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September 28, 2023

Ret. Colonel Thomas Golden
Executive Director
Nebraska Public Service Commission
1200 N Street, Suite 300
Lincoln, NE 68508

Re: *Black Hills Nebraska Gas, LLC d/b/a Black Hills Energy
Response to Commission Financial (accounting) and Management (gas prudence) Reports
Response to Public Advocate Comments
Commission Application No. NG-119*

Dear Ret. Col. Golden:

Black Hills Nebraska Gas, LLC d/b/a Black Hills Energy hereby transmits its Response to the Financial Report (i.e., gas accounting) and to the Management Report (i.e., gas prudence review) prepared by Consultants of the Nebraska Public Service Commission. Black Hills Energy's response also addresses comments submitted by the Public Advocate of Nebraska in response to the Commission's gas accounting and prudence reports.

Please contact me using the contact information provided above if you have any questions or need additional information.

Respectfully submitted,

Douglas J. Law

Douglas J. Law #19436
Associate General Counsel

DJL:ce
Attachment
cc: Service List

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF NEBRASKA**

In the Matter of the Commission, to conduct)	
a review of gas supply cost adjustment)	
schedules implemented by Black Hills)	Application No. NG-119
Nebraska Gas, LLC d/b/a Black Hills)	
Energy, Rapid City, South Dakota, pursuant)	
to Neb. Rev. Stat. § 66-1854.)	

**RESPONSE OF BLACK HILLS NEBRASKA GAS, LLC
D/B/A BLACK HILLS ENERGY TO
THE CONSULTANT’S AUDIT REPORTS OF THE
NEBRASKA PUBLIC SERVICE COMMISSION**

In accordance with the Order Setting Procedural Schedule entered by the Nebraska Public Service Commission (the “Commission”) in this docket on April 12, 2023, Black Hills Nebraska Gas, LLC, d/b/a Black Hills Energy, (“Black Hills Energy” or the “Company”) hereby files this Response to the Horne audit report titled “Report on Financial and Accounting Audit Procedures of Black Hills Nebraska Gas d/b/a Black Hills Energy” (“Financial Report”), filed with the Commission on or about August 15, 2023, and the Bates White Economic Consulting (“Bates White”) audit report titled “Management Review Audit of Black Hills Nebraska Gas, LLC d/b/a Black Hills Energy” (“Management Report”), filed with the Commission on or about August 28, 2023.

Black Hills Energy also responds to comments filed by the Public Advocate of Nebraska (“Public Advocate”) regarding the Management Report.

Black Hills Energy’s Response to Financial Report

Horne’s Financial Report conducted a thorough analysis of the significant processes impacting gas supply costs from a review of gas cost adjustment filings submitted by Black Hills Energy to the Commission during the period from January 1, 2020, to December 31, 2022. The

filings included routine filings and a sample of accounting transactions related to gas supply and transportation costs, as well as several discussions with Black Hills Energy team members. The results of that examination are in the Financial Report. The audit identified no errors specific to transactions and the scope of procedures. The Financial Report found that Black Hills Energy exercises appropriate oversight and maintains reasonable systems to ensure proper accounting for its gas supply and transportation costs and revenue reporting. Black Hills Energy has no objection or further comments to the Financial Report and appreciates the thorough investigation, review and analysis conducted by Horne on behalf of the Commission.

Black Hills Energy’s Response to Management Report

At the request of the Commission, the Bates White’s Management Report focuses on a management audit of prudence, risk, and administration of natural gas purchases by Black Hills Energy for the period January 1, 2020, to the present (“Audit Period”). The Management Report also included an informal review of Black Hills Energy’s gas supply cost adjustment (“GSCA”), as well as an examination of Black Hills Energy’s processes, procedures and general approach to natural gas supply, transportation procurement and hedging.

