BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

In the Matter of Black Hills/ Nebraska Gas Utility Company, LLC, d/b/a Black Hills Energy, Omaha, seeking Approval of its Cost of Service Gas Hedge Agreement With Black Hills Utility Holdings, Inc.	Application No. NG-0086 DENIED Entered: July 19, 2016

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BY THE COMMISSION:

On September 30, 2015, Black Hills/Nebraska Gas Utility Company, LLC, d/b/a Black Hills Energy (Black Hills) filed an Application with the Nebraska Public Service Commission (Commission) seeking approval of its Cost of Service Gas Hedge Agreement with Black Hills Utility Holdings, Inc., Petitions for Formal Intervention were received from the Public Advocate (PA), the Nebraska Municipal Power Pool (NMPP), the Alliance for Community Energy (ACE), and Constellation NewEnergy-Gas Division, LLC (CNEG). The Petitions were granted.

After a planning conference on November 16, 2015, a Hearing Officer Order issued on November 20, 2015, set a procedural schedule and set a hearing date of April 12, 2016, through April 15, 2016, if necessary.

On March 31, 2016, the PA filed a Motion for a Continuance and for Leave to Propound Additional Discovery upon the Applicant. Black Hills filed an Answer to the PA's Motion on April 1, 2016, whereby it asked for certain limitations on the PA's Motion, but did not object to either request. The Hearing Officer granted the PA's Motion in an order issue on April 4, 2016.

Hearing in above-captioned docket began on May 2, 2016, in the Commission Hearing Room.

E V I D E N C E

At the hearing on the above-captioned matter, the Applicant and Intervenors offered the testimony of multiple witnesses. Due to the waiving of cross examination by all parties, some witnesses did not appear and offer oral testimony during the hearing, but submitted pre-filed testimony into the record. Black Hills offered the pre-filed testimony of eight (8) witnesses, Mr. Ivan Vancas, Mr. Richard C. Loomis, Mr. T. Aaron Carr, Mr. John Benton, Mr. Chris Kilpatrick, Ms. Julia Ryan, Mr. Adrian Mckenzie, and Mr. Kyle White. Five (5) of Black Hills witnesses offered oral testimony at the hearing.

The PA offered the pre-filed testimony of Mr. Michael J. McGarry and Mr. McGarry also testified at the hearing. CNEG offered the pre-filed testimony of three (3) witnesses, Mr. Andrew Bushra, Mr. Stephen Bennett, and Mr. Stephen Sorenson. ACE offered the pre-filed testimony of Ms. Beth Ackland and NMPP offered the pre-filed testimony of Mr. John Harms. All other parties to the proceeding waived cross examination of CNEG, ACE, and NMPP's witnesses, so no oral testimony was offered at the hearing on behalf of CNEG, ACE, and NMPP.

Mr. Vancas, Group Vice President for the natural gas utilities for Black Hills Corporation, filed direct and rebuttal testimony, both confidential and Public versions in this matter. Mr. Vancas's testimony was accepted into the record as Exhibits 101-102 and 114-116.

Mr. Vancas testified regarding the cost of service gas (COSG) proposal by Black Hills describing the proposal as a long-term gas supply for Black Hill's supply portfolio. Mr. Vancas testified that if the Commission approved what he characterized as Phase I of the proposal, the company would then return later with a specific property and actual numbers for Commission consideration. Mr. Vancas further stated that approving Phase I would not impact customer rates. Mr. Vancas testified the purpose of the proposal is to bring price stability, and possibly savings, to Nebraska ratepayers.[1]

Mr. Vancas also testified on what he called a "rare opportunity" for Black Hills to acquire gas reserves at attractively low prices due to the depressed prices of natural gas and financial stress in the oil and gas industry. He went on to elaborate that low prices that are bad for the gas industry are good for natural gas customers now and in the future.[2] However, he warned that the timeframe to secure reserves at a low cost could be short and called for quick action.[3]

Mr. Vancas additionally testified the COSG concept proposed by Black Hills was not a new concept and cited the example of a COSG-like program used by a Questar, a company serving Utah and Wyoming utility customers.[4]

