

January 19, 2021

William Seuffert
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. G011/M-20-833

Dear Mr. Seuffert:

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

Minnesota Energy Resources Corporation's (MERC or the Company) request (Petition) for an Extension of Rule Variances to Recover the Costs of Financial Instruments Through the Purchased Gas Adjustment.

The Petition was filed on December 17, 2020 by:

Joylyn Hoffman-Mauleg
Project Specialist 3
Minnesota Energy Resources Corporation
2685 145th Street West
Rosemount, MN 55068

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

Sincerely,

/s/ ADAM J. HEINEN
Public Utilities Rates Analyst

AJH/ar
Attachment



Before the Minnesota Public Utilities Commission

Comments of the Minnesota Department of Commerce Division of Energy Resources

Docket No. G011/M-20-833

I. INTRODUCTION AND BACKGROUND

Pursuant to Minnesota Rules 7829.3200, Minnesota Energy Resources Corporation (MERC or the Company) requested that the Minnesota Public Utilities Commission (Commission) grant an extension of the variance to Minnesota Rules 7825.2400, 7825.2500, and 7825.2700 (Purchased Gas Adjustment [PGA] Rules) to allow MERC to continue to recover prudently incurred costs associated with financial instruments used for hedging purposes in the procurement of natural gas supplies for its Minnesota ratepayers. Specifically, MERC requested that the Commission approve a four-year extension to its current variance through June 30, 2025. MERC also proposed to continue all prior hedging reporting requirements, and to continue recording the cost of the various financial instruments (including fixed-price, index-price, and swing contracts) used to hedge its purchased gas costs to Federal Energy Regulatory Commission (FERC) Account No. 804, stating that it would continue to recover those costs through the commodity portion of rates. MERC also requested that the Commission continue to cap hedging at 30 percent of total projected heating season volumes.

In accordance with the Commission's May 8, 2017 Order in Docket No. G011/M-17-85, MERC also included a discussion of the benefits of hedging to ratepayers.

The Company's request in its Petition represents its seventh request for a variance to the PGA Rules for recovery of financial hedging costs. MERC's proposal in its Petition is the same as its previous variance requests, and the Company does not request modifications to its hedging plan or the type of hedging instruments it wishes to procure.

II. DEPARTMENT ANALYSIS

A. OVERVIEW

The cost of purchased natural gas, as defined by Minnesota Rules 7825.2400, reflects only the cost for delivered physical natural gas; consequently, utilities must obtain a variance to the PGA Rules if the utility is to recover costs of hedging through the PGA. 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. In fact, absent hedging cost recovery, utilities would face a disincentive for hedging activities, as hedging activities frequently cost the utility (or, rather, the utility's customers) more often than they save money. Thus, the question before the Commission is whether to continue to allow utilities to hedge natural gas costs.

In other recent hedging variance dockets, the Department has noted, and the Commission has agreed, that current low prices for natural gas lower risks associated with price spikes.¹ However, low current prices of natural gas do not eliminate the risks of price spikes caused by factors such as supply disruptions, high demand for natural gas, demand for gas from electricity producers, changes in environmental policy, and/or market speculation.

The Department concludes that, so long as the costs of hedging tools are appropriate, hedging is analogous to an insurance policy in that it protects ratepayers against price volatility in natural gas markets. If a utility waits until events such as the TransCanada pipeline explosion in 2014, unexpected extreme cold over New Year's 2018, or the polar vortex in late January 2019 to occur, it is too late to hedge against the price effects. Like insurance, hedging is not free, but it is important to have it as protection against unexpected circumstances.

While the Commission could choose to deny cost recovery of hedging, such a decision would most likely result in MERC abandoning its hedging program. This decision would leave its customers without the protection of hedging. Because of the risks associated with events such as those listed in the previous, the Department concludes that it is appropriate to allow MERC to continue to recover the costs of hedging in its PGA so long as the costs are reasonable. The Department discusses its position below.

B. APPROPRIATENESS OF HEDGING UNDER CURRENT MARKET CONDITIONS

Since MERC's prior hedging variance, filed in January 2017, natural gas spot prices have remained within a relatively narrow band, ranging from \$1.63 to \$4.09 per Dekatherm (Dth) at Henry Hub,² a major gas delivery and trading location.³ This spread of \$2.46/ Dth is a relatively wide on a percentage basis but, because the price of gas remains low, the impact of the change in prices on ratepayers has been relatively small. At the time of this docket's analysis, the price of natural gas remains relatively low at \$2.59 per Dth in December 2020.⁴

