

**BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS**

In the Matter of the Filing of Written)
Documents and Gas Purchase Reports by)
UtiliCorp United Inc., d/b/a Peoples Natural)
Gas Company and Kansas Public Service) Docket No. 02-UTCG-371-GPR
Company, as Prescribed by Commission Order)
Dated June 21, 2001 in Docket No. 106,850-)
U/75-GIMC-009-GIG.)

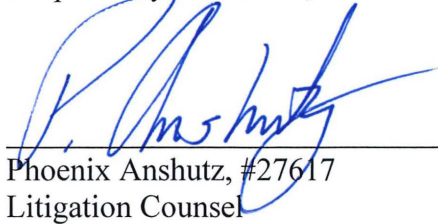
NOTICE OF FILING OF STAFF MEMORANDUM [PUBLIC VERSION]

This matter comes before the State Corporation Commission of the State of Kansas (Commission) for consideration and decision. Having reviewed the pleadings and record, the Commission makes the following findings and conclusions:

Pursuant to the Commission's June 21, 2001 Order issued in Docket No. 106,850-U/75-GIMC-009-GIG, Staff hereby files the attached Memorandum dated August 15, 2019, jointly prepared by Justin Prentiss, Senior Research Economics; Lana Ellis, Deputy Chief of Economics and Rates; Robert Glass, Chief of Economics and Rates; and Jeff McClanahan, Director of Utilities, informing the Commission of the June 10, 2019, and July 11, 2019, annual meeting of Black Hills, Staff and Citizens' Utility Ratepayer Board, scheduled for the purpose of discussing Black Hills 2019-2020 Gas Purchase Plan and Hedge Plan. Inasmuch as Staff's Memorandum contains confidential commercial information pertaining to Black Hills', Staff, in accordance with K.S.A. 66-1220a, has filed both confidential and public versions of its Memorandum.

WHEREFORE, Staff submits its Memorandum for the Commission's review and consideration.

Respectfully Submitted,

A handwritten signature in blue ink, appearing to read 'P. Anshutz', is written over a horizontal line.

Phoenix Anshutz, #27617

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Dwight D. Keen, Chair
Shari Feist Albrecht, Commissioner
Susan K. Duffy, Commissioner

Laura Kelly, Governor

**REPORT AND RECOMMENDATION
UTILITIES DIVISION
PUBLIC VERSION**

****Confidential Information Denoted by Asterisks****

TO: Dwight D. Keen, Chair
Shari Feist Albrecht, Commissioner
Susan K. Duffy, Commissioner

FROM: Justin Prentiss, Senior Research Economist
Lana Ellis, Deputy Chief of Economics and Rates
Robert Glass, Chief of Economics and Rates
Jeff McClanahan, Director of Utilities

DATE: August 15, 2019

SUBJECT: Docket No. 02-UTCG-371-GPR: *In the Matter of the Filing of Written Documents and Gas Purchase Reports by UtiliCorp United Inc., d/b/a People Natural Gas Company and Kansas Public Service Company, as Prescribed by Commission Order Dated June 21, 2001 in Docket No. 106,850-U/75GIMC-009-GIG.*

EXECUTIVE SUMMARY:

On June 10, 2019, and again on July 11, 2019, Staff met with Black Hills/Kansas Gas Utility Company, LLC, d/b/a Black Hills Energy (Black Hills or Company), and the Citizens' Utility Ratepayer Board (CURB) to discuss Black Hills' 2019-2020 Gas Purchase Plan and Hedge Plan. Based on its Gas Purchase Plan and the information provided during the meeting, Staff believes that the Company's gas purchasing practices are reasonable and that Black Hills is able to supply sufficient gas for the 2019-2020 heating season (November 2019 through March 2020). In addition, Staff believes Black Hills' proposed Hedge Plan is reasonable. Staff will continue to monitor Black Hills' hedge and gas purchasing practices and will inform the Commission of any significant changes. No Commission action is required at this time.

