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COMMERCE

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February 25, 2016 **PUBLIC DOCUMENT**

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

RE: **PUBLIC Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. G002/M-16-88

Dear Mr. Wolf:

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

> A petition submitted by Northern States Power Company (Xcel or the Company) requesting Minnesota Public Utilities Commission (Commission) approval of an extension of variances to Minnesota Rules to allow Xcel to recover the costs of financial instruments through the Purchased Gas Adjustment (PGA) clause.

The petition was filed on January 27, 2016 by:

> Amy A. Liberkowski
> Manager, Regulatory Analysis Xcel Energy
> 414 Nicollet Mall, 7th Floor
> Minneapolis, Minnesota 55401

The Department recommends that the Commission **approve** Xcel's petition.

The Department is available to answer any questions the Commission may have.

Sincerely,

/s/ MICHAEL RYAN
Rate Analyst
651-539-1807

MJR/lt
Attachment

PUBLIC DOCUMENT

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

PUBLIC COMMENTS OF THE MINNESOTA DEPARTMENT OF COMMERCE DIVISION OF ENERGY RESOURCES

DOCKET NO. G002/M-16-88

I. SUMMARY OF PROPOSAL

Pursuant to Minnesota Statute §216B.16, subdivision 7, and Minnesota Rule (Minn. R.) 7829.3200, Northern States Power Company d/b/a Xcel Energy (Xcel or the Company) has requested that the Minnesota Public Utilities Commission (Commission) grant an extension of the variance to Minnesota Rules 7825.2400, 7825.2500, and 7825.2700 (the Purchased Gas Adjustment or PGA rules) to allow Xcel to continue to recover prudently incurred costs associated with financial instruments used to manage price risks in the procurement of natural gas supplies for its Minnesota customers.

Specifically, Xcel requested that the Commission approve an extension to its current variance through June 30, 2020. Xcel proposed to continue recording the purchase cost of various financial hedging instruments (*i.e.,* fixed for float contracts, call options, costless collars) used to hedge approximately 24.5 percent of its winter requirements to Federal Energy Regulatory Commission (FERC) Account No. 804 and to continue providing the reports required in Docket Nos. G002/M-01-1336 and G002/M-03-1627. Xcel also requested that the Commission modify the variance to allow a decrease in the existing cap to [TRADE SECRET DATA HAS BEEN EXCISED] dollars for financial hedging instruments (previously set in Docket No. G002/M-12-519 at $7 million dollars).

II. THE DEPARTMENT'S ANALYSIS

A. OVERVIEW

The cost of purchased natural gas as defined by Minn. R. 7825.2400 reflects only the cost for delivered physical natural gas; consequently, utilities must obtain a variance to these rules to recover costs of hedging. Without recovery of the costs of hedging, utilities have little incentive to undertake hedging on behalf of ratepayers since the utility earns no return on gas costs and passes changes in the cost of gas directly to ratepayers. Thus, the question before the Commission is whether or not to allow utilities to hedge natural gas costs.

The Commission has discussed this question recently and has noted that the current low prices for natural gas minimize the effects of price spikes in natural gas prices. At the same time, the Commission has also noted that the current low prices of natural gas do not eliminate the effects of price spikes due to factors such as unforeseen glitches in supplies (*e.g.*, due to damage to natural gas infrastructure), high demand for natural gas (*e.g.*, due to weather, demand for electricity production, etc.), changes in environmental policies either domestically or worldwide, or market speculation.

The Department concludes that, so long as the costs of hedging tools are appropriate, hedging provides reasonable protection for ratepayers against price volatility in natural gas markets. Once events such as Hurricane Katrina or the TransCanada pipeline explosion in 2014 occur, it is too late to hedge against the price effects. As such, hedging, whether it is financial or physical, is analogous to an insurance policy. Like insurance, hedging is not free, but it is important to have as protection against unexpected circumstances.