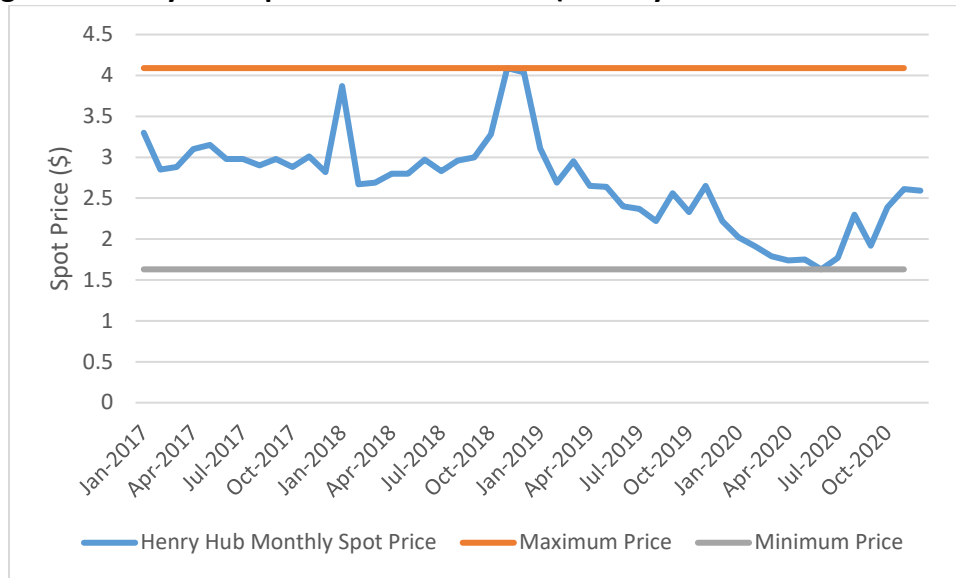
¹ Docket No. G011/M-17-85.

² The Department notes that natural gas prices in Minnesota are not the same as Henry Hub, but the prevailing price at Henry Hub is generally a reasonable proxy for pricing dynamics in Minnesota.

³ <https://www.eia.gov/dnav/ng/hist/rngwhhdm.htm>. Department Attachment 1.

⁴ <https://www.eia.gov/dnav/ng/hist/rngwhhdm.htm>. Department Attachment 1.

Figure 1: Henry Hub Spot Natural Gas Price (January 2017 to December 2020)



As noted above, the Commission’s May 8, 2017 Order in Docket No. G011/M-17-85 required MERC to demonstrate that hedging is beneficial to ratepayers given the current low natural gas prices and price volatility.

1. MERC Hedging Support

The Company framed its support for hedging in terms of reductions in winter price volatility and the corresponding cost of hedges relative to total cost of gas. MERC stated that its use of financial instruments over the period July 2010 through June 2020 resulted in a 10.9 percent reduction in winter price volatility. The Company also noted that the costs of these hedges were approximately 1.7 percent of total gas costs over the same period. MERC concluded that these reductions in price volatility represent a benefit to the Company’s ratepayers by providing increased price certainty.⁵ The Company explained that its historical hedging strategies have involved purchasing up to 20 percent of each winter month’s forecasted gas requirement as call option contracts and up to 10 percent of each winter month’s price forecast as natural gas futures contracts.⁶

MERC also noted that it has continually refined its hedging strategy in an effort to reduce premium costs while still providing upside price protection. The Company explained that these strategy changes have improved results and that over the most recent five-year period from July 2015 to June 2020 its hedging costs have represented 1.3 percent of total gas costs. MERC also noted that price volatility

⁵ Petition, Page 4.

⁶ A call option is a financial contract that gives the buyer, in this case MERC, the option or right to buy a commodity at a certain price, or price range, and within a specific time period. This option is not an obligation, but it is just an opportunity to buy at a given price. For this right to purchase, the buyer pays the seller a premium. A futures contract is a financial contract where a buyer agrees to purchase a specific amount of a commodity for delivery to a specific location on a specific date.

also decreased slightly from 10.9 percent over the 2010 to 2020 timeframe to 10.7 percent over the 2015 to 2020 timeframe.

The Company provided information and data supporting its ratepayer analysis in Attachment A to its Petition.⁷ The Department reviewed this information and it appears to be reasonable.

MERC concluded its ratepayer benefit analysis by noting that its financial hedges are unlikely to provide lower overall costs, but the reduction in price volatility relative to the costs of these hedges is a valuable benefit to ratepayers and represents a reasonable cost for ratepayers.

2. Department Discussion on Hedging

The natural gas market has changed dramatically since the Company's first variance request for hedging instruments in 2006. When MERC first requested recovery of financial instrument costs, the transition to primarily shale gas had not begun and natural gas prices were significantly higher than current prevailing prices. The threat of price spikes was also a significant concern, especially in light of events such as Hurricane Katrina in Fall 2005. Since MERC's current variance was approved in 2017, natural gas prices have remained relatively stable between approximately \$1.60 per Dth and \$4.00 per Dth. Despite this price stability, however, there remains a risk of significant, unexpected price spikes due to extreme weather events or other market disruptions, and because of this, hedging still has value for ratepayers. The possibility for significant price volatility, and price increases, is best illustrated by the unexpected cold weather that occurred over New Year's in 2018. In this instance, colder than normal conditions occurred on a holiday that also happened on a weekend. This unusual circumstance required natural gas buyers to schedule gas delivery several days in advance. These deliveries were based on warmer weather expectations, so, when conditions turned out to be colder than expected, there was a significant spike in natural gas prices and associated price volatility. Financial hedges can help mitigate these types of unexpected circumstances by allowing a utility to purchase gas at a previously known, or fixed, rate.