BACKGROUND:

On June 10, 2019, and again on July 11, 2019, Staff met with members of Black Hills and CURB to discuss Black Hills' 2019-2020 Gas Purchase Plan and Hedge Plan. This meeting is an annual requirement pursuant to the Commission's June 21, 2001 Order issued in Docket No. 106,850-U/75-GIMC-009-GIG and the Stipulation and Agreement approved in Docket No. 05-AQLG-616-HED.

75-GIMC-009-GIG Order: Paragraph 4 Requirements

Pursuant to the Order in Docket No. 75-GIMC-009-GIG, the Commission requires an annual meeting to review and discuss the utility's gas portfolio, contracts, and purchasing practices. The primary purpose of the meetings is to discuss the utility's plans for the future year. An evaluation of the previous year's activities and plans is to provide a basis for considering whether changes might be appropriate. The substance of these meetings should include a review of the next year's plans for gas purchases, transportation, storage, capacity release, and risk management. Black Hills must also file an annual report of its Gas Purchase Plan each year, which details its current situation, states its plans for the next 12 months, and evaluates the manner in which its plans for the prior year were followed or modified.

05-AQLG-616-HED S&A: Paragraph 5 Requirements

Per the terms of the 05-AQLG-616-HED S&A, Black Hills must meet with and consult with Staff and CURB prior to program implementation for the purpose of establishing a planned program design, which includes specifying certain parameters (quantity or volume of gas to hedge, months to be hedged, price cap level, hedge instruments to be used, and timing of hedge placement). While Black Hills has full discretion over selection of the final program parameters, Black Hills must describe its decision-making process and the budget for its Gas Hedge Program cannot exceed \$2.3 million annually. Black Hills must also submit a report on the cumulative, historical performance of its hedge program efforts at the end of each program year. In addition, Black Hills must meet with Staff and CURB to discuss any significant changes from the planned hedge program that may arise over the course of the implementation period.

ANALYSIS:

The Company filed its report on May 10, 2019. At the meetings, Black Hills presented its view of market dynamics, last year's Hedge and Purchase Plan performance, as well as this year's Hedge Plan and portfolio strategy as discussed below.

Market Dynamics

Current Market

The 2018-2019 winter was 11.6% colder than normal and, by the end of April, national storage levels were 14.7% lower than the five-year average.¹ As a result of the colder-than normal temperatures, prices increased, however, EIA expects strong growth in natural gas production to put downward pressure on prices in 2019 and in 2020.²

Short-Term Outlook

In part, the Energy Information Administration's (EIA) *Short-term Energy Outlook* reports on the performance of the natural gas industry and makes forecasts for the upcoming years.

¹ Black Hills Energy Gas Supply Plan 2019-2020 Presentation, June 10, 2019, and July 11, 2019 (2019 Presentations).

² Black Hills Annual 2019-2020 Gas Purchase Plan, p. 8.

EIA's consumption growth forecast for 2019 increased from 1.8% in March to 3.0% in April.³ This increase in projected consumption growth is largely driven by an increase in consumption by residential and commercial customers. Residential and commercial customer consumption went up because the temperatures in the first quarter of 2019 were lower than originally forecasted. These lower temperatures in turn generated a need for heat, which required natural gas heating customers to increase their use of natural gas beyond the original forecasted volumes.⁴

Not only were these temperatures lower than forecasted, but in March in particular, the temperatures were significantly lower than March's normal average temperatures. As with the entirety of the first quarter, March's natural gas consumption grew with the need for space heating to counter the colder temperatures.

These significantly colder March temperatures and the corresponding natural gas space heating to accommodate the significantly colder temperatures caused a Henry Hub natural gas spot price average of \$2.95/MMBtu in March. The average of \$2.95/MMBtu in March is an average of 26 cents/MMBtu increase from February average price per MMBtu.⁵ In addition, the natural gas consumption growth forecast for 2019 for the industrial sector and the electric power sector was also slightly raised.⁶

Even though there is an increase in the natural gas consumption growth forecast for 2019, there is an even bigger increase in projected production. 2019 natural gas production is forecast to increase by 7.6 billion cubic feet per day, from an average of 83.4 in 2018 to an average 91 billion cubic feet per day in 2019. And that growth is expected to continue increasing up to an average of 92.5 billion cubic feet per day in 2020.⁷

