BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION OF BLACK HILLS/ NEBRASKA GAS UTILITY COMPANY, LLC, d/b/a BLACK HILLS ENERGY, FOR APPROVAL OF ITS COST OF SERVICE GAS HEDGE AGREEMENT WITH BLACK HILLS UTILITY HOLDINGS, INC.	)))))))	DOCKET NO. NG-0086

POST-HEARING BRIEF OF PUBLIC ALLIANCE FOR COMMUNITY ENERGY AND NEBRASKA MUNICIPAL POWER POOL

I. BACKGROUND STATEMENT

Black Hills/Nebraska Gas Utility Company, LP (Collectively Black Hills or Company) has requested the Nebraska Public Service Commission's approval of a Cost of Service Gas (COSG) agreement between Black Hills and its unregulated parent company Black Hills Utility Holdings (BHUH) establishing a COSG Program.

The Public Alliance for Community Energy (ACE) has submitted and it has been accepted in the record, prefiled testimony from Beth Ackland, Director of the ACE Choice Gas Program. It, along with cross examination, expresses ACE's concern that Black Hills will use the COSG program to end the Nebraska Choice Gas Program in the future by expanding COSG to the west. Today's Choice Gas program is valued by the customers. As a result of the separate docket for Black Hills to acquire SourceGas, Black Hills has agreed to continue the Nebraska Choice Gas Program for three years, and in good faith consider and evaluate the program with ACE and other suppliers before making substantive changes. However, during investor meetings, Black Hills has clearly stated a desire to expand the proposed COSG program into the recently acquired territories, along with stating that COSG and Choice cannot co-exist.

The Nebraska Municipal Power Pool (NMPP) has submitted prefiled testimony from John Harms, accepted and in the record to show NMPP's concerns about the COSG program which, in summary, are that the program is:

- Complex and impossible to regulate without expensive modeling experts,
- It may take years before a hedge credit is given to ratepayers,
- Today's producers may make a rate of return but not a guaranteed rate – such as suggested in this docket,
- This is a purely a financial hedge on production in the East, not a physical purchase of gas delivered to the customer in the Midwest, and
- It is not an arm's length transaction with unaffiliated suppliers competing in the market.

II. PARTY'S SUBSTANTIVE ARGUMENTS ON WHY THIS IS NOT IN THE PUBLIC'S INTEREST

a. Summary of the Testimony of Beth Ackland

Beth Ackland, Director of Retail Gas Services for ACE, has filed testimony in Exhibit 500 on behalf of ACE before the Nebraska Public Service Commission. The purpose of this testimony was to address ACE's concerns about BHUH's plan and the impact it could have on ratepayers and the possibility it will allow for more of these programs elsewhere, in particular, the areas BHUH has acquired formerly served by SourceGas.

Although BHUH's acquisition cost is relatively low right now, the production cost under BHUH's plan is higher than market prices. Under this program, the ratepayer will most likely have to pay higher rates than the market prices in order to cover BHUH's production costs. This program will give the shareholders a guaranteed return on equity, which puts the majority of the risk involved on the ratepayers. (Ex. 500). Aaron Carr's testimony employs a hypothetical model (Ex. AC-2 COSG Model NA – 0086) to show an economic evaluation of the COSG program based on market data and other information provided by Black Hills Exploration and Production (BHEP). This data along with estimated costs and projections calculated the net present value of the COSG program's production costs. This hypothetical shows the COSG program's price is higher than the forecast of the market price during the initial years. This higher cost would result in a hedge cost to customers. "The hypothetical illustrative example shows four years of hedge costs before turning to hedge credit." (Tr. 336:20-22). The model indicates after the first four years, a hedge credit is likely, but this is based on an array of unknown factors. "[T]here could be instances where there is no hedge credit or hedge cost and the results of COSGO are within the 200-point range of ROEs in which there would be no receipt or disbursement of hedge credit or hedge costs between either customers, BHUH or COSGO." (Tr. 343:24-25, 344:1-4).

