MINNESOTA DEPARTMENT OF COMMERCE

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December 11, 2015

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
Saint Paul, Minnesota 5510-2147

RE: **Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. G008/M-15-912

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 (CenterPoint or the Company) 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 (PGA) Clause.

The petition was filed on October 12, 2015 by:

> Kevin Marquardt
> Regulatory Analyst
> CenterPoint Energy
> 505 Nicollet Mall
> Minneapolis, Minnesota 55402

The Department recommends that the Minnesota Public Utilities Commission (Commission) **extend** CenterPoint's variance to Minnesota Rules parts 7825.2400, 7825.2500, and 7825.2700, subject to reporting requirements, and allow the Company to recover certain costs associated with financial hedging instruments through the monthly PGA.

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

Sincerely,

/s/ ADAM J. HEINEN
Rates Analyst
651-539-1825

AJH/lt
Attachment

MINNESOTA DEPARTMENT OF COMMERCE

# BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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

DOCKET NO. G008/M-15-912

## I. SUMMARY OF PROPOSAL

Pursuant to Minnesota Statute § 216B.16, subdivision 7, and Minnesota Rule 7829.3200, CenterPoint Energy (CenterPoint or the Company) requests that the Minnesota Public Utilities Commission (Commission) extend the variance to Minnesota Rules 7825.2400, 7825.2500, and 7825.2700 (the Purchased Gas Adjustment [PGA] rules) granted by the Commission on July 26, 2012, in Docket No. G008/M-12-166 to allow for the use of certain financial instruments intended to minimize price volatility of natural gas supplies purchased on behalf of Minnesota customers. The currently approved variance ends on June 30, 2016; CenterPoint's new variance proposal would expire on June 30, 2020.

CenterPoint seeks continued approval of the ability to recover costs associated with financial instruments in the procurement of natural gas supplies for its Minnesota customers in the monthly PGA.[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. The Company also asks that the Commission grant the requested PGA variance before the expiration of the current authorization on June 30, 2016. If the Commission is unable to issue an Order prior to June 30, 2016, CenterPoint requests that the Commission approve CenterPoint's continued ability to recover the costs of financial instruments during the period after June 30, 2016 and prior to the issuance of its Order in this docket. CenterPoint proposes to continue to record in Federal Energy Regulatory Commission (FERC) Account 804—Natural Gas City Gate Purchases the gain, or loss, on various transactions involving financial instruments based on the settlement cost of each transaction.

CenterPoint's variance request in this docket is identical to the current variance which was approved by the Commission in Docket No. G008/M-12-166. Despite the Company's variance request being identical to the current variance, it is still necessary to address the issue of whether hedging is an appropriate tool in today's natural gas market.

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[1] Currently, recovery of the costs of purchased natural gas, as defined by Minnesota Rule 7825.2000, reflects only the cost for delivered physical natural gas.

## II. DEPARTMENT ANALYSIS

### *A. OVERVIEW*

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 it is reasonable for a utility to hedge natural gas costs on behalf of its ratepayers.

Hedging protects ratepayers against price volatility in natural gas markets. For a certain reservation price, or fee, the purchaser, in this case CenterPoint on behalf of its ratepayers, is assured a given level of supply at a set price. As discussed further below, the price of natural gas, while low, will continue to be volatile, since it is subject to numerous factors as wide-ranging as hurricanes, environmental policies (for both the natural gas and electric industries), extreme weather (both cold winters and hot summers), and the strength of the economy. Further, once events such as Hurricane Katrina or the TransCanada explosion of 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. However, also like insurance, hedging is important to have when unexpected circumstances arise.

While the Department is aware that the Commission could choose to deny cost recovery of hedging, such a decision would result in CenterPoint's ratepayers not having the protection of hedging. Because there is uncertainty in all of the factors noted above, the Department concludes that it is reasonable to allow CenterPoint to continue to recover the costs of hedging in its purchased gas adjustment. The Department discusses these issues further below.

### *B. APPROPRIATENESS OF HEDGING UNDER CURRENT MARKET CONDITIONS*

In the time since CenterPoint's current hedging variance was approved, natural gas prices have remained low relative to prices during the 2000s. Unconventional gas production, such as shale gas, has worked to maintain downward pressure on prices, which raises the question of whether financial hedging is still appropriate at current price levels. CenterPoint included information from the United States Energy Information Administration (EIA)'s August 2015 Short-Term Energy Outlook (STEO) projecting natural gas prices at the Henry Hub through the end of 2016, which suggest that natural gas prices will continue to remain low in the near term. The EIA anticipates natural gas prices of around $3.00 per Mcf, with upper bound forecasts (*i.e.,* highest potential forecasted price) of up to approximately $5.40 per Mcf, and lower bound forecasts (*i.e.,* lowest potential forecasted price) of just under $2.00 per Mcf.

