

**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 Rates for Natural Gas Service

Docket No.
14-BHCG- 502 -RTS

DIRECT TESTIMONY OF

LAURA A. PATTERSON

FOR BLACK HILLS/KANSAS GAS UTILITY COMPANY, LLC

1 **I. INTRODUCTION AND QUALIFICATIONS**

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

3 A. My name is Laura A. Patterson and my business address is 625 9th Street (4th
4 Floor), Rapid City, South Dakota 57701.

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

6 A. I am employed by Black Hills Service Company, ("Service Company") a wholly-
7 owned subsidiary of Black Hills Corporation ("BHC") as the Director of
8 Compensation, Benefits and Human Resources Information Systems ("HRIS"). In
9 my position, I am responsible for partnering with business leaders to design and
10 execute compensation and benefits strategies and plans. I also provide input
11 related to strategic planning, implementation and administration of compensation
12 and benefits programs, executive plans, equity programs, non-qualified plans

1 and other initiatives. My responsibilities also include compensation and benefits
2 for Black Hills/Kansas Gas Utility, LLC. (“Black Hills Kansas” or the “Company”).

3 **Q. PLEASE BRIEFLY SUMMARIZE YOUR ACADEMIC AND PROFESSIONAL**
4 **BACKGROUND?**

5 A. I have more than 23 years of experience in compensation and benefits, with
6 responsibilities including the development, management, administration and
7 regulatory compliance of such plans. I began my current position as Director of
8 Compensation, Benefits and HRIS for BHC in April 2009. Prior to this position, I
9 spent 6 years as Director of Compensation, Benefits and HRIS and 2 years as
10 Employee Benefits Manager, for PNM Resources, Inc. (PNMR), where I was
11 responsible for managing and administrating all compensation and benefit
12 programs for PNMR, its subsidiaries and for its joint venture business with
13 Cascade Investments, Optim Energy. Prior to working for PNMR, I was employed
14 as a Tax Manager and Human Capital Consultant for four years at Arthur
15 Andersen, a global tax and consulting firm. In this position, I worked with
16 organizations to identify, analyze and apply regulatory rules that govern
17 structure, compliance, and administration of employee benefit plans. Prior to
18 Arthur Andersen, I was employed as a Trust Officer at Mercantile Trust Company
19 from 1995 to 1999 with responsibilities for managing and administration of profit
20 sharing, 401(k), and pension purchase retirement plans sponsored by a wide
21 range of clients. I have a Bachelor of Business Administration degree from the
22 University of Iowa.

1 **Q. HAVE YOU PROVIDED TESTIMONY IN REGULATORY PROCEEDINGS**
2 **PRIOR TO THIS CASE?**

3 A. Yes. I have previously testified in New Mexico PRC Case No. 06-00210-UT, a
4 gas rate case; in New Mexico PRC Case No. 07-00077-UT, an electric rate case;
5 in Texas PUC Case Docket No. 36025, an electric rate case; in Nebraska PUC
6 Case Docket No. NG-0061, a gas rate case; and in Colorado PUC Case Docket
7 No. 11-AL-382E, an electric rate case. I have also submitted testimony in Black
8 Hills Power's 2012-2013 rate application with the South Dakota PUC. Finally, I
9 testified on behalf of Cheyenne Light before the Wyoming Commission in
10 Cheyenne Light's last electric and natural gas rate proceedings in Docket Nos.
11 20003-114-ER-11 (Record No. 13028) and Docket No. 30005-157-GR-11.
12 (Record No. 13029).

13 **Q. DESCRIBE YOUR PROFESSIONAL ASSOCIATIONS.**

14 A. I served on the Corporate Board of Directors of the International Foundation of
15 Employee Benefit Plans and currently serve on the Employee Benefits
16 Committee for the U.S. Chamber of Commerce. I am also a Certified Retirement
17 Services Professional.

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

19 A. Black Hills Kansas.

20 **Q. DID YOU PREPARE ANY EXHIBITS IN SUPPORT OF YOUR DIRECT**
21 **TESTIMONY?**

22 A. No.

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

1 A. I describe and support the general compensation program for BHC employees
2 and Black Hills Kansas employees, including the variable compensation
3 program and the equity compensation program. I explain why these programs
4 and their associated costs are reasonable and necessary to attract, motivate
5 and retain well qualified and competent employees to support utility operations.
6 Black Hills Kansas employees, both non-union and union, participate in the
7 compensation and benefit plans sponsored by BHC.

8 I also describe and support the general benefits programs and policies for BHC
9 employees, and Black Hills Kansas employees, including the health, welfare and
10 retirement benefits, and explain why those programs and their associated costs
11 are reasonable and necessary.