When questioned regarding the impact of Colorado's dismissal of Black Hill's COSG proposal on Nebraska, Mr. Vancas testified Colorado's dismissal would have no practical impact on Nebraska ratepayers, as those costs will be borne by Black Hills and not recoverable in the program.[5] Mr. Vancas stated Colorado had dismissed the application without prejudice and characterized the Colorado dismissal as the Colorado Commission telling Black Hills to come back with a specific property for Colorado to review. However, Mr. Vancas pointed out the actual order by the Colorado Commission had not been issued. He also explained Black Hills won't know what sized property to look for until all the states involved decided whether to participate in the COSG program.[6]

When asked how the proposal was different from P0802 contract recently terminated by SourceGas Distribution, Mr. Vancas stated that this proposal was different in every material respect. P0802 was setting a price to insure gas supply for the state, and that Black Hills COSG proposal is tied to production

[1] NG-0086 Transcript, 53:9-22 (Hereinafter "TR page number:line number").
[2] TR 53:23 - 54:12.
[3] TR 55:9-12.
[4] TR 54:13-18.
[5] TR 56:17 - 57:1.
[6] TR 56:11 - 57:15.

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costs, not market price with the P0802 contract.[7] Mr. Vancas further asserted that while prices to ratepayers under this proposal would go up in the short term, it was Black Hills opinion that in the long term this proposal would be much better for ratepayers.[8]

Upon cross-examination by the PA, Mr. Vancas confirmed the purpose of the COSG proposal was not to provide an assured supply of physical gas for use by Nebraska Black Hills customers, but to instead hedge a portion of customer's costs.[9] Mr. Vancas further testified that the unregulated Black Hills utility in the proposal producing the gas would incur the same type of expenses that any production company would incur, and that these expenses were defined under the COSG agreement as Operational Expenses (OpEX) and would be recoverable from ratepayers in the COSG program through the purchase gas adjustment.[10]

When questioned about the proposed Accounting and Hydrocarbon Monitors, Mr. Vancas testified that Black Hills would hire the monitors, but as a practical matter, Black Hills would not hire anyone the Commission was not comfortable with.[11] He also stated Black Hills was willing to extend the time the monitors had to file reports from ten (10) days, as contained in the COSG Agreement, to 120 days.[12] When asked about the short timeframe included for a formal review by the Commission of any property put forward by Black Hills, Mr. Vancas stated that the sixty (60) days was based on a determination of the maximum amount of time a seller would most likely be willing to guarantee a price.[13]

The PA further explored the termination provisions in the COSG Agreement. Mr. Vancas offered his opinion that the language stating the remaining states in the program must approve a sale before another state can sell out of the contract doesn't require other Commissions in the COSG Program to approve another state exiting the Agreement, but instead make sure their gas doesn't get sold.[14]

Mr. Vancas was also questioned regarding the Mancos Shale property owned by Black Hills Exploration. Mr. Vancas stated that Black Hills is considering using this property in the COSG

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[7] TR 58:8 - 59:17.
[8] TR 60:15-17.
[9] TR 62:3 - 63:7.
[10] TR 64:12 - 65:15; 67:6 - 68:1.
[11] TR 81:14 - 82:7.
[12] TR 84:14-15.
[13] TR 91:19 - 92:6.
[14] TR 96:5-24.

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Program.[15] Mr. Vancas also stated that Black Hills Exploration & Production, the non-regulated entity that would manage any properties for Black Hills is currently experiencing some losses.[16] Finally, Mr. Vancas testified that part of the reason they filed this agreement as a multi-state program was that the more states that participate, the more states there are to absorb the costs for administrating the program.[17]

Black Hills next called John Benton, Vice President and General Manager of Black Hills Exploration & Production (BHEP). Mr. Benton filed direct and rebuttal testimony in this matter. Mr. Benton's testimony was accepted into the record as Exhibits 107 and 119. Mr. Benton testified that BHEP is a wholly-owned subsidiary of Black Hills Corporation. BHEP is a non-regulated utility that will seek out proven and producing wells with stable and predictable costs, but will not be involved in exploration or speculation.[18]