In the past, there have been discussions before the Commission regarding the necessity of financial hedging given current low prices and market dynamics. The Company provided pricing and volatility analyses in its initial filing in response to concerns regarding hedging at lower natural gas prices.

### *1. CenterPoint Discussion in Support of Hedging*

As noted by the Company, commodity markets are, by their nature, highly volatile. In its initial filing, CenterPoint provided a discussion of historical gas prices over the past 20 years. The Company noted that prices have fluctuated significantly over the past 20 years; beginning in the $2 to $3 per Mcf range in the 1990s, then spiking into the $10 to $14 per Mcf range on three separate occasions during the 2000s, and then falling again to the $2 to $4 per Mcf range over the past several year. Despite several years of relatively stable natural gas prices, the natural gas market is expected to continue its long-term pattern of high volatility. This volatility is best illustrated by the TransCanada explosion that occurred in early 2014. This incident, along with cold weather conditions, temporarily increased Henry Hub natural gas prices by $1.00 per Mcf, or nearly 20 percent, and prices remained elevated in 2014 through the rest of the heating season and shoulder months.

Since natural gas pricing is volatile, it is important to consider hedging as a means of maintaining stable prices for customers. Natural gas price stability is an important goal because, even with $2 per Mcf gas, PGA costs represent over 50 percent of a customer's bill.[2]

As noted above, CenterPoint provided the EIA's natural gas pricing expectations through 2016 from the August 2015 STEO. In addition to point estimates for price, the EIA also included forecasting bands showing both the upper bound and lower bound of expected prices through 2016. The bands of the confidence intervals around the EIA's natural gas prices underscore the volatility, despite low prices, that is still present in the natural gas market. Specifically, the EIA model has an upper bound approaching $5.50 per Mcf by the end of 2016 and a lower bound of approximately $1.80 per Mcf at the end of 2016. The large confidence intervals illustrate the amount of risk, mostly in the form of higher prices, that currently exists for ratepayers. If commodity costs are near $5.50 per Mcf during the 2015/2016 heating season, this would represent a large, significant increase in commodity prices, specifically over 15 percent, compared to the commodity prices charged to CenterPoint firm customers last heating season. If unmitigated by hedging or other supply portfolio management strategies, this scenario may place financial burdens on many of the Company's customers.

CenterPoint also included an expanded discussion of price volatility relative to call premiums since 2008 in its initial filing. This analysis shows that the percentage cost of call premiums has been consistently less volatile than price volatility since 2008. The Company also noted that there are significant events, such as geo-political events and environmental regulation, which could cause supply disruptions that result in shorter-term price spikes. This salient point, along with the price volatility data provided by the Company, emphasizes the importance of hedging even when current prices are low. Further, although CenterPoint is the largest gas utility in Minnesota, it represents a small portion of the domestic and global natural gas market. In other words, CenterPoint's operations cannot influence market

[2] For the residential class, CenterPoint's Commission-approved non-gas margin rate is approximately $1.85 per Mcf and its monthly PGA costs range from $3.00 per Mcf to $3.75 per Mcf. Adding these costs together results in total volumetric costs between $4.85 and $5.60 per Mcf.

prices; therefore, CenterPoint and its ratepayers are susceptible to all adverse market impacts. The fact that CenterPoint's prices, absent hedging and other purchasing strategies, are fully exposed to market forces is further evidence of hedging's importance when mitigating risk, even at low market prices.

Finally, CenterPoint's initial filing included a ratepayer benefit analysis for the last three heating seasons (2012/2013, 2013/2014, and 2014/2015). The Company's analysis showed that actual costs incurred, which included hedging instruments, were less, by approximately 0.5 percent, than what the costs would have been had CenterPoint relied solely on the market. This is a somewhat unusual result since, as noted earlier, it is expected that gas costs are, generally speaking, higher when hedging is used since the primary goal of hedging is to mitigate price volatility, not produce lower-priced gas. However, under certain circumstances, such as the TransCanada incident that occurred during the 2013/2014 heating season, hedging can mitigate price increases to such an extent that overall costs, including premium costs, are lower than prevailing market costs.