12 My testimony specifically supports employee compensation related adjustments,
13 including base salary, variable compensation, equity compensation, retiree
14 healthcare, pension plan, pooled medical, and 401(k) plan, that are part of the
15 overall benefits adjustment made in Black Hills Kansas' revenue requirement
16 model.

17 In addition, my testimony will explain why the strategic workforce programs
18 discussed in the testimony of Lon Meyer and Jennifer Landis are reasonable
19 and necessary to attract, motivate and retain well qualified and competent
20 employees to support utility operations.

21 Finally, my testimony supports Black Hills Kansas' request to implement pension
22 and other post-employment benefits ("OPEB") trackers consistent with the
23 trackers approved by this Commission for other Kansas utilities.

1 **II. COMPENSATION PHILOSOPHY AND PROGRAMS**

2 **Q. WHAT IS BHC'S GENERAL COMPENSATION PHILOSOPHY?**

3 A. BHC's long-term success depends on operational excellence, providing reliable
4 products and services to our customers, and investing wisely to ensure present
5 and future strength. BHC's strength allows us to invest in our utility infrastructure
6 and systems to improve the safe, reliable and affordable service our customers
7 and communities depend on. To consistently achieve these outcomes, BHC
8 must attract, motivate and retain employees to achieve appropriate business
9 results. For these reasons, BHC promotes a compensation program that
10 supports the overall operational excellence and customer service objectives,
11 based on principles designed to:

- 12 • attract, motivate, retain and encourage the development of highly
13 qualified employees;
- 14 • provide compensation that is competitive;
- 15 • promote the relationship between pay and performance;
- 16 • promote overall performance that is linked to our customers and
17 shareholders; and
- 18 • recognize and reward individual performance appropriately.

19 All compensation programs are designed to be strategically aligned, externally
20 competitive, internally equitable, personally motivating, cost effective and legally
21 compliant.

1 **Q. PLEASE DESCRIBE BHC'S COMPENSATION PROGRAMS.**

2 A. There are two primary components to the compensation program – Base Salary
3 and Variable Pay programs.

4 • Base Salary: Base salary represents the fixed portion of an employee's
5 total cash compensation opportunity. Base salary compensation is
6 determined by the market value of the job, the experience level of the
7 employee, and specific performance standards and competencies. Base
8 salaries are reviewed on an annual basis and merit salary increases are
9 based on individual performance and contributions. Base rates of pay for
10 Black Hills Kansas' union employees are established under the terms of
11 the collective bargaining agreement.

12 • Variable Pay: Variable Pay is pay that is "at risk" and is not fixed or
13 guaranteed. Variable Pay is only earned and awarded based on
14 achievements against specific performance-based goals. All BHC
15 employees (non-union and union) participate in the Annual Incentive Plan
16 (AIP) which is described in detail later in this testimony.

17 **Q. PLEASE EXPLAIN BHC'S PHILOSOPHY ON BASE PAY COMPENSATION.**

18 A. Base pay is intended to reflect the median of the market for similar positions in
19 similar companies. Overall, our goal is to target direct compensation (base salary
20 and variable pay / annual incentives) at the median of the appropriate market
21 when our operating results approximate average in relation to our peers.

22 There are twenty-three (23) pay grades which are used for all non-executive,
23 non-union jobs. Each grade has a minimum, midpoint, and a maximum pay level.

1 This means that the pay ranges within the grades are competitive with what other
2 companies pay for similar positions. All jobs are compared to the market, where
3 data exists, and placed in the grade where the midpoint of the range is closest to
4 the average market rate for that job. After the close of the purchase of the
5 Aquila, Inc. ("Aquila") properties, Towers Watson conducted an independent
6 market review of the BHC's positions and benchmarked each position. Each
7 position was placed in the appropriate salary grade, reflecting the market median
8 values. Subsequent to the Towers Watson study, the BHC Human Resources
9 Compensation Department periodically reviews each position in the company
10 and compares it to credible market survey data to ensure that current
11 compensation remains within the competitive range.

12 Market rates are determined by utilizing compensation survey data where
13 companies report actual compensation paid to employees by position. The
14 survey most widely used by BHC is from Towers Watson, as they are recognized
15 nationally as the leader in the energy services / utility market place.

16 **Q. IN ADDITION TO THE TOWERS SURVEY, ARE THERE ANY OTHER**
17 **SURVEYS THAT BHC UTILIZES TO ENSURE THAT ITS OVERALL**
18 **COMPENSATION IS COMPETITIVE IN COMPARISON WITH OTHER**
19 **COMPANIES?**

20 A. Yes. BHC also utilizes surveys conducted by Aon Hewitt, Mercer, the Edison
21 Electric Institute (EEI), ECI, the EAPDIS LLC, Ed Powell, and other surveys,
22 including several specific to wages by state. The surveys provide compensation
23 and other data for each position by company size, revenue, and number of

1 employees so that BHC can match each of its positions to positions in the market
2 that are most similar in duties and most similar for the company size/revenue.