While the Commission could choose to deny cost recovery of hedging, such a decision would leave Xcel's ratepayers without the protection of hedging. Because there is uncertainty in all of the factors noted above, the Department concludes that it is appropriate to allow Xcel to continue to recover the costs of hedging in its purchased gas adjustment so long as the costs are reasonable. The Department discusses its position below.

B. APPROPRIATENESS OF HEDGING UNDER CURRENT MARKET CONDITIONS

Since Xcel's prior hedging variance was approved, the market has remained within a narrow pricing window. At the time of this docket, the price of natural gas remains relatively low. The natural gas market is also set to come out of winter season with a large amount of gas in storage due to the warm winter and limited weather demand. Given the lower pricing, it is prudent to ask if hedging is still appropriate at current price levels.

1. Xcel Discussion in Support of Hedging

Xcel stated that the goal of its hedging strategy is to mitigate sharp increases in natural gas prices. The Company acknowledged that the final cost of its hedging efforts may be higher than the cost had it purchased all gas supply in the monthly or daily spot market. However, as noted in previous hedging variance dockets, incurring hedging losses is not necessarily a detriment to customers, as the main purpose of hedging is to provide an insurance against catastrophic price increases that affect natural gas customer rates. The goal of mitigating sharp increases in natural gas prices is constant regardless of whether the starting point for natural gas prices is higher, as in 2007 or 2008, or lower, as in more recent years and as is expected to occur in 2016.

Xcel stated that although gas prices are at low levels currently, the possibility of significant price fluctuations remains. The Company referenced two factors that affect the wholesale natural gas market. The first factor is the potential for increased commercial and industrial usage due to sustained low gas prices. The second factor is the potential implementation of a variety of environmental regulations (*e.g.*, coal emissions, hydraulic fracking). Any combination of these or other factors could combine to modify the current supply and demand imbalance. This uncertain supply and demand picture underscores the need for continued price volatility mitigation efforts. Therefore, the goals of the Company's gas price mitigation efforts will be similar to those of previous year's plans.

2. Department Discussion on Hedging

The natural gas market has changed dramatically in light of developments in shale gas, which have led to some of the lowest prices in the last decade. However, despite recent stable natural gas prices, the Department shares similar concerns with Xcel regarding future prices. There is still considerable uncertainty regarding how government and/or market forces could disrupt recent price stability.

Increased demand from commercial and industrial customers, including electric generators could push up pricing. Also, low natural gas pricing for the country as a whole does not take into account regional differences and constraints. This was shown in February and March 2014 when a portion of the TransCanada Pipeline exploded in Canada and drove index pricing at Northern Natural Gas Ventura and Demarc to increase dramatically. As discussed on pages 83 – 87 of the Department's *Review of 2013-2014 Annual Automatic Adjustment Reports* in Docket No. G-999/AA-14-580, each of the three Minnesota natural gas utilities participating in hedging programs experienced net gains and/or cost savings due to hedging during FYE14.

Given the numerous factors that influence gas pricing on both sides (supply and demand), and continued uncertainty existing for Minnesota natural gas consumers, the Department continues to conclude that hedging should be available as a tool for utilities to manage and diversify gas costs.

C. XCEL'S PROPOSAL

1. Modifying Existing Cap

Xcel proposed to decrease the existing annual limit (cap) on the level of prudently incurred costs of financial instruments (used to hedge natural gas prices) that Xcel may recover through the PGA. Specifically, the Company proposed to decrease the annual limit from $7 million dollars (set in Docket No. G002/M-12-519), to **[TRADE SECRET DATA HAS BEEN EXCISED]** dollars. The Company stated that:

- **[TRADE SECRET DATA HAS BEEN EXCISED]** dollars equals the Annual Gas Hedging Budget based on the Northern Natural Gas (NNG) Ventura At-the-Money call option premium for November 2016 through March 2017 of **[TRADE SECRET DATA HAS BEEN EXCISED]** per MMBtu times the proposed financial hedge quantity of 13.68 Bcf;
- a fixed dollar cap based on the calculation of At-the-Money call options is more reflective of the true costs to purchase

financial options than the price floor used in prior variances for financial and physical hedging instruments; and

- the proposed cap would be adequate for the Company to continue to provide customers with a hedge that covers approximately 50 percent of the winter commodity gas supply requirements; 24.5 percent of the normal winter requirements are expected to be hedged using financial hedging instruments and the remaining 25.5 percent with storage.

