-6, column (d) reflects the incremental increase of BH Nebraska Gas' allocable charges for annual costs for BHSC employees from the Base Year to the Test Year. The pro forma adjustment to wages was made to reflect average merit increases of 2.71% that occurred in March 2020. Mr. Amdor explains the merit increase and overall compensation philosophy in his Direct Testimony. BH Nebraska Gas's share of the resultant operating costs for annual merit increases to BHSC staff compensation is $424,001.

**Q. Staff Additions Adjustment**

**Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT FOR SHARED SERVICE COST SURROUNDING ADDITIONAL STAFFING AND ADMINISTRATION.**

A. BHC started realigning several internal employee organizations starting in 2017. The realignments and enhancements were done to maintain and expand the organization's focus on exceptional regulatory and reporting requirements that are ever evolving.

The key areas of expanded employee staffing positions occurred at both BHSC and BH Nebraska Gas. There are three categories of expanded employee positions that are intended to support BH Nebraska Gas:

1. BH Nebraska Gas is adding thirteen (13) positions within BH Nebraska Gas;
2. BHSC will add five (5) positions that are dedicated solely to providing support for BH Nebraska Gas; and
3. BHSC adds 114 positions that will be allocated through the BHSC CAM.

The various types of staff positions can be found on Table MCC-7 below. As shown on Table MCC-7, the majority of positions added to the workforce (BH Nebraska Gas and BHSC) are in areas of Construction, Gas Engineering, Information Technology, Accounting, Training, Business Development, and Supply Chain.

Mr. Jarosz discusses the eighteen (18) positions added to directly support BH Nebraska Gas in his direct testimony. The labor cost for thirteen (13) of the eighteen BH Nebraska Gas employee positions included in the adjustment on Exhibit No. MCC-2, Schedule H-4 are directly employed by BH Nebraska Gas. The labor costs for the other five (5) BHSC employees whose roles will be to exclusively support BH Nebraska Gas are included as an adjustment on Exhibit No. MCC-2, Schedule H-6, column (e).

The 114 BHSC employee positions added by BHSC whose labor costs will be allocated to BH Nebraska Gas through the BHSC CAM are included as an adjustment on Exhibit No. MCC-2, Schedule H-6.

Table MCC-7 below for a listing of the new positions, the adjustment schedule for which it is included, and the witness supporting its rationale.

| Table MCC-7 | | | | |
|---|---|---|---|---|
| **Staff and Administrative Positions** | | | | |
| Line No. | **Job Title** | **Count** | **Schedule of Adjustment** | **Testimony Support** |
| 1 | BH Nebraska Gas Additional Headcount | | | |
| 2 | Spec Utility Construction | 3 | Schedule H-4 | Mr. Jarosz |
| 3 | Construction Planning Manager | 1 | Schedule H-4 | Mr. Jarosz |
| 4 | Inspector Construction | 8 | Schedule H-4 | Mr. Jarosz |
| 5 | Supv Construction Inspector | 1 | Schedule H-4 | Mr. Jarosz |
| 6 | Subtotal | 13 | | |
| 7 | | | | |
| 8 | BHSC Additional Headcount - 100% Direct Charged to BH Nebraska Gas | | | |
| 9 | Damage Prevention Coordinator | 2 | Schedule H-6 | Mr. Jarosz |
| 10 | Business Development | 1 | Schedule H-6 | Mr. Jarosz |
| 11 | Regulatory Analyst | 1 | Schedule H-6 | Mr. Jarosz |
| 12 | Community Affairs | 1 | Schedule H-6 | Mr. Jarosz |
| 13 | Subtotal | 5 | | |
| 14 | | | | |
| 15 | Additional Indirect Headcount by department from BHSC adjustment - Allocated through the BHSC CAM | | | |
| 16 | Gas Engineering | 29 | Schedule H-6 | Mr. Clevinger |
| 17 | Information Technology | 19 | Schedule H-6 | Mr. Clevinger |
| 18 | Training | 10 | Schedule H-6 | Mr. Clevinger |
| 19 | Business Development | 6 | Schedule H-6 | Mr. Clevinger |
| 20 | Accounting | 24 | Schedule H-6 | Mr. Clevinger |
| 21 | Risk | 2 | Schedule H-6 | Mr. Clevinger |
| 22 | Regulatory & Finance | 5 | Schedule H-6 | Mr. Clevinger |
| 23 | Land | 3 | Schedule H-6 | Mr. Clevinger |
| 24 | Environmental | 1 | Schedule H-6 | Mr. Clevinger |
| 25 | Human Resources | 2 | Schedule H-6 | Mr. Clevinger |
| 26 | Supply Chain | 7 | Schedule H-6 | Mr. Clevinger |
| 27 | Asset Programs | 3 | Schedule H-6 | Mr. Clevinger |
| 28 | Gas Asset Optimization | 3 | Schedule H-6 | Mr. Clevinger |
| 29 | Subtotal | 114 | | |

## R. Reasons for BHSC Staff Additions

The reasons for adding BHSC employees is set forth below.

### 1. Gas Engineering.

The Gas Engineering Services department began realigning its organization in 2017 to focus on improving technical support for BHC's natural gas utility subsidiaries including BH Nebraska Gas. It was identified within the integration of the prior SourceGas entities that the Company's Gas Engineering Services Department needed realignment and expansion to handle the ever-increasing regulatory requirements for gas utilities due to the increased service territory now under management. The focus has been to develop and staff a specific safety and integrity project management organization and a project management organization, to increase the engineering and project management support levels for capital projects. Positions are to be added to focus on integrity management programs, as well as GIS support.

**2. Corporate Accounting.**

The Company's Corporate Accounting department includes several key accounting and financial reporting functions of the organization. Corporate Accounting has identified the need to expand and enhance the employee support for its functional areas. The Corporate Accounting team has historically staffed at a lower than necessary level which has attributed to a higher than normal employee turnover ratio. To ensure appropriate levels of assistance for our operational business units, additional indirect headcount is needed. The accounting of federal and state regulatory requirements continue to increase throughout BHC regulated utility subsidiaries. Accordingly, BHSC requires additional Corporate Accounting staff ensure compliance is maintained.

**3. Information Technology.**

The Company's Information Technology department continues to enhance and requires additional headcount to continue to provide the organization with needed technology requirements and requests. In addition to the indirect employees identified above, there are several shared service employees that are considered direct employees that will support BH Nebraska Gas entities specifically.

**4. Training.**

The Company has added several positions for training its workforce of approximately 3,000 employees located in seven different states. These positions are needed to ensure that our employees are working in compliance with applicable rules and regulations and promoting customer and employee safety.

**5. Business Development.**

The Business Development department has identified several positions to drive growth through sales and marketing efforts, economic development and community partnerships and customer management.

**6. Supply Chain.**

With significant investment capital spending on infrastructure to serve approximately 1.2 million electric and natural gas customers located within seven states, BHSC has determined that expansion of its Supply Chain will lead to greater project efficiencies and timeliness of completing projects.

The BH Nebraska Gas share of the resultant operating costs for additional direct and indirect staffing in the Gas *Engineering* Services, Corporate Accounting Services, Information Technology, Community Affairs, Regulatory and Finance, and Business Development functions is $2,393,967.

**Q. PLEASE DISCUSS THE AREAS WHERE CORPORATE INITIATIVES ARE DRIVEN BY LONG-TERM UTILITY BUSINESS NEEDS.**

A. Corporate initiatives exist that require increased investment by BHC to ensure successful operations of all BHC subsidiaries, including BH Nebraska Gas. For example, BHC perceives cyber security and system reliability as a risk necessitating investment in key technological measures to reduce risks associated with cyber-attacks and system failures. BHC understands and appreciates the importance of protecting its electric and natural gas systems, as well as protecting customer information. Accordingly, BHC has determined that additional investment in cyber security and key information systems as prudent and necessary.