3 **Q. HOW DO THE COMPANY'S COMPENSATION STRATEGIES COMPARE TO**
4 **THE CURRENT MARKET?**

5 A. The BHC Compensation Department reviews the pay structure annually to see
6 how the structure and pay practices reflect the market. As of January 1, 2014,
7 the average base pay for non-union employees of Black Hills Kansas was 98% of
8 the market median, indicating Black Hills Kansas' employees' base pay rates
9 were slightly lower than the market median. Compensation is considered to be
10 competitive to the market at a range of 95% to 105% of the market median, so
11 compensation for Black Hills Kansas is at the lower end of this range.

12 **Q. DOES BHC HAVE A VARIABLE COMPENSATION COMPONENT OF ITS**
13 **TOTAL COMPENSATION PHILOSOPHY?**

14 A. Yes. The BHC Annual Incentive Plan (the "AIP" or the "Plan") is designed to
15 motivate and reward employees for achieving and exceeding goals that benefit
16 our customers and our shareholders. The AIP is designed to reward eligible
17 employees, including both non-union and union employees of Black Hills Kansas,
18 who contribute to the success of the BHC and/or their assigned Business Unit;
19 reward employees who contribute to the quality of service provided to customers
20 including, but not limited to, the provision of safe, reliable and affordable service;
21 motivate work performance and behavior that supports the Corporation's financial
22 and non-financial goals and increase the employee's understanding of the
23 Corporation's business objectives and performance.

1 **III. COMPANY ANNUAL INCENTIVE PLAN**

2 **Q. PLEASE DESCRIBE BHC’S ANNUAL INCENTIVE PLAN.**

3 A. The purpose of BHC’s AIP is to promote BHC’s pay for performance philosophy,
4 to provide competitive incentive opportunities that are consistent with other
5 companies in the industry, and to focus employees on important performance
6 objectives. The AIP is an important component of the total pay package
7 necessary to ensure BHC is competitive with market practices for employees. In
8 addition, the AIP directly links pay with performance, and therefore total
9 compensation expense varies with BHC’s performance on measures important to
10 the customers, and provides a tool to align employees’ interests with customer
11 and community interests.

12 **Q. WHAT PERFORMANCE GOALS ARE MEASURED UNDER THE AIP?**

13 A. An eligible employee can earn an incentive award based on that employee’s
14 performance toward goals designed to achieve business unit operational
15 performance targets. The components of the incentive award for plan year 2013
16 were as follows:

- 17 • An employee could qualify for up to 50% of the maximum possible award
18 for goals tied to customer satisfaction, cost control, safety, reliability,
19 operations efficiency, expense reductions and other operational
20 measures;
- 21 • An employee could qualify for up to 25% of the maximum possible award
22 for the achievement of direct business unit operating income goals,
23 including initiatives on cost control, continuous improvement and

1 improvements in operations efficiencies; and

- 2 • An employee could qualify for up to 25% of the maximum possible award
3 if BHC realizes established earnings per share (“EPS”) targets.

4 Each goal is measured independently. Goal performance that meets or exceeds
5 the threshold level will be used to calculate the incentive award. Achievement of
6 financial results is not a condition to award incentive for achievement of other
7 goals. An employee can earn from 0 to 1.50 times the target percentage
8 incentive based on achievement against each of the AIP goals. Performance
9 below threshold results in a zero payout for the associated goal. Achievement of
10 a goal’s “target” performance results in a payout of 100% of the payment relative
11 to that goal. There is also a Maximum payout, which means that if performance
12 exceeds target, no more than 1.50 times the target payment will be made relative
13 to that goal.

14 **Q. HOW DOES THE AIP PROVIDE VALUE TO CUSTOMERS?**

15 A. The AIP provides direct and indirect value to customers in a number of different
16 ways. For example, AIP goals are aligned with BHC’s high-level objectives and
17 strategic framework. Business unit goals are primarily designed to improve the
18 performance of utility operations by focusing on improvements to operational
19 excellence, safety, reliability, and customer satisfaction. Examples of Black Hills
20 Kansas’ business unit goals include:

- 21 • Continuous improvement in results from customer satisfaction surveys.
22 These results are measured each quarter.
- 23 • Service reliability metrics.

- 1 • Increase in number of completed service orders per day.
- 2 • Reduction in labor cost per service order.
- 3 • Reductions in O&M expense resulting from Continuous (Process)
- 4 Improvement projects.
- 5 • Reduction in number of lost time accidents, preventable vehicle accidents,
- 6 and OSHA recordable accidents.

