DORSEY
DORSEY & WHITNEY LLP

MICHAEL J. AHERN
(612) 340-2881
FAX (612) 340-2643
ahern.michael@dorsey.com

March 6, 2015

VIA ELECTRONIC FILING

Mr. Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 Seventh Place East, Suite 350
St. Paul, MN 55101

Re: In the Matter of the Petition of Minnesota Energy Resources Corporation For Extension of Rule Variances to Recover the Costs of Financial Instruments Through the Purchased Gas Adjustment

Docket No. G011/M-15-___

Dear Mr. Wolf:

Enclosed please find the petition of Minnesota Energy Resources Corporation ("MERC" or "Company") for approval of a two-year extension of variances allowing the recovery of costs of financial instruments through the purchased gas adjustment ("PGA"). MERC's current variances to the PGA Rules expire on June 30, 2015. MERC requests the Commission act to extend its variances before June 30, 2015, to allow MERC to continue to use the PGA to recover the incurred costs of financial instruments used for hedging purposes in procuring natural gas supplies for its Minnesota customers.

MERC has served a copy of this petition on the Office of the Attorney General – Antitrust and Utilities Division. A summary of the filing has been served on all parties on the Company's general service list.

Please contact me at 612-340-2881 if you have any questions regarding this matter.

Sincerely yours,

/s/ Michael J. Ahern

Michael J. Ahern

cc: Service List

STATE OF MINNESOTA
BEFORE THE
MINNESOTA PUBLIC UTILITIES COMMISSION

Beverly Jones Heydinger	Chair
Nancy Lange	Commissioner
Dan Lipschultz	Commissioner
John Tuma	Commissioner
Betsy Wergin	Commissioner

In the Matter of the Petition of Minnesota Energy Resources Corporation for Extension of Rule Variance to Recover Costs of Financial Instruments Through the Purchased Gas Adjustment	Docket No. G011/M-15-__

SUMMARY OF FILING

Pursuant to Minnesota Rule 7829.3200, Minnesota Energy Resources Corporation ("MERC" or "Company") hereby petitions the Minnesota Public Utilities Commission ("Commission") for an order granting an extension of variances to Minnesota Rules 7825.2400, 7825.2500 and 7825.2700 (the "Purchased Gas Adjustment rules" or "PGA rules"), to use the PGA to recover the incurred costs of financial instruments used for hedging purposes in procuring natural gas supplies for Minnesota customers. The Commission first granted the variances at issue to MERC by Order dated July 10, 2007, in Docket No. G007,011/M-06-1358. The Commission issued an Order extending those variances on June 30, 2009, in Docket No. G007,011/M-09-262, on August 17, 2011, in Docket No. G007,011/M-11-296, and on June 21, 2013, in Docket No. G007,011/M-13-207. The most recent Order extended the Company's variances through the period ending June 30, 2015. With this Petition, MERC requests extensions of the variances to the PGA rules for two years through June 30, 2017.

STATE OF MINNESOTA
BEFORE THE
MINNESOTA PUBLIC UTILITIES COMMISSION

Beverly Jones Heydinger	Chair
Nancy Lange	Commissioner
Dan Lipschultz	Commissioner
John Tuma	Commissioner
Betsy Wergin	Commissioner

In the Matter of the Petition of Minnesota Energy Resources Corporation For Extension Of Rule Variances to Recovery to Costs of Financial Instruments Through the Purchased Gas Adjustment	Docket No. G011/M-15-___

PETITION

Pursuant to Minnesota Rules 7829.3200, Minnesota Energy Resources Corporation ("MERC" or the "Company") hereby petitions the Minnesota Public Utilities Commission (the "Commission") for an order granting extensions of variances to Minnesota Rules 7825.2400, 7825.2500 and 7825.2700 (the "Purchased Gas Adjustment rules" or "PGA rules"), to use the PGA to recover the incurred costs of financial instruments used for hedging purposes in procuring natural gas supplies for Minnesota customers. The Commission first granted the variances at issue to MERC by Order dated July 10, 2007, in Docket No. G-007,011/M-06-1358. The Commission issued an Order extending those variances on June 30, 2009, in Docket No. G007,011/M-09-262, on August 17, 2011, in Docket No. G-007,011/M-11-296, and on June 21, 2013, in Docket No. G007,011/M-13-207. The most recent Order extended the Company's variances through the period ending June 30, 2015. With this Petition, MERC requests extensions of the variances to the PGA rules for two years through June 30, 2017.

I. Summary of Filing

Pursuant to Minn. R. 7829.1300, subp. 1, a one-paragraph summary of the filing is attached.

II. Service

Pursuant to Minn. R. 7829.1300, subp. 2, MERC has served a copy of this Petition on the Department of Commerce Division of Energy Resources (the "Department") and the Office of the Attorney General – Antitrust and Utilities Division. The summary of the filing has been served on all parties on the attached service list.

III. General Filing Information

A. Name, Address, and Telephone Number of the Utility

Minnesota Energy Resources Corporation
1995 Rahncliff Court, Suite 200
Eagan, MN 55122
(651) 322-8965

B. Name, Address, and Telephone Number of Attorney for the Utility

Michael J. Ahern
Dorsey & Whitney LLP
50 S. Sixth Street, Suite 1500
Minneapolis, MN 55402-1498
(612) 340-2600

C. Date of the Filing

The date of the filing is March 6, 2015. MERC respectfully requests that the Commission grant the requested PGA rule variances by June 30, 2015.

D. Statute Controlling Schedule for Processing the Filing

No statute controls the schedule for processing this filing. Under Minn. R. 7829.0100, subp. 11, the requested variances fall within the definition of a "Miscellaneous Tariff Filing," since no determination of MERC's general revenue requirement is necessary. Under Minn. R. 7829.1400, initial comments on a miscellaneous filing are due within 30 days of filing, with reply comments due 10 days thereafter.

E. Utility Employee Responsible for Filing

Amber S. Lee
Regulatory and Legislative Affairs Manager
Minnesota Energy Resources Corporation
1995 Rahncliff Court, Suite 200
Eagan, MN 55122
(651) 322-8965

IV. Description and Purpose of Filing

A. Background

On July 10, 2007, in Docket No. G-007,011/M-06-1358, the Commission issued an Order granting MERC variances to the PGA rules for a two-year period. The Commission extended these variances in Docket No. G007,011/M-09-262, again in Docket No. G007,011/M-11-296, and most recently in Docket No. G007,011/M-13-207. In that docket, the Commission extended the variances for a two-year period ending June 30, 2015.