The method used by Xcel to calculate the **[TRADE SECRET DATA HAS BEEN EXCISED]** cap was different from the method used in previous dockets (see Docket No G002/M-12-519). Xcel based the proposed cap on the lowest of three third-party bids received for At-the-Money call premiums. Through informal discussions initiated by the Department in seeking further clarity on the Company's proposal, the Company indicated that it generally strives to obtain three quotes prior to executing any financial hedging option. Further, Xcel indicated that it proposed the new method of cap calculation in response to the Commission's Order in Docket No. G002/M-12-519 which imposed a cap on only the financial hedging costs instead of a setting a higher, general cap on all physical and financial hedging costs.

The proposed annual cap of **[TRADE SECRET DATA HAS BEEN EXCISED]** is a fixed cap for the duration of the variance. The Department does not object to this cap. However, in informal conversations with Xcel, the Department expressed concern regarding the sufficiency of this cap if option prices increase significantly. The Company stated that it is comfortable with the cap and would file a revised proposal if market conditions change drastically making the **[TRADE SECRET DATA HAS BEEN EXCISED]** cap insufficient to properly hedge its winter requirements. The Company also stated that it could use other lower cost financial products if the Company was nearing the fixed cap. The Department requested that the Company provide a cost analysis of the prior years beginning with 2007-2008 to aid the Commission's and the Department's ability to assess whether the proposed cap is reasonable. The Company was able to provide the cost analysis as it was prepared for the Annual Automatic Adjustment filing, Docket No. G999/AA-15-612, Attachment G. As shown in the table below, costs since 2012-2013 have been below the cap established in Docket No. G002/M-12-519 and the current request.

Table 1: Minnesota Hedging Costs

Hedge Year	NSPM - Hedged Volumes (Dth)	MN State Actual Costs[1]	MN State Cost Excluding Hedging[2]	Hedging Cost - MN State	MN State Hedge Cost/Dth[3]	MN State Cost as % of Annual
2007-2008	12,790,000	$576,571,051	$566,843,252	$9,727,799	$0.13	1.69%
2008-2009	13,960,000	$458,654,791	$443,825,881	$14,828,910	$0.21	3.23%
2009-2010	14,675,000	$312,671,414	$311,675,493	$995,921	$0.01	0.32%
2010-2011	14,235,000	$325,282,768	$308,084,365	$17,198,404	$0.24	5.29%
2011-2012	14,310,000	$225,568,004	$205,124,054	$20,443,950	$0.35	9.06%
2012-2013	4,530,000	$251,190,939	$251,190,939	$0	$0.00	0.00%
2013-2014	4,530,000	$430,082,253	$438,254,092	($8,171,840)	($0.10)	-1.90%
[TRADE SECRET DATA HAS BEEN EXCISED]						

Xcel proposed to continue hedging approximately 50 percent of its winter commodity gas supply requirements. While Xcel has indicated that it has no intention of hedging above the 50 percent threshold, the Department recommends that the Commission require Xcel to hedge no more than 50 percent of its annual winter requirements. As noted above, Xcel proposed that a maximum of 24.5 percent of normal winter requirements will be allocated to financial hedging options and the remaining 25.5 percent to physical storage hedging.

2. *Longer-Term Hedging Options*

In its filing, Xcel stated that while previously it would have been difficult for the Company to enter into a long-term contract for natural gas, more recently, the longer-duration transactions have become more feasible. Accordingly, Xcel will consider and evaluate two- to five-year hedging opportunities for its customers. The Company indicated that should it identify a longer-term hedging opportunity, Xcel would make a separate filing requesting Commission approval of that transaction.