7 BHC must maintain a skilled and motivated workforce in order to provide safe,
8 reliable and affordable service and products. To do so, it is important to pay our
9 employees at rates competitive to rates paid by similar utilities and other
10 companies with which we compete for employees. Because the actual base
11 salaries for Black Hills Kansas' employees fall somewhat below the market
12 median levels, total compensation would be significantly less competitive without
13 the incentive plan component. An employee's total cash earnings potential (base
14 salary *plus* AIP incentive award) depends on both competitive base salary and
15 on a competitive AIP incentive compensation opportunity awarded for the
16 achievement of key operating and strategic goals.

17 **Q. HOW WOULD AVERAGE BASE SALARIES BE AFFECTED IF AIP**
18 **INCENTIVES WERE ELIMINATED?**

19 A. If BHC did not offer employees the opportunity to earn AIP incentive
20 compensation, BHC would need to make-up the difference by increasing base
21 salaries in at least an equivalent amount, which would result in higher fixed costs
22 for salaries and benefits. An alternative to variable compensation would be for
23 BHC to raise all employees base pay to reflect the median variable

1 compensation earnings provided by other utilities. While this would provide a
2 competitive total compensation rate that is “fixed and measurable”, it would de-
3 link those costs with customer performance measures and increase overall costs
4 as many of our benefits are also tied to base pay rates.

5 **Q. WHAT ARE THE OTHER RISKS ASSOCIATED WITH NEGATIVE IMPACTS**
6 **UPON AIP?**

7 A. If BHC were to eliminate its variable pay program and did not replace that
8 compensation with base pay, employees would be much less likely to stay with
9 BHC because their total compensation would significantly lag what other utilities
10 were paying for the same positions. Coupling this risk with the loss of experience
11 that Black Hills Kansas will realize over the next eight years due to retirements
12 results in a significant and immediate business risk.

13 Furthermore, it is especially critical that BHC remain competitive with regards to
14 compensation for its employees since BHC froze its pension plans as of January
15 1, 2010. Without the retentive features provided through a pension benefit, BHC
16 must ensure its compensation programs remains competitive as employees may
17 be less likely to stay with the company otherwise.

18 **Q. PLEASE FURTHER EXPLAIN HOW CUSTOMERS BENEFIT FROM A TOTAL**
19 **COMPENSATION PACKAGE THAT INCLUDES THE AIP.**

20 A. Providing total compensation in the form of base pay and variable pay provides
21 customers with overall savings. In particular, retention of highly skilled and
22 experienced employees who work to achieve incentive plan goals results in cost
23 reductions and other efficiencies that are inherent in the goals. Further,

1 attracting and retaining a highly skilled and experienced workforce enables BHC
2 to continue to provide service that is efficient, effective, safe and reliable.
3 Customers also benefit from employee retention through avoidance of the high
4 costs associated with employee turnover. AIP business unit goals support the
5 strategic objectives of BHC, which include achieving high levels of customer
6 satisfaction, improving operations and safety, reducing costs and delivering
7 excellent service.

8 **Q. ARE THERE OTHER ASPECTS OF BHC'S COMPENSATION STRUCTURE**
9 **THAT DRIVE CUSTOMER BENEFITS?**

10 A. Yes. The AIP also provides direct and indirect benefits to customers in that BHC
11 has a common pay structure for all of its business units. This means that BHC
12 can more easily relocate employees among company business units, reduce the
13 cost of maintaining numerous payroll systems, reduce the cost of training
14 employees on benefits, and better manage the cost of administrating
15 compensation plans than would be possible with multiple compensation
16 schemes.

17 **Q. WHO IS ELIGIBLE TO PARTICIPATE IN THE AIP?**

18 A. All regular full-time and part-time employees, both union and non-union, who are
19 hired and working by October 1 of the plan year are eligible to participate in the
20 Plan for that plan year. Part-time employees who work a minimum of 20 hours
21 per week are eligible for a pro-rata award based on their actual wages for hours
22 worked. Pro-rata awards for the number of months actively employed at each

1 eligibility level during the plan year will also be paid to Participants who are hired,
2 promoted, retire or have other job changes during the year.

3 **Q. PLEASE PROVIDE ADDITIONAL DETAIL REGARDING THE**
4 **METHODOLOGY FOR DETERMINING AIP COMPENSATION.**

5 A. A set of operational goals with “threshold,” “target,” and “maximum” performance
6 metrics are established at the beginning of each calendar year for each identified
7 business unit. The Company establishes its incentive targets to achieve the
8 market median incentive opportunity of similar companies. The “Threshold” is the
9 minimum performance level that must be met for the year. If the Threshold is not
10 met, no incentive payment is made relative to that goal. Target performance for
11 each goal is set at a level of an “expected” result, with sufficient stretch,
12 necessary for a successful year. The goal is to provide Black Hills Kansas
13 employees with a total compensation package that is competitive with other
14 companies when Black Hills Kansas achieves target performance levels on
15 annual incentive goals. Operational goals can be based on reliability of service,
16 safety, customer satisfaction, effective use of capital, expense management
17 (reductions in controllable O&M), and continuous (process) improvement. The
18 “Safety” measures include chargeable vehicle incidents and lost time injury
19 incidents, both of which have implications for cost and service to customers. The
20 “Customer Satisfaction” measure includes 5 customer service quality metrics
21 including customer service call time and emergency service call times.
22 “Continuous (Process) Improvement” goals reflect initiatives to reduce on-going
23 cost of service and focuses employees on identifying additional opportunities to