The Commission's June 21, 2013 Order in Docket No. G007,011/M-13-207 authorized MERC to continue to engage in certain limited financial transactions to minimize price volatility of natural gas purchased to serve Minnesota customers, subject to certain limitations and an annual cost cap. The Order set the cap on the amount of financial hedging to 30 percent of total projected heating-season sales volumes for the combined MERC system. The Order also required that cost recovery occur through the commodity portion of rates rather than the demand portion, and it required MERC to continue to include information on the costs and benefits of financial instruments in its monthly PGA filings and annual Demand Entitlement and Annual Automatic Adjustment filings. The Commission also ordered MERC, in its next request for PGA rule variances, to demonstrate that ratepayers benefit from hedging and that there is not an undue price penalty.

This Petition is consistent with prior approvals and continues all prior reporting requirements.

B. Proposed Variances

MERC is requesting an extension of variances to Minn. R. 7825.2400, subp. 12, 7825.2500(B), and 7825.2700, to continue to recover through the PGA the costs of financial instruments such as futures and options contracts to mitigate the risks of price volatility for retail gas customers.

1. Extension of Variance

The existing variance expires June 30, 2015. MERC is proposing a two-year extension that would apply to financial positions entered into through June 30, 2017. A two-year extension of the variances would enable MERC to use financial instruments for the next two heating seasons, (2015-2016 and 2016-2017) while also leaving ample opportunity for MERC to request, and the Commission and the Department to review, a subsequent extension petition before the variance ends.

MERC proposes that the extension be conditioned on MERC continuing to provide the reports required in Dockets Nos. G007,011/M-09-262, G007,011/M-06-1358, G007,011/M- 03-821, and G007/011/M-13-207. These reports allow the Department and the Commission to regularly review MERC's financial instrument practices. If the Commission determines at some point during the extension period that the PGA rule variance for financial instrument cost recovery is resulting in excessive costs to ratepayers, the Commission has the authority to disallow the costs or terminate the variance prior to June 30, 2017.

2. Accounting

MERC proposes to continue the accounting practices required by the existing variance, such that MERC would continue to record the cost associated with all financial instruments to FERC Account 804. MERC will continue to recover these costs through the commodity portion of rates.

3. Permitted Financial Instruments

MERC proposes to continue to use the mix of financial instruments permitted in the existing variances, including fixed-price, index-price, and swing contracts. As under the existing variances, MERC would be permitted to use put options in combination with call options to form a "collar," but would not be permitted to use put options for any other reason without Commission approval.

4. Cap on Amount of Financial Hedging

MERC proposes that the current cap on hedging of up to 30 percent of total projected heating season sales volumes remain in place. It is MERC's strategy to hedge 30 percent of total projected normal winter requirements with the use of financial derivatives.

C. Ratepayer Benefit

In the June 21, 2013, Order extending the PGA rule variances, the Commission required MERC to demonstrate that ratepayers benefit from hedging and that there is not an undue price penalty. MERC uses financial instruments to hedge against natural gas price volatility, not for market speculation, and the Company's hedging strategies are cost effective relative to other energy purchasing strategies and do not place an undue price burden on ratepayers.

To demonstrate the ratepayer benefit, MERC compared hedge strategies for each of the previous nine winter seasons – November through March, from 2006 through 2014, and from November 2014 through January 2015. The hedging analysis compared the MERC hedging strategy of fixed price, which is comprised of fixed price purchases and storage and call options, to the cost if purchased at market prices. The comparison of the hedged volumes, assuming purchases at market prices, resulted in approximately $4.4 million gas cost savings ($.0345/MMbtu) without any additional hedging cost. During this period, MERC paid approximately $30.4 million ($.2385/MMBtu) in hedge premium, for a total additional cost of approximately $26.0 million ($.2040/MMbtu) over this nine-year period.

In review of this data, one hedge year, November 2008 through March 2009, appears to be an anomaly. Hedge purchases were made in Spring/Summer of 2008 for that hedge year. The New York Mercantile Exchange (NYMEX) closing prices for the period of April 2008 through October 2008 ranged from a low of $7.472 to a high of $13.105 per MMBtu. The NYMEX closing prices for the period of November 2008 through March 2009 ranged from a low of $4.056 to a high of $6.469. Typically, prices are higher in the winter months and lower in the summer months. The winter of 2008/2009 (November 2008 through March 2009) was the exact opposite. The main reason for the disconnect in prices was the correlation that natural gas had with crude oil during the spring/summer of 2008. At that time, crude oil prices hit all-time highs and natural gas prices rose in correlation even though there was not a strong demand for natural gas. At the beginning of the winter, the correlation between the two commodities began to dissipate, which was the primary reason for the big drop in prices. Please see Attachment A, MERC Hedging Analysis.[1]

Because that hedge year was an anomaly, MERC removed the November 2008 through March 2009 data and compared the remaining data. Without adding hedge costs to the hedge portfolio, hedging resulted in approximately $35.6 million cost savings ($.3169/MMbtu) for customers. Part of MERC's hedge strategy utilizes financial call options, which require a premium to be paid. During this period, MERC paid approximately $22.6 million ($.2014/MMbtu) in call option hedge premium. When the two costs are added together, the hedge portfolio would have resulted in an approximate $13.0 million cost savings ($.1155/MMbtu). With the data for the 2008-2009 hedge year removed, the data demonstrates that the MERC's hedge strategy meets the purposes of hedging: mitigating price volatility and providing reasonably priced natural gas for MERC's customers. Please see Attachment A, MERC Hedging Analysis.

MERC's hedging strategy will never provide the lowest priced natural gas over a period of time. The purpose of hedging is to mitigate price volatility by removing the price spikes and also to provide reasonably priced natural gas. By mitigating volatility, hedging also removes major shifts from high prices to low prices and provides more consistently priced natural gas.

[1] MERC is also filing an Excel spreadsheet containing the data supporting Attachment A.

MERC does not speculate on what natural gas prices are going to do but is ready to adapt the hedging portfolio as market prices warrant.