Lower natural gas prices in recent years have led to an increase in demand from commercial, industrial, and electric generation customers. If this demand remains at higher levels and any kind of supply constraint, either nationally or locally, arises, it can result in price spikes that can harm ratepayers. This risk must also be considered in light of changes to the natural gas market and exploration now that shale gas is the primary source of natural gas in North America. The dynamics of shale gas have allowed the North American natural gas market to become more of a just-in-time market (*e.g.*, supply matching demand in real time), even during the heating season months. Although storage is still important, especially in the heating season months, small disruptions in production can have significant impacts on prices. The benefits of MERC's hedging strategy in the current natural gas environment is illustrated by its performance during the 2013-2014 and 2018-2019 heating seasons. During these heating seasons, which experienced supply constraints, the Company experienced net gains to ratepayers and it is possible that this was the result of hedging.

⁷ Petition, Attachment A.

The most appropriate way to view hedging is as an insurance policy because it provides valuable “insurance” against natural gas market volatility caused by any number of forces. Given the numerous factors that influence gas pricing on both sides (supply and demand) resulting in continued uncertainty for MERC’s ratepayers, the Department continues to conclude that hedging should be available as a tool for MERC to manage natural gas cost volatility.

3. MERC’s Recent Hedging Performance

As noted above, MERC provided data from its hedging program and support for its hedging proposal in Attachment A to its Petition. The Department reviewed these data in an effort to assess the Company’s hedging performance. The Department also reviewed these data to determine both the cost of MERC’s hedging program since its inception and the effect the program has had on the volatility of gas costs paid by the Company’s ratepayers. As discussed by MERC in its Petition, MERC’s hedging costs have decreased, along with price volatility, over the past five years relative to the 10-year period 2010 to 2020.⁸ This is a positive outcome for ratepayer; as such, the Department reviewed these data to verify MERC’s conclusions. The Department summarizes certain hedging related data in Table 1 below.

Table 1: MERC Hedging Performance (2006-2020)

Heating Season	Fiscal Year Sales (July-June) (Dth)	Total Heating Season Cost	NYMEX Market Cost (Heating Season)	Hedging Costs over Market	Hedging Cost per Dth
2006-07	29,397,508	\$76,650,349	\$67,541,000	\$9,109,349	\$0.31
2007-08	32,914,562	\$84,653,434	\$80,837,089	\$3,816,345	\$0.12
2008-09	30,370,392	\$76,069,599	\$54,019,570	\$22,050,029	\$0.73
2009-10	28,026,887	\$54,436,531	\$50,835,231	\$3,601,300	\$0.12
2010-11	29,356,626	\$45,811,467	\$39,994,300	\$5,817,167	\$0.20
2011-12	23,851,235	\$33,187,280	\$26,854,100	\$6,333,180	\$0.27
2012-13	30,057,410	\$40,964,680	\$39,986,000	\$978,680	\$0.02
2013-14	34,321,087	\$36,973,690	\$39,751,900	\$(2,778,210)	\$(0.17)
2014-15	31,993,948	\$32,081,640	\$28,349,500	\$3,732,140	\$0.11
2015-16	28,458,686	\$25,381,240	\$20,433,700	\$4,947,540	\$0.17
2016-17	29,397,305	\$23,352,400	\$22,345,830	\$1,006,570	\$0.03
2017-18	35,027,722	\$22,237,720	\$20,624,250	\$1,613,470	\$0.05
2018-19	36,056,386	\$22,825,120	\$24,728,350	\$(1,903,230)	\$(0.05)
2019-20	33,880,502	\$16,807,410	\$15,187,030	\$1,620,380	\$0.05

As illustrated in Table 1 above, the price per Dth for hedging has decreased since the Company was first granted a variance to recover these costs through the monthly PGA. In addition, since MERC’s

⁸ Petition, Page 5.

latest variance request was approved in 2017, the price per Dth has been consistent between a benefit of \$0.05 per Dth and a cost of \$0.05 per Dth.

As a further check on the reasonableness of the cost of MERC’s hedging program, the Department calculated MERC’s per Dth cost of hedging and the cost of hedging as a percentage of total gas costs. The result of this analysis is shown in Table 2 below.