Upon cross examination by the PA, Mr. Benton testified that BHEP held several properties that would be eligible for acquisition under the COSG Agreement, including properties in the San Juan Basin and Mancos Shale in the Piceance Basin, all in the Rocky Mountain region of the United States.[19] Mr. Benton further testified regarding the financial condition of BHEP, stating BHEP was currently experiencing financial difficulties.[20] Additionally, Mr. Benton testified that his company had not predicted the price drop in natural gas to the extent it had occurred.[21] Finally, he testified that when the price of natural gas goes up, the cost to produce also goes up.[22]

Upon cross-examination by CNEG, Mr. Benton testified regarding a presentation in October 2015 in New York to shareholders of Black Hills Energy where it referred to properties held by BHEP. When asked about the strategic objectives of the company, Mr. Benton testified that the presentation had indicated the intention to evaluate the Mancos Shale development, property held by BHEP, for use in and support of the COSG Program.[23] Mr. Benton confirmed BHEP has struggled to sell the gas it produced at a price that was profitable and had been losing money for more than five years.[24] Mr. Benton also

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[15] TR 100:11-17.
[16] TR 102:13-15.
[17] TR 109:1-6.
[18] TR 182:4-17.
[19] TR 187:1 - 190:18 and 185:8-19.
[20] TR 190:22 - 191:6.
[21] TR 194:19-24.
[22] TR 196:24-25.
[23] TR 208:12 - 210:1.
[24] TR 211:24 - 212:6.

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testified that he was not aware of any prohibition in the agreement against selling for a profit anything else gathered from a well which provides natural gas in the agreement.[25]

Mr. Kilpatrick, the Director of Resource Planning for Black Hills, next offered testimony on behalf of Black Hills. Mr. Kilpatrick filed direct and rebuttal testimony in this matter. Mr. Kilpatrick's testimony was accepted into the record as Exhibits 108 and 120. Mr. Kilpatrick testified that he did not believe that the COSG program shifts risks to the ratepayers.[26] Upon cross-examination by the PA, Mr. Kilpatrick said that while he wouldn't characterize the program as guaranteeing a rate-of-return for shareholders, it is more than the authorized rate-of-return given to the company by the Commission in the last rate case.[27] Further, during rebuttal Mr. Kilpatrick testified that, in his opinion, shareholders were taking on greater risk under the COSG Program than ratepayers, as the cost of gas may rise.[28]

Next to offer testimony on behalf of Black Hills was Mr. Carr, the Director of Corporate Development for Black Hills Corporation. Mr. Carr filed direct and rebuttal testimony in this matter that were accepted into the record as Exhibits 105, 106 and 118. Mr. Carr sponsored the proposed model intended by Black Hills to evaluate any properties that would be brought for Commission consideration in Phase II of the proceeding. Mr. Carr further testified regarding what he termed the primary tools for aiding the Commission's oversite of the COSG Program. He identified those tools as: Commission review of the COSG Agreement and other acquisition criteria, retaining Accounting and Hydrocarbon Monitors, and the Phase II review, including a review of a potential property, drilling plans, and the reports filed by the Monitors in Phase II and annually thereafter.[29]

Mr. Carr testified regarding the proposed model, stating that it was a demonstrative model only using illustrative numbers for hypothetical purposes to educate and inform the parties in this proceeding regarding the mechanics and formulas driving the costs underlying the COSG Program.[30] Mr. Carr also calculated the hypothetical customer impacts from the illustrative model. He cautioned it is premature to attempt to draw any conclusions or run any sensitivities on the model and his hypothetical numbers, stating it would be better to wait until a real property was brought forth in Phase II.[31]

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[25] TR 220:23 - 221:4.
[26] TR 280:5-9.
[27] TR 273:17 - 274:17.
[28] TR 299:6-20.
[29] TR 327:15 - 328:7.
[30] TR 328:17-25.
[31] TR 328:17 - 329:24.