Another area of focused investment is in BHSC's centralized Gas Engineering function. As discussed in the Direct Testimony of Marc Lewis, pipeline safety and compliance continue to be the primary goal of the Gas Engineering Department. To meet the level of service needed in this area, additional staffing is required. The gas utility group, including BH Nebraska Gas, has significant capital investments planned in the near term to improve pipeline integrity. To successfully execute, while maintaining compliance with the myriad of regulations facing utilities (e.g., PHMSA, DOT, Federal and State Utility Commissions), additional investment in our Gas Engineering function is prudent.

**S. <u>Cyber Security and IT Adjustment</u>**

**Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT FOR THE CYBER SECURITY, AND INFORMATION TECHNOLOGY SYSTEMS COSTS.**

A. BHC began investing in a project internally called "CT20" in 2017. This is a security initiative adopted to respond to heightened cyber threats. It includes safeguards, known as "controls," that leading IT security professionals and governing bodies recognize as best practices. These 20 critical controls were created by: National Security Agency (NSA) Red and Blue teams, the US Department of Energy nuclear energy labs, law enforcement organizations and some of the nation's top forensics and incident response organizations including McAfee and Lockheed. The return on investment comes from being better able to avoid, detect, counteract or minimize security risks to property, information, computer systems and other assets. In addition to the critical controls, BHC has implemented information technology to enhance the safety and reliability of our gas distribution systems through updated GIS mapping and location related software. Existing software licensing and maintenance agreements maintained by BHC continues to increase at a slightly higher rate than other operating expense. The incremental investment and annual increased software expenses included as a pro forma adjustment to the Test Year amounts to a $558,975 increase in costs indirectly allocable to BH Nebraska Gas. The incremental projected costs are more specifically for BH Nebraska Gas's share of investments for the following technology security items:

(a) Increased tools for secure coding/development;
(b) New systems and expanded licenses for security logging, monitoring, and alerting including a security data lake system for analytics;
(c) Increased licenses for security vulnerability management - more assets are being scanned and analyzed;
(d) New technology for identity and access management;

(e) Expanded licenses for account management; and

(f) Expanded licenses for application whitelisting.[31]

### T. FERC Software Adjustment

**Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT FOR THE FERC SOFTWARE ADJUSTMENT.**

A. As a result of a FERC audit performed over one of BHC subsidiaries it was identified that certain software maintenance costs were incorrectly capitalized over several years. Based on this finding, an adjustment was made by BHC to remove these costs from capital and expense them in the Test Year. As these expenses are not considered as a normal cost of business, they have been removed from the test year, resulting in a decrease of $98,215 in the revenue requirement.

### U. Facilities Adjustment

**Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT FOR FACILITIES.**

A. BHC continues to undertake actions to update its facilities portfolio. The actions taken include the anticipated consolidation of BHC's Papillion and Council Bluff locations as well as the replacement of a Lincoln, NE facility rented by BHSC and allocated to the BH Nebraska Gas entities.[32] The consolidated office is located in Council Bluffs, IA and will maintain several

[31] Definition from techterms.com: A whitelist is a list of items that are granted access to a certain system or protocol. When a whitelist is used, all entities are denied access, except those included in the whitelist.
[32] Mr. Jarosz presents several other office facility consolidations and improvements in his direct testimony.

shared service employees as well as house a centralized safety training facility for our BH gas utilities. The Council Bluffs office will be owned by Black Hills/Iowa Gas Utility Company d/b/a Black Hills Energy ("Black Hills Energy – Iowa"), an affiliate company of BH Nebraska Gas, which is reflected as an increase in Account 931 Rent Expense.

In addition to the Council Bluffs facility BHC maintains two other facilities that are owned by affiliates, one in Rapid City, SD and one in Fayetteville, AR. Horizon Point in Rapid City, SD is owned by BH Black Hills Power, Inc. ("Black Hills Power") and the Fayetteville Millsap facility is owned by BH Nebraska Gas's affiliate Black Hills Energy Arkansas. The rent expense for these facilities is charged to BHSC (and ultimately allocated to BH Nebraska Gas) via an affiliate transaction under a Shared Facility.

The decision for (i) Black Hills Power, (ii) Black Hills Energy Arkansas and (iii) Black Hills/ Iowa Gas Utility Company to own the facilities was driven by the relative tax advantages to ownership at the utility versus the shared service level (both lower property tax and the absence of state income tax). In addition, the consolidation of offices in Rapid City at BHC's corporate offices also leads to over-all lower costs assigned to BH Nebraska Gas.

The Shared Facility Agreement provisions are modeled as a "revenue requirements" computation consisting of return on equity investment + Recovery of interest on debt financing + Depreciation Expense + Property Tax Expense + Income Tax + O&M Reimbursement at cost.

An additional adjustment in connection to the administrative and general transfer credit was applied to the rent expense charged to BHSC. Prior to the

Pro Forma year, intercompany rent expense was not included in the calculation of transferring costs to the balance sheet. It was determined by BHC that it was appropriate to start including intercompany rent into the expense that the credit is applied to. The inclusion of intercompany rent expense account is reflected as a decrease in account 922 Admin Expense Transfer Credit.

The office consolidation adjustments and the increased administrative and general transfer credit results in a net effect of to the pro forma period of an increase of $18,749 included in the revenue requirement.

**1. Affiliate Transactions**

**Q. WHAT IS AN AFFILIATE TRANSACTION?**

A. An Affiliate Transaction is defined in Commission Rule 001.01A2 as follows:

> The purchase, sale, trade or lease of a good, service, or tangible or intangible asset from the regulated utility to an affiliate, regulated or unregulated other than a shared resources affiliate, or from an affiliate other than a shared resources affiliate to the regulated utility.

Commission Rule 001.01A1 defines "Shared Resources Affiliate" as "… an entity who primary purpose is to share employees, departments, or other physical assets used by the jurisdictional utility."[33]

**Q. WHAT IS THE DIFFERENCE BETWEEN THE TWO TYPES OF AFFILIATE TRANSACTIONS?**

A. Commission Rule 005.07 requires that any payments to an affiliate other than a "Shared Resources Affiliate" demonstrate that the payment under affiliate

[33] 291 Neb. Admin. Code, Ch. 9, § 001.01A.

transaction is prudent and reasonably approximate market value.[34] Thus, Affiliate Transactions that are between BH Nebraska Gas and a Shared Resources Affiliate, (i.e., from BHSC or BHUH) do not require the same level of evidentiary support to be deemed prudent. Those Shared Resources Affiliate Transactions are deemed to be prudent.

On the other hand, if BH Nebraska Gas purchases gas supplies or other goods or services from an affiliate that is not a "Shared Resources Affiliate," then it must demonstrate that the costs charged by the affiliate reasonably approximate the market value of the good or service.

**Q. DOES BH NEBRASKA GAS PROVIDE A SCHEDULE DETAILING AFFILIATE TRANSACTIONS BETWEEN BH NEBRASKA GAS AND ITS AFFILIATES?**

A. Yes. Commission Rule 004.04F requires that BH Nebraska Gas provide a schedule detailing the Company's Affiliate Transactions.[35] The schedule detailing Affiliate Transactions for BH Nebraska Gas is provided as Application Exhibit No. 1, Section 3, Exhibit F.