MERC's hedging strategy is designed to protect customers from catastrophic prices that can occur due to many market factors and to provide reasonably priced natural gas. There are several factors that influence natural gas prices including:

- Natural Gas Rig Counts
- Natural Gas Production
- Imports from Canada
- Exports to Mexico
- Liquified Natural Gas (LNG)
- EIA Storage Balances
- Hurricane Impact
- Economy
- Warmer or Colder Winter Weather
- Other Competing Commodities (Oil, Heating Oil, etc.)
- World Events Related to Oil Production

The aforementioned factors are hard to project on the influence of pricing, so MERC believes the implemented hedging strategy is necessary to protect customers from high natural gas prices.

In the past, the United States has seen disruption in natural gas production due to hurricanes like Hurricanes Katrina and Rita in 2005 and Hurricane Sandy in 2012. Other events such as world conflicts can impact oil prices and potentially natural gas prices. Additionally, the actual weather experienced has an impact on natural gas prices. Many of these events cannot be anticipated and no one knows with certainty what the weather will do until it happens. These reasons are why MERC believes hedging is a crucial tool to mitigate price volatility and provide reasonably priced natural gas for its customers. MERC believes its hedging strategy povides this protection for its customers at a reasonable price.

V. <u>Application of Variance Standards</u>

MERC must obtain Commission approval of variances from three Commission rules in order to recover the costs of its hedging program through the PGA. These rules are:

- Minn. R. 7825.2400, subp. 12, which defines the cost of purchased gas as the cost of gas defined by the Minnesota uniform system of accounts, including specific accounts set forth by the Federal Energy Regulatory Commission ("FERC"); and defines "demand delivered gas cost" as the portion of the cost of purchased gas "other than the commodity-delivered gas costs," including "associated costs incurred to deliver the gas to the utility's distribution system."
- Minn. R. 7825.2500(B), which permits an automatic adjustment of charges for "changes in the cost of commodity-delivered gas cost and demand-delivered gas cost for purchased gas."
- Minn. R. 7825.2700, which permits natural gas utilities to file to adjust retail rates on a monthly basis to reflect changes in the delivered cost of the commodity natural gas, pipeline and contract storage capacity, and peak-shaving supplies purchased for resale.

Minn. R. 7829.3200 provides that the Commission may grant a variance to its rules if it finds that:

1. Enforcement of the rule would impose an excessive burden upon the applicant or others affected by the rule;
2. Granting the variance would not adversely affect the public interest; and
3. Granting the variance would not conflict with standards imposed by law.

A. Enforcement of the Rule Would Impose an Excessive Burden on MERC and Its Customers

The requested extension of variances will continue to facilitate MERC's use of financial instruments, allowing MERC to execute transactions that will benefit customers by mitigating natural gas commodity price volatility risk. Since MERC's predecessor Aquila first obtained variances in 2003, the wholesale natural gas commodity market has experienced significant price volatility, confirming the continued need to use financial instruments in natural gas commodity acquisition. Although natural gas prices have been fairly stable over the last two years, there are world events that raise concern over prices remaining stable in the long term. As stated above, the purpose of MERC's hedging strategy is to mitigate price volatility and provide reasonably priced natural gas. Given these benefits, enforcement of the PGA rules would prevent MERC from using an important tool for providing reliable and reasonably-priced natural gas service to its customers. Therefore, enforcement of the rule would impose an excessive burden on MERC and its ratepayers.

B. The Public Interest is not Adversely Affected by Varying the Rule

The public interest would not be adversely affected by granting the requested extension of variances. As the Commission and the Department determined in Docket Nos. G007,011/M-06-1358, G007,011/M-09-262, G007,011/M-11-296, and G007,011/M-13-207 ratepayers benefit from the use of financial instruments to mitigate natural gas volatility, and the responsible use of such instruments will be ensured by regulatory oversight for the duration of the extension.

C. The Proposed Variances would not Conflict with Standards Imposed by Law

The proposed variances do not conflict with any standards imposed by law. The Commission has previously granted the rule variances to MERC in Docket Nos. G007,011/M-06-1358, G007,011/M-09-262, G007,011/M-11-296, and G007,011/M-13-207 and has granted similar PGA rule variances to other Minnesota gas utilities. The Commission has therefore previously determined a variance to the PGA rules does not conflict with standards imposed by law.

VI. Effect on MERC's Revenue

The extension would allow recovery of the costs of financial instruments from MERC's retail natural gas customers pursuant to the PGA and annual PGA true-up. The additional revenue would be offset by the costs of the financial instruments and have no net change on MERC's earnings.

VII. Conclusion

MERC believes it is in the best interest of its ratepayers to be allowed the flexibility to recover through the PGA the incurred costs of financial instruments used for hedging purposes in procuring natural gas supplies for Minnesota customers. MERC respectfully requests that the Commission grant extensions to PGA rule variances subject to the reporting requirements and limitations described above. MERC requests Commission action no later than June 30, 2015, so MERC may continue to engage in limited hedging transactions and recover the costs through the PGA.

