

BEFORE THE STATE CORPORATION COMMISSION  
OF THE STATE OF KANSAS

In the Matter of the Application of Black Hills/Kansas Gas Utility Company, LLC, d/b/a Black Hills Energy, for Approval of the Commission to Make Certain Changes in its Rate for natural Gas Service

Docket No.

14-BHCG-502 -RTS

---

DIRECT TESTIMONY OF

BRIAN G. IVERSON

FOR BLACK HILLS/KANSAS GAS UTILITY COMPANY, LLC

---

1        **I. INTRODUCTION AND QUALIFICATIONS**

2        **Q. WHAT IS YOUR NAME AND BUSINESS ADDRESS?**

3        A. My name is Brian G. Iverson. My business address is 625 9th Street, Rapid City,  
4        South Dakota 57709.

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

6        A. I am currently employed by Black Hills Service Company (“Service Company”),  
7        and serve as Vice President and Treasurer of Black Hills Corporation (“BHC”) and  
8        its subsidiaries.

9        **Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS APPLICATION?**

10       A. I am appearing on behalf of Black Hills/Kansas Gas Utility LLC (“Black Hills  
11       Kansas” or the “Company”), a wholly-owned subsidiary of Black Hills Utility  
12       Holdings.

1 **Q. PLEASE DESCRIBE YOUR DUTIES AND RESPONSIBILITIES IN YOUR**  
2 **CURRENT POSITION.**

3 A. In my role, I am responsible for the financing activities of BHC and its  
4 subsidiaries and affiliates, including Black Hills Kansas.

5 **Q. WOULD YOU PLEASE OUTLINE YOUR EDUCATIONAL AND**  
6 **PROFESSIONAL BACKGROUND?**

7 A. I have a B.S. degree in Accounting and a M.B.A. from the University of South  
8 Dakota. I am a Certified Public Accountant (South Dakota). I have a law degree  
9 also from the University of South Dakota.

10 I have been employed by BHC since 2004, working in various positions within the  
11 legal, regulatory, resource planning, and finance areas. Prior to joining BHC, I  
12 worked in the banking industry and in the private practice of law, where I focused  
13 on business and financial transactions.

14

15 **II. PURPOSE OF TESTIMONY**

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

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

- 19
- Certify Books and Records of Black Hills Kansas;

20

  - Certify Use of Federal Energy Regulatory Commission (“FERC”) Uniform  
21 System of Accounts for Black Hills Kansas;

22

  - Discuss the corporate finance philosophy of Black Hills Kansas;

23

  - Support the proposed capital structure of Black Hills Kansas;

- 1           • Support the cost of long term debt and cost of equity;
- 2           • Discuss debt financing activity; and
- 3           • Support the weighted average cost of capital.

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

5 A. Yes. I am sponsoring Exhibit BGI-1, which I will describe and refer to in my

6 testimony.

7 **Q. DOES YOUR DIRECT TESTIMONY SUPPORT ANY SPECIFIC SCHEDULES**

8 **THAT ARE PART OF THE COMPANY’S RATE APPLICATION IN THIS**

9 **PROCEEDING?**

10 A. Yes. My testimony supports the weighted average cost of capital schedules.

11 **Q. HAVE THE TESTIMONY AND EXHIBITS WHICH YOU ARE SPONSORING**

12 **BEEN PREPARED BY YOU OR UNDER YOUR SUPERVISION?**

13 A. Yes.

14

15 **III. ACCOUNTING RECORDS**

16 **Q. ARE YOU FAMILIAR WITH THE BOOKS AND RECORDS OF BLACK HILLS**

17 **KANSAS AND THE MANNER IN WHICH THEY ARE KEPT?**

18 A. Yes. The financial statements and records have been prepared on the accrual

19 basis in conformity with GAAP and in accordance with accounting requirements

20 of the FERC as set forth in its applicable Uniform System of Accounts.