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Upon cross examination, Mr. Carr confirmed that the illustrative model he sponsored was not included in the COSG Agreement, but was intended as an example only of how the Phase II evaluation of a property might work, but other models could be utilized.[32] Mr. Carr also responded to questions regarding his hypothetical model results which show the COSG Program losing money and ratepayers paying hedge costs for four (4) years and taking another three (3) years before ratepayers would break even.[33] On Redirect, Mr. Carr clarified his model was conservative and not intended to reflect a best case scenario for the COSG Program.[34]

Finally, Mr. Michael J. McGarry Sr., a consultant retained by the PA, offered testimony on behalf of the PA. Mr. McGarry filed direct testimony in this matter that was accepted into the record as Exhibits 200-205. Mr. McGarry testified that the PA was concerned that the COSG Program unduly shifts the risk of excessive costs to Black Hills ratepayers and inappropriately guarantees the cost recovery for investment and operating costs of an unregulated affiliate, COSGCO, through the proposed hedge true-up.[35] Further, Mr. McGarry stated that the proposed rate-of-return based on an annual national average of electric and gas utilities set during the preceding year was unreasonable, and may lead to Black Hills realizing a rate-of-return that is higher than the Commission's currently authorized rate-of-return.[36] Mr. McGarry further stated that the requested debt-to-equity ratio would overstate the return to the unregulated COSGCO.[37]

In addition, Mr. McGarry testified that the Hydrocarbon and Accounting Monitors proposed to provide oversight in the COSG Program would be an insufficient safeguard.[38] Mr. McGarry stated that based in the hypothetical nature of the Company's model, it is impossible to know when, if ever, ratepayers might see a benefit from the COSG Program beyond the possibility of increased price stability.[39] Mr. McGarry further testified regarding the impact on Nebraska ratepayers if other Black Hills states decline to join the COSG Program, stating Nebraska will be left to shoulder additional costs.[40] Finally, Mr. McGarry stated the PA's concerns regarding the ability of the Nebraska

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32 TR 332:18 - 333:10.
33 TR 334:14-25.
34 TR 352:20-25.
35 TR 372:13-18.
36 TR 372:19 - 373:3.
37 TR 373:4-6.
38 TR 373:18-23.
39 TR 373:24 - 374:6.
40 TR 374:7-13.

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Commission to exit the COSG Agreement based on the language in the COSG Agreement.[41]

Mr. McGarry was questioned on cross-examinations regarding the Company's willingness, or lack of objection, to changing the debt-to-equity ratio, removing electric utilities from the rate-of-return annual average calculation, extending the timeframes for reviews by the Monitors and the Commission during Phase II, including NYMEX forecasts into the Company's price forecasts, and capping production costs. Mr. McGarry was asked if such changes would allay any of the PA's concerns. In response, Mr. McGarry generally agreed some of these proposed modifications would be favorable, but noted they were not in the actual proposal.[42]

O P I N I O N   A N D   F I N D I N G S

The Commission's jurisdiction over state jurisdictional utilities is derived from the State Natural Gas Regulation Act ("the Act").[43] The Act grants the Commission broad powers stating:

> The commission shall have full power, authority, and jurisdiction to regulate natural gas public utilities and may do all things necessary and convenient for the exercise of such power, authority, and jurisdiction.[44]

The Act further gives the Commission discretion to review and allow the implementation of gas supply cost adjustment rate schedules, including gas price volatility risk management activities with the pertinent provisions of the Act stating:

> The commission shall allow jurisdictional 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 such as (a) federally regulated wholesale rates for energy delivered through interstate facilities, (b) direct costs for natural gas delivered, or (c) costs for fuel used in the manufacture of gas. Such costs may, in the discretion of the commission, include costs related to gas price volatility risk management activities, the costs of financial instruments purchased to hedge against gas price volatility, <u>**if prudent**</u>, and other relevant factors.[45]

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41 TR 374:14-20.

42 TR 380:14 - 394:18.

43 NEB. REV. STAT. §§ 66- 1801 et. seq. (Supp. 2015).

44 NEB. REV. STAT. §§ 66- 1804 (Supp. 2015).

45 NEB. REV. STAT. §§ 66- 1854 (Reissue of 2009)(Emphasis added).

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The Act gives the Commission the authority to entertain programs designed to hedge against price volatility, such as Black Hills proposes in the current application. Further, the determination of whether a jurisdictional utility may implement such a proposal is completely within the discretion of the Commission. The Act directs the Commission to review any such programs before them for prudency.

Prudent is defined as practically wise, judicious, careful, discreet, circumspect, and sensible.[46] In a prudency review, the Commission must exercise good judgment and determine whether a proposal is reasonable, practical and in the best interest of ratepayers. The current proceeding also adds an additional layer of complexity as we are asked to review the prudency of a prospective program, not retrospectively review decisions for prudency, as in a general rate case proceeding. As always, the Commission is tasked with balancing the interests of the utility and the ratepayers.

