COMMERCE DEPARTMENT

December 5, 2019

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
Saint Paul, Minnesota 55101-2147

RE: **Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. G008/M-19-699

Dear Mr. Wolf:

Attached are the Comments of the Minnesota Department of Commerce, Division of Energy Resources (Department), in the following matter:

> Petition of CenterPoint Energy for Approval of an Extension of Rule Variances to Minnesota Rules to Recover the Costs of Certain Natural Gas Financial Instruments Through the Purchased Gas Adjustment.

The Petition was filed on November 5, 2019 by:

> Donald Wynia
> Regulatory Analyst, Regulatory Services
> CenterPoint Energy
> 505 Nicollet Mall
> Minneapolis, MN 55402
> (612) 321-4677

The Department recommends that the Minnesota Public Utilities Commission (Commission) **approve** CenterPoint Energy's Petition. The Department is available to answer any questions that the Commission may have in this matter.

Sincerely,

/s/ GEMMA MILTICH
Financial Analyst, CPA

GM/ja
Attachment

Before the Minnesota Public Utilities Commission

Comments of the Minnesota Department of Commerce
Division of Energy Resources

Docket No. G008/M-19-699

I. INTRODUCTION

On November 5, 2019, pursuant to Minnesota Statute § 216B.16, subdivision 7, and Minnesota Rule 7829.3200, CenterPoint Energy (CenterPoint or the Company) submitted a filing (Petition) requesting that the Minnesota Public Utilities Commission (Commission) extend the previously approved variance to Minnesota Rules 7825.2400, 7825.2500, and 7825.2700 (the Purchased Gas Adjustment [PGA] rules). The Commission last granted this variance in its February 5, 2016 *Order* in Docket No. G008/M-15-912. This *Order* allowed CenterPoint to recover through its PGA the costs of certain financial hedging instruments, which are intended to minimize price volatility of the natural gas supplies purchased on behalf of Minnesota customers. The currently approved variance ends on June 30, 2020; CenterPoint's new four-year variance extension proposal would expire on June 30, 2024.

II. DEPARTMENT ANALYSIS

CenterPoint seeks continued approval to recover through its monthly PGA the costs associated with the financial hedging instruments that the Company uses in conjunction with its procurement of natural gas supplies for its Minnesota customers.[1] Specifically, the Company requests approval to recover the costs of forward futures contracts, call options, put options in combination with call options to form a collar, and financial swaps.[2] The Company also requests that the Commission grant the proposed rule variance before the current authorization expires on June 30, 2020. If the Commission is unable to issue an order in this matter prior to June 30, 2020, CenterPoint requests that the Commission permit the Company to recover financial hedging instrument costs during the period after June 30, 2020 and before the issuance of the Commission's order in this docket.[3]

CenterPoint's present rule variance request is identical to the currently approved variance, which was authorized by the Commission in Docket No. G008/M-15-912. Despite the Company's proposal being identical to the current variance, it is still relevant to address whether hedging is an appropriate tool in today's natural gas market.

[1] Currently, recovery of the costs of purchased natural gas, as defined by Minnesota Rule 7825.2700, reflects only the cost for delivered physical natural gas.

[2] Petition, page 6.

[3] Petition, page 9.

A. *APPROPRIATENESS OF HEDGING UNDER CURRENT MARKET CONDITIONS*

In the past, there have been discussions before the Commission regarding the necessity of financial hedging during periods in which natural gas prices are low. Since the relevant rule variance was initially approved, natural gas prices have remained low, relative to prices during the early 2000s. Unconventional gas production, such as shale gas, continues to maintain downward pressure on prices, which raises the question of whether financial hedging is still appropriate at current price levels.