1 increase process efficiency and effectiveness for our customers. By having a
2 portion of the incentive program tied to the business unit, employees and
3 management are held accountable for seeing that the overall operation of the
4 delivery of services occurs in the most efficient manner possible. The business
5 unit component of the AIP ensures that management and employees understand
6 that strong performance for the customer unrelated to financial results will be
7 recognized and rewarded.

8 **Q: ONE OF THE INCENTIVE GOALS UNDER THE AIP RELATES TO THE**
9 **COMPANY'S OPERATING INCOME OR EARNINGS PER SHARE ("EPS")**
10 **PERFORMANCE. DO CUSTOMERS BENEFIT FROM COMPANY EPS**
11 **PERFORMANCE IN LINE WITH INCENTIVE PLAN TARGETS?**

12 A. Yes. Earnings Per Share is an easily recognized benchmark for successful
13 and productive companies that are meeting their customers' needs. They
14 provide company-wide objective measures of performance that cannot
15 reasonably be separated from customer interest. Both shareholders and
16 customers benefit from strong EPS performance - - they are not mutually
17 exclusive. Two primary drivers of EPS are expense management and debt
18 costs. Customers benefit from receiving service from a company that is
19 able to effectively manage its costs. When the Company is managing its
20 costs, rate cases are less frequent, and when a rate case is required, the
21 requested increase is less than would otherwise be required.

1 **Q. DO INDIVIDUAL EMPLOYEES CONTRIBUTE TO THE COMPANY'S**
2 **EPS PERFORMANCE?**

3 A. Yes. Each employee primarily contributes to the financial success of the
4 Company through the prudent actions he or she takes to control costs,
5 work efficiently, and drive operational excellence. By setting an EPS
6 target, and monitoring company performance against the target throughout
7 the year, employees receive immediate feedback regarding performance.
8 Providing incentive compensation related to meeting financial performance
9 drives employees to cost-conscious behavior that is beneficial to
10 customers.

11 **Q. HOW ELSE DO CUSTOMERS BENEFIT FROM A STRONG EPS**
12 **RECORD?**

13 A. As described in the Direct Testimony of Brian G. Iverson, Black Hills
14 Kansas must maintain financial integrity to access capital at reasonable
15 costs. A strong financial position provides the financial flexibility necessary
16 to meet the ongoing demand for utility services. Credit ratings agencies
17 compare quantitative measures of a company's financial performance,
18 including EPS, to determine a company's credit ratings. These ratings
19 have a direct impact on the cost of Company's debt, both for acquiring
20 debt and refinancing higher cost debt, which directly impact customer
21 rates.

22

1 **IV. COMPANY LONG-TERM INCENTIVE PROGRAM**

2 **Q. PLEASE DESCRIBE BHC'S LONG-TERM INCENTIVE PROGRAM.**

3 A; The Company provides a long-term incentive program on a limited basis to key
4 employees who are responsible for various aspects of management and
5 business results. These long-term incentives include restricted stock and
6 performance share awards. Restricted stock is granted to key employees and
7 vests ratably over a 3-year period.

8 Performance shares, if any, are based on achievement against established
9 criteria measured over a 3-year period and are made at the conclusion of that 3-
10 year period. The performance share component measures relative performance
11 of BHC against other utilities - - it is about operational performance and metrics.
12 BHC focuses on top quartile performance in all areas and performs at this level
13 on a regular basis. This operational excellence is recognized by the market, and
14 using performance measures to compare BHC to its peers provides focus for key
15 employees in these areas. This operational excellence also results in lower
16 costs to customers in very direct ways.

17 Both forms of equity grants under the long-term incentive program are intended
18 to provide participants with incentives for excellent performance, to promote
19 teamwork and to motivate, retain and attract the services of participants who
20 make significant contributions to the success of the company and its operational
21 goals.

1 **V. INDUSTRY COMPENSATION COMPARISONS**

2 **Q. DO OTHER COMPANIES IN THE UTILITY INDUSTRY USE COMPARABLE**
3 **VARIABLE AND LONG-TERM COMPENSATION MECHANISMS?**

4 A. Yes. Other utilities do provide incentive or variable compensation as part of their
5 compensation packages, as do companies in other industries. Other utilities also
6 provide key employees with long-term incentives designed to retain these key
7 employees and to motivate them to achieve operational and strategic goals.
8 Without similar annual and long-term plans, BHC's total compensation package
9 would not be competitive with other utilities and BHC would be at risk for
10 retention of its key employees.