The Department notes that long-term contracts expose ratepayers to higher-than-market rates if prices decrease over time, and conversely, provide ratepayer benefit if prices increase. If Xcel pursues long-term contracts, the Department would expect that the Company would provide comprehensive evidence as to why this type of contract would be in the best interest of Xcel's ratepayers.

[1] These costs consist of gas commodity and peak shaving (LNG, propane) commodity supply costs. These values do not include any demand charges associated with gas supply, transportation, or storage.
[2] These costs were calculated by subtracting the Minnesota state allocated jurisdictional share of hedging costs from the values in the "MN State Actual Costs" column.
[3] Cost per Dth for all volumes delivered, not the cost per Dth for the volume hedged.

D. EXTENSION OF CURRENTLY APPROVED PGA RULES VARIANCE

In its Order dated January 23, 2002, in Docket No. G002/M-01-1336, the Commission granted Xcel a two-year variance to Minn. R. 7825.2500 B and 7825.2400, subp. 12, subject to reporting requirements, to allow Xcel to recover through the PGA, prudently incurred costs of directly related futures market instruments. The Commission has granted multiple four-year extensions since the original order. All related orders, including Docket No. G002/M-01-1336, are listed in the below table.

Table 2: Prior Variances

Order Date	Docket No.	Order Length	Variance Dates
January 23, 2002	G002/M-01-1336	Two-year variance	7/1/02 – 6/30/04
January 23, 2004	G002/M-03-1627	Four-year variance	7/1/04 – 6/30/08
May 27, 2008	G002/M-08-46	Four-year variance	7/1/08 – 6/30/12
October 2, 2013	G002/M-12-519	Four-year variance	7/1/12 – 6/30/16

In the instant petition, Xcel stated that it seeks to continue to use a mix of financial instruments, such as costless collars, futures contracts and options, to help reduce the volatility of natural gas prices for its retail gas customers. Thus, the Company requested that the Commission grant a four-year extension to the currently approved PGA rules variance through June 30, 2020, to allow Xcel to continue to flow the costs and benefits of various financial instruments to Account No. 804 and through the PGA.

As noted earlier, the Department concludes that financial hedging can provide appropriate insurance against price increases so long as the costs of hedging are reasonable; therefore, the Department is generally supportive of the use of appropriate hedging instruments as long as these instruments do not unreasonably increase the annual average cost of purchased gas over time.

The Department believes that price stability is an important objective, but it should not be pursued at all costs. The Department also notes that its conclusion regarding the conditions for a variance is contingent upon Xcel only using financial instruments for risk hedging on behalf of ratepayers and not for speculation.

At the February 4, 2016 Commission Agenda meeting regarding CenterPoint Energy's hedging variance in Docket No. G008/M-15-912, the Commission expressed interest in taking a closer look at utility hedging practices given the current state of the natural gas market. The Department expects that all retail rate-regulated natural gas utilities participating in financial hedging, including Xcel, will participate.

For now, the Department concludes that Xcel's currently approved variance to the PGA rules should be extended for the same reason it was granted in the first place. That is, it meets the conditions provided in Minn. R. 7829.3200. Specifically:

1. Enforcement of the Rules Would Impose an Excessive Burden upon the Applicant or Others Affected by the Rules

Enforcement of the rules may not allow Xcel to take advantage of the existing financial instruments in the wholesale natural gas markets. Therefore, Xcel may not be able to mitigate price volatility by taking advantage of contracts for futures, options and collars (*e.g.*, combination of put/call options). Moreover, enforcement may reduce protection for Xcel's ratepayers from potentially high energy costs via the Company's use of financial instruments. Therefore, the Department concludes that enforcement of the rules may impose an excessive burden upon Xcel's ratepayers.

2. Granting the Variance Would Not Adversely Affect the Public Interest

Based on its earlier discussion, the Department concludes that granting the variance would not adversely affect the public interest. In addition, there is nothing in the Company's proposal that would preclude the Commission from exercising its authority to disallow imprudent or unreasonable transactions. If, in the future, the Commission concludes that Xcel acted in an unreasonable manner, it could rule that certain costs were imprudent and should not be recovered from ratepayers. As such, the public interest is fully protected.