1. *Natural Gas Price Outlook and Volatility*

In its Petition, CenterPoint discussed the fact that, like other commodity markets, the natural gas market is, by its nature, highly volatile. Using historical data from the New York Mercantile Exchange (NYMEX), the Company demonstrated the natural gas market volatility by showing the significant natural gas price fluctuations over the past 18 years, ranging from approximately $1.71 to $13.91 per MMBtu between January 2001 through September 2019.[4] CenterPoint explained that significant events, such as geo-political circumstances and environmental regulation, can cause supply disruptions that result in short-term natural gas price spikes.[5] For example, over the New Year's holiday during the 2017-18 heating season, cold weather conditions coupled with a long weekend resulted in unexpected customer demand and resulting supply constraints at Ventura. These issues resulted in significant price spikes and daily price volatility, which raised costs for ratepayers and necessitated the filing of a revised January 2018 PGA by CenterPoint.[6]

CenterPoint's Petition also included data from the United States Energy Information Administration's (EIA)'s April 2019 Short-Term Energy Outlook (STEO), which projects natural gas prices at the Henry Hub through the end of 2020. This information suggests that natural gas prices are generally expected to continue to remain relatively low in the near term; however, such forecasts by their nature are typically not able to predict unexpected price increases. The EIA anticipates natural gas prices with upper bound forecasts of $5.13 per Mcf,[7] and lower bound forecasts of $1.67 per Mcf. According to the Company's filing, the projected Henry Hub price of natural gas averages $2.82 in 2019 and $2.77 in 2020.[8] If natural gas prices were to approach the EIA's upper bound forecast of about $5.00 per Mcf during the 2019/2020 heating season, this upward movement in prices would represent a relatively large price increase, compared to the weighted average cost of gas charged (ranging from $3.04 - $4.49) to CenterPoint's firm customers throughout the months of the last heating season (2018-19).[9]

---

[4] Petition, pages 10 – 11, table titled *NYMEX Natural Gas Settled Pricing*.
[5] Petition, pages 12 – 13, table titled *History of Option Prices & Volatility by Quarter*.
[6] Docket No. G008/AA-18-55.
[7] This pricing information was presented in MMBtu in the Company's Petition. The Department notes that Mcf, MMBtu, and Dekatherm are generally comparable.
[8] Petition, page 11.
[9] The weighted average cost of gas (commodity cost) is included in Schedule F of CenterPoint's November 2018 – March 2019 PGA dockets, as follows: G008/AA-18-666 → $3.4556; G008/AA-18-741 → $4.4871; G008/AA-19-026 → $4.0692; G008/AA-19-122 → $3.5553; G008/AA-19-192 → $3.0421.

In addition to price point estimates, the EIA's April 2019 STEO showed the NYMEX's 95 percent confidence intervals associated with the EIA's natural gas price predictions. The wide range of these confidence intervals underscores the volatility and illustrates the amount of risk that exists in natural gas markets, despite the current relatively low prices.[10]

Because CenterPoint's operations comprise a very small fraction of the natural gas industry, the Company cannot influence market prices; thus, CenterPoint and its ratepayers are susceptible to adverse natural market impacts. Even during periods of lower gas prices, the price volatility and the potential for unexpected price increases continues to be a risk that could create a financial burden for CenterPoint and its ratepayers. Financial hedging, when done effectively, is a useful tool for maintaining price stability and mitigating pricing risk, regardless of the current natural gas pricing trends.

2. CenterPoint's Hedging Data for Recent Years

CenterPoint's Petition included a ratepayer benefit analysis for the last three heating seasons (2016-17, 2017-18, and 2018-19). The Company's analysis showed that actual costs incurred, including those for hedging instruments, were less, by approximately 4 percent, than the costs that would have been incurred had CenterPoint relied solely on the market.[11] This result is a somewhat unusual result, since it is generally expected that gas costs will be higher when hedging is used, as the primary goal of hedging is to mitigate price volatility and not to produce lower-priced gas. However, under certain circumstances, hedging can mitigate price increases to such an extent that overall costs, including premium costs, are lower than prevailing market costs. In its Petition, CenterPoint also included certain call premium cost data. The Company's analysis shows that, since 2008, the percentage cost of call premiums has been consistently less volatile than natural gas price volatility.[12]