The Proposal

The application filed by Black Hills seeks Commission approval for Black Hills' regulated utility in Nebraska to enter into a Cost of Service Gas Agreement (COSGA), along with Black Hills' other regulated utilities in Colorado, Iowa, Kansas, South Dakota, and Wyoming.[47] Black Hills has filed similar dockets for approval of the COSGA in all six (6) states. Black Hills seeks to set a hedge target of upwards to 50% of its regulated utility's forecasted annual firm gas demand to be procured under COSGA. Pursuant to the agreement, an unregulated subsidiary of Black Hills, identified as the Cost of Service Gas Company (COSGCO), would acquire natural gas reserves based on certain criteria and produce natural gas under approved five-year drilling plans. The gas produced would be sold by COSGCO on the open market. From the amount made from the sale of the gas, all of the operating expenses of COSGCO, denoted as OpEx in the agreement, are deducted, resulting in the net revenues. The allowed return on equity (ROE), plus or minus 100 basis points, is next deducted from the net revenues. The allowed ROE would be determined based on an average of gas and electric utility rate cases for the preceding calendar year. If the actual ROE exceeds the allowed ROE by 100 basis points, ratepayers would be issued a Hedge Credit. If the actual ROE fails to meet the allowed ROE by more than 100 basis points, ratepayers would be assessed a

[46] *Black's Law Dictionary* 853 (6th ed. 1991).

[47] The COSGA discussed in the next section is found at Hearing Exhibit 101, Pre-Filed Public Direct Testimony of Ivan Vancas, exhibit IV-1.

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Hedge Cost. The Hedge Cost or Credit would be passed through to Nebraska ratepayers via the Purchased Gas Cost Adjustment (PGA).

The COSGA also contains provisions whereby Black Hills would hire a Hydrocarbon Monitor to ensure the acquisition criteria and drilling plans contained within COSGA are met by any proposed properties and drilling plans. The Company would also hire an Accounting Monitor to review all the calculations in determining Hedge Costs and Credits for accuracy under the program. Both Monitors would be hired with the approval of the participating state regulatory agencies.

Lastly, the COSGA will be effective until the production on the acquired property ceases, estimated anywhere from 20 to 30 years or until any participating state's utility commission enters an order terminating that state's participation in the program. In the event of such an order, Black Hills would sell, as soon as practical, the portion of the gas interest utilized by that state. The Agreement also states the remaining utilities in the program must approve the gas interest to be sold before the sale can occur.[48]

We find the overall concept of exploring new and innovative ways to stabilize gas prices to benefit both the utility and its ratepayers positive. While we have a general positive view of the end goals of the program, there are a number of significant concerns the Commission finds with the COSG Program that Black Hills proposes. Some of our major concerns are discussed below.

<u>Hedging vs. Speculating</u>

Black Hills referenced insurance policies as an analogy to the type of hedging Black Hills is attempting to do with the COSG Program. However, it is critical to our prudency analysis to recognize there are important differences between hedging risk and hedging uncertainty. To use the insurance analogy, a homeowner that lives in a floodplain invests in flood insurance as a hedge against the risk of damage resulting from a flood. The risk associated with potential flooding is measureable making it predictable within the limits of a probability analysis. Uncertainty, on the other hand, cannot be measured and thus is not predictable with probability analysis. Hedging risk is prudent. An attempt to hedge uncertainty is speculative and rarely prudent.

There is no dispute that natural gas market prices are unpredictable. All the experts in this proceeding agree gas prices will most likely rise in the future. However, opinions on

48 Hearing Exhibit 101, exhibit IV-1.

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when prices will rise, how quickly they will rise, and how much they will rise, vary greatly. Commodity markets change day to day as the ebb and flow of supply and demand over a short period often results in large price movements in the spot market. For example, increased demand for natural gas due to a cold weather snap or a supply disruption will increase price movements. Volatility is a measure of the day to day price variation. Further, price volatility in natural gas markets can vary from market location to market location across the U.S. due to infrastructure restrictions, such as how much natural gas is in storage.