The possibility of this type of program expanding to other areas is a major concern for ACE, its customers, and its municipal members. Although the harm would not be immediate, if this program expanded to other areas it could affect the continuation of the Nebraska Choice Gas Program. Information acquired from Black Hills Investor Relations shows an intent to develop the plan into territories formerly served by SourceGas. Referencing the SourceGas acquisition on its Investor Relations call on July 13, 2015, Black Hills President and CEO David Emery noted, "As you know at Black Hills we've been working to implement a cost of service gas program to provide a portion of our gas supply for our own utilities. The SourceGas acquisition essentially doubles that long-term opportunity for us." (Transcript of Black Hills to Acquire SourceGas Holdings LLC – Conference Call at page 4 (July 13, 2015)) (Tr. 110:21-25). Recognizing the need for regulatory approval to expand the program into the SourceGas territories, Emery said, "So when we look at integrating a cost of service gas program with SourceGas, we obviously have to work through the differences in the programs." (*Id.*, at 6). He added, "So we will have to resolve the differences going through the utility commission approval process [sic]. We don't view that as particularly complicated. It just may take a little more time in their territories than it will in ours." (*Id.*, at 6-7). Furthermore, the COSG program proposal does not include a Choice Gas Program.

In order to evaluate all of the risks and benefits to the ratepayers, the Commission should deny this application until BHUH has fully analyzed its acquisition of SourceGas. BHUH needs to analyze the present operations of their existing and acquired properties in order to compare the COSG program and the Nebraska Choice Gas Program. At a minimum, BHUH should examine a year of Choice Gas Program data after its acquisition of SourceGas and then decide which program would be most beneficial to the ratepayers. (Ex. 500).

b. Summary of the Testimony of John Harms

John Harms, then Director of Risk Management and Compliance for NMPP, has submitted testimony in Exhibit 400 on behalf of NMPP to the Nebraska Public Service Commission to discuss concerns from the application by Black Hills/Nebraska Gas Utility Company, LLC for approval of its COSG Hedge Agreement with BHUH. Harms discussed the risks associated with the long-term COSG Program and asked the Commission to consider other alternatives before approving the COSG as proposed by BHUH.

If approved, BHUH will acquire natural gas reserves and plans to use these reserves for the purpose of hedging against long-term price increases of natural gas. These programs are not common because they are uncertain in nature and do not have a set end term. Although the cost of acquiring reserves is currently at a record low, there is a possibility the cost of producing gas from reserves could exceed future market price levels. This could then result in a "hedge cost" provision which would serve as a revenue guarantee from Nebraska rate payers. The major risk associated with gas production from reserves is the unpredictable costs. Long-term operating costs will be determined by inflationary factors which usually impact wages and materials. Future development costs, such as environmental compliance and environmental clean-up after abandonment, are also uncertain for this type of project.

A major concern with this type of project is the impact to ratepayers. The COSG project would most likely reduce rate volatility because it is not subject to yearly fluctuations in the market, but the decrease in volatility does not necessarily mean there will be savings when compared to the market price. This project does not provide any increased protection to customers against longer-term increases in natural gas prices. Any sort of protection would be based on the assumption that the reserves were diversified in multiple supply units. It would not be sensible to have all of the reserves in one location because Nebraska's supply prices are often influenced by national supply and demand factors which can affect both Rocky Mountain and Mid-Continent supplies. An effective reserve based hedging program would demand that the prices paid to BHUH for production would correlate to the actual prices paid by BHUH for the supplies delivered to customers. Harms expressed concern about BHUH's requested rate of return on equity and called for a comparison to historical producer profit margins. If BHUH's return on equity were to consume the majority of the potential profit margin, the remaining benefit to the consumers would not likely outweigh the potential risks of uncompetitive prices and undefinable term.

There are also a number of competitive issues that may arise from reserve based hedging programs and pose significant risks. For example, "if alternative power generation sources and increases in energy efficiency make electricity an attractive alternative for space heating, significant gas usage reduction within the BHUH distribution areas may result in a COSG gas hedging position that is significantly higher than the targeted 50% level." (Ex. 400, at 8). Reserve based hedging levels cannot be reduced quickly. Nebraska is at risk of being put at a competitive disadvantage if future market gas prices do not increase as anticipated and hedges through the COSG program create above market costs for a prolonged period of time. Nebraska is also at risk of losing the usual competitive advantage it has by being located relatively near to both Rocky Mountain and Mid-Continent supplies. During the hearing, Mark Nadeau, an intervenor on behalf of Constellation New Energy Gas, questioned Ivan Vancas, the witness for Black Hills, on COSGCO as a new buyer in the marketplace.