DATED: March 6, 2015

Respectfully Submitted,

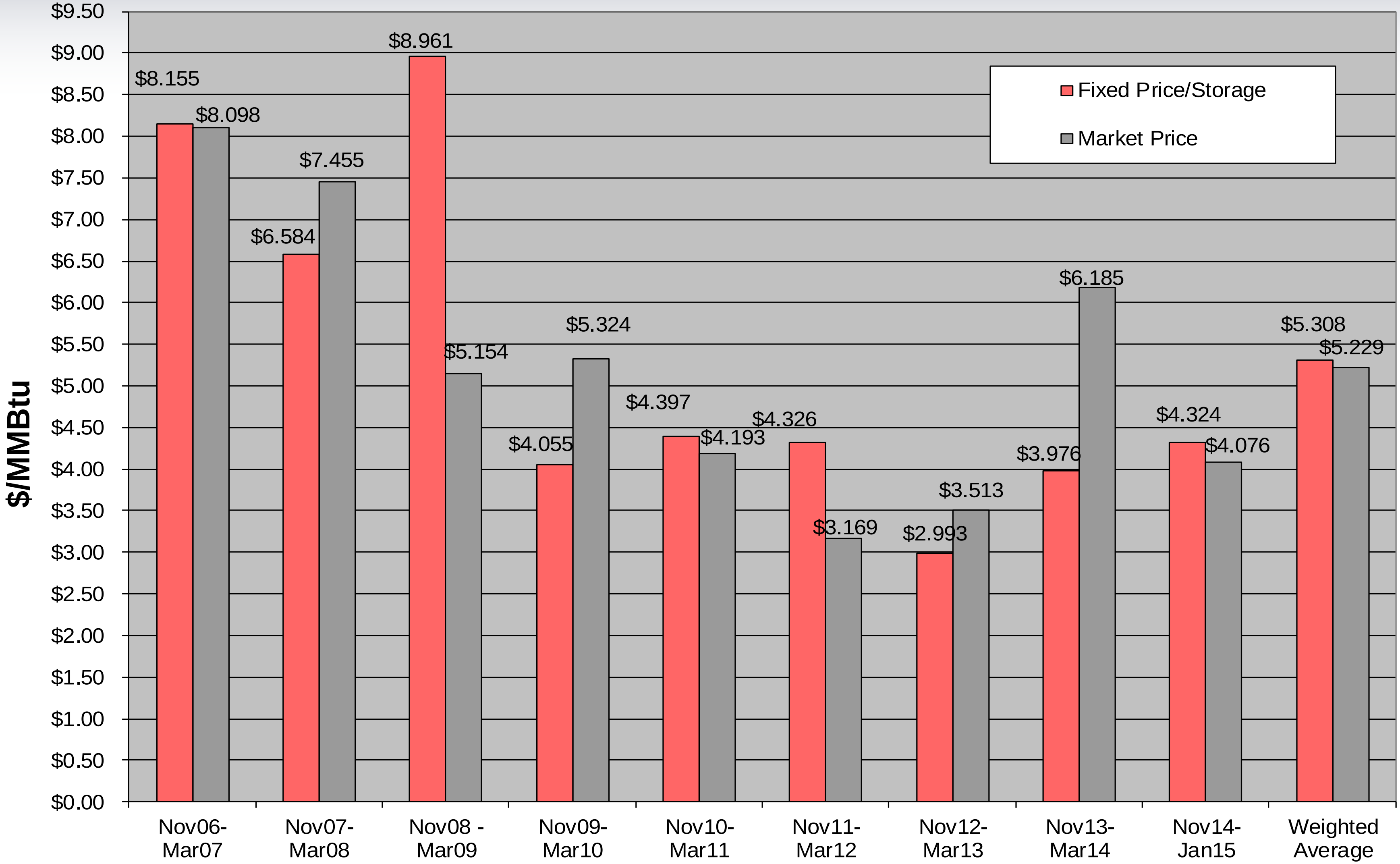
DORSEY & WHITNEY LLP

By /s/ Michael J. Ahern

Michael J. Ahern
Suite 1500, 50 South Sixth Street
Minneapolis, MN 55402-1498
Telephone: (612) 340-2600
Attorney for Minnesota Energy
Resources Corporation