Black Hills currently, and for a number of years, has used spot market purchases, short-term fixed price contracts, seasonal storage agreements, and short-term financial hedges to provide protection against short-term market volatility. These short-term hedges are usually one to two years in duration.[49]

However, the day-to-day volatility of the day-to-day spot market is not indicative of long-term gas price trends. Long-term hedges are less about mitigating volatility and more about forecasting what market prices may look like in the future, in attempt to lock in a favorable price. The COSG Program is an attempt to forecast or predict market prices 20 to 30 years out, and is, at its most basic, a form of long-term futures contract. Uncertainty that comes with such securities cannot be measured or insured against. Such long-term securities are expensive, as predicting market prices on such a long-term basis is highly speculative.[50] As the PA points out in his brief, we heard a lot of opinion about gas prices, nothing more.[51] We have no doubt as to the intelligence and sincerity of the people offering those opinions, however, it does not alter the speculative nature of the undertaking.

Throughout the entire proceeding, Black Hills has maintained that the COSG Program will be less expensive than other long-term hedging contracts and no other reasonable long-term hedging options exist.[52] However, for the Commission, the crucial question is not whether the COSG Program may be less or more expensive than other long-term hedging securities, but rather whether the COSG Program will be of greater benefit to ratepayers than the shorter term strategies utilized by the company today to hedge and stabilize risk. We find Black Hills has failed to make its case that the long-term COSG Program

[49] Black Hills Post Hearing Brief, p.1.

[50] This was confirmed by Black Hills in its brief discussing how hedging with long-term fixed price contracts entails significant expense. *See* Black Hills Post Hearing Brief, pp. 1-2.

[51] Public Advocate Post Hearing Brief, pp. 7-8.

[52] Black Hills Post Hearing Brief, p.2.

benefits will outweigh the risks of such long-term speculation. While stability in price is a laudable goal, a stable price does not necessarily translate into cost savings and other benefits for ratepayers. There are just simply too many unknowns at this time to confidently say that the COSG Program will result in lower prices and less volatility for the ratepayers in Nebraska.

Risk Shifting

The long-term speculative nature of the forecasts and models in the COSG Program translate into significant risk to ratepayers. Black Hills stated it didn't consider the COSG Program to be shifting risk to ratepayers. Black Hills witness Mr. Kilpatrick even went as far as to state that not only did he believe the COSG Program does not shift risk to the ratepayers, but Black Hills shareholders are actually taking on greater risk under the COSG Program than ratepayers.[53] We find these statements are simply unsupported by the evidence before us. As the Program is structured, shareholders are guaranteed a rate of return on their investment in the Program, while ratepayers are guaranteed nothing.

Ratepayers are instead given the promise they *may* see a hedge credit at some point in the future, however, a number of factors must converge for a ratepayer credit to be possible. The company must produce, gather, process, transport, and market natural gas at a cost less than the cost of purchasing gas at market. After the Company recovers 100% of its operating expenses for the program, any remaining profit must be extensive enough to enable the company to recover more than 100 basis points above its ROE. Keeping in mind, both the ROE and cost of capital structure are established artificially by the Program, and outside the Commission's control and oversight. Therefore, only after the company has recovered its costs and paid its shareholders their return, will ratepayers be eligible for any credits. On the flip side, if there is insufficient revenue generated from the program, the COSGCO's expenses are still covered, and shareholder risk is still limited to 100 basis points below the allowed return. Any losses beyond the 100 basis points will be reimbursed by ratepayers through a Hedge Cost incorporated in their GCA. To obligate Nebraska ratepayers to shoulder that level of risk, while insulating Black Hills shareholders from similar risk seems neither reasonable nor prudent.

[53] TR 280:5-9 and TR 299:6-20.

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Lack of Regulatory Oversight

The Commission is also concerned about the consistent void of regulatory oversight in the COSG Program.[54] Black Hills assures us they won't do anything we don't agree with or wouldn't like, however, the COSG Program offers nothing concrete to that affect. Such oral representations do little to relieve our concerns. COSGCO is an unregulated affiliate and as such, the Commission will not review the prudency of costs and expenses incurred by COSGCO, even though they will directly determine whether Nebraska ratepayers receive a credit or must pay into the Program. The monitors contained within the proposal seem to be an attempt to alleviate concerns about lack of Commission oversight. However, the concerns expressed by the intervenors about the monitors are shared by the Commission. Black Hills will hire the Accounting and Hydrocarbon Monitors, provide them with the data and information they will review, and set the timeframe for their analysis and report. To characterize this arrangement as independent is a stretch and does little to nothing to remedy the lack of Commission oversight within the program.