In its ratepayer benefit analysis, the Company converted its additional costs related to hedging (Actual Costs less Cost at Market) into a cost per dekatherm (Dkt) measure. In terms of annual sales, CenterPoint's hedging strategy cost $0.28 per Dkt in 2016-17 and saved $0.36 and $0.41 per Dkt in 2017-18 and 2018-19, respectively. On a percentage basis, hedging represented costs to ratepayers of 8 percent in 2016-17 and savings of 11 percent in both 2017-18 and 2018-19.[13]

---

[10] Petition, page 11, table titled *Henry Hub natural gas price and NYMEX confidence intervals*.

[11] Petition, page 13, section titled *7.3.6 "Ratepayer Benefit" – Cost of Winter Supply with and without Hedges*.

[12] Petition, pages 12 – 13, table titled *History of Option Prices & Volatility by Quarter*. Through its review of CenterPoint's Petition, the Department noted minor discrepancies between the historical data sets presented in Docket No. G008/M-19-699 and G008/M-15-912 for the winter strip prices and call premiums. The Department does not believe that these discrepancies are cause for concern, and CenterPoint has provided a reasonable explanation as to why the discrepancies exist. See Department Attachment 1.

[13] Petition, page 13, section titled *7.3.6 "Ratepayer Benefit" – Cost of Winter Supply with and without Hedges*.

3. Department's Conclusion on the Reasonableness of Hedging for the Time Period Proposed

Given that the natural gas market continues to be volatile and mitigation of natural gas price volatility risk can be achieved through financial hedging activities, the Department concludes that it is reasonable for CenterPoint to continue using financial hedging and recovering the associated costs through the monthly PGA, within the proposed time period.[14]

B. PROPOSED LIMITATIONS AND RESTRICTIONS FOR CENTERPOINT'S HEDGING ACTIVITIES

The Company proposes that the Commission approve the following provisions relevant to the variance request:

- Set an annual limit on hedging volumes of 26 Bcf ;
- Set an overall limit on hedging volumes of 65 Bcf;
- Allow multi-year hedging contracts of up to 60 months duration, with annual limits on volume for years beyond 2024 - 2025 of 13 Bcf;
- Set an annual limit on net option premiums of $6.5 million, excluding premiums or reservation fees paid for daily call gas;
- Allow the variance to apply to all financial positions into which CenterPoint enters through June 30, 2024;
- Allow the use of put options only in combination with a call option to form a collar; and
- Deny recovery of interest costs thru the PGA.[15]

The previously listed limitations and restrictions are consistent with those recommended by the Department and approved by the Commission in CenterPoint's last related variance request docket, Docket No. G008/M-15-912. The Department believes that these provisions continue to be relevant and reasonable and recommends that the Commission incorporate the bulleted items into its order in this matter.

C. PROPOSED ACCOUNTING AND REPORTING

In its Petition, the Company stated that it did not propose any changes to the accounting for its financial hedging instruments. Rather, CenterPoint proposes to continue (1) recording transaction outcomes based on the settlement cost of each of the financial instrument transactions and in the Federal Energy Regulatory Commission (FERC) Account 804 – *Natural Gas City Gate Purchases* and (2) maintaining records of each specific transaction, including the gain or loss and other transaction costs, such that there is an audit trail for each transaction. CenterPoint also proposes to maintain the same

---

[14] CenterPoint proposes that the relevant rule variance be extended through June 30, 2024.
[15] Petition, page 6.

reporting requirements as approved by the Commission in the last hedging variance request.[16] The Department concludes that the proposed accounting and reporting requirements are reasonable and recommends that the Commission incorporate these requirements into its order in this matter.