Specifically, the Management Report includes four substantive chapters, each addressing a different aspect of our scope of work and Black Hills Energy’s procurement and hedging activities. The Management Report is structured as follows:

Chapter II – Organization, staffing, and controls

Chapter III – Planning and forecasting

Chapter IV – Procurement

Chapter V – Hedging

As explained in the Management Report, each chapter follows the same structure. Each Chapter begins with the Findings section, which contains factual records, evidence, and analysis.

This section of the Chapter provides a factual basis for the next two sections. The next section within each Chapter is the Management Report's Conclusions section, which includes deductions and judgments of the Consultant on Black Hills Energy's procurement and hedging activities during the Audit Period. The final portion of each Chapter contains the Management Report Recommendations section, which contains action items for Black Hills Energy to address.

Overall, the Management Report states that the Commission's Consultants found no material violations or concerns associated with Black Hills Energy's organization nor the implementation of risk management policies during the audit period. The Management Report noted that Black Hills Energy took reasonable steps in cross-training staff and expanding recruitment efforts to meet the challenges it faced during the audit period, allowing for increased workforce flexibility. The Management Report states that there were no reported or observed instances of non-compliance, violations, or other non-conformance with risk protocols during the audit period. Black Hills Energy appreciates the thorough investigation, review and analysis conducted by Bates White on behalf of the Commission.

The Management Report contains several Conclusions and offers nine different Recommendations. Instead of providing extensive discussion, rebuttal, or comment on each of the Conclusions and Recommendations, Black Hills Energy acknowledges its general understanding and agreement with the presentation of the Conclusions and Recommendations set forth in the Management Report. Black Hills Energy provides a brief response to each Recommendation in the Management Report below.

- **Recommendation 2023-1:** Black Hills Energy should complete its consideration of the Aether Report recommendations and seek to implement those that are identified as in customers' interest.

Black Hills Energy's Response: Black Hills Energy has already acted on many areas of the Aether Report and will consider implementing the recommendations contained within the Aether Report if Black Hills Energy, using its reasonable judgment, experience, and expertise determines that those recommendations will result in gas prudent natural gas portfolio management in the future.

- **Recommendation 2023-2:** Black Hills Energy should assess the definition and implementation of a “design winter” as the coldest winter for which they plan, using a long-term historical data set (i.e., at least 30 years of historical data) to the extent it is colder than its current planning standard.

Black Hills Energy's Response: Black Hills Energy will review and analyze this recommendation further in the future to ensure that Black Hills Energy is using assets, forecasts, and information to prepare for cold weather events. However, Black Hills Energy asserts that its current forecasting methodology as outlined in Black Hills Energy's response to Data Request No, PSC-3-6 has served customers well in both projecting seasonal loads under normal winter weather conditions and accurately predicting requirements during extreme weather events over the last few winters. Black Hills Energy reviews and re-forecasts its Design Day forecast each year by using the coldest winter day over the last 30 years to project peak load requirements, ensure adequate supply, and pipeline capacity is available to serve its firm customer load.

- **Recommendation 2023-3:** Black Hills Energy should consider implementing an integrated resource planning process for Nebraska Gas, its gas utility division, or both, to determine risks, benefits, and costs of future scenarios (e.g., changes in law, technological/resource breakthroughs (i.e., hydrogen), high gas prices, low gas prices, etc.).

Black Hills Energy's Response: Black Hills Energy continually monitors local, state, and federal government and industry activity. One benefit of providing gas and electricity in multiple jurisdictions is the education and experience gained from this broad service area. Each area identified by the Management Report for inclusion in an Integrated Resource Plan (“IRP”) is already monitored by different subject matter experts and departments within Black Hills Corporation. Black Hills Energy does not believe that a formal IRP process is necessary to achieve the results understandably intended by such a requirement. For example, the State of Nebraska has not yet mandated IRPs for electric power districts or gas distribution companies, including the Metropolitan Utilities District in Nebraska.

In addition, the Commission provides for quarterly meetings under Commission Application No. NG-101. To that end, the Commission has previously sought and can seek additional information from the Company on any topic that may otherwise be required under an IRP. Black Hills Energy opposes the recommendation to formalize an IRP process for natural gas distribution services.