The production increase was expected to outweigh the increase in the consumption growth forecast for 2019 and drive the average price for all of 2019 down to an average of \$2.82/MMBtu in 2019 and then down further to \$2.77/MMBtu in 2020 to 2023.⁸

Long-Term Outlook

Natural gas production in EIA's Reference case grows 7% per year from 2018 to 2020, which is greater than the 4% per year average growth rate from 2005 to 2015.⁹ However, production slows to less than 1% per year for the remainder of the projection after 2020.¹⁰ Growing demand in domestic and export markets is expected to increase production costs as production expands into more-expensive-to-produce areas.¹¹

³ Black Hills Annual 2019-2020 Gas Purchase Plan, p. 9.

⁴ Black Hills Annual 2019-2020 Gas Purchase Plan, p. 9.

⁵ Black Hills Annual 2019-2020 Gas Purchase Plan, p. 8.

⁶ Black Hills Annual 2019-2020 Gas Purchase Plan, p. 9.

⁷ Black Hills Annual 2019-2020 Gas Purchase Plan, p. 8.

⁸ Black Hills Annual 2019-2020 Gas Purchase Plan, p. 8.

⁹ Black Hills Annual 2019-2020 Gas Purchase Plan, p. 10.

¹⁰ Black Hills Annual 2019-2020 Gas Purchase Plan, p. 10.

¹¹ Black Hills Annual 2019-2020 Gas Purchase Plan, p. 11.

2018-2019 Plan Performance

In Black Hills' 2018-2019 Gas Purchase Plan (Plan), the Company indicated it expected to cover its supply requirements by purchasing ** [REDACTED] ** at Index-prices without a financial hedge, ** [REDACTED] ** of purchases to be backed by Call Options, and ** [REDACTED] ** withdrawn from storage.¹² Black Hills stated that the Plan was executed according to the filed Plan and that it was able to cover storage requirements for the 2018-2019 heating season.¹³

In 2018-2019, Black Hills planned to hedge ** [REDACTED] ** Bcf, which was ** [REDACTED] ** of forecasted demand volumes, using call exclusively with a budget of ** [REDACTED] **. Actual volumes hedged were ** [REDACTED] ** Bcf¹⁵ with an average call cost of ** [REDACTED] ** per Dth (or ** [REDACTED] ** per Bcf) and a cost of ** [REDACTED] **. ¹⁶

2019-2020 Portfolio Strategy

Black Hills uses regression to forecast daily usage and the corresponding supply requirements. Black Hills expects a normal winter requirement of ** [REDACTED] **¹⁷ Bcf for the upcoming heating season and estimates that its total supply requirement for the year will be ** [REDACTED] ** Bcf.¹⁸ Because forecasts are based on normal weather requirements, actual usage could differ due to warmer or colder temperatures throughout the heating season.

The majority of gas Black Hills delivers to its customers is purchased from its suppliers,¹⁹ who deliver it into the interstate pipeline systems for transport by Black Hills to its city-gates. The second supply source is to withdraw gas from storage.²⁰ Black Hills has indicated that its strategy for the 2019-2020 winter will be similar to the previous year's Plan.²¹ The plan entails purchasing approximately ** [REDACTED] ** of normal requirements at Seasonal-Index prices without a financial hedge, ** [REDACTED] ** of normal requirements purchased will be backed by Call Options at a fixed strike price, and the remaining ** [REDACTED] ** of normal requirements will be withdrawn from storage.²²

¹² Black Hills Annual 2019-2020 Gas Purchase Plan, p. 17.

¹³ 2019 Presentations.

¹⁴ Black Hills Annual Purchase Plan 2018-2019 pp. 15.

¹⁵ Black Hills Annual 2019-2020 Gas Purchase Plan, Exhibit 12.

¹⁶ 2019 Presentations.

¹⁷ Black Hills projects system wide growth of ** [REDACTED] **. The projected growth factor is based on sales customer counts for February 2018 compared to February 2019 customer counts. Black Hills attributes the majority of the growth to normal load growth. Black Hills Annual 2019-2020 Gas Purchase Plan, Page 2. Normal winter requirement is from the Black Hills Annual 2019-2020 Gas Purchase Plan, Exhibit 13.