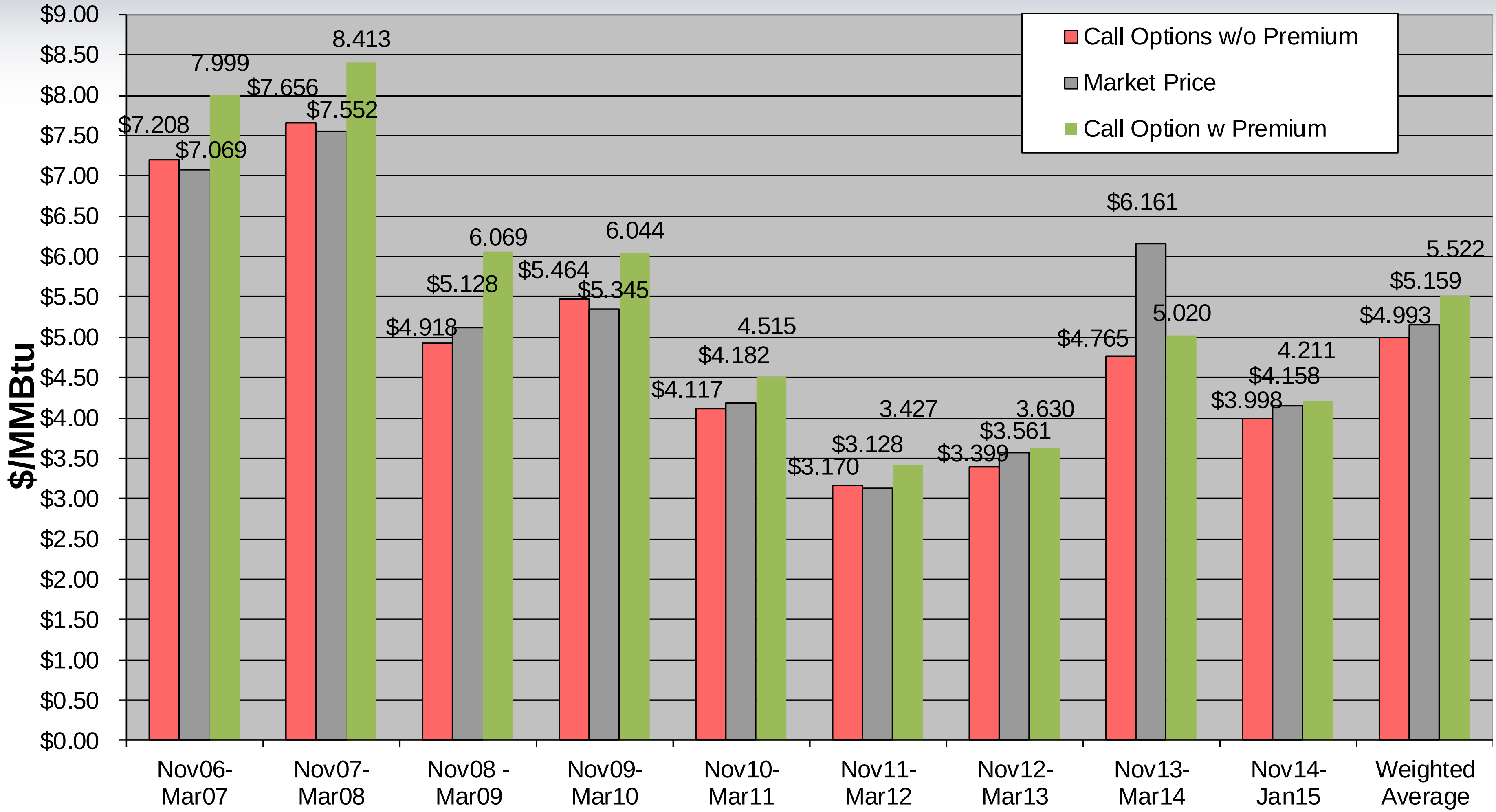
Attachment A

MERC Fixed Price/Storage Portfolio to Market Price



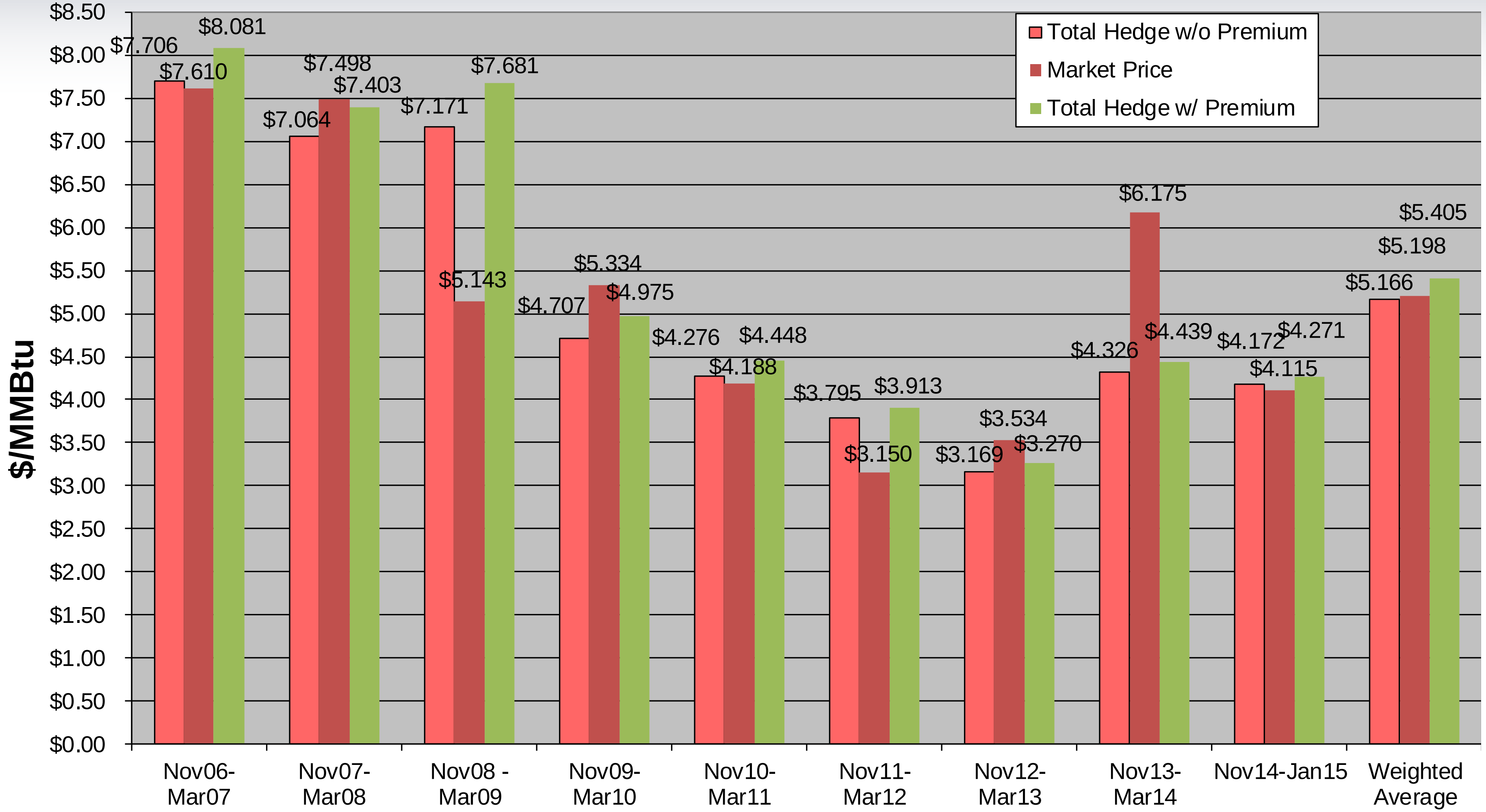
Notes: The weighted average of the hedge years results in approximately $5.55 million additional costs compared to market prices or approximately $.079/Dth.