11 **Q. ARE YOU AWARE OF ANY STUDIES THAT SUPPORT THIS CONCLUSION?**

12 A. Yes. Aon Hewitt Associates, an international business consulting firm that
13 specializes in compensation issues, conducted a survey of broad-based variable
14 pay plans in 2013 titled "Variable Compensation Measurement (VCM) Report –
15 U.S. Edition," which includes 125 companies, including 25 energy / utility
16 companies. Results from the survey indicate the following:

- 17 • All energy / utility companies offer at least one broad-based variable
18 incentive plan and all cover 100% of their employees. 90% of participating
19 companies offered at least one broad-based variable compensation plan
20 covering 99% of total U.S. employees, an increase from 89% in 2007 and
21 from 80% in 2002 as companies continue to turn to variable pay as a
22 means to attract, retain and award performance. .
- 23 • 74% of the participating companies in the survey have an annual incentive

1 program with a plan design similar to BHC's AIP, where awards are based
2 on the combined achievement of Company financial and business unit
3 operating performance.

- 4 • 88% of the participating companies reported the benefits realized from
5 their variable pay plan and the improved business results outweighed the
6 cost.
- 7 • Notable outcomes reported by companies with a variable pay plan similar
8 to the AIP include reduced costs, increased productivity, increased quality,
9 increased customer satisfaction, and increased employee morale.

10
11 Other surveys published in 2012-2013 include:

- 12 • Mercer: 93% of employers provide short-term incentive or variable pay
13 plans, an increase from 78% in 2004.
- 14 • World at Work: 84% of employers provide short-term incentive or variable
15 pay plans, an increase from 77% in 2004. Of those providing a short-term
16 incentive plan, 98% of hourly employees (average payout was 5%) and
17 100% of salaried employees (average payout was 12%) are eligible under
18 the plan.
- 19 • Buck Consulting: 87% of utilities in the survey provide a short-term
20 incentive plan to all employees.
- 21 • Kenexa: 88.5% of energy and utility companies in the survey provide a
22 short-term incentive plan to all employees.

1 **Q. HOW DOES BHC MAKE IMPROVEMENTS TO ITS AIP?**

2 A. Through its annual strategic and operational planning process, BHC routinely
3 evaluates the effectiveness of the plan in meeting its goals. These goals are
4 modified and continually refined to drive continued operational excellence and
5 performance improvements. BHC also continuously evaluates the AIP design to
6 ensure that it remains competitive and comparable to other utilities.

7

8 **VI. COMPANY RECOVERY OF EMPLOYEE COMPENSATION EXPENSES**

9 **Q. SHOULD THE COMPENSATION MERIT INCREASE BE APPROVED?**

10 A. Yes. Recovering the actual amount of employee compensation expense is
11 necessary to attract and retain the high quality of employees that are needed to
12 serve the customers of Black Hills Kansas. Under existing economic conditions,
13 independent surveys reflected that more than 97% of US-based companies will
14 award merit pay increases during 2014, with an average budget of 3% to 4%.
15 Non-union employee pay changes are effective each March, with the most recent
16 increase effective March 3, 2014. The union employee wage increases are
17 effective each January 1st. The non-union rate increases implemented March 3,
18 2014 averaged 3.25%. The January 1, 2013 union increase was 2.5 percent,
19 and the January 1, 2014 increase was 3.0 percent. Increases in employee
20 compensation are known and measurable, and these increases in employee
21 compensation are supported by extensive reviews of competitive market data.
22 Without merit increases, BHC would further lag the median pay for these
23 positions, significantly increasing retention and performance risk, and the

1 company will incur higher costs for turnover and related issues. A summary of
2 independent surveys regarding merit pay follows:

- 3 • Mercer: The survey of 634 employers reflects that energy and utility
4 employers plan to provide merit increases to employees in 2014, with an
5 average budgeted increase ranging from 3.0% to 4.0%.
- 6 • Aon Hewitt: The 2013-2014 survey of 1,096 employers reflects planned
7 2014 merit increases, with an average budget of 3.1%. The energy and
8 utility employers in the survey reflect a merit budget average of 3.7%.
- 9 • Towers Watson: The 2013-2014 survey of 633 employers reflects planned
10 2014 merit increases, with an average budget of 3.1%. This survey does
11 not reflect utility specific information.
- 12 • World at Work: The 2013-2014 survey of 1,834 employers reflects a 3.1%
13 merit increase budget average for 2014 across all industries. The average
14 merit increase budgets for energy and utility companies average up to
15 4.1%.