> "Q. In your original submission to the panel, in your declaration, didn't you attach to the declaration an outline that said it [COSGCO] would focus generally on Rocky Mountains and Mid-Continent? A. Yes, I said Rockies and Mid-Continent. Q. And the reason for that, as I understood it, was because that's the region that BHEP has the most experience with, correct? A. It is because that's where our utilities are. Q. Okay. So it was unrelated to BHEP experience? A. BHEP has looked at properties outside of the Mancos – rather, outside of the Piceance, yes."

(Tr. 131:2-13).

The COSG program could implement pipeline restraints because, according to BHUH's filing, the gas produced by the reserves will be sold into the market where it is produced. Gas for delivery is then purchased where BHUH has the necessary pipeline to complete delivery. Any restraint that limits the ability to deliver gas either into or throughout Nebraska will reduce the competitive advantage the state would normally have.

Harms recommends the Commission ask BHUH to submit other hedging strategies based on a specific premise of a seven year rolling program commitment. If BHUH were to submit its hedging strategies for end-use customers, the effectiveness of its consumer objectives, such as rate stability and reduced rate volatility, can easily be compared to historical actual market price relationships. Additionally, energy management firms should be consulted to provide other hedging strategies that are based on the market.

Overall, the Commission should look to the needs and wants of the consumers. More pipeline capacity in Nebraska would help all customers and would likely be a better use of resources than reserves. There are also customers who may have made a choice to install natural gas systems and prefer to deal with the market price. In this instance, it would be unfair to force these customers into a price controlled system. Most importantly, before the Commission makes a decision, it should consider the other one- to seven-year hedging strategies that can be supported using a revenue guarantee similar to the tools proposed by BHUH. (Ex. 400).

c. Summary of P0-802

Lastly, in the record is submitted and accepted as evidence this Commission's own recent order in NG-0088 (Ex. 502) regarding P0-802 with a certified transcript (Ex. 402) of SourceGas experts testifying that getting out of a high cost gas field was in the best interest of the rate payers, that it was a take or pay contract, **and** that it cost rate payers going forward a surcharge in the millions of dollars to get out of an existing hedge contract. William Austin, as public advocate, described the contract to the Commission. "I would remind the Commission, of course, that you just got out of one long-term contract, the P0-802 contract, that seemed like a great idea at the time." (Tr. 423:2-5).

III. IMMEDIATE HARM

If this initial application and phase I of the application moves forward, customers will have immediate costs as required by the COSG Agreement, even if the Commission does not approve any subsequent Phase II acquisitions. ACE and NMPP argued that costs should not be expended to pursue gas reserve acquisitions at rate payer expense with such little evidence in support of the program.

The record reflects and acknowledges that the Colorado Public Utilities Commission issued a decision dismissing the application of Black Hills. Mr. Nadeau questioning Mr. Vancas: "Q. But the fact is on a 3-0 decision, they [Colorado Public Utilities Commission] rejected your [Black Hills] application as it stood as of last Wednesday; isn't that true? A. Without prejudice, correct." (Tr. 134:7-10). While this Commission is not bound by another Commission's approval or disapproval of the program, in this case the methodologies were the same.

Natural gas providers can typically set their own rates. The Commission allows natural gas public utilities "to implement and thereafter modify gas supply cost adjustment rate schedules that reflect increases or decreases in the cost of the utility's gas supply." (Neb. Rev. Stat. § 66-1854). However, a provider must adjust rates prudently because under Nebraska's State Natural Gas Regulation Act, natural gas rates must be just and reasonable. The Commission has the power to determine what rates are just and reasonable by balancing the public's necessity for natural gas with the provider's need for revenue. (Neb. Rev. Stat. § 66-1825).

IV. IN SUMMARY AND CONCLUSION

With this evidence and cross examination, ACE and NMPP ask you to dismiss this application. Turn down a risky opportunity that favors the Black Hills affiliates and the parent company. Dismiss this application because it has modeling with no mathematical way to predict an outcome. Dismiss the application because it may harm Choice Gas in the western part of Nebraska and because it is so similar to P0-802 where the Commission just recently granted rate payer relief from a high cost gas field that failed to deliver market priced gas over the long run.

Neither ACE nor NMPP's core concerns have been addressed by the hearing. ACE and NMPP request that the Commission rule that this docket is not in the public interest.

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Respectfully Submitted,

ACE and NMPP, intervenor

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CERTIFICATE OF SERVICE

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