MERC Call Option Portfolio to Market Price



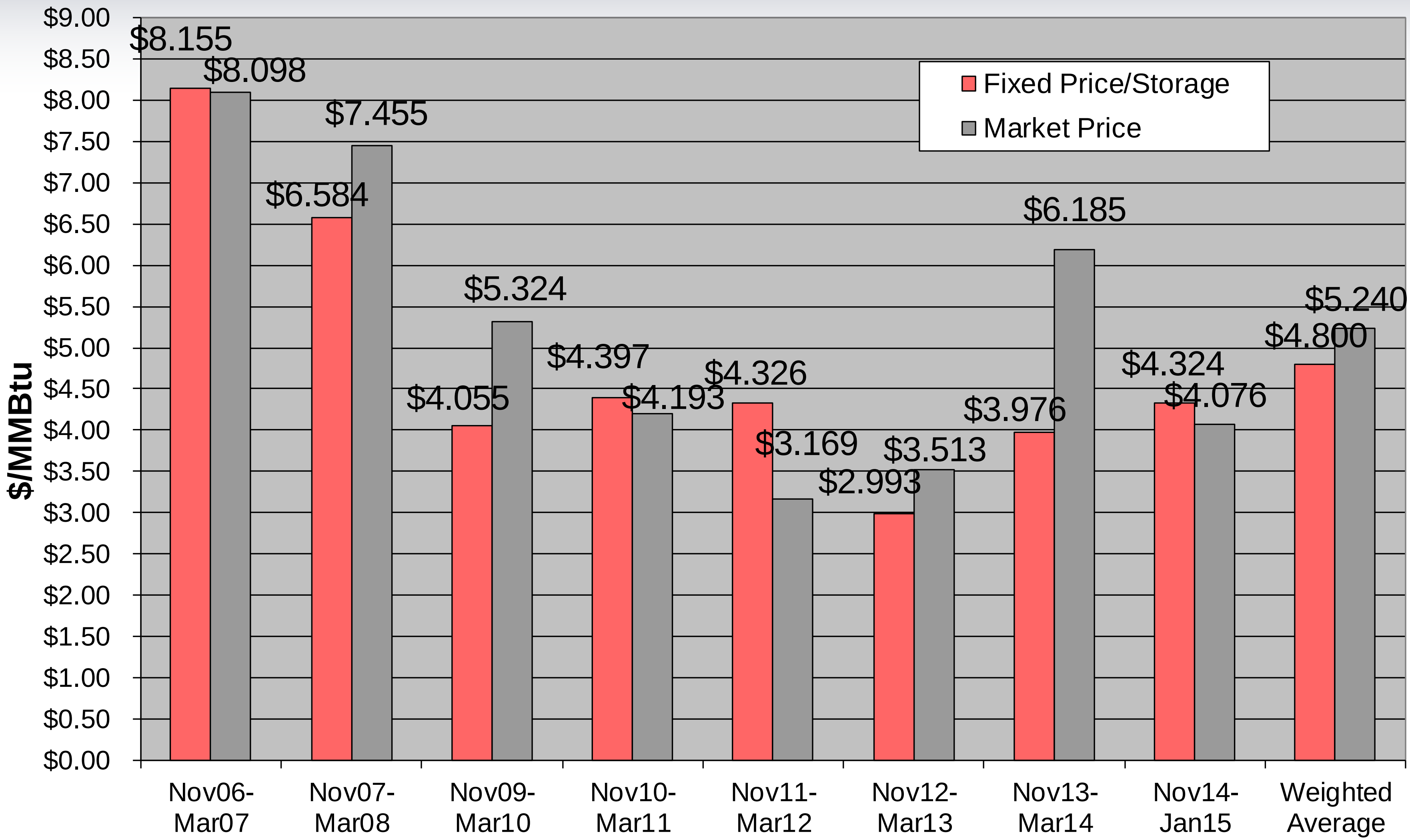
Notes: The weighted average of the hedge years (premium not included) results in approximately ($9.56) million savings compared to market prices or approximately ($.1664)/MMBtu. Total premium paid was approximately $30.43 million or approximate cost of $.5297 per MMBtu. The weighted average of hedge years (premium included) results in approximately $20.87 additional costs or approximate cost of $.3633 per MMBtu.

MERC Total Hedging Portfolio to Market Price



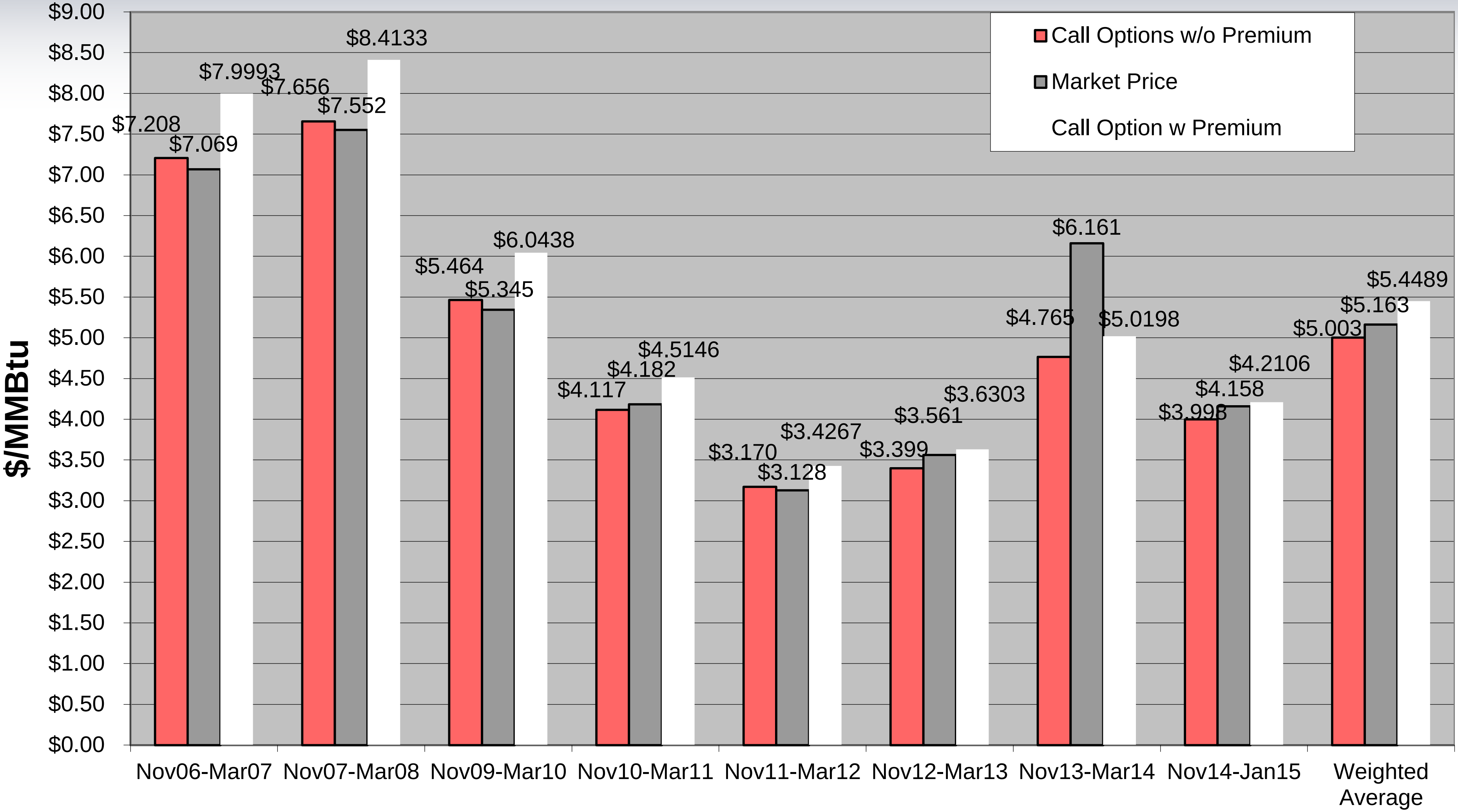
Notes: The weighted average of the hedge years (premium not included) results in approximately ($4.01) million savings compared to market prices or approximately ($.0315)/MMBtu. Total premium paid was approximately $30.43 million or approximate cost of $.2385 per MMBtu. The weighted average of hedge years (premium included) results in approximately $26.42 additional costs or approximate cost of $.2070 per MMBtu.