Table 2: Historical MERC Hedge Cost and Pricing for Heating Season (2007-2020)

	Heating Season Volumes (Dth)	Hedge Price	Market Price	Total Cost	NYMEX Market Cost	Premium Cost	Hedging Cost Over Market	Price Difference	Percentage Difference
2007	9,530,000	\$8.0431	\$7.0872	\$76,650,349	\$67,541,000	\$5,255,750	\$9,109,349	\$0.96	13.49%
2008	10,026,204	\$8.4432	\$8.0626	\$84,653,434	\$80,837,089	\$4,980,430	\$3,816,345	\$0.38	4.72%
2009	10,330,651	\$7.3635	\$5.2291	\$76,069,599	\$54,019,570	\$7,827,875	\$22,050,029	\$2.13	40.82%
2010	10,324,110	\$5.2728	\$4.9239	\$54,436,531	\$50,835,231	\$3,946,483	\$3,601,300	\$0.35	7.08%
2011	9,710,000	\$4.7180	\$4.1189	\$45,811,467	\$39,994,300	\$2,616,517	\$5,817,167	\$0.60	14.54%
2012	9,800,000	\$3.3865	\$2.7402	\$33,187,280	\$26,854,100	\$1,692,770	\$6,333,180	\$0.65	23.58%
2013	11,570,000	\$3.5406	\$3.4560	\$40,964,680	\$39,986,000	\$1,747,560	\$978,680	\$0.08	2.45%
2014	8,330,000	\$4.4386	\$4.7721	\$36,973,690	\$39,751,900	\$1,565,390	\$(2,778,210)	\$(0.33)	-6.99%
2015	8,870,000	\$3.6169	\$3.1961	\$32,081,640	\$28,349,500	\$1,669,350	\$3,732,140	\$0.42	13.16%
2016	10,220,000	\$2.4835	\$1.9994	\$25,381,240	\$20,433,700	\$1,752,600	\$4,947,540	\$0.48	24.21%
2017	6,850,000	\$3.4091	\$3.2622	\$23,352,400	\$22,345,830	\$1,292,390	\$1,006,570	\$0.15	4.50%
2018	6,890,000	\$3.2275	\$2.9934	\$22,237,720	\$20,624,250	\$865,650	\$1,613,470	\$0.23	7.82%
2019	7,000,000	\$3.2607	\$3.5326	\$22,825,120	\$24,728,350	\$455,310	\$(1,903,230)	\$(0.27)	-7.70%
2020	7,000,000	\$2.4011	\$2.1696	\$16,807,410	\$15,187,030	\$453,190	\$1,620,380	\$0.23	10.67%

The Department’s calculations show that MERC’s peak hedging cost was \$2.1344 per Dth during the 2008-2009 heating season. This heating season also marked the period when hedging costs were the greatest percentage of overall rates at 40.82 percent. In previous hedging variances, the Company explained that the high prices that occurred during the 2008-2009 were the result of the 2008 financial crisis and recession. Excluding the anomalous 2008-2009 heating season, MERC’s highest seasonal per Dth heating cost was \$0.9559 for the 2006-2007 heating season. The Department also looked at the most recent five-year period, during which MERC’s highest seasonal per Dth heating cost was the \$0.48 per Dth average paid in the 2016-2017 season. The Department notes that the two instances where MERC’s gas price was lower than the prevailing market price occurred during the 2013-2014 and 2018-2019 heating seasons. It is important to note that significant cold weather events (*e.g.*, Polar Vortex) occurred during both of these heating seasons, which suggests that during harsher winter conditions (also corresponding to greater natural gas consumption), MERC’s ratepayers benefit from overall lower natural gas prices as a result of hedging.

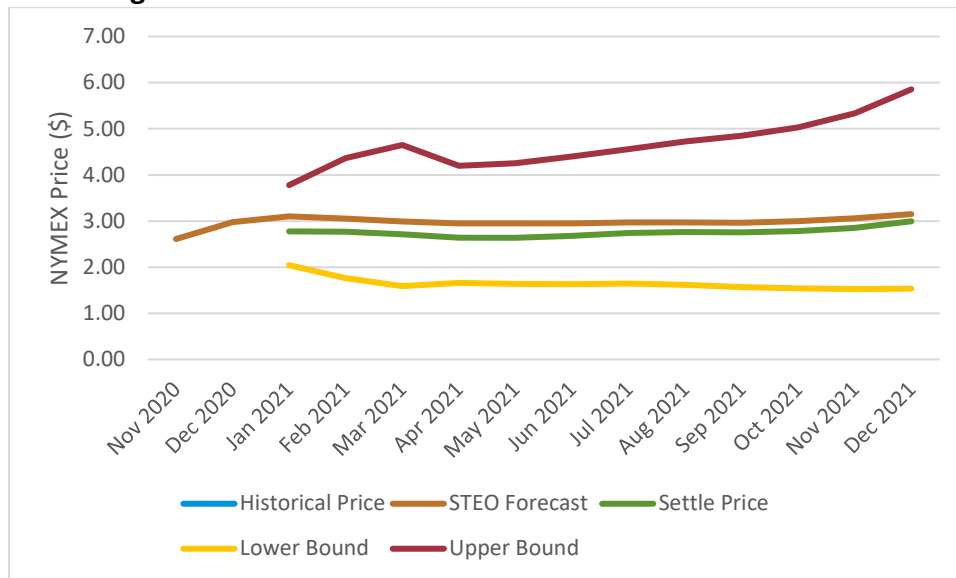
To put the hedging costs paid by MERC into perspective, the Department obtained NYMEX natural gas price forecast data from the EIA’s December 2020 Short Term Energy Outlook (STEO).⁹ The STEO is a monthly publication that details near-term energy markets, including short-term price and consumption forecasts for various energy sources such as natural gas. The STEO forecast provides a 95 percent confidence interval for the forecasted natural gas price. These 95 percent confidence intervals are essentially a proxy for expected price volatility because any value within the confidence band is statistically similar. In other words, although there is a point forecast, any price within the confidence interval is considered valid, reasonable, or expected compared to the point forecast. The EIA’s current short-term natural gas forecast data (November 2020 through December 2021) are presented in Table 3 below.