- **Recommendation 2023-4:** Black Hills Energy should consider formalizing and codifying its process for determining its storage injection and storage withdrawal timing and volume levels.

Black Hills Energy's Response: Black Hills Energy disagrees that its storage injection and storage withdrawal time and volume levels should be changed significantly or that its storage injection and storage withdrawal is not structured. Currently, Black Hills Energy injects natural gas ratably throughout the summer period when gas prices are traditionally lower in price. Black Hills Energy acknowledges that higher summer gas costs were present in 2022; however, lower prices for storage gas were available in most other years. As Black Hills Energy understands this

recommendation, it appears to suggest that Black Hills Energy either adopt some other arbitrary methodology or speculate on future pricing events.

For example, if Black Hills Energy were to forego a structured storage injection methodology because gas prices were higher during that period than prior years, and prices only increased in the fall and winter months, then such an act could lead to higher prices than the dollar cost averaging method currently used for storage injections.

Black Hills Energy holds the same type of concern regarding storage withdrawal. The withdrawal of gas from storage serves primarily as a price mitigation activity. Black Hills Energy systematically withdraws gas but also leaves some flexibility in its portfolio management to withdraw based on weather forecasts, customer usage, and other events that may cause natural gas prices or consumption to alter from the many years of experience gas usage relied upon by Black Hills Energy.

As technology improves, and more end-use customers have smart meters that provide real time information on customer usage, then Black Hills Energy can look for storage injection and storage withdrawal strategies that may better mitigate natural gas price risk. However, the gas purchasing strategy currently employed works under the current set of gas technology and assets available.

One strategy to consider for storage could be to build out Liquefied Natural Gas storage reservoir near Lincoln or other larger communities to better manage natural gas price events. However, in the past and perhaps currently, the cost of constructing, operating, and maintaining those assets may cost more than managing the price risk inherent in the marketplace.

- **Recommendation 2023-5:** Future audits of Black Hills Energy should include in its work scope a complete assessment of the target hedge percentages.

Black Hills Energy's Response: Black Hills Energy does not oppose this recommendation. In addition, Black Hills Energy has already adopted this recommendation by tracking its hedge targets in internal reporting to Black Hills Energy's Risk Management Committee.

- **Recommendation 2023-6:** In pursuing put and call options to hedge exposure to physical supply contracts, BHSC should consider contracting with counterparties that specialize in such products, such as financial counterparties.

Black Hills Energy's Response: Black Hills Energy is not against this recommendation. However, Black Hills Energy contends that its past hedge activities have been prudent and effective. In addition, Black Hills Energy and its parent company, Black Hills Corporation, can transact with a variety of counterparties, including financial institutions. However, the financial institutions may inject some additional transaction risk that is not present with a supplier or other counterparty that is also interested in a longer-term relationship with natural gas utilities. Black Hills Energy will continue to review this recommendation to provide a prudent balance and portfolio of available price strategies and protection against foreseeable natural gas price or reliability risk.

- **Recommendation 2023-7:** Black Hills Energy should seek to hedge natural gas supply basis risk in its hedging activities, with consideration given to cost-effectiveness and availability of suitable hedging instruments.

Black Hills Energy's Response: Black Hills Energy opposes this recommendation to the extent that it infers that Black Hills Energy's current natural gas hedging activities do not already account for cost-effectiveness and availability of suitable hedging instruments. As noted above, Black Hills Energy seeks affordable hedging instruments to manage price risk.