MERC Fixed Price/Storage Portfolio to Market Price (Exclude Nov08-Mar09)



Notes: The weighted average of the hedge years results in approximately $27.03 million cost savings compared to market prices or approximately ($.4392)/Dth.

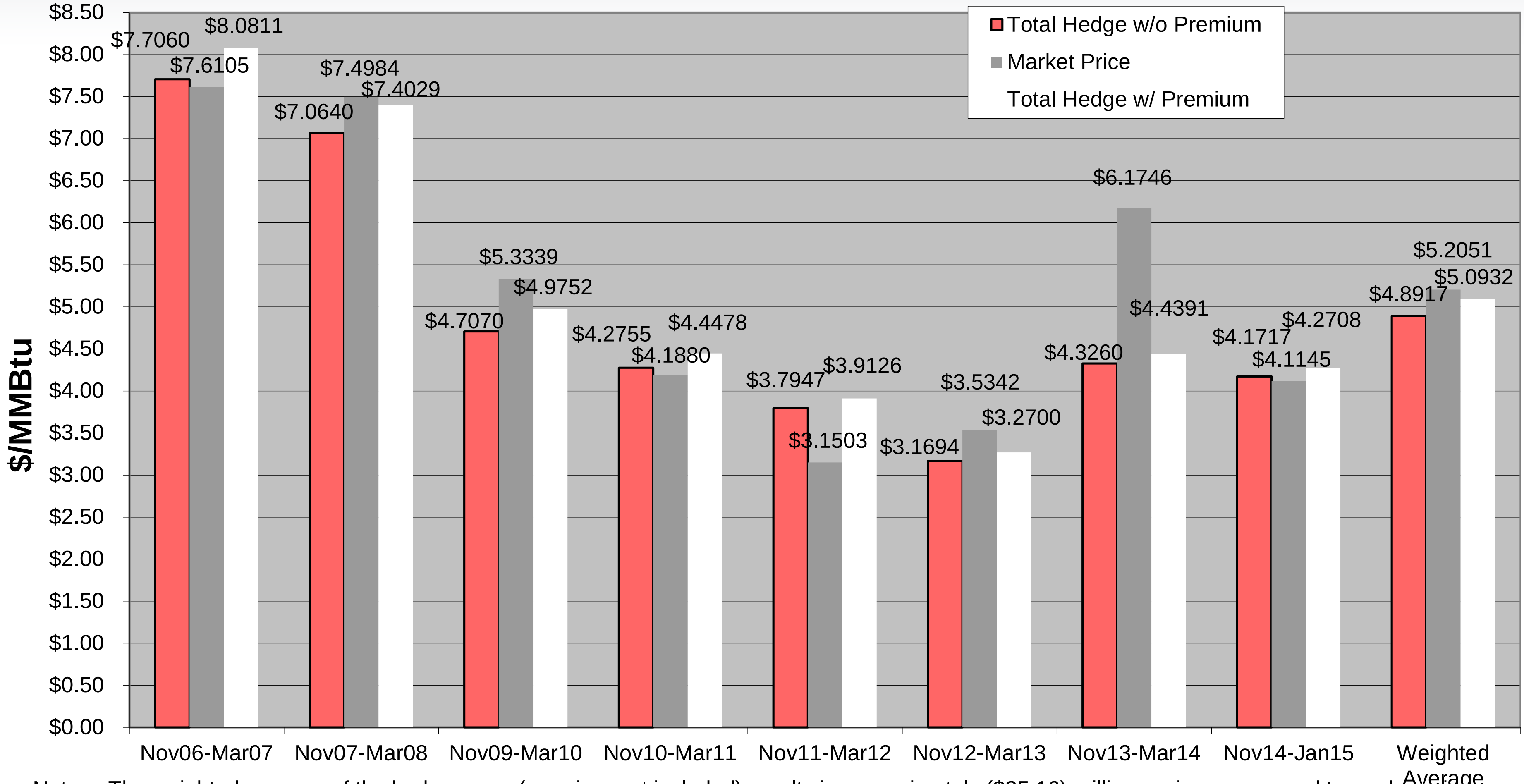
MERC Call Option Portfolio to Market Price (Excluding Nov 08-Mar 09)



Notes: The weighted average of the hedge years (premium not included) results in approximately ($8.13) million savings compared to market prices or approximately ($.1605)/MMBtu. Total premium paid was approximately $22.60 million or approximate cost of $.4463 per MMBtu. The weighted average of hedge years (premium included) results in approximately $14.47 additional costs or approximate cost of $.2858 per MMBtu.

MINNESOTA ENERGY RESOURCES

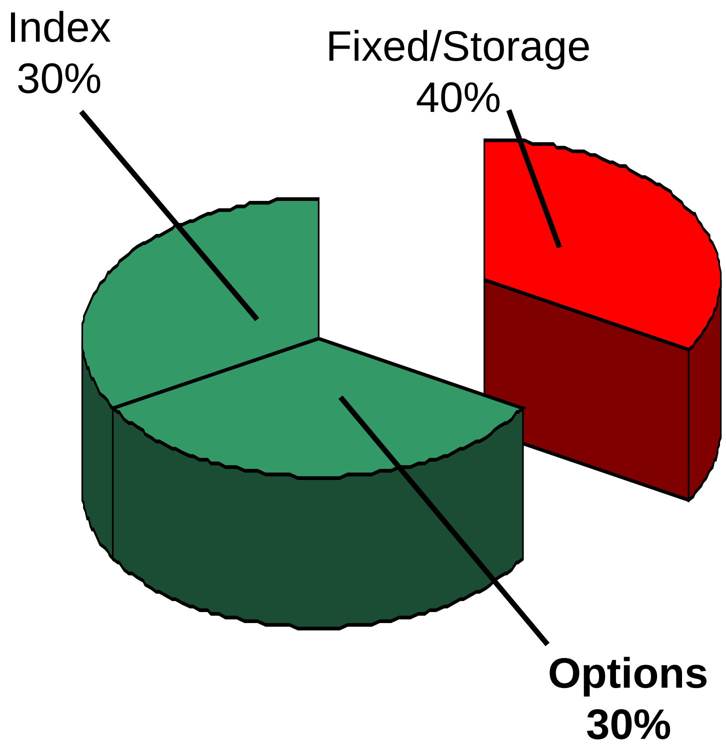
MERC Total Hedging Portfolio to Market Price (Excludes Nov 08-Mar 09)