Table 3: November 2020 STEO Natural Gas Price Forecast (November 2020-December 2021)

Month	Historical	STEO	Settle	Confidence Interval	
	Price	Forecast	Price	Lower	Upper
Nov 2020	2.61	2.61	#N/A	#N/A	#N/A
Dec 2020	#N/A	2.98	#N/A	#N/A	#N/A
Jan 2021	#N/A	3.10	2.78	2.04	3.78
Feb 2021	#N/A	3.05	2.77	1.76	4.36
Mar 2021	#N/A	2.99	2.72	1.59	4.65
Apr 2021	#N/A	2.95	2.64	1.66	4.20
May 2021	#N/A	2.95	2.64	1.64	4.25
Jun 2021	#N/A	2.95	2.68	1.63	4.40
Jul 2021	#N/A	2.97	2.74	1.64	4.56
Aug 2021	#N/A	2.97	2.76	1.61	4.72
Sep 2021	#N/A	2.96	2.75	1.57	4.85
Oct 2021	#N/A	3.00	2.78	1.54	5.03
Nov 2021	#N/A	3.06	2.85	1.52	5.34
Dec 2021	#N/A	3.15	2.99	1.53	5.86

⁹ <https://www.eia.gov/outlooks/steo/marketreview/natgas.php>.

Figure 2: December 2020 STEO Natural Gas Price Forecast



The Department reviewed the amount prices could increase or decrease and still remain within the EIA’s 95 percent confidence interval and found that MERC’s recent historical hedging costs, as shown in Tables 1 and 2 above, have been within the bounds of the forecasting interval for the entirety of the forecasting period, which runs through the end of 2021. This result suggests that, if MERC’s future hedging costs follow recent historical performance, it is unlikely that future costs of gas, inclusive of hedging costs, will not exceed the confidence interval of the EIA’s natural gas price forecast for 2021.

Based on this analysis, the Department concludes that MERC’s recent hedging performance has been reasonable, and the Company’s hedging plan is not likely to result in unreasonable price increases.

C. MERC’S PETITION

1. Extension of Variance

MERC requested a four-year extension of the hedging variances that would apply to financial hedge positions entered into through June 30, 2025.¹⁰ This marks the second instance where the Company has requested a four-year extension of its variance for hedging cost recovery. In its Petition, MERC stated that a four-year variance would allow the Company to use financial instruments for the next four heating seasons and allow sufficient time for the Department and the Commission to review any subsequent hedging variance petition.¹¹

¹⁰ Petition, Page 3.

¹¹ *Id.*

MERC proposed that the requested variance be conditioned on the Company continuing to provide the reports required in its previous hedging variance dockets.¹² MERC explained that providing these reports will allow the Department and the Commission to regularly review MERC's financial instrument practices. If during these regular reviews the Commission determines that the PGA Rule variance is resulting in excessive costs to ratepayers, the Commission has the authority to disallow these costs or terminate the variance prior to June 30, 2025.¹³

The Department reviewed MERC's extension request and concludes that the request is similar to previous MERC hedging variance extension requests. This request marks the second time that MERC has requested a four-year extension, and other natural gas utilities have requested, and been granted, four-year variances to continue their hedging programs, as well.¹⁴ The Department also agrees with MERC's assertion that continued filing of the reports required in previous hedging dockets, paired with the Commission's authority to revoke the variance if costs become excessive, will protect ratepayers from the risk of hedging costs becoming too high during the variance period.

2. Accounting

MERC proposed to continue the accounting practices authorized in the previous various extension requests, including recording all costs associated with the purchase of financial instruments for hedging purposes in FERC Account 804. The Company also proposed to continue recovering these costs through the commodity portion of the monthly PGA.¹⁵

The Department reviewed MERC's accounting proposal and concludes that it contains no changes from previous variance extensions granted to MERC by the Commission. The Department supports the Company's proposal to continue its existing accounting practices related to hedging.