D. CRITERIA FOR GRANTING A VARIANCE TO A MINNESOTA RULE

Minnesota Rule 7829.3200 outlines three conditions that must be met in order for the Commission to grant a variance to a Minnesota rule. In its prior related petitions, CenterPoint provided, and the Commission accepted, relatively consistent supporting reasoning as to why the Company's requests met the criteria required for Commission approval of a rule variance. In its current Petition, the Company continues to assert that its proposal meets the relevant standards detailed in Minnesota Rule 7829.3200. The following discussion addresses the three criteria to be considered by the Commission in determining whether it may grant a rule variance.

(1) **Enforcement of the rules would impose an excessive burden upon the applicant or other affected by the rules**: According to CenterPoint, by granting a variance to Minnesota Rules 7825.2400, 7825.2500, and 7825.2700, and allowing the Company cost recovery of hedging costs, the Commission makes it possible for the Company to efficiently and cost-effectively use financial instruments to mitigate existing and future natural gas price risk. Through its financial hedging activities, CenterPoint has an opportunity to reduce retail natural gas rate volatility.[17]

(2) **Granting the variance would not adversely affect the public interest**: As explained in section A of the instant Comments, granting a variance in this case stands to provide potential benefits, rather than harm, to both the Company and its ratepayers through reduced natural gas price volatility. CenterPoint also specifically stated in its Petition that the public interest would not be adversely affected by an extension of the rule variance.[18] The Department notes that there is nothing in the Company's proposal that would preclude the Commission from exercising its authority in the future to disallow imprudent or unreasonable transactions, which provides further protection of the public interest.

(3) **Granting the variance would not conflict with standards imposed by law**: As it has done in its prior related dockets, the Company stated that it is not aware if any laws with which the proposed variance would conflict.[19] The Department is also not aware of any laws with which the proposed variance would conflict.

As noted previously, the Commission has consistently determined in prior variance requests that the Company's proposal meets the criteria required to grant a variance to the relevant Minnesota Rules. In the current Petition, CenterPoint provided the same reasoning it used in prior related dockets to

---

[16] Petition, pages 8 – 9.
[17] Petition, page 10.
[18] *Id.*
[19] Petition, page 13.

demonstrate that request meets the requirements of Minnesota Rule 7829.3200. The Department concludes that the Company has shown that its proposal meets the criteria for granting a rule variance.

E. EXTENSION OF CURRENT VARIANCE

As noted earlier, given the mitigation of natural gas price volatility risk that can be achieved through financial hedging activities, the Department concludes that CenterPoint's continued use of financial hedging and recovery of associated costs through the monthly PGA is reasonable. The Department supports the Company's continued use of appropriate hedging instruments, as long as these instruments do not unreasonably increase the annual average cost of purchased gas over time.

In its February 5, 2016 *Order* in Docket No. G008/M-15-912, the Commission granted CenterPoint a variance to Minnesota Rules 7825.2400, 7825.2500, and 7825.2700, allowing CenterPoint to recover, through the PGA, the costs of certain financial instruments entered into by June 30, 2020. The Company now requests that the Commission grant a four-year extension, ending June 30, 2024, to the currently approved variance. CenterPoint does not seek to modify any portion of the currently approved variance. The Department emphasizes that its support for a variance is contingent upon CenterPoint using financial instruments exclusively for risk hedging on behalf of ratepayers, and not for speculative purposes.

III. CONCLUSION AND RECOMMENDATIONS

The Department recommends that the Commission:

- Find that CenterPoint's variance extension request complies with the requirements set forth in Minnesota Rules 7825.3200;
- Extend the variance to Minnesota Rules parts 7825.2400, 7825.2500, and 7825.2700 for a four-year period ending June 30, 2024;
- Allow the variance to apply to all Commission-approved financial positions that CenterPoint enters into through June 30, 2024;
- Require an annual limit on hedging volumes of 26 Bcf;
- Require an overall limit on hedging volumes of 65 Bcf;
- Allow multi-year hedging contracts of up to 60 months in duration; with annual limits on volumes for years beyond 2024-25 of 13 Bcf;
- Require an annual limit on net option premiums of $6.5 million, excluding premiums or reservation fees paid for daily call gas;