### 2. Bad Debt

**Q. PLEASE EXPLAIN THE ADJUSTMENT FOR BAD DEBT EXPENSE SHOWN ON SCHEDULE H-7.**

A. The Company calculated an average effective uncollectible rate of 0.4402%. This is accomplished by calculating the three-year average of the bad debt

[34] 291 Neb. Admin. Code, Ch. 9, § 005.07.
[35] 291 Neb. Admin. Code, Ch. 9, § 004.04F.

expense associated with base rate and other revenues from January 1, 2017 through December 31, 2019. Then the Company divided the total three-year expense from January 1, 2017 through December 31, 2019, by the total base rate and other revenue over the same time period. To determine the adjustment, the Company multiplied the average effective uncollectible rate by the adjusted revenue requirement shown on Statement M, line 5 Column (e) plus the Gas Cost Revenues from Statement I, lines 4 and 10 Column (a). The result is a total company Test Year expense of $697,023 compared to the Base Year expense of $519,241. An adjustment of $177,782 incorporated to reflect the Test Year expenses calculated.

**Q. HOW WILL THE BAD DEBT EXPENSE ASSOCIATED WITH GAS PURCHASES BE RECOVERED?**

A. Bad debt expense associated with gas purchases will be recovered through the GCA for legacy BH Gas Utility and through the supplier charges calculated annually through the Choice Gas Program. The Company only included the bad debt expense associated with the portion of the customer bills included with the base rates, in its revenue requirement. This is consistent with the current method to recover bad debt expense.

## V. <u>Customer Payment Methods</u>

**Q. PLEASE DESCRIBE THE ADJUSTMENT FOR ALTERNATE FORMS OF PAYMENT ON SCHEDULE H-8.**

A. Under current base rates for BH Gas Distribution, the Commission has allowed the processing costs associated with credit card and ACH transactions to be included in the revenue requirement. This allows customers the convenience of paying their bill with a credit card or Automated Clearing House ("ACH") without the customer incurring separate fees. The Commission has not yet approved these processing costs for BH Gas Utility. The Company proposes to expand this practice for BH Nebraska Gas to include in the Company's Revenue Requirement Study processing costs associated with credit card and ACH transactions for the combined utility. The expansion of the customer payment methods to the other rate areas will enhance the Customer's relationship with BH Nebraska Gas. More and more customers want the convenience of multiple payment opportunities for payment. The estimate to expand this practice to the BH Gas Utility is $243,387. The Company makes the adjustment of $243,387 to reflect the expansion of the practice in the Test Year.

**W. <u>SourceGas Acquisition Regulatory Assets</u>**

**Q. DESCRIBE THE SYNERGY REGULATORY ASSET AMORTIZATION SHOWN ON SCHEDULE H-9?**

A. As discussed by Mr. Amdor in his direct testimony, in Application No. NG-0084 ("SourceGas Acquisition") the Commission ordered the Company to create a regulatory asset for two specific transition costs to be included in the Company's first Rate Review Application following the SourceGas Acquisition.[36] Those two costs are defined on page 11 of the order as:

> "… (1) costs related to long-term financing for the Transaction; and (2) Limited severance related costs as specified in the PA settlement Agreement … The regulatory asset value shall be established by the total sum of the Black Hills NE allocated share of the annual base salary of each employee of Black

[36] *See Commission Application No. NG-0084 (SourceGas Acquisition).*

> Hills Service Company ("BHSC"), BHUH and the acquired SourceGas companies that have been granted a severance payment within the first eighteen months following the closing of the acquisition. The allocation shall be determined as provided for in the Black Hills cost allocation manuals that are effective at the time of the severance. Black Hills NE shall not earn a return on the value of the regulatory asset.
>
> The amortization expense for determining the revenue requirement in Black Hills NE's first rate case shall be the value of the regulatory asset amortized over a four (4) year period…" *Id.*

**Q. WHAT IS THE AMOUNT OF THE REGULATORY ASSET AS DEFINED IN THE SOURCEGAS ACQUISITION ORDER?**

A. The regulatory asset balance is $850,705 with the annual amortization of $212,676. The regulatory asset balance is solely related to the item described as (2) Limited severance related costs. The annual amortization is added to the Base Year to reflect the annual amortization beginning in the Test Year.

**Q. DID THE COMPANY FILE A TRANSITION REPORT IN CONJUNCTION WITH REQUESTING THE RECOVERY OF THE SYNERGY REGULATORY ASSET?**

A. Yes. Mr. Klapperich presents and supports the Transition Report or Synergy Savings Report in his direct testimony.

## X. Research and Development Adjustment

**Q. PLEASE EXPLAIN THE RESEARCH AND DEVELOPMENT ADJUSTMENT SHOWN ON SCHEDULE H-10?**

A. The research and development adjustment relates to a fee BH Nebraska Gas proposes to pay to the Operations Technology Development ("OTD") organization, which then funds the Gas Technology Institute ("GTI"). OTD is a member-controlled partnership of natural gas distribution companies formed to develop, test, and implement new technologies. The objective of OTD is to address a wide range of technology issues related to gas operations and its infrastructure. By working collaboratively, participating companies leverage funds, so that no single company is responsible for carrying the entire financial burden. In addition, participants benefit from input from numerous sources, address common regulatory issues, and serve to demonstrate the broad industry support needed to gain the interest of potential product manufacturers. GTI is a research, development and training organization addressing energy and environmental challenges. The pro forma adjustment for the membership cost is $0.50 per customer multiplied by the average number of customers in the Test Year as determined by the average number of monthly bills from the billing determinants. The pro forma adjustment of $142,854 is shown on Schedule H-10 Line 1.

**Y. <u>Line Location Adjustment</u>**

**Q. PLEASE EXPLAIN THE LINE LOCATE ADJUSTMENT FOUND ON SCHEDULE H-11?**

A. This adjustment accounts for two changes in the cost for line locates. The first change is as discussed above under the labor adjustments, line locates outside of Lincoln, NE will no longer be completed by contractors, but rather done by Company employees. The second change is the price increase for line locates by the contractor for the Lincoln, NE area.

**Q. HOW DO THE CHANGES IN LINE LOCATES IMPACT THE REVENUE REQUIREMENT?**

A. First, the line locates outside of Lincoln, NE will no longer pay contractors to complete and those costs will be absorbed through the labor costs. Therefore, the Company included an adjustment to the Base Year to reflect the removal of $248,193 of costs that will no longer be paid to contractors in the Test Year. Second, the Company calculated the increase of line locate costs for Lincoln, NE due to the contracted rate increase. The rate increase causes an incremental cost of $410,191 over that of the Base Year. The net of these adjustments is to add $161,999 to the Base Year to reflect the costs incurred during the Test Year.

### Z. Fleet Depreciation Adjustment

**Q. PLEASE DESCRIBE THE ADJUSTMENT MADE FOR DEPRECIATION OF FLEET IN O&M ON SCHEDULE H-12?**

A. Depreciation expense associated with fleet investment is recorded into a clearing account and included in the fleet loading process, which allocates fleet costs based upon the actual use of the vehicles. An adjustment to the depreciation expense was made to annualize the expense. The adjustment is made with the recognition that only a portion of the actual expense is recorded to O&M Expenses, and that the remaining depreciation expense is coded to either capital projects or to non-utility expenses based on the use of the vehicle. The adjustment is then allocated to accounts in the same ratio as the fleet loadings. This method reflects the adjusted Test Year annualized depreciation expense as though it had been recorded through the fleet loadings process.