3. Permitted Financial Instruments

MERC proposed no changes to the types of financial instruments it would be allowed to use under the hedging variance. As in previous variance extension requests, the Company requested that the Commission allow it to use fixed-price, index-price, and swing contracts, as well as put and call options to form a price collar. Consistent with previous hedging variance extensions, the Company did not request authorization to use put options that are not part of a price collar.¹⁶ If the Company wishes to use put options, it will need to request specific authorization from the Commission.

¹² Docket Nos. G007,011/M-03-821, G007,011/M-06-1358, G007,011/M-09-262, G007,011/M-13-207, G011/M-15-231, and G011/M-17-85.

¹³ Petition, Page 3.

¹⁴ See Docket Nos. G008/M-19-699 and G002/M-19-703.

¹⁵ Petition, Page 3.

¹⁶ Petition, Page 4.

The Department concludes that MERC's requested forms of financial hedging instruments are reasonable. The Department also agrees with the Company's decision not to use put options without specific additional approval from the Commission.

4. Cap on Amount of Financial Hedging

The Company proposed that the existing cap on hedging, 30 percent of total projected heating season volumes, remain in place under the proposed extension. This 30 percent is part of MERC's 40/30/30 hedging strategy, which calls for MERC to obtain 40 percent of its winter supply requirements at a fixed price,¹⁷ 30 percent hedged via financial instruments, and 30 percent from the market.¹⁸

The Department reviewed MERC's 2020 Annual Automatic Adjustment Report (AAA) and found that the Company has not changed its hedging strategy in recent years. The Department reviewed the hedging strategy in its comments on MERC's 2019-2020 AAA and concluded that the Company provided reasonable price protection on the hedged portion of its winter gas supplies and that the hedging program performed as expected. With a 30 percent cap on gas purchases hedged with financial instruments, up to 70 percent of MERC's winter gas supplies may be insulated from price volatility; 40 percent via fixed price contracts, which provide price certainty, and 30 percent via hedging instruments, which do not provide absolute certainty but limit volatility. The Department concludes that MERC's proposal to continue its hedging program with the 30 percent cap is reasonable.

5. Reporting Requirements

MERC proposed that the requested variance be conditioned on the Company continuing to provide the reports required in previous hedging variance dockets.¹⁹ The reporting requirements included in this proposal were required in the Commission's May 8, 2017 Order in Docket No. G011/M-17-85 and are as follows:

1. Required MERC to include, in its annual requests for approval of changes in demand entitlements, the following:
 - a. a list of all financial-instrument arrangements entered into for the upcoming heating season;
 - b. the cost premium associated with each contract;
 - c. the size (in dekatherms) of each contract;
 - d. the contract date;
 - e. the contract price;
 - f. an attachment that details the projected total system sales estimates for the upcoming heating season, including all supporting data and assumptions used when calculating the sales forecast, and the total number of volumes hedged using financial instruments for the upcoming heating season; and

¹⁷ This includes storage volumes. See MERC's September 1, 2020 Initial Filings in Docket No. G999/AA-20-172.

¹⁸ Petition, Page 4.

¹⁹ Petition, Page 3.

- g. a detailed discussion of the anticipated benefits to ratepayers related to MERC’s financial-instrument contracts.
- 2. Required MERC to include data on the relative benefits of price-hedging contract, including the average cost per dekatherm for natural gas purchased under financial instruments compared to the comparable monthly and daily spot index prices, in the Company’s yearly Automatic Annual Adjustment (AAA) reports due on September 1 of each year, together with:
 - a. a list of each hedging instrument entered into;
 - b. the total volumes contracted for in 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.
- 7. Required MERC to provide, in its AAA report, a full post-mortem analysis of its hedged volumes for the preceding heating season compared to other hedging strategies and the prevailing market prices strategy.
- 8. Required MERC, in its next request for a PGA rule variance, to demonstrate that ratepayers benefit from hedging and that there is not an undue price penalty.

These reporting requirements are the same, or similar, to reporting requirements laid out by the Commission in previous hedging variance dockets. The Department notes that the first three requirements have been included in each of the Company’s prior hedging variance requests. The other reporting requirements have been included in the Commission’s five previous Orders in the Company’s hedging variance request dockets. The Department supports the proposal to continue requiring MERC to submit these reports and reporting requirements.

D. EXTENSION OF CURRENTLY APPROVED PGA RULES VARIANCES

In its July 10, 2007 Order in Docket No. G007,011/M-06-1358, the Commission granted MERC its first variance to the PGA rules for recovery of financial hedging instrument costs through the monthly PGA. In this original variance request, the Commission granted a two-year variance to the PGA Rules. The Company has requested several subsequent variance extensions, as detailed in Table 4 below.