However, there is a significant cost to hedging also that must be balanced in a forward-looking manner. One can always look back in time and wish that one knew then what one knows

now. Cost-effectiveness and availability of suitable hedging instruments are two of the items that Black Hills Energy already applies when deciding on how and how much of its natural gas purchase to hedge. To be clear, Black Hills Energy is not engaging aimlessly in hedging activity each year. Instead, Black Hills Energy relies on historical data, employs subject matter experts engaged in those areas, and accepts bids from many different counterparties who offer hedging instruments. Obviously, Black Hills Energy will continue to look for ways to improve its natural gas portfolio. In fact, beginning this summer (2023), Black Hills Energy entered into financial basis hedges that match up with its Nymex futures hedges for our Nebraska Rate Area 3 customers. This was a recommendation from the Aether report. This act is also in line with what the Commission's consultant is recommending in the Management Report.

- **Recommendation 2023-8:** Black Hills Energy should consider using a volatility measure to assess the effectiveness of its hedging activities.

Black Hills Energy's Response: Black Hills Energy is not opposed to this recommendation. Again, Black Hills Energy notes that its current natural gas portfolio management has been tested in several different states over many years. Obviously, a significant weather event can stress, if not, expose the weakness of any gas purchasing strategy. Black Hills Energy could mitigate 100% of its natural gas purchases; however, the price of that type of strategy would lead to significantly higher gas costs. Black Hills Energy currently relies upon 30-years of historical gas usage, monitors weather, storage levels, and incorporates other data into its natural gas price and usage portfolio management.

- **Recommendation 2023-9:** Black Hills Energy should consider alternatives to a strict adherence to relying on non-hedged summer volumes for its storage injections.

Black Hills Energy's Response: For the reasons provided above, Black Hills Energy opposes this recommendation to the extent that it calls for more speculation of storage injection and storage withdrawal practices, whether in the summer or other periods of the year.

For example, historically, the summer/winter spread favors not hedging storage injections with negligible exceptions. In addition, it is difficult to align the hedge to the injected price (i.e., the physical injected gas could be priced at a mixture of the daily index, first of the month index and/or fixed price while the forward market might be purely FOM). Finally, the unpredictability of injected volume especially for no notice services challenges setting hedge targets (i.e., one must be conservative not to over hedge); compared to nominated storage.

- **Public Advocate Comments**

On September 26, 2023, the Public Advocate submitted Comments in this proceeding. The Public Advocate raised concerns with the content and presentation of the Management Report regarding the discussion of February 2021 natural gas pricing event experienced by many utilities during Storm Uri. The Public Advocate referenced the significant pricing impact of Storm Uri on natural gas purchases during that period.

The Public Advocate stated that more discussion regarding Storm Uri gas pricing and recommendation on how the Company may mitigate those significant impacts in the future should be addressed in the Management Report, and by Black Hills Energy

As the Public Advocate points out, Storm Uri's impact on natural gas prices was a unique and significant weather event in Nebraska (and of course in numerous other states) in decades. Keeping the gas flowing in Black Hills Energy's Nebraska service areas cost approximately eighty (80) million dollars, which amount is being reimbursed to the company over a 3-year period, with interest.

The Public Advocate seeks discussion and response from Black Hills Energy on how Black Hills Energy has changed its purchasing decisions or planning process to account for weather and natural gas pricing events in the future. The Public Advocate seeks confirmation that Black Hills is taking weather events into account in its “peak day” study. The Public Advocate asserts that with Storm Uri, being so consequential and exposing considerable weakness in the transportation, distribution, and pricing structures for natural gas in America, warrants discussion and portfolio practices so that the Company can adequately react to future weather or pricing events.

The Public Advocate presents the following observations and recommendations for the Commission to consider for future gas audits:

1. Bates White’s ex-post test of hedge effectiveness (Bates White, pp. 55-62) was used to determine the prudence of the utility's hedging actions. Future prudence review should consider to what extent the utility's hedging actions cost effectively identify, quantify, and mitigate the risks that the utility faces in meeting its natural gas planning objectives for (1) reasonably priced gas, (2) high reliability, and (3) mitigation of price volatility.
2. Any future review should consider incorporating discussion regarding similar reviews that the Company’s LDC affiliates in other jurisdictions have experienced or are experiencing.
3. Any future review should consider a deeper look into the historical basis differences between Henry Hub and the Company’s delivery points on its pipelines. For example, a major issue of concern would exist if a significant basis difference existed prior to Storm Uri that was unhedged.
4. Any future review should consider additional discussion on the frequency of severe weather experienced during the audit period. An occurrence of once every 10 years would necessitate a different response from an occurrence of once every 100 years.
5. Blue Ridge believes the redactions of the Bates White public report were excessive. While certain data, such as gas supply contract pricing, must be kept proprietary, the report weighed heavily on incorporating such redacted data in the reported analysis and conclusions.