16 Simply put, the merit increases and the union wage increases will be incurred,
17 and the overall compensation to Black Hills Kansas employees is fair and
18 competitive as tested against prevailing market comparisons.

19 **Q. SHOULD THE COMPENSATION INCREASE BE APPROVED FOR UNION**
20 **EMPLOYEES?**

21 A. Recovering the actual amount of employee compensation expense is necessary
22 – as described above – to attract and retain the high quality of employees that
23 are needed to serve the customers of Black Hills Kansas.

1 The ratified contract between Black Hills Kansas and Kansas unions requires an
2 increase in union employee compensation of 2.5 percent for 2013 and 3.0
3 percent for 2014. Black Hills Kansas' union employees also participate in the
4 AIP under the terms of the contract. Accordingly, the January 1, 2014, rate
5 increase of 3.0% and AIP compensation for union employees is representative of
6 the amount that Black Hills Kansas will be obligated to pay while its rates will be
7 in effect. Black Hills Kansas' union employee compensation adjustment qualifies
8 as a known and measurable change over the four-year contract.
9

10 **VII. COMPANY BENEFITS AND PERIODIC REVIEW**

11 **Q. PLEASE DESCRIBE THE BENEFIT PLANS THAT BHC PROVIDES TO ITS**
12 **BLACK HILLS KANSAS EMPLOYEES?**

13 A. BHC offers a combination of company-provided and voluntary benefits.
14 Employees are enrolled in certain company-provided benefits automatically and
15 BHC pays the costs (for example, short-term and long-term disability benefits).
16 Employees choose whether or not to participate in the voluntary benefits and
17 they pay a portion or all of the costs. These company-provided and voluntary
18 benefit programs consist of: (1) medical, dental and vision plans, (2) flexible
19 spending accounts, (3) life insurance and accidental death and dismemberment
20 insurance, (4) paid time off, (5) retirement, and (6) other benefits including
21 educational assistance, holidays and other time away from work, business travel
22 accident insurance, rewards & recognition and wellness programs.

1 **Q. WHAT BENCHMARKING HAS BEEN CONDUCTED TO EVALUATE**
2 **COST/PERFORMANCE LEVELS?**

3 A. BHC solicits a number of independent reviews from external organizations and
4 consulting firms such as Towers Watson, Aon Hewitt, Mercer, etc. These
5 reviews cover a wide range of compensation and benefit program designs and
6 costs including compensation and benefit programs, HR function administrative
7 expenses, and market data for positions. BHC compares its benefit programs
8 and costs with companies from the utility sector and from general industry to
9 ensure the company can attract and retain employees with the necessary skills.
10 BHC utilizes multiple nationally recognized third-party surveys and also conducts
11 customized surveys where appropriate and necessary. These benchmarking
12 surveys allow BHC to evaluate the competitiveness and efficiencies of its benefit
13 programs and costs compared to other companies in the market. If a program
14 does not meet performance, cost or efficiency expectations, it is reviewed to
15 determine the root cause and the options or alternatives available. BHC closely
16 monitors market practices and benchmark data for costs to maintain competitive
17 and cost effective programs.

18 **Q. WHAT TYPE OF OVERSIGHT IS IN PLACE TO ENSURE THAT BHC'S**
19 **COMPENSATION AND BENEFIT PROGRAMS ARE THOSE THAT ARE MOST**
20 **BENEFICIAL FOR THE SUPPORT OF THE OPERATING COMPANIES'**
21 **UTILITY SERVICE?**

22 A. The BHC Human Resources Department, in partnership with the business unit
23 leaders and company management, develop annual budgets and long-range

1 plans (5 years), including compensation, benefit and other programs supporting
2 the business' goals and objectives. HR and key operating personnel manage
3 these budgets and review all programs for effectiveness, cost and any proposed
4 modifications. All costs are modeled to determine impacts to cost and are
5 benchmarked against the market parameters to ensure competitiveness and cost
6 effectiveness.

7 **Q. ARE YOU AWARE OF OTHER STATE COMMISSIONS THAT HAVE**
8 **APPROVED THE EMPLOYEE COMPENSATION AND BENEFIT STRUCTURE**
9 **PROPOSED IN THIS PROCEEDING?**

10 A. Yes. Through rate case settlements and contested proceedings, commissions in
11 Nebraska, Iowa, Wyoming and Colorado in both gas and electric rate cases have
12 approved this employee compensation and benefit structure. BHC places
13 emphasis on maintaining a common employee compensation structure and
14 program. The same is true for its proposal related to its employees living in or
15 supporting our Black Hills Kansas customers.