Table 4: Prior PGA Variance Requests

Order Date	Docket No.	Approved Variance Length	Variance Dates
July 10, 2007	G007,011/M-06-1358	Two-year	7/10/07-6/30/09
June 30, 2009	G007,011/M-09-262	Two-year	7/1/09-6/30/11
August 17, 2011	G007,011/M-11-296	Two-year	7/1/11-6/30/13
June 21, 2013	G007,011/M-13-207	Two-year	7/1/13-6/30/15
May 28, 2015	G007,011/M-15-231	Two-year	7/1/15-6/30/17
May 8, 2017	G011/M-17-85	Four-year	7/1/17-6/30/21

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 MERC only using financial instruments for risk hedging on behalf of ratepayers and not for speculation.

The Department concludes that the Company's currently approved variance to the PGA Rules should be extended for the same reasons it was initially granted. That is, the variance meets the conditions provided in Minnesota Rule 7829.3200. The Department discusses the rule variance requirements separately below.

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 MERC to take advantage of the existing financial instruments in the wholesale natural gas markets. The Company may be unable to mitigate price volatility by taking advantage of contracts for futures, options, and collars (*i.e.*, combination of put/call options). Any price volatility in natural gas markets is passed directly to ratepayers through the PGA. Therefore, the Department concludes that enforcement of the PGA Rules may expose MERC's ratepayers to excessive price volatility and impose an excessive burden on the Company's ratepayers.

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

Under the Company's proposal the Commission would maintain its authority to disallow imprudent or unreasonable transactions. If, in the future, the Commission concludes that MERC acted in an unreasonable manner, it could rule that certain costs are imprudent and should not be recovered from ratepayers. Furthermore, the Company is required to file periodic reports detailing its hedging costs, and MERC has acknowledged that the Commission has the authority to revoke the variance if the Commission determines that costs have become excessive. As such, the Department concludes that the public interest is fully protected and would not be adversely affected if the Commission were to grant the variance.

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

The Commission has previously granted this rule variance on six occasions (see Table 4 above). In these previous dockets, the Commission determined that a variance to the PGA Rules did not conflict with standards imposed by law. The Commission has also approved variances to the PGA Rules for recovery of financial hedging instruments for other Minnesota gas utilities.²⁰ As such, the variance is consistent with the purpose of the PGA Rules and does not conflict with any other laws.

²⁰ The Commission had approved hedging cost variances for CenterPoint Energy and Xcel Energy.

III. CONCLUSIONS AND RECOMMENDATIONS

Based on its review and analysis of MERC's Petition, the Department recommends that the Commission:

1. Extend the variance to Minnesota Rules 7825.2400, 7825.2500, and 7825.2700, originally granted in Docket No. G007,011/M-06-1358 for four years, until June 30, 2025;
2. Direct MERC to continue the accounting practices required by the existing variance;
3. Allow MERC to continue using the financial instruments allowed in previous hedging variance;
4. Leave the hedging cap unchanged at 30 percent of MERC's total projected heating season sales volumes;
5. Require MERC to include, in its annual request for approval of changes in demand entitlements, the following:
 - a. a list of all financial-instrument arrangements entered into for the upcoming heating season;
 - b. the cost premium associated with each contract;
 - c. the size (in dekatherms) of each contract;
 - d. the contract date;
 - e. the contract price;
 - f. an attachment that details the projected total system sales estimates for the upcoming heating season, including all supporting data and assumptions used when calculating the sales forecast, and the total number of volumes hedged using financial instruments for the upcoming heating season; and
 - g. a detailed discussion of the anticipated benefits to ratepayers related to MERC's financial-instrument contracts.
6. Require MERC to include data on the relative benefits of price-hedging contract, including the average cost per dekatherm for natural gas purchased under financial instruments compared to the comparable monthly and daily spot index prices, in the Company's yearly Automatic Annual Adjustment (AAA) reports due on September 1 of each year, together with:
 - a. a list of each hedging instrument entered into;
 - b. the total volumes contracted for in 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.
7. Require MERC to provide, in its AAA report, a full post-mortem analysis of its hedged volumes for the preceding heating season compared to other hedging strategies and the prevailing market prices strategy.
8. Require MERC, in its next request for a PGA rule variance, to demonstrate that ratepayers benefit from hedging and that there is not an undue price penalty.