Therefore, fleet depreciation is not included on Statement J as part of the depreciation adjustment.

**Q. DID THE COMPANY USE THE NEW DEPRECIATION RATES PRESENTED IN EXHIBITS MCC-4 AND MCC-5 TO CALCULATE THE FLEET DEPRECIATION EXPENSE?**

A. Yes.

**Q. WHAT ARE THE RESULTS OF THE ADJUSTMENT FOR FLEET DEPRECIATION EXPENSE?**

A. The Company calculates a total reduction in fleet depreciation expense of $269,127 and uses the Base Year fleet loadings to determine that 39.66% of fleet loadings were recorded to capital or non-utility activities. The Company makes the adjustment to reduce fleet loading O&M expense due to the change in depreciation rates of $162,394 [$269,127 x (1-39.66%)]. This amount is then prorated to the individual O&M Accounts in the same ratio as the Fleet loadings were recorded during the Base Year.

## IX. <u>DEPRECIATION AND AMORTIZATION</u>

**Q. WAS A DEPRECIATION STUDY COMPLETED AS PART OF THIS RATE REVIEW?**

A. Yes, a single depreciation study was completed for BH Nebraska Gas as part of this rate review. That study is presented as Exhibit No. MCC-4 and represents the depreciation rates calculated for the combined company. Additionally, BHSC has implemented a new depreciation study as of March 1, 2020. BHSC's depreciation study was approved in two other states and is presented as Exhibit

No. MCC-5 and is used as the basis for calculating depreciation expense for allocated plant.

**Q. IS THE COMPANY ADOPTING ANY CHANGES IN ITS DEPRECIATION ACCOUNTING IN THIS PROCEEDING?**

A. Yes. Both the Company and BHSC are proposing to adopt the use of Accounting Release Number 15 ("AR 15"), which is a vintage year accounting method approved by the FERC, *Vintage Year Accounting for General Plant Accounts*, dated January 1, 1997.

**Q. PLEASE EXPLAIN VINTAGE YEAR ACCOUNGING UNDER AR 15?**

A. Vintage year accounting for group depreciation allows a company to simplify its depreciation method for high volume, low cost assets. This method does not require a company to track these types of assets individually, but rather allows for the assets to be systematically retired after their depreciable life. These assets are limited to assets commonly referred to as General Plant excluding buildings, transportation equipment, and land.

**Q. ARE ANY ACTIONS NECESSARY TO IMPLEMENT AR 15?**

A. Yes. Gannett Fleming recommends aligning the accumulated depreciation reserve balances with an appropriate starting point to implement AR 15. This realignment will reflect the appropriate Accumulated Depreciation balances going forward for depreciation groups that were calculated in the study and allows a clean implementation of AR 15. This realignment creates a debit balance, of unrecovered reserve, to be amortized separately from the depreciation study. The Company proposes to amortize BH Nebraska Gas' unrecovered reserve balance over 5 years. This amortization amount is

$212,172 and shown on Statement J, line 14. BHSC proposes to amortize its unrecovered reserve balance over 10 years. The allocated portion of this amortization expense for is $643,729 annually and is shown on Schedule J-1, lines 64 and 68.

**Q. PLEASE DESCRIBE HOW DEPRECIATION AND AMORTIZATION EXPENSE WAS CALCULATED IN THE REVENUE REQUIREMENT STUDY?**

A. Depreciation and amortization expense for assets directly owned by the Company was calculated by multiplying the adjusted plant balances as shown on Exhibit No. MCC-2, Schedule D-1, less any non-depreciable items, by each account's depreciation rate as presented in the Exhibit No. MCC-4 (Gas Plant Depreciation Study for BH Nebraska Gas). This study provides the on-going annual depreciation and amortization expense for the Test Year based on the plant in service at the end of the Test Year.

Depreciation and amortization expense for assets owned by BHSC was calculated by multiplying the allocated portion of each allocation basis by the corresponding composite rate of each method of allocation.

**Q. WHY WAS THE COMPOSITE RATE CALCULATED FOR THE BHSC ASSETS CALCULATED INSTEAD OF USING THE DEPRECIATION RATES FROM THE BHSC DEPRECIATION STUDY (EXHIBIT NO. MCC-5)?**

A. The composite rate was calculated in order to accurately determine the depreciation expense that would be allocated to the Company. For instance, computer software account 391.04 is allocated to the Company by multiple allocation factors. Software used to track locations of pipe would be used by all gas utilities and would use a blended ratio to allocate those assets to the Company. Additionally, software used produce customer bills for both electric and gas customers would be allocated based upon the customer count of all regulated utilities. Therefore, in order to calculate the appropriate amount of depreciation expense for each allocation method, the Company used the detail of the Base Year ending balance and depreciation expense as the basis of its composite rate for BHSC assets.

**Q. HOW WAS THE COMPOSITE RATE CALCULATED?**

A. The Company applied the depreciation rates from the Common Plant Depreciation Study for BHSC to the detail of the plant FERC accounts that make up each of the allocation methods.[37] The total depreciation expense calculated for each category and compared to the total plant used to determine the depreciation expense. The percentage of depreciation expense to the gross plant used to calculate the depreciation expense is the percentage used as the composite rate for each allocation method.

## X. TAXES OTHER THAN INCOME

**Q. WHAT ARE TAXES OTHER THAN INCOME?**

A. Taxes Other Than Income ("TOTI") are amounts paid to Federal, State, and local governments for revenues not associated with income. These taxes are: Federal Insurance Contributions Act ("FICA"), federal and state unemployment, property taxes, other payroll taxes, and Sales/Use tax.

[37] See Exhibit No. MCC-5 (Common Plan Depreciation Study for BHSC).

**Q. ARE THE AMOUNTS RECORDED IN THE BASE YEAR REPRESENTATIVE OF THE TEST YEAR?**

A. Unemployment taxes and Other payroll taxes are representative of the Test Year, but FICA, property taxes and sales/use tax are not representative of the Test Year.

**Q. WHY ARE BASE YEAR FICA TAXES NOT REPRESENTATIVE OF THE TEST YEAR?**

A. FICA tax is based on the wages that an employee makes and since the Company has adjusted the wages on Schedule H-4 then the FICA tax is disconnected from the amount of wages that will be paid. The Company adjusts the FICA taxes by the amount of the wage adjustment of $2,973,428 by .07645 (or the FICA rate) and ads the result of $227,467 to the FICA expense to align the wages requested with the FICA Tax expense. This calculation is shown on Schedule L-1 lines 2 through 4.

**Q. WHY ARE BASE YEAR PROPERTY TAXES NOT REPRESENTATIVE OF THE TEST YEAR?**

A. There are two reasons why Base Year property taxes are not representative of the Test Year. First, the Base Year expense recorded includes out of period adjustments related to the timing that occurs each year for the property tax expense estimated and actually incurred during the calendar year. Second, the Base Year Property tax expense does not represent the company plant additions proposed in this case.

**Q. PLEASE EXPLAIN THE PROPERTY TAX OUT OF PERIOD ADJUSTMENTS?**

A. Property taxes are finalized around the end of March for the previous calendar year, therefore, each calendar year's expense is estimated until the final amount is known. This process skews the annual expense recorded for both the prior year's true up and the true up to be made in the following year. For the Base Year, the booked annual expense would include a true up from tax year 2018, recorded in 2019, to increase expense by $12,019. The true up related to the Base Year expense was recorded in March of 2020 to decrease property tax expense by $106. Additionally, the Company recorded a credit to the property tax expense related to a prior period dispute that was settled in 2019. The amount associated with that settlement was recorded to decrease property tax expense by $247,984. The out of period adjustments to increase property tax expense by $235,859 ($247,984 - $12,019 - $106) represent the out of period adjustments necessary to reflect a normal property tax expense of $4,145,025 (or $3,909,166 + $235,859). The adjustment is shown on Statement L, line 27.