21

1 **IV. FINANCIAL INTEGRITY OF BLACK HILLS KANSAS**

2 **Q. PLEASE EXPLAIN THE CORPORATE FINANCE PHILOSOPHY OF THE**  
3 **COMPANY.**

4 A. The corporate philosophy of Black Hills Kansas is the same philosophy of BHC.  
5 That philosophy is that Black Hills Kansas must maintain financial integrity and its  
6 ability to access capital as needed at a reasonable cost. Financial integrity is  
7 critical to Black Hills Kansas' ability to satisfy its obligation to supply safe and  
8 reliable natural gas delivery services. BHC defines financial integrity as the  
9 financial stability necessary to weather the peaks and valleys of business cycles,  
10 volatility in financial markets and interest rates, and unanticipated changes in  
11 operational requirements; all of which may strain an organization's ability to  
12 finance expenditures and provide quality service. A strong financial position  
13 provides the financial flexibility necessary to meet the ongoing demand for utility  
14 services. BHC is conservative in its financial philosophy and only takes on risk  
15 where appropriate and reasonable. Even with a conservative corporate finance  
16 philosophy, no corporation is insulated from market forces, credit crunches, and  
17 other financing difficulties that cannot be foreseen or avoided. In those  
18 situations, BHC follows the guidelines of prudence and reasonableness in  
19 evaluating its credit and financing options.

20 **Q. WHAT IS BLACK HILLS KANSAS' PRO FORMA CAPITAL STRUCTURE?**

21 A. My testimony supports the actual capital structure for Black Hills Kansas of 50.34  
22 percent equity and 49.66 percent debt.

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

1 A. Mr. McKenzie will cover this topic in greater detail; however, investors generally  
2 rely on nationally recognized credit rating services to evaluate a company's  
3 financial integrity and to inform them of the company's current financial  
4 position. Three nationally recognized credit rating services are Moody's  
5 Investors Service ("Moody's"), Standard and Poor's ("S&P"), and Fitch Ratings  
6 ("Fitch"). As of the end of March, BHC's senior secured debt is respectively rated  
7 Baa1 by Moody's, BBB by S&P, and BBB by Fitch. Fitch rates with a "positive"  
8 outlook, and Moody's and S&P rate as "stable." In 2013, all three of the credit  
9 agencies upgraded BHC's credit rating, and Moody's upgraded BHC again in  
10 January 2014.

11 **Q. HOW DOES BHC'S CREDIT RATINGS AFFECT BLACK HILLS KANSAS?**

12 A. Since Black Hills Kansas does not access the credit markets directly, it sources  
13 financing through BHC. The Company's financing and liquidity needs are  
14 provided by BHC. The credit quality of BHC and recent improvements in ratings  
15 for BHC reduce the cost of debt used to finance the utility's operations and in  
16 turn, reduce costs to customers. This is explained in more detail below in  
17 Section VI.

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

19 A. The credit rating services issue guidelines that all companies must follow. In  
20 general, a company must provide detailed financial and operational information  
21 to rating agencies for their analysis before issuing credit ratings for the  
22 company's securities. As noted below, these credit rating agencies compare  
23 quantitative measures of a company's financial performance, as well as a

1 qualitative assessment of the company's risks (such as management, forecasts,  
2 and regulatory climate), to their guidelines to rate the company and determine  
3 the investment attributes of its debt securities. The credit ratings given by these  
4 agencies provide important information to creditors, investors, vendors and  
5 counterparties regarding the creditworthiness and financial risk of BHC and its  
6 subsidiaries.

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

8 A. There are several steps in the ratings evaluation process. One step in the  
9 methodology is to assess the credit support that is gained from operating within a  
10 particular regulatory framework. The rating agencies also consider the level of  
11 risk posed by the business. These criteria and others established by the credit  
12 rating agencies then lead to an overall assessment of the qualitative business  
13 risk of the company's activities.

14 As part of the quantitative assessment of a given entity, the rating agencies will  
15 review numerous financial ratios of a given entity. Such ratios will be used to  
16 review trends over various periods of time within a given entity, as well as to  
17 provide comparisons among other companies in a given industry, or among  
18 various industry averages.

19 For example, Moody's has identified four areas that are considered most useful  
20 in completing analysis for electric utility companies. They are as follows: (1)  
21 Regulatory Framework, (2) Ability to Recover Costs and Earn Returns, (3)  
22 Diversification and (4) Financial Strength and Liquidity. By maintaining credit

1 quality and higher credit ratings, BHC achieves better credit terms and lower cost  
2 of debt which directly benefits Black Hills Kansas customers.

3 **Q. WHAT IS THE FINANCIAL CONDITION OF BLACK HILLS KANSAS?**

4 A. The financial integrity of Black Hills Kansas is sound. Additionally, Black Hills  
5 Kansas has access to short-term capital through BHC, its parent company. Black  
6 Hills Kansas' financial integrity is an important factor in supporting BHC's  
7 investment grade credit rating.