¹⁸ Black Hills estimates normal sales and storage requirements for the year beginning in May and ending in the following April. Black Hills Annual 2019-2020 Gas Purchase Plan, Exhibit 1.

¹⁹ Black Hills secures its natural gas requirements through Term Supply, Monthly Supply, and Daily Supply Purchases. Term Supply purchases are packages of gas that are in excess of a calendar month and obtained through a Request-For-Proposal (RFP) process. Term Supply purchases can either be Fixed or Index: Term-Fixed means that both the term and the price of the purchase are fixed for more than one month; Term-Index means that the term is fixed for more than one month, but the price will reflect the resulting index each month. Monthly Supply packages of gas are purchased in the spot market for a one-month term based on an index or a fixed price. Daily Supply packages of gas are purchased in the spot market on a day-to-day basis, which may be based on an index or a fixed price. 2019-2020 Gas Purchase Plan, p.18.

²⁰ Black Hills Annual 2019-2020 Gas Purchase Plan, p.18.

²¹ Black Hills Annual 2019-2020 Gas Purchase Plan, p.18.

²² Black Hills Annual 2019-2020 Gas Purchase Plan, p. 18.

Seasonal-Index Purchases

[REDACTED] of Black Hills' normal winter requirements will be purchased at Inside FERC Index prices as described in the "Natural Gas Purchasing Process" discussed above.²³ The total Seasonal-Index volumes are approximately **[REDACTED]** Bcf of winter requirements.²⁴

Call Options/Financial Hedging

[REDACTED] or **[REDACTED]** Bcf of Black Hills' normal winter requirements are backed by purchasing Call Options at a budgeted premium price up to **[REDACTED]**.²⁵ The same budget as the previous year of up to **[REDACTED]** million will be spent to purchase Call Options. Further, Black Hills will purchase all Options financially and the corresponding physical gas will be purchased at Inside FERC Indexes.²⁶

Storage Injections/Withdrawals

Typically, Black Hills injects natural gas into storage during the months of May through October with **[REDACTED]** to **[REDACTED]** of Maximum Storage Quantity (MSQ) injected each month.²⁷ Black Hills estimates that it will inject **[REDACTED]** or **[REDACTED]** Bcf of normal winter requirements during its injection season.²⁸ This will fill the storage to around **[REDACTED]** MSQ. From November through March, gas is withdrawn from storage to a final balance of around **[REDACTED]** MSQ. This **[REDACTED]** cushion is left at the beginning and end of the heating season to aid if temperatures are warmer or colder than normal.²⁹

RECOMMENDATION:

Staff believes that Black Hills is able to supply sufficient gas for the 2019-2020 heating season based on its Gas Purchase Plan and the information provided at the meetings held on June 10, 2019, and again on July, 11, 2019. Staff also believes Black Hills' proposed Hedge Plan is reasonable. Staff will continue to monitor Black Hills' hedge and gas purchasing practices and will inform the Commission of any significant changes. No Commission action is required at this time.

²³ Index terms are fixed for more than one month. This type of supply is locked in, eliminating the risk of not being available when needed, and the price is index-based which means it will be at or near market prices each month.

²⁴ Black Hills Annual 2019-2020 Gas Purchase Plan, Exhibit 13.

²⁵ Black Hills Annual 2019-2020 Gas Purchase Plan, p. 19, Exhibit 13.

²⁶ Black Hills Annual 2019-2020 Gas Purchase Plan, p. 18.

²⁷ Black Hills Annual 2019-2020 Gas Purchase Plan, p. 1.

²⁸ Black Hills Annual 2019-2020 Gas Purchase Plan, p. 19, Exhibit 13.

²⁹ Black Hills Annual 2019-2020 Gas Purchase Plan, p. 1.

CERTIFICATE OF SERVICE

02-UTCG-371-GPR

I, the undersigned, certify that a true and correct copy of the above and foregoing Notice of Filing of Staff Memorandum [Public Version] was electronically served this 15th day of August, 2019, to the following:

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