NATURAL GAS

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Referring Pages:

- [Natural Gas Futures Prices \(NYMEX\)](#)

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Henry Hub Natural Gas Spot Price

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Dollars per Million Btu

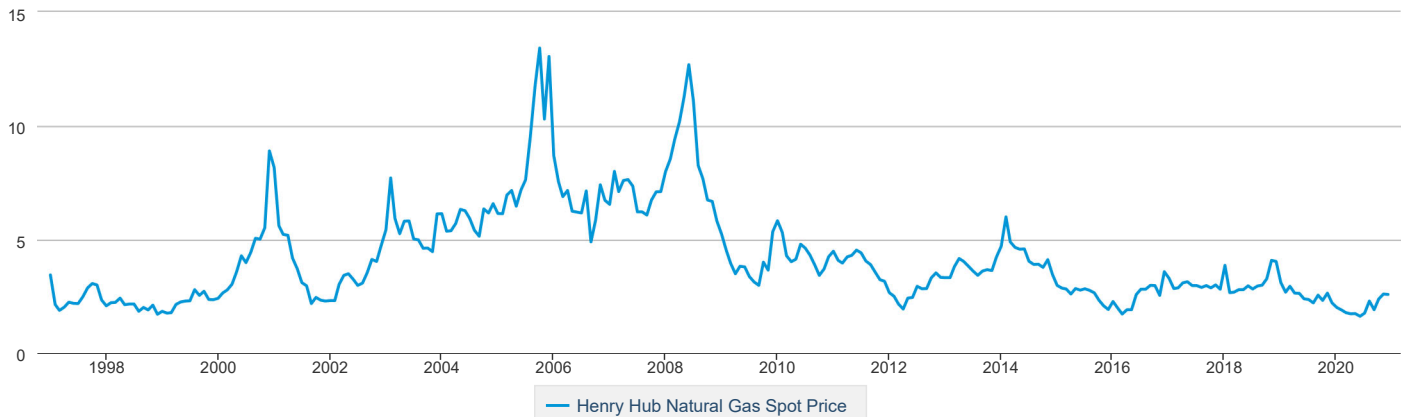


Chart Tools

no analysis applied

This series is available through the EIA open data API and can be downloaded to Excel or embedded as an interactive chart or map on your website.

Henry Hub Natural Gas Spot Price (Dollars per Million Btu)

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1997	3.45	2.15	1.89	2.03	2.25	2.20	2.19	2.49	2.88	3.07	3.01	2.35
1998	2.09	2.23	2.24	2.43	2.14	2.17	2.17	1.85	2.02	1.91	2.12	1.72
1999	1.85	1.77	1.79	2.15	2.26	2.30	2.31	2.80	2.55	2.73	2.37	2.36
2000	2.42	2.66	2.79	3.04	3.59	4.29	3.99	4.43	5.06	5.02	5.52	8.90
2001	8.17	5.61	5.23	5.19	4.19	3.72	3.11	2.97	2.19	2.46	2.34	2.30
2002	2.32	2.32	3.03	3.43	3.50	3.26	2.99	3.09	3.55	4.13	4.04	4.74
2003	5.43	7.71	5.93	5.26	5.81	5.82	5.03	4.99	4.62	4.63	4.47	6.13
2004	6.14	5.37	5.39	5.71	6.33	6.27	5.93	5.41	5.15	6.35	6.17	6.58
2005	6.15	6.14	6.96	7.16	6.47	7.18	7.63	9.53	11.75	13.42	10.30	13.05
2006	8.69	7.54	6.89	7.16	6.25	6.21	6.17	7.14	4.90	5.85	7.41	6.73
2007	6.55	8.00	7.11	7.60	7.64	7.35	6.22	6.22	6.08	6.74	7.10	7.11
2008	7.99	8.54	9.41	10.18	11.27	12.69	11.09	8.26	7.67	6.74	6.68	5.82
2009	5.24	4.52	3.96	3.50	3.83	3.80	3.38	3.14	2.99	4.01	3.66	5.35
2010	5.83	5.32	4.29	4.03	4.14	4.80	4.63	4.32	3.89	3.43	3.71	4.25
2011	4.49	4.09	3.97	4.24	4.31	4.54	4.42	4.06	3.90	3.57	3.24	3.17
2012	2.67	2.51	2.17	1.95	2.43	2.46	2.95	2.84	2.85	3.32	3.54	3.34
2013	3.33	3.33	3.81	4.17	4.04	3.83	3.62	3.43	3.62	3.68	3.64	4.24
2014	4.71	6.00	4.90	4.66	4.58	4.59	4.05	3.91	3.92	3.78	4.12	3.48
2015	2.99	2.87	2.83	2.61	2.85	2.78	2.84	2.77	2.66	2.34	2.09	1.93
2016	2.28	1.99	1.73	1.92	1.92	2.59	2.82	2.82	2.99	2.98	2.55	3.59
2017	3.30	2.85	2.88	3.10	3.15	2.98	2.98	2.90	2.98	2.88	3.01	2.82
2018	3.87	2.67	2.69	2.80	2.80	2.97	2.83	2.96	3.00	3.28	4.09	4.04
2019	3.11	2.69	2.95	2.65	2.64	2.40	2.37	2.22	2.56	2.33	2.65	2.22
2020	2.02	1.91	1.79	1.74	1.75	1.63	1.77	2.30	1.92	2.39	2.61	2.59

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
Comments

Docket No. G011/M-20-833

Dated this 19th day of **January 2021**

/s/Sharon Ferguson

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