**Q. PLEASE EXPLAIN THE PROPERTY TAX ADJUSTMENT RELATING TO PLANT ADDITIONS ON SCHEDULE L-1?**

A. The Base Year property tax expense is based on the ending plant balances as of December 31, 2019. The Company adjusted the Base Year plant balances to reflect the December 31, 2020 (Test Year) plant balances and must adjust the property tax expense in order to maintain symmetry between the plant balances and the property tax expense.

**Q. HOW WAS THE PROPERTY TAX EXPENSE ADJUSTMENT CALCULATED FOR THE PLANT ADDITIONS?**

A. The Company calculated a ratio of property tax expense to plant balances. The resulting percentage ("Property to Gross Plant Factor"), achieved by dividing the property tax expense for 2019 by the total Gross Plant, is a reasonable estimate of incremental property tax expense expected from each dollar of Capital Additions and results in .05700% of the gross plant additions to be the incremental property tax expense for the test year. The total BH Nebraska Gas Capital Additions proposed are multiplied by the Property to Gross Plant Factor. This calculation is shown on Schedule L-1, lines 11 through 13.

## XI. TCJA TREATMENT

**Q. HAS THE COMPANY REFLECTED ALL OF THE IMPACTS OF THE TAX CUTS AND JOBS ACT ("TCJA") IN ITS REVENUE REQUIREMENT STUDY?[38]**

A. Yes. The Revenue Requirement Study reflects the impacts of the TCJA on several elements of cost, as follows:

- Federal income tax rate of 21% was used to determine income tax expense and ADIT;
- ADIT associated with all pro forma plant additions did not use bonus depreciation;
- The Deficient Deferred Income Tax ("DDIT") balances are included as an increase to rate base;

[38] *See Commission Application Nos. NG-0095.2 and NG-0095.3 (Tax Cut and Jobs Act).*

- Excess Deferred Income Tax ("EDIT") balances are included as a reduction to rate base; and
- The 2020 Average Rate Assumption Method ("ARAM") amortization was included as a component of the federal income tax expense.

**Q. PLEASE DESCRIBE THE EDIT THAT IS INCLUDED IN THE REVENUE REQUIREMENT?**

A. Mr. Klapperich classifies EDIT in two categories: Protected EDIT and Non-Protected EDIT. These categories are found on Schedule M-1, lines 29-34 with each subcategory described before netting EDIT and DDIT together. These amounts are components of Other Rate Base Items which is included in the calculation of rate base.

**Q. HOW WILL THE RETURN OF NON-PROTECTED EDIT IMPACT THE REVENUE REQUIREMENTS?**

A. The Company reflects the return of Non-Protected EDIT by removing the amounts refunded to customers through the bill credit. The amount refunded to customers is $4,497,852 million and is shown as the total of the adjustment on Schedule M-1 line 32. Mr. Klapperich discusses the origin and types of EDIT in his direct testimony.

## XII. <u>REVENUES</u>

**Q. HOW DO REVENUES IMPACT THE REVENUE REQUIREMENT?**

A. Revenues do not impact the calculation of the revenue requirement. Revenues are used as the measure of whether a company is receiving the required revenues calculated in the study. The difference between the revenues received and the revenue requirement is the Revenue Deficiency (if the revenues received are less than the revenue requirement) or the Excess Revenues (if the revenues received are more than the revenue requirement).

**Q. HOW WERE THE TEST YEAR REVENUES DEVELOPED FOR PURPOSES OF THE REVENUE REQUIREMENT STUDY?**

A. Statement I of the Revenue Requirement Study summarizes the per book revenues and the pro forma adjustments to provide the amounts used to calculate the revenue deficiency on Exhibit No. MCC-2, Statement N. The Company incorporated the adjusted Revenues for the Test Year as calculated and explained by Mr. Hyatt in his direct testimony.

**Q. PLEASE EXPLAIN THE ADJUSTMENT TO REMOVE UNBILLED AND OTHER REVENUES?**

A. Unbilled revenues represent revenue that is recorded during the Base Year that are associated with activity outside the Base Year. For this reason, unbilled revenues are eliminated from the total of the revenues. The Provision for Rate Refunds (Statement I, line 5) is associated with the refund of revenues associated with the reduction of income tax expense from the Tax Cuts and Jobs Act. The Company removes the Provision for Rate Refunds in order to align the revenues with tariff rates. The adjustment is found on Statement I, column (b).

**Q. PLEASE EXPLAIN THE REMOVAL OF DISCONTINUED REVENUES?**

A. The lease for rent associated with Company gas property has expired and the Company does not expect to receive any further revenues from the rental of its

Gas property. The Company removes $1,000 of rental revenue because it is not an ongoing revenue. The adjustment is found on Statement I, column (c).

**Q. WHAT IS THE BILLING DETERMINANT SYNCHRONIZATION ADJUSTMENT?**

A. This adjustment is required to synchronize the revenues calculated using the Base Year billing determinants and the revenues calculated from the accounting system. The differences between the billing determinants and the accounting system total $64,844 summing lower than the billing determinants. Therefore, the Company made an adjustment to increase revenues $64,844 and shows this adjustment on Exhibit No. MCC-2, Statement I, column (d).

**Q. DOES THIS ADJUSTMENT NOW ALIGN THE REVENUES TO THE BILLING DETERMINANTS PRESENTED BY MR. HYATT?**

A. Yes. The sum of columns (a) through (d) equals the total presented by Mr. Hyatt in Application Exhibit No. 1, Section 3, Exhibit B, Line 1 for both the jurisdictional base rate revenues of $118,459,393 (Exhibit No. MCC-2, Statement I, line 2) and non-jurisdictional revenues of $23,448,534 (Exhibit No. MCC-2, Statement I, line 9).

**Q. WHAT ARE THE REMAINING ADJUSTMENTS FOR BASE RATE REVENUES?**

A. The remaining adjustments to base rate revenue are explained in detail by Mr. Hyatt in his direct testimony. The remaining adjustments are:

- Customer Revenues – column (e),
- Customer Class – column (f),
- Weather Normalization – column (h),

- Incremental Growth – column (i),
- Agriculture Revenue – column (j),
- Pipeline Replacement – column (k),
- 2020 System Safety and Integrity Rider – column (l), and
- Fuel Line Replacement – column (m).

**Q. ARE THERE ANY OTHER ADJUSTMENTS TO REVENUES?**

A. Yes, the Company made two adjustments to non-base rate revenues. First, the Company removed the revenues associated with gas costs, in Statement I, column (g), because those revenues would be collected under the GCA. The O&M adjustment discussed above for Exhibit No. MCC-2, Schedule H-3 removes the purchase gas costs that are collected in the GCA to maintain symmetry between the income and expenses calculated in the Revenue Requirement Study. The second adjustment to revenues is a revenue credit calculated for the use of utility property in the performance of non-utility work, in Exhibit No. MCC-2, Statement I, column (n) and detailed on Exhibit No. MCC-2, Schedule I-2.

**Q. HOW WOULD THE COMPANY USE UTILITY PROPERTY TO PERFORM NON-UTILITY WORK?**

A. The Company uses resources primarily for the function and maintenance of the system. The Company also takes the opportunity to satisfy the non-utility needs of its customers by conveniently assisting with appliance repairs. As explained earlier in my testimony, a BH Nebraska Service Technician may be called to a customer’s premise to check for a suspected gas leak. The Service Technician may discover that the repair needed is not needed for Company owned property.