3. Granting the Variance Would Not Conflict With Standards Imposed by Law

The Commission has previously granted the rule variances in Docket Nos. G002/M-01-1336, G002/M-03-1627, G002/M-08-46 and G002/M-12-519, which determined that a variance to the PGA rules did not conflict with standards imposed by law. As such, the variance is consistent with the purpose of the PGA statute and rules and does not conflict with any other laws.

E. REPORTING REQUIREMENTS

Xcel proposed to continue to provide the reports required in Docket Nos. G002/M-01-1336 and G002/M-03-1627. The Department supports this proposal and recommends that the Commission require Xcel to:

- Separately identify, in its monthly PGA filings, the amount of anticipated financial instrument costs and/or benefits included in the calculation of the PGA rate.

- Include, in its requests for approval of changes in demand entitlements submitted about August 1 each year, a list of all financial instrument arrangements entered into for the upcoming heating season, including the cost premium associated with each contract, the size of each contract, contract date, contract price, and an explanation of the anticipated benefits of these contracts to Xcel's ratepayers.

- Include data on the relative benefits of price hedging contracts, specifically the average cost per Dth for natural gas purchased under financial instruments compared to the comparable monthly and daily spot index prices, in its annual AAA reports due on September 1 of each year as well as:

a. a list of each hedging instrument entered into;
b. the total volumes contracted for, for each instrument; and
c. the net gain or loss, including all transaction costs for each instrument in comparison to the appropriate monthly and daily spot prices.

The above information would allow the Department to continue to monitor the Company's hedging activity and provide notice to the Commission if further action is warranted.

III. RECOMMENDATIONS

Based on its review and analysis of Xcel's petition the Department recommends that the Commission:

- Extend the variance to Minnesota Rules 7825.2400, 7825.2500, and 7825.2700, originally granted in Docket No. G002/M-01-1336, until June 30, 2020;

- Allow the variance to apply to the costs and benefits of prudent financial positions that Xcel enters into through June 30, 2020;

- Allow Xcel to hedge no more than 50 percent of its annual winter requirements and no more than 24.5 percent with financial hedging instruments;

- Limit the prudently incurred cost of financial hedging instruments that Xcel may recover through the PGA to **[TRADE SECRET DATA HAS BEEN EXCISED]** dollars per fiscal year;

- Require Xcel to provide the actual final (settled) cost of financial instruments in required reports and to use the actual settled cost to determine the gain or loss on financial instruments; and

- Require Xcel to:

  1. Separately identify, in its monthly PGA filings, the amount of anticipated financial instrument costs and/or benefits included in the calculation of the PGA rate.

  2. Include, in its requests for approval of changes in demand entitlements submitted on approximately August 1 of each year, a list of all financial instrument arrangements entered into for the upcoming heating season, including the cost premium associated with each contract, the size of each contract, contract date, contract price, and an explanation of the anticipated

benefits of these contracts to Xcel's ratepayers.

3. Include data on the relative benefits of price hedging contracts, specifically the average cost per Dth for natural gas purchased under financial instruments compared to the comparable monthly and daily spot index prices, in its annual AAA reports due on September 1 of each year as well as:

   a. a list of each hedging instrument entered into;

   b. the total volumes contracted for, for each instrument; and the net gain or loss, including all transaction costs for each instrument in comparison to the appropriate monthly and daily spot prices.

/lt

CERTIFICATE OF SERVICE

I, Sharon Ferguson, hereby certify that I have this day, served copies of the following document on the attached list of persons by electronic filing, certified mail, e-mail, or by depositing a true and correct copy thereof properly enveloped with postage paid in the United States Mail at St. Paul, Minnesota.

Minnesota Department of Commerce
Public Comments

Docket No. G002/M-16-88

Dated this 25th day of February 2016

/s/Sharon Ferguson

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