See Public Advocate Comments on pages 2 and 3.

Black Hills Energy Response to the Public Advocate’s Comments:

Black Hills Energy acknowledges the Public Advocate’s concerns and will incorporate those comments into its gas supply purchasing discussion, analysis, and decision-making. In response to Storm Uri and other potential future weather or natural gas supply disruption events, Black Hills Energy engaged a natural gas consultant, Aether, to review Black Hills Energy’s gas purchasing practices, assets, and strategies.

The Company has previously, is currently, and will continue to look for cost-effective gas purchasing strategies in the future. There is no natural gas purchasing portfolio strategy that removes all price risk – at least not one that is currently cost-effective. Black Hills Energy has taken meaningful actions to mitigate or avoid another \$80 million natural gas pricing event. For example, in addition to following the recommendations of the Aether Report, Black Hills Energy has and will continue to explore physical and financial price hedging strategies. However, those strategies must always be weighed against current and predicted future costs of gas supplies. If the Commission directs Black Hills Energy to hedge a greater percentage of its natural gas pricing, then Black Hills Energy will want assurances from the Public Advocate and the Commission that those incremental hedging costs will be recovered.

Please note that a significant impact on natural gas pricing during Storm Uri was caused by electric power plants seeking natural gas during a period of peak usage by natural gas consumers. To avoid those impacts in the future may be a risk management cost decision that the Public Advocate and the Commission can weigh in on to provide direction to the Company as to how much risk the Public Advocate or the Commission believe is prudent. This is an area that the Company would be willing to engage in more discussion as we all want to effectively manage price risk and avoid another Storm Uri pricing event to the extent possible. However, it should

also be recognized that no matter how much one prepares for weather, supply disruption, or other pricing events, Black Hills Energy is a price taker and not a price maker in the natural gas market.

Black Hills Energy does not oppose incorporating discussion from other jurisdictions in which its affiliates provide natural gas services. However, those discussions should be limited to relevance and applicability. Other jurisdictions may be served by different interstate pipelines or supply sources. Some states in which Black Hills Energy affiliates service may not view natural gas service as vital to their economy as does the State of Nebraska.

Regarding the Public Advocate's comments on confidentiality, Black Hills Energy would submit that the Management Report was properly redacted to protect the buying strategies and portfolio management recommendations. Black Hills Energy would rather err on the side of over protection of public disclosure on those items than gas suppliers, marketers, and interstate pipelines having a clear road map into the decision-making, strategies, pricings, and Commission requirements related to natural gas portfolio management. Black Hills Energy understands the need to balance public interests against corporate interests; however, those same customers are protected by Commission Staff, Commission Consultants, the Public Advocate, and Public Advocate Consultants.

Conclusion

Black Hills Energy respectfully requests that the audits be approved by the Commission, subject to the clarifications and comments identified above. Black Hills Energy looks forward to working with the Commission and the Public Advocate to address and implement the recommendations presented in the Management Report, subject to the discussion, objections and comments provided above.

Dated: September 28, 2023.

Respectfully Submitted,

BLACK HILLS NEBRASKA GAS, LLC,
D/B/A BLACK HILLS ENERGY, Applicant.

BY: *Douglas J. Law*

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the above and foregoing Response of Black Hills Nebraska Gas, LLC d/b/a Black Hills Energy to the Report of the Nebraska Public Advocate was served electronically on September 28, 2023, upon the following:

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