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

10 A. For a company to attract equity capital, the potential investor must believe that  
11 the company will earn a return that exceeds the cost of capital. If a company  
12 earns less than its cost of capital, value is destroyed for the shareholders, and  
13 consequently, the ability to raise additional capital for future projects declines.  
14 The components of cost of capital include both cost of debt and the cost of  
15 equity. The cost of equity is impacted by a number of factors, including the risk  
16 premium investors expect above the long-term U.S. Treasury Rates, the market  
17 risk of the company, the industry risk premium, the size of market capitalization,  
18 and the ratio of debt to total capitalization. Black Hills Kansas believes that its  
19 cost of equity capital is 10.6% and therefore is requesting rates to support that  
20 return. If Black Hills Kansas earns less than 10.6% on its equity capital  
21 component, its shareholders will not meet their return expectations, and  
22 consequently, access to capital markets will be diminished. I believe the  
23 philosophy of Black Hills Kansas is consistent with the opinion of Mr. McKenzie.

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

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

9 **Q. WHY IS THIS IMPORTANT TO BLACK HILLS KANSAS?**

10 A. Access to capital is important to refinancing and to provide additional capital to  
11 pay for safety and system reliability infrastructure and make prudent investments  
12 to enhance the operating efficiency of Black Hills Kansas' gas distribution  
13 system. In addition, as noted above, credit ratings impact vendor payments,  
14 including collateral requirements.

15

16 **V. CAPITAL STRUCTURE**

17 **Q. WHAT IS THE CAPITAL STRUCTURE PROPOSED FOR BLACK HILLS**  
18 **KANSAS?**

19 A. The Company proposes a capital structure of 50.34 percent equity and 49.66  
20 percent debt.

21 **Q. WHY IS THIS CAPITAL STRUCTURE APPROPRIATE FOR BLACK HILLS**  
22 **KANSAS?**



1 A. This capital structure is appropriate for the financial position and relative size of  
2 Black Hills Kansas; to support utility operations; to serve its customers with the  
3 appropriate capacity; for replacement and expansion of assets used to provide  
4 natural gas service; to maintain liquidity; and to attract cost effective sources of  
5 capital for refinancing plant improvement and growth.

6 **Q. IS THE CAPITAL STRUCTURE PROPOSED FOR BLACK HILLS KANSAS**  
7 **CONSISTENT WITH ITS HISTORICAL CAPITAL STRUCTURE?**

8 A. Yes. Exhibit BGI-1 sets forth the capital structure for Black Hills Kansas for the  
9 period of March 2011 to December 2013. As shown on this Exhibit, the  
10 percentage of debt of Black Hills Kansas has ranged from approximately 43.5  
11 percent to 49.7 percent during the period of 2011 through 2013 as efforts have  
12 been taken to align Black Hills Kansas' capital structure to approximately 50  
13 percent debt and 50 percent equity. Thus, applying a capital structure of 50.34  
14 percent equity and 49.66 percent debt to set rates in this case is conservative  
15 and reasonable.

16 **Q. WHY IS 50.34 PERCENT EQUITY REASONABLE FOR BLACK HILLS**  
17 **KANSAS?**

18 A. The Company believes that a common equity ratio of 50.34 percent is a  
19 reasonable capitalization level that is consistent with other utilities in the industry.  
20 It considers the relatively small size of Black Hills Kansas' utility operations and is  
21 necessary and appropriate for BHC to support its investment grade credit rating.

22

1 **VI. COST OF DEBT**

2 **Q. WHAT IS THE COST OF DEBT FOR BLACK HILLS KANSAS?**

3 A. The pro forma cost of debt for Black Hills Kansas is 4.402 percent.

4 **Q. WHY IS THE COST OF DEBT LOWER THAN THE TEST PERIOD?**

5 A. At the end of 2013, BHC re-financed \$525 million of corporate debt. BHC's  
6 recent credit rating upgrades as well as the current low interest rate environment  
7 for investment-grade corporate debt contributed to BHC's ability to secure this  
8 lower cost financing. BHC assigned \$60 million of the \$525 million new financing  
9 to Black Hills Kansas. The interest savings due to the lower cost of debt from this  
10 refinancing at the corporate level will result in annual interest savings for  
11 customers of Black Hills Kansas of approximately \$1.8 million.

12 **Q. HOW DID BHC DECIDE TO ASSIGN THIS MUCH DEBT TO BLACK HILLS**  
13 **KANSAS?**

14 A. This amount of debt was the appropriate amount necessary to establish the  
15 proposed capital structure in the rate case.