However, a repair may be needed to stop a gas leak on customer owned property such as a furnace or water heater. The Service Technician can perform that leak repair work directly for the customer, and will code the time, expenses, and revenues associated with that repair work to be recorded in Non-Utility Operating Income (& Expense)[39].

**Q. WHAT IS INCLUDED IN THE REVENUE REQUIREMENT TO PERFORM THE NON-UTILITY WORK?**

A. Plant in service used to complete the non-utility work is included in the rate base of the revenue requirement. None of the O&M expenses associated with non-utility work are included in the revenue requirement.

**Q. DOES THE REVENUE CREDIT PROVIDE THE NECESSARY OFFSET TO THE REVENUE REQUIREMENT?**

A. Yes. The revenue credit serves as a reduction to the revenue requirement for rate design purposes to provide customers with the offset necessary to account for the use of those assets in a non-utility business.

**Q. HOW WAS THE REVENUE CREDIT CALCULATED?**

A. The credit was calculated by allocating the net plant in service of the assets used by either the use of the fleet loading rates or by the ratio of revenues generated. Fleet loading rates were used to allocate the use of vehicles, communication equipment, and other equipment (plant accounts 387, 392, 396, and 397), and revenues were used to allocate the remainder of the general plant function such as tools, computer equipment, structures and improvements, and land. Once the

[39] See Statement B Line 24 for reference of where non-utility revenues and expenses are recorded in the Company financials.

rate base components were allocated (as shown on Exhibit No. MCC-2, Schedule I-2, page 2), then revenue requirement was calculated based upon the proposed WACC, an allocated portion of the property tax expense, and the income tax expense associated with the rate base. The revenue requirement calculation is shown on Schedule I-2, page 1 and shows that there is $1,023,704 included in the revenue requirement that is offset by the revenue credit adjustment on Exhibit No. MCC-2, Statement I, column (n).

## XIII. SHARED SERVICES COSTS

**Q. PLEASE DESCRIBE THE NATURE OF BLACK HILLS CORPORATION ("BHC") AND ITS CENTRALIZED SHARED SERVICE FUNCTIONS.**

A. BHC is a public utility holding company subject to regulation under the Public Utility Holding Company Act of 2005 ("PUHCA"). BHC operates with two major business groups: 1) Utilities - which deliver retail electric and natural gas service in eight states through twelve regulated jurisdictional utilities; and 2) Non-regulated Energy - which is involved in various wholesale energy businesses.

As described in the testimony of Mr. Amdor, BH Nebraska Gas is a Nebraska limited liability company and is also a separate operating regulated utility subsidiary in the BHC organization. BH Nebraska Gas owns regulated utility assets in Nebraska and has employees to manage BH Nebraska Gas operations.

As a utility company operating in multiple states, BHC created and historically utilized two shared service companies (i.e., BHSC and Black Hills

Utility Holdings ("BHUH")), which provided essential centralized shared services to each of its subsidiaries. As is discussed further below, the two shared service companies were combined effective January 1, 2019, with BHSC as the surviving centralized shared service organization. As noted above, BHSC and BHUH are defined as Shared Resources Affiliates of BH Nebraska Gas.

Costs of centralized shared services are assigned pursuant to a Cost Allocation Manual ("CAM"). Having centralized service functions avoids the cost of duplication of the functions, assets, and expertise, but still has access to all the resources necessary to conduct business efficiently. Accordingly, BHC subsidiaries, such as BH Nebraska Gas, realize lower costs through the sharing of these services and assets with other BHC subsidiaries.

**Q. WHAT IS MEANT BY SHARED SERVICE COSTS AND SHARED SERVICE ASSETS?**

A. In the context of this proceeding, shared service costs are the costs for services provided by centralized employees and functions for the benefit of any of BHC's subsidiaries needing that particular service. Examples of centralized shared services include information technology, accounting, tax, regulatory, engineering, gas supply, shipper services, and legal services. Shared service assets reflect the investment in plant assets purchased and owned by centralized functions that benefit multiple BHC subsidiaries, including BH Nebraska Gas. Examples of shared service assets, also referred to as common assets, include the Customer Information System, computer software (such as Click, SCADA, Endur), computer hardware, the Enterprise Resource Planning system

(PeopleSoft), corporate pooled vehicle fleet, buildings and facilities. These assets are held at the BHSC level for the benefit of more than one BHC subsidiary.

**Q. PLEASE PROVIDE SOME BACKGROUND REGARDING BHC'S USE OF SHARED RESOURCES AFFILIATE SERVICES.**

A. Upon acquiring Cheyenne Light in 2005, BHC became a registered Public Utility Holding Company under PUHCA. The PUHCA includes provisions regarding the distribution of common corporate costs between the various regulated and non-regulated subsidiaries. As is common practice for registered PUHCA holding companies, BHC established a separate service company subsidiary, BHSC, where most common shared services activities occur. Following BHC's acquisition of multiple gas and electric utilities in four states in 2008 from Aquila, Inc., BHC created a second service company subsidiary, BHUH. The additional service subsidiary was needed at the time to provide utility-specific services.

Effective January 1, 2019, in a process improvement effort designed to eliminate complexity from the business, BHC transitioned all centralized service functions from BHUH to BHSC, resulting in only one shared service company. BHSC charges its shared services, at cost, to the benefited subsidiaries under the terms of the BHSC CAM, included as Application Exhibit No. MCC-2, Exhibit F. Under the BHSC CAM, costs for Shared Resources Affiliate services are either directly charged, directly distributed, or indirectly allocated to the various subsidiaries at cost.

**Q. ARE THE SERVICES PROVIDED TO BH NEBRASKA GAS UNDER A WRITTEN AGREEMENT?**

A. Yes. BH Nebraska Gas as well as all other BHC regulated utilities, operates under a written service agreement with BHSC. Prior to 2019, BHC regulated utilities have operated under separate service agreements with BHUH and BHSC.[40] With the combination of centralized shared service functions under BHSC effective January 1, 2019, only one operable service agreement is needed.[41] The agreement calls for BHSC to provide services at cost to BH Nebraska Gas through direct charges and indirect charges. Expenses for support services received by BH Nebraska Gas are charged to BH Nebraska Gas on a monthly basis pursuant to the agreement.

**Q. DID BH NEBRASKA GAS RECEIVE SHARED SERVICES DURING THE BASE YEAR?**

A. No. The entity BH Nebraska Gas was not an existing or operating utility during the Base Year, however, the two operating utilities of BH Gas Utility and BH Gas Distribution did receive centralized shared services during the Base Year from BHSC.

**Q. WILL BH NEBRASKA GAS CONTINUE TO RECEIVE SHARED SERVICES FROM BHSC?**

A. Yes. BH Nebraska Gas will continue to receive shared services from BHSC in the same manner as BH Gas Utility and BH Gas Distribution received services prior to their consolidation into BH Nebraska Gas.

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[40] The service agreements between BH Gas Utility or BH Gas Distribution and BHUH or BH Service Company in place prior to 2019 are included as Exhibit Nos. MCC-6, MCC-7, and MCC-8.
[41] See Application No. 1, Section 2, Exhibit F (2019 CAM).