The Company's analysis converts the additional costs related to hedging (Actual Costs – Cost at Market) into a cost per dekatherm (Dkt) measure. In terms of annual sales, CenterPoint's hedging strategy saved $0.04 per Dkt in 2012/2013, saved $1.11 per Dkt in 2013/2014, and cost $0.40 per Dkt in 2014/2015. On a percentage basis, hedging represented savings to ratepayers of 0.2 percent in 2012/2013 and 2.2 percent in 2013/2014; hedging represented costs to ratepayers of 1.6 percent in 2014/2015. The Department concludes that the additional costs that may be borne by CenterPoint ratepayers over the period that this proposal is in place are reasonable considering the price volatility risks that are averted and the potential for price mitigation that also exists.

### *C. PROPOSED ACCOUNTING AND REPORTING*

CenterPoint proposes to continue recording transaction outcomes, based on the settlement cost of each of the various financial instrument transactions, in FERC Account 804. The Company also proposes to continue to maintain records of the specific transactions, including the gain or loss and other transaction costs, so there is an audit trail for each transaction. CenterPoint also proposes to maintain the same reporting requirements as approved by the Commission in the last hedging request variance. The Department concludes that the proposed accounting and reporting requirements are reasonable.

### *D. VARIANCE REQUEST CONDITIONS*

As noted earlier, the Department concludes that financial hedging can provide insurance against price increases; 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. After reviewing the Company's *Petition* and historical hedging data, the Department concludes that CenterPoint's proposal generally meets the conditions for a variance articulated in Minnesota Rule 7829.3200. The conditions necessary for a variance are as follows:

1. **Enforcement of the rules would impose an excessive burden upon the applicant or other affected by the rules**
   Enforcement of the PGA rules may preclude CenterPoint from taking advantage of the existing financial instruments in the wholesale natural gas markets. Without a continued variance, the Company would not use additional tools (*e.g.,* futures, options, collars) available to help mitigate price volatility. Further, enforcement of the rules may reduce protection for CenterPoint's ratepayers from potentially high energy costs, as illustrated in Section II.B of these *Comments*. As such, the Department concludes that enforcement of the rules may impose an excessive burden upon CenterPoint's ratepayers.
2. **Granting the variance would not adversely affect the public interest**
   Based on earlier discussions in these *Comments*, 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 CenterPoint 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**
   As noted earlier, the Commission has already allowed an identical variance to what is being proposed in this docket. As such, the variance is consistent with the purpose of the PGA statute and rules and does not conflict with any other laws.

The Department reiterates that support for a variance is contingent upon CenterPoint only using financial instruments for risk hedging on behalf of ratepayers and not for speculation.

### *E. EXTENSION OF THE CURRENT PGA RULES VARIANCE*

In its July 26, 2012 *Order* in Docket No. G008/M-12-166, the Commission granted CenterPoint a variance to Minnesota Rules 7825.2400, 7825.2500, and 7825.2700. The variance allowed CenterPoint to recover, through the PGA, the costs of certain financial instruments entered into by June 30, 2016. The variance also allowed the Company to enter into multi-year hedging contracts up to 60 months in duration, but also included an annual limit on hedging volumes beyond the 2016-17 heating season to 13 Bcf per year. CenterPoint was also required to comply with detailed reporting requirements and was denied the ability to recover interest costs through the PGA.

The Company requests that the Commission grant a four-year extension to the currently approved PGA rules variance through June 30, 2020. CenterPoint does not seek to modify any portion of the currently approved variance.

## III. DEPARTMENT CONCLUSIONS AND RECOMMENDATIONS

Based on its review of CenterPoint's variance *Petition*, the Department concludes the Company's variance request is reasonable and should be granted by the Commission. In addition, historical data suggests that CenterPoint's existing hedging variance, which is identical to the proposal in this docket, has not adversely impacted natural gas prices for the Company's ratepayers.

Based on these conclusions and its analysis, 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, 2020;
- Allow the variance to apply to all Commission-approved financial positions that CenterPoint enters into through June 30, 2020;
- 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 2020-21 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 deny the Company's use of put options for any other reasons without specific Commission approval;
- Require CenterPoint to report data and follow the reporting requirements as detailed in Section II of CenterPoint's *Petition*;
- Require CenterPoint to include, in future variance requests, a ratepayer benefit analysis similar to what the Company provided in its response to informal Department discovery in this docket;
- Require CenterPoint to file, as compliance in this docket, a copy of its hedging plan each year once the plan has been approved for use by Company management; and
- Require CenterPoint to provide, on an annual basis, any, and all, input data, output data, and results associated with any statistical analyses (*e.g.,* Monte Carlo simulation) used in the determination of its annual hedging strategy and risk analyses.

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# 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. G008/M-15-912

Dated this 11th day of December 2015

/s/Sharon Ferguson

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