16 **Q. HOW DID YOU DETERMINE THE COST OF DEBT FOR BLACK HILLS**  
17 **KANSAS?**

18 A. Black Hills Kansas has \$60 million in assigned debt as of April 18, 2014 at a cost  
19 of 4.402 percent as compared to a cost of debt of approximately 8 percent during  
20 the test year. The cost of the debt allocated to Black Hills Kansas can be found  
21 in the Cost of Debt schedules attached as filed in the Application as Section 7,  
22 Schedule 2.

1 **Q. WHAT IS THE WEIGHTED AVERAGE COST OF CAPITAL REQUESTED FOR**  
2 **BLACK HILLS KANSAS?**

3 A. The weighted average cost of capital requested for Black Hills Kansas  
4 incorporates the cost of equity of 10.60 percent, the weighted average cost of  
5 debt of 4.40 percent, and a capital structure of 50.34 percent equity and 49.66  
6 percent debt financing. This calculation results in a weighted average cost of  
7 capital of 7.53 percent.

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

9 A. Yes.


State of South Dakota     )  
  ) ss  
County of Pennington     )

**AFFIDAVIT OF BRIAN G. IVERSON**

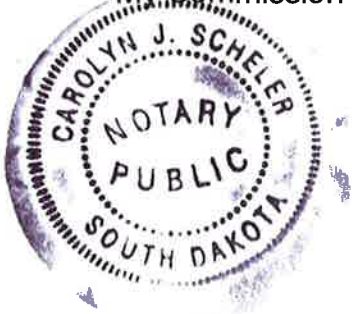
I, Brian G. Iverson, being first duly sworn on oath, depose and state that I am the same Brian G. Iverson identified in the foregoing Direct Testimony; that I have caused the foregoing Direct Testimony to be prepared and am familiar with the contents thereof, and that the foregoing Direct Testimony as identified therein is true and correct to the best of my knowledge, information, and belief as of the date of this Affidavit.

  
\_\_\_\_\_  
Brian G. Iverson

Subscribed and sworn to before me,  
A Notary Public, in and for said County  
and State, this 2<sup>nd</sup> day of April.

  
\_\_\_\_\_  
Notary Public

My Commission expires: 1-10-2015





Capital Structure Review - Treasury  
 BH KANSAS GAS UTILITY CO LLC  
 Actual Data by Quarters for 2013 and 2 Prior Years

Exhibit BGI-1

	3/31/11	6/30/11	9/30/11	12/31/11	3/31/12	6/30/12	9/30/12	12/31/12	3/31/13	6/30/13	9/30/13	12/31/13
<b>I/C Notes Payable</b>	59.6	59.6	59.6	59.6	59.6	59.6	59.6	62.7	50.2	50.2	50.2	60.0
<b>Total Debt (no Money Pool)</b>	<b>59.6</b>	<b>59.6</b>	<b>59.6</b>	<b>59.6</b>	<b>59.6</b>	<b>59.6</b>	<b>59.6</b>	<b>62.7</b>	<b>50.2</b>	<b>50.2</b>	<b>50.2</b>	<b>60.0</b>
APIC	55.5	55.5	55.5	55.5	55.5	55.5	55.5	55.5	55.5	55.5	55.5	55.5
Retained Earnings	15.4	16.2	16.3	17.9	21.9	4.8	5.3	8.1	4.0	0.1	0.1	5.3
<b>Total Equity</b>	<b>70.9</b>	<b>71.7</b>	<b>71.9</b>	<b>73.4</b>	<b>77.4</b>	<b>60.3</b>	<b>60.9</b>	<b>63.6</b>	<b>59.5</b>	<b>55.6</b>	<b>55.6</b>	<b>60.8</b>
<b>Total Debt and Equity</b>	<b>130.5</b>	<b>131.3</b>	<b>131.5</b>	<b>133.0</b>	<b>137.0</b>	<b>119.9</b>	<b>120.5</b>	<b>126.3</b>	<b>109.7</b>	<b>105.8</b>	<b>105.8</b>	<b>120.8</b>
Debt %	45.7%	45.4%	45.3%	44.8%	43.5%	49.7%	49.5%	49.6%	45.8%	47.4%	47.4%	49.7%
Equity %	54.3%	54.6%	54.7%	55.2%	56.5%	50.3%	50.5%	50.4%	54.2%	52.6%	52.6%	50.3%