**Q. ARE THE COSTS ALLOCATED BY BHSC IN THIS PROCEEDING CONSIDERED TO BE FROM A SHARED RESOURCES AFFILIATE?**

A. Yes. Those costs are allocated to BH Nebraska Gas pursuant to the methodologies established in the BHSC CAM. Those costs are prudent and reasonable costs to be allocated through the CAM. For example, the BHSC Supply Chain purchases materials and supplies from third-party vendors, at market prices, and often engages in competitive bidding for its pipes, materials, equipment, and other supplies. Similarly, the employee costs that flow through the CAM are established by using market studies for compensation. The same process is true for other items purchased by BHSC and then allocated to BH Nebraska Gas through the CAM.

**Q. WHAT TYPES OF SHARED SERVICES DOES BH NEBRASKA GAS RECEIVE?**

A. BHSC provides essential services to BH Nebraska Gas, such as human resources, legal, accounting, and regulatory and finance services. BHSC also provides the essential utility-specific services formerly provided by BHUH, primarily related to customer service, engineering, gas supply services administration, and regulatory.

**Q. HOW DOES BH NEBRASKA GAS BENEFIT FROM THE SHARED SERVICES AND INVESTMENTS IN COMMON ASSETS PROVIDED BY BHSC?**

A. Having a central source for the necessary shared services minimizes the need for each subsidiary, including BH Nebraska Gas, to provide such services independently. The result is the business units gain access to specialized skills and resources in an efficient and cost-effective manner. The goals for BHSC are to: (i) generate efficiencies through the sharing of standardized best practices across all utilities, (ii) enhance the ability to share resources across the companies; (iii) reduce liability through the implementation of risk-pooling and best practices; and (iv) provide the attendant cost efficiencies across all utilities. For example, BH Nebraska Gas benefits from the shared service functions described below:

**A. <u>Gas Engineering</u>**

Develops standardized operating procedures and manuals designed to ensure safe and reliable operations and maintenance of all gas utilities; trains technicians; employs specialized professional engineering and design professionals in-house; develops integrity management plans; and ensures compliance with regulations put forth by the Department of Transportation ("DOT") and Pipeline and Hazardous Materials Safety Administration ("PHMSA").

**B. <u>Gas Supply and Load Services</u>**

Provides for the development and execution of the natural gas supply portfolio plans for all gas distribution operating companies.

**C. <u>Customer Service</u>**

Provides centralized call centers, field resource centers (i.e., dispatch) and billing department that capture economies of scale when supporting multiple utilities; and develops standard and best practice implementation of technology to make it easier for customers to conduct business with BHC utility subsidiaries.

**D. Business Development**

Provides program management for the development of customer energy solutions; and acts as a centralized point of contact for new large customers seeking the provision of utility services.

**E. Regulatory and Finance**

Manages required filings and reporting with state utility commissions; employs specialized subject matter experts in regulatory affairs with best practice sharing and implementation across multiple jurisdictions; and ensures compliance with regulations put forth by the Federal Energy Regulatory Commission ("FERC").

**F. Executive Management**

Provides stable and long-term-focused management of all utilities; and manages investor relations such that capital markets can be accessed readily and in a cost-effective manner to support the capital needs of all utilities.

**G. Human Resources**

Administers consistent benefit programs across all utilities; reduces compliance risk by employing specialized personnel to perform duties relative to Internal Revenue Service (“IRS”), Department of Labor, and other regulatory agencies; administers payroll for all utilities; and implements organizational development initiatives as well as recruiting functions to ensure BHC can attract, develop and retain talent in the organization.

**H. <u>Information Technology</u>**

Manages the use of operational and administrative technology throughout the organization including supervisory control and data acquisition ("SCADA"), billing, metering, accounting, payroll and cyber security; and deploys common IT systems and platforms that result in economies of scale.

**I. <u>Legal</u>**

Employs specialized in-house attorneys. The Legal Department provides legal support to all utilities.

**J. <u>Supply Chain/Procurement</u>**

Provides a centralized procurement function for bulk purchasing and the use of master agreements with large suppliers allowing for lower costs per-unit. Negotiating leverage is increased with suppliers when larger, centralized orders are placed.

**K. <u>Accounting</u>**

Provides specialized and centralized support in the areas of accounting, treasury, tax and internal audit; and reduces Securities and Exchange Commission, IRS, Pension Benefit Guaranty Corporation and other compliance risk by employing subject matter experts and deploying best practices across all utilities.

## XIV. THE COST ALLOCATION MANUAL

**Q. WHAT IS A COST ALLOCATION MANUAL?**

A. A cost allocation manual or CAM is an internal written document that governs and directs how corporate costs and assets are distributed among the corporation's affiliates. Or more simply stated, the CAM is the document that details the methodology used to allocate shared service costs.

**Q. WHAT CAMS WERE USED TO DEVELOP BH NEBRASKA GAS'S REVENUE REQUIREMENT IN THIS PROCEEDING?**

A. The BHSC CAM in place as of December 20, 2019, presented as Application Exhibit No. 1, Section 2, Exhibit F, was used to develop BH Nebraska Gas's proposed revenue requirement in this proceeding for both the Base Year and the Test Year.

**Q. PLEASE PROVIDE AN OVERVIEW OF THE CAM.**

A. The CAM employs the Modified Massachusetts formula[42] and identifies the methods used to ensure that expenditures are appropriately and consistently assigned, distributed or allocated among utility operations and to the non-regulated activities within BHC. In accordance with the CAM, costs incurred by BHC to support and administer non-regulated activities are charged to non-regulated accounts to avoid any subsidization.

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[42] The methodology applied in the BHSC and BHUH CAM is modeled after a commonly used multi-factor formula approved for use by state and federal utility regulators called the "Modified Massachusetts" formula. The Modified Massachusetts formula consisting of direct labor, capital investment and net operating revenues (i.e. without cost of goods sold) was initially approved in *Distrigas of Massachusetts Corp*., 41 FERC ¶ 61,205 (1987). *See Accounting for Public Utilities*, by Robert L. Hahne and Gregory E. Aliff, Release No. 31, November 2014 Chapter 19.03[4][d]

**Q. WHAT IS THE DIFFERENCE BETWEEN ASSIGNED, DISTRIBUTED, AND ALLOCATED COSTS?**

A. Direct costs are either assigned or distributed, while indirect costs are allocated. Direct costs are those corporate costs that are specifically associated with a particular service or product within an identified subsidiary or group of identified subsidiaries and result in direct charges to the service or product within that specific subsidiary or group of subsidiaries. Indirect costs are those corporate costs that cannot be identified with a particular service or product within an identified subsidiary. This means the costs indirectly support all subsidiaries or directly support the operation of BHSC. All services billed to BHC subsidiaries are either directly assigned, directly distributed, or where direct assignment/distribution is not practical, allocated as indirect costs under allocation methodologies based on cost causation principles as memorialized in the CAM.

**Q. HOW ARE DIRECT COSTS CHARGED TO BH NEBRASKA GAS?**

A. The costs of services that can be directly assigned or distributed to a service or product within a subsidiary are billed directly to the service or product within that benefiting subsidiary. An example of a directly assigned charge to BH Nebraska Gas is a trainer from the Gas Engineering Department provides safety and operating procedure training to the employees of BH Nebraska Gas. The employee related expenses associated with the training are specifically associated with BH Nebraska Gas. Therefore, this would be a directly assigned cost.

An additional type of direct cost is a cost that is distributed directly to a BHC entity. A directly distributed cost is a cost that benefits a product or service of multiple BHC subsidiaries and can be distributed based upon a primary cost driver. By reflecting the operational characteristics of a service, the directly distributed cost methodology transfers costs to the BHC subsidiaries in an impartial manner. The directly distributed cost methodology reflects how each BHC subsidiary caused the costs of a product or service to be incurred in a stable, predictable and consistent method. An example of a directly distributed cost is the cost of centralized employee benefit administration by members of the Human Resource Department. The costs are distributed under the CAM to the multiple product lines and services within the BHC subsidiaries that benefit from the service based on the cost driver of employee count.