Lack of Detail

The Commission is also concerned about the distressing lack of detail provided by Black Hills upon which we are to base our finding of prudency. Black Hills is asking the Commission to commit Nebraska ratepayers to a long-term program on its assurances that it will be a beneficial venture, while providing no specificity upon which to base such a claim.

For example, the proposal simply contains a provision whereby COSGCO will sell the gas produced under the program to third parties.[55] Black Hills has provided a detailed description of what they will do to minimize uncertainties relative to the cost of production, but the application is silent on how the physical gas produced by COSGCO will be actively marketed. The critical issue for ratepayers in Nebraska is not how cheaply COSGCO can produce the gas. It is instead how COSGCO intends to maximize the difference between the revenue generated from the sale of the gas produced and the total cost to produce and transport the gas to the market center. That difference will determine whether the Program is financially favorable or harmful to Nebraska ratepayers. However, we are provided no detail on that critical aspect of the program.

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[55] Hearing Exhibit 101, Pre-Filed Public Direct Testimony of Ivan Vancas, p. 15.

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Additionally, requests to provide estimates regarding costs and benefits of the program are summarily dismissed. While claiming on the one hand production costs of natural gas wells and fields are stable and predictable enough to engender a level of certainty in forecasting costs,[56] the company then claims it is unable to provide any details for a model for reviewing potential properties, claiming it is not useful to even hypothesize any numbers until a property has been found.[57] They desire the Commission to make a determination finding the program prudent without even trying to estimate in any significant detail, costs, structures, or benefits to ratepayers.

The few details they do provide relate to review timeframes for potential properties, including an abbreviated formal proceeding before the Commission, plans to hire Hydrocarbon and Accounting Monitors, and frameworks for reports to be filed and reviewed. However, even these details the company orally offered to change at the hearing.

In response to our requests for more details and specifics, Black Hills assures us all our questions will be answered once we move to Phase II of the process. They next assure us that any decision we make in this Phase I proceeding has no binding effect on Nebraska and will cost Nebraska ratepayers nothing. We however, remain unconvinced. Black Hills must operate with at least a presumption that any state that approves Phase I will approve Phase II, or it would be unable to find an appropriately sized property to meet the needs of the participating states. If a state that approves Phase I is under no obligation to participate in Phase II when an actual property to acquire is brought forward, we see no benefit to this Phase I proceeding. Black Hills would just as well bring us a specific property with the associated costs and potential benefits and forego this Phase I proceeding entirely.[58]

Conclusion

While we find the overall concept contained in the Program worthy of consideration, this proposal as presented to us is simply insufficient to allow us to be confident the benefits of obligating Nebraska ratepayers to such a program outweigh the potential downsides. The speculative, long-term nature of this

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[56] Hearing Exhibit 107, Pre-Filed Direct Testimony of John Benton, p. 9.

[57] Hearing Exhibit 118, Pre-Filed Rebuttal Testimony of T. Aaron Carr, pp. 2-4.

[58] As an additional matter, Black Hills has not addressed what would occur if Nebraska approved or liked a certain portion of any phase II proposal, but other participating state commission(s) did not. How would they resolve any inconsistency of viewpoints or opinions by participating commissions?

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proposal, the significant risks shouldered by Nebraska ratepayers, the lack of meaningful Commission oversight of crucial aspects of the COSG Program, and the decidedly lack of detail upon which to base any decision, outweigh any potential benefits Nebraska might enjoy. Therefore, the Commission finds the proposal before us is not prudent and not in the best interests of ratepayers, and the application should be denied.

O R D E R

IT IS THEREFORE ORDERED by the Nebraska Public Service Commission that 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., be, and is hereby, denied.

ENTERED AND MADE EFFECTIVE at Lincoln, Nebraska, this 19th day of July, 2016.

NEBRASKA PUBLIC SERVICE COMMISSION

COMMISSIONERS CONCURRING:

Chairman

ATTEST:

Executive Director

//s//Frank E. Landis
//s//Tim Schram

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