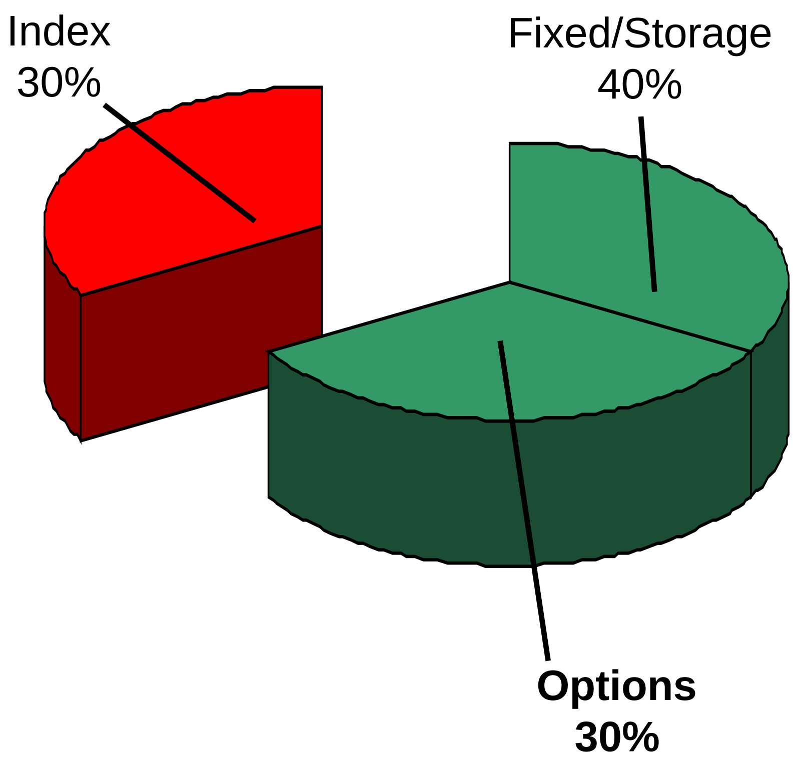


Notes: The weighted average of the hedge years (premium not included) results in approximately ($35.16) million savings compared to market prices or approximately ($.3134)/MMBtu. Total premium paid was approximately $22.60 million or approximate cost of $.2014 per MMBtu. The weighted average of hedge years (premium included) results in approximately ($12.56) million savings or approximate savings of ($.1120) per MMBtu.

MINNESOTA ENERGY RESOURCES

MERC Hedging Strategy – Bear/Bull Market





At/Under Cap Price   Over Cap Price

AFFIDAVIT OF SERVICE

STATE OF MINNESOTA)
) ss
COUNTY OF HENNEPIN)

Kristin M. Stastny hereby certifies that on the 6th day of March, 2015, on behalf of Minnesota Energy Resources Corporation, she electronically filed a true and correct copy of the attached Petition on www.edockets.state.mn.us. Said documents were also served via U.S. mail and electronic service as designated on the attached service list.

/s/ Kristin M. Stastny
Kristin M. Stastny

Subscribed and sworn to before me
This 6th Day of March, 2015.

/s/ Alice Jaworski
Notary Public, State of Minnesota

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Michael	Ahern	ahern.michael@dorsey.com	Dorsey & Whitney, LLP	50 S 6th St Ste 1500 Minneapolis, MN 554021498	Electronic Service	No	GEN_SL_Minnesota Energy Resources Corporation_General Service List
Julia	Anderson	Julia.Anderson@ag.state.mn.us	Office of the Attorney General-DOC	1800 BRM Tower 445 Minnesota St St. Paul, MN 551012134	Electronic Service	No	GEN_SL_Minnesota Energy Resources Corporation_General Service List
Michael	Bradley	mike.bradley@lawmoss.com	Moss & Barnett	150 S. 5th Street, #1200 Minneapolis, MN 55402	Electronic Service	No	GEN_SL_Minnesota Energy Resources Corporation_General Service List
Sharon	Ferguson	sharon.ferguson@state.mn.us	Department of Commerce	85 7th Place E Ste 500 Saint Paul, MN 551012198	Electronic Service	No	GEN_SL_Minnesota Energy Resources Corporation_General Service List
Daryll	Fuentes	dfuentes@usg.com	USG Corporation	550 W Adams St Chicago, IL 60661	Electronic Service	No	GEN_SL_Minnesota Energy Resources Corporation_General Service List
Amber	Lee	ASLee@minnesotaenergyresources.com	Minnesota Energy Resources Corporation	2665 145th Street West Rosemount, MN 55068	Electronic Service	No	GEN_SL_Minnesota Energy Resources Corporation_General Service List
John	Lindell	agorud.ecf@ag.state.mn.us	Office of the Attorney General-RUD	1400 BRM Tower 445 Minnesota St St. Paul, MN 551012130	Electronic Service	No	GEN_SL_Minnesota Energy Resources Corporation_General Service List
Brian	Meloy	brian.meloy@stinsonleonard.com	Stinson,Leonard, Street LLP	150 S 5th St Ste 2300 Minneapolis, MN 55402	Electronic Service	No	GEN_SL_Minnesota Energy Resources Corporation_General Service List
Andrew	Moratzka	apmoratzka@stoel.com	Stoel Rives LLP	33 South Sixth Street Suite 4200 Minneapolis, MN 55402	Electronic Service	No	GEN_SL_Minnesota Energy Resources Corporation_General Service List
Eric	Swanson	eswanson@winthrop.com	Winthrop Weinstine	225 S 6th St Ste 3500 Capella Tower Minneapolis, MN 554024629	Electronic Service	No	GEN_SL_Minnesota Energy Resources Corporation_General Service List
Daniel P	Wolf	dan.wolf@state.mn.us	Public Utilities Commission	121 7th Place East Suite 350 St. Paul, MN 551012147	Electronic Service	No	GEN_SL_Minnesota Energy Resources Corporation_General Service List