16
17 **VIII. INDUSTRY WORKFORCE COMPARISONS**

18 **Q. WHAT WORKFORCE CHALLENGES DOES BLACK HILLS KANSAS FACE?**

19 A. A significant portion of BHC's workforce could retire over the next 5-7 years,
20 given that 44.4% of BHC's total workforce, including Black Hills Kansas, is age
21 50 or older, and 28.1% are age 55 or older. Approximately 23 percent of Black
22 Hills Kansas' workforce is age 50 or older, and 22 percent are age 55 or older.
23 BHC's average tenure continues to drop. Continued decreases in average

1 tenure, coupled with the increased number of less experienced workers,
2 emphasizes the need to find ways to transfer knowledge across the organization.
3 Additionally, more than 50% of BHC's business units have manager spans of
4 control (the number of employees directly supervised by a supervisor/manager)
5 that exceed the utility benchmarks, creating additional knowledge transfer
6 concerns.

7 **Q. ARE OTHER COMPANIES IN THE UTILITY INDUSTRY FACING THE SAME**
8 **WORKFORCE CHALLENGES?**

9 A. Yes. Other utilities are facing the same challenges as far as aging workforce and
10 scarcity of talent. As of 2008, 53% of the utilities workforce nationwide was age
11 45 or older. With over 50% of the workforce eligible to retire within the next
12 decade, many utilities will be competing for the same qualified candidate pool to
13 replace retiring workers. BHC and Black Hills Kansas are taking actions to
14 improve current employee retention as well as offer attractive training and
15 development opportunities to new employees. As technology continues to
16 progress and change the landscape of the utility workforce skills and duties,
17 investment in skills and experience will be just as important to providing safe,
18 reliable service as any piece of equipment or infrastructure.

19 **Q. IS BLACK HILLS KANSAS MAKING EFFORTS TO ADDRESS THESE**
20 **ISSUES?**

21 A. Yes. As indicated in the testimony of Lon Meyer and Jennifer Landis, Black Hills
22 Kansas has implemented a strategic workforce planning process to proactively
23 address these challenges and remain competitive in the talent market.

1 **Q. PLEASE DESCRIBE THE IMPORTANCE OF WORKFORCE PLANNING FOR**
2 **THE UTILITY INDUSTRY AND ITS APPLICATION TO BLACK HILLS**
3 **KANSAS?**

4 A. As noted by Lon Meyer and Jennifer Landis, on behalf of Black Hills Kansas, the
5 BHC strategic workforce planning team reviews and will continue to monitor,
6 numerous studies that have been published concerning the aging of the national
7 workforce necessary to serve and operate the nation's utility systems. As Mr.
8 Meyer and Ms. Landis testify, Black Hills Kansas must prepare to address its
9 own workforce issues. My role will be to monitor compensation and benefit
10 packages to ensure that we manage through this matter prudently.

11 **Q. WILL THE COMPANY PLACE STRATEGIC WORKFORCE POSITIONS ON**
12 **COMPENSATION PLANS THAT DIFFER FROM EXISTING EMPLOYEES?**

13 A. No, the new employees would be provided the same compensation and benefits
14 as other Black Hills Kansas and BHC employees.

15

16 **IX. PENSION AND OPEB TRACKERS**

17 **Q. IS BLACK HILLS KANSAS ASKING FOR AUTHORITY TO IMPLEMENT**
18 **TRACKERS RELATING TO ITS PENSION AND OPEB COSTS AS PART OF**
19 **THIS RATE CASE FILING?**

20 A. Yes. Black Hills Kansas is asking for authority to implement those trackers.
21 Black Hills Kansas would implement the same type of trackers that have been
22 approved by this Commission for the other large natural gas distribution
23 companies operating in Kansas. Black Hills Kansas is requesting authority to

1 implement the trackers to accumulate in a regulatory asset or liability the
2 difference between the company's pension/OPEB expense included in base
3 rates determined in this rate case and its actual pension/OPEB expense. The
4 balance of the regulatory asset or liability is to be recovered through amortization
5 on a straight-line basis over a period not to exceed five years, to be determined
6 within the context of a rate case. As with the trackers approved by this
7 Commission for the other gas utilities, the regulatory asset or liability established
8 with the implementation of the trackers would not be a component of rate base in
9 the Company's next rate proceeding, nor would deferred balances receive
10 carrying changes in that proceeding.

11 **X. CONCLUSION**

12 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

13 **A.** Yes.

State of ~~South Dakota~~ ^{Colorado})
County of ~~Pennington~~ ^{Denver}) ss

AFFIDAVIT OF LAURA A. PATTERSON

I, Laura A. Patterson, being first duly sworn on oath, depose and state that I am the same Laura A. Patterson 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.



Laura A. Patterson

Subscribed and sworn to before me,
A Notary Public, in and for said County
and State, this 09 day of April, 2014.



Notary Public

My Commission expires: 04/27/2017 ~~2014~~

AMBER L GARRETT
NOTARY PUBLIC
STATE OF COLORADO
NOTARY ID # 20094011937
MY COMMISSION EXPIRES APRIL 27, 2017