- Not allow recovery of interest costs thru the PGA;

- Continue to allow CenterPoint to engage in put options in combination with call options to form a collar, but disallow the Company's use of put options for any other reason, without specific Commission approval;

- Require CenterPoint to report data and follow the reporting requirements as detailed in Section 6.2 *Proposed Regulatory Reporting* of CenterPoint's Petition;

- Require CenterPoint to include, in future variance requests, a ratepayer benefit analysis similar to that shown in Section 7.3 *Ratepayer Benefit Analysis* of CenterPoint's Petition; and

- Require CenterPoint to file, as compliance in this docket, a copy of its hedging plan each year after the plan has been approved by Company management.

/ja

From: Wynia, Donald W
To: Miltich, Gemma (COMM)
Subject: RE: [External Email] Department Question on 19-699 Docket
Date: Tuesday, December 03, 2019 2:07:54 PM
Attachments: image012.png
image002.png
image005.png
image007.png
image009.png
image011.png

Hi Gemma,

Your question: on 11/27 you sent an email showing that there was a difference in what CNP reported for Winter Strip Pricing and Call Premiums for our 2019 and 2015 hedging variance filing. You asked for additional information.

A:
CNP switched to using a third party to provide us our volatility measurements since our 2015 hedging variance filing (Docket: 15-912), because employees who produced those values retired from the Company. The information submitted as part of the 2019 (Docket: 19-699) filing came from Kiodex Global Market Data. It includes a SOCS-1 compliance letter and it is compliant with SSAE-18 accounting standards. The volatility is calculated based on:

1. Underlying futures price
2. Strike price of option
3. Option premium
4. Time to expiration

Differences in volatility values between the 2015 filing report and the most recent filing result from two separate issues.

First, there are basic differences in the option model supplying the volatility data resulting in slightly different calculations.

Second, there were minor differences in data points included in the 2015 filing, as highlighted in your November 27, 2019 email. We have validated this does not affect the information provided in Docket: 19-699 and the current information is accurate. Since we are now using a third party, volatility will be calculated slightly differently than the 2015 filing but we are using a method to measure volatility that is recognized by industry standards.

If you have any questions, please do not hesitate to contact me.
Regards,

Donny Wynia
Regulatory Analyst | Regulatory Portfolio Management
MN
(612) 321-4677 w.

CenterPointEnergy.com

From: Miltich, Gemma (COMM) <gemma.miltich@state.mn.us>
Sent: Wednesday, November 27, 2019 10:51 AM
To: Wynia, Donald W <donald.wynia@centerpointenergy.com>
Subject: [External Email] Department Question on 19-699 Docket

EXTERNAL EMAIL

Hi Donald,

I am working on CenterPoint's recent filing, docket G008/M-19-699, which proposed an extension to the previously approved variance to Minnesota Rules 7825.2400, 7825.2500, and 7825.2700. I had a quick question regarding the historical data on winter strip prices and call premiums included in this current filing, as compared to the corresponding data included in CenterPoint's previous variance request filing, docket G008/M-15-912. I attached both filings to this message for your reference.

If you compare the historical data in the table showing winter strip prices and call premiums (see page 12 of CenterPoint's filing in 19-699 and page 14 of CenterPoint's filing in 15-912), you will see that the data does not consistently match between the old and the new filing. For example, the first date (7/1/2008) shows a winter strip price of $14.21 in docket 19-699 and $14.07 in docket 15-912. So my question is this: Why would the historical data change from filing to filing for years that had long since passed (like 2008) by the time that both of these filings were made?

If you would rather talk on the phone about this, we can connect on Monday, December 2nd, which is when I will be back in the office.

Thank you!

Gemma Miltich
Public Utilities Financial Analyst | Division of Energy Resources
651-539-1819
mn.gov/commerce

Minnesota Department of Commerce
85 7th Place East, Suite 280 | Saint Paul, MN 55101