**Q. HOW ARE INDIRECT COSTS CHARGED TO BH NEBRASKA GAS?**

A. Indirect costs that are not associated with a product or service within an identified subsidiary, or that are attributable to more than one product or service within multiple subsidiaries, are indirectly allocated as mandated by the CAM. Such indirect costs are allocated using one of several pre-defined allocation ratios. Where applicable, each BHSC department has been assigned an allocation ratio for its indirect costs based on the primary cost driver of the department. All indirect costs of that department are then allocated using the department's assigned allocation ratio set forth in the CAM. An example of an indirectly allocated cost is the Corporate Accounting department's monthly closing of the consolidated BHC financial statements. Since the Corporate Accounting department is supporting all the subsidiaries of the enterprise, it is impractical to directly charge. Thus, the charge would be considered an indirect cost. The monthly financial close activity is in support of all products and services within BHC subsidiaries, thus, the driver for the indirect costs is the relative managerial attention invested in a given subsidiary as measured by the plant, margin and payroll (the "blended ratio") of the subsidiary. The indirect costs for the consolidated monthly financial close activity are allocated to BH Nebraska Gas using a pre-defined allocation based on the blended ratio[43].

**Q. DOES THE CAM DIFFERENTIATE BH NEBRASKA GAS FROM BHC'S ELECTRIC UTILITIES, NON-REGULATED SUBSIDIARIES, AND OTHER NATURAL GAS UTILITIES?**

A. Yes. BH Nebraska Gas is a regulated natural gas utility and is assigned and allocated costs consistent with its inclusion in the natural gas utility segment of BHC. The CAM language differentiates BHC's natural gas utilities from BHC's electric utilities and non-regulated affiliates. For example, certain departments, such as the Design Engineering - Gas Department's indirect costs are allocated exclusively to the natural gas utility segment. Similarly, Electric Engineering Services, exclusively serve the electric utility segment. Therefore, the indirect costs incurred by the Electric Engineering Services department are allocated exclusively to the electric utility segment.

**Q. WHEN WAS THE CAM LAST UPDATED?**

A. The last update to the CAM was completed December 20, 2019. The update included some minor changes in department names, grammatical errors, and

[43] See Appendix 2 included within the CAM (Application Exhibit No. 1, Section 2, Exhibit F) for a listing of all allocation ratios, including the blended ratio.

other updates. The most substantive update was to document the process of allocating to FERC Functional Accounts. This process was to ensure that utilities would not receive allocations for which the utility does not perform. For example, BHC does have the function of production and gathering operations among its gas utilities, but BH Nebraska Gas does not have production and gathering operations as part of its operations. Therefore, allocations should and do only allocate to utilities that have those operations. This practice was being done as part of the process throughout the Base Period but was found during the annual review that the process was not documented in the BHSC CAM, therefore, the CAM was updated to document the process.

Prior to that update the BHSC CAM experienced a significant change on December 31, 2018 to recognize the transfer of shared service functions from BHUH to BHSC. With this amendment, allocations from BHUH were eliminated. The amendment terminated the BHUH CAM because BHUH no longer performs shared service functions. In addition to the CAM amendments made for the BHUH-to-BHSC shared services transfer, BHC amended the CAM consistent with changes resulting from its annual CAM review procedure. The annual CAM review was performed independently from the combination of the shared service organizations.

**Q. WILL BHC CONTINUE PROVIDING SHARED SERVICES THROUGH TWO SEPARATE SERVICE COMPANIES?**

A. No. As mentioned earlier in my testimony, effective January 1, 2019, BHC provides shared services to each of its subsidiaries only through BHSC, rather than through both BHSC and BHUH. As part of a continuous improvement effort, BHC determined that the service functions provided by BHC's two shared service companies (i.e. BHSC and BHUH) should be combined into one. Accordingly, BHC decided that on and after January 1, 2019, BHSC will provide all shared service functions to BHC subsidiaries. The shared services and employees of BHUH were transferred to BHSC. With very minor exceptions, beginning January 1, 2019, only BHSC provided centralized shared services to all BHC subsidiaries.

**Q. HOW DOES THE COMBINATION OF SERVICE COMPANIES AFFECT BH NEBRASKA GAS?**

A. Employee departments previously operated under BHUH were moved to BHSC at the end of 2018. BHUH will continue to exist as a parent entity to BHC regulated utility subsidiaries, including BH Nebraska Gas. BHUH will not provide services to its subsidiaries as those services will be provided by BHSC.

**Q. DID THE TRANSFER OF SHARED SERVICES FROM BHUH TO BHSC IMPACT NON-REGULATED ACTIVITIES OF BHC?**

A. No. The transfer of shared service functions from BHUH to BHSC did not cause any change in the required separation of costs and assets for regulated and non-regulated entities of BHC.

**Q. WERE ANY EFFICIENCIES GAINED BY THE TRANSFER OF SHARED SERVICES FROM BHUH TO BHSC?**

A. Yes. Moving BHUH departments to BHSC eliminated what has historically been a "two-step allocation process." The two-step process was the process of first allocating indirect BHSC costs to BHUH for service provided by BHSC for BHUH. The second step in the two-step process occurred when BHUH allocated all its costs, including those from BHSC, to each of the BHUH regulated utility subsidiaries. Eliminating the two-step process reduces unnecessary complexity. Over time, less complexity and a fewer number of service companies will also create compliance cost efficiencies. For example, BHC filed two FERC Form 60 *Annual Report of Centralized Service Companies* ("Form 60 Report"), and after the transfer of shared services from BHUH to BHSC only one Form 60 Report is required.

**Q. WILL THE TRANSFER OF BHUH SHARED SERVICES TO BHSC SHIFT MORE COSTS TO BH NEBRASKA GAS?**

A. No. This corporate change in shared services does not produce any overall impact or change in allocation of costs to the utilities. BH Nebraska Gas will neither be advantaged nor disadvantaged from the decision to move shared services from BHUH to BHSC. The cost for shared services that were previously allocated by BHUH will now be allocated by BHSC as BHSC will be providing those shared services instead of BHUH.

**Q. DID BHUH ALLOCATE COSTS DURING THE BASE YEAR TO BH NEBRASKA GAS OR THE LEGACY COMPANIES BH GAS UTILITY AND BH GAS DISTRIBUTION?**

A. No. As discussed earlier, BHSC became the single shared service company at the beginning of the Base Year and has maintained that status ever since January 1, 2019. BH Nebraska Gas and its legacy companies began allocating costs through one CAM on that date.

## XV. CONCLUSION

**Q. DOES THIS CONCLUDE YOUR PRE-FILED DIRECT TESTIMONY?**

A. Yes.

STATE OF NEBRASKA )

) SS

COUNTY OF LANCASTER )

I, Michael C. Clevinger, being first duly sworn on oath, depose and state that I am the witness identified in the foregoing prepared testimony and I am familiar with its contents, and that the facts set forth are true to the best of my knowledge, information and belief.

Michael C. Clevinger

Subscribed and sworn to before me this 27th day of May, 2020.

(SEAL)

GENERAL NOTARY - State of Nebraska
CHRISTINA L. ELLIS
My Comm. Exp. July 4, 2022

Notary Public

My Commission Expires:

07/02/2022