

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of)	Docket No. 09-035-15
Rocky Mountain Power for)	Surrebuttal Testimony
Approval of its Proposed Energy)	Lori Smith Schell
Cost Adjustment Mechanism)	For the Office of
)	Consumer Services

August 10, 2010

Surrebuttal Testimony on Issues Relating to Hedging and
Reliance on Market Energy in Connection with an ECAM

1 **Q. WHAT IS YOUR NAME, OCCUPATION AND BUSINESS ADDRESS?**

2 A. My name is Lori Smith Schell. I am the founder and President of
3 Empowered Energy, which has its business address at 174 North Elk Run,
4 Durango, Colorado, 81303.

5

6 **Q. HAVE YOU PREVIOUSLY TESTIFIED IN THIS DOCKET?**

7 A. Yes. I provided direct testimony in Phase I of this docket on November
8 16, 2009, that discussed the stated goals of PacifiCorp Energy's Risk
9 Management Policy and showed that, with respect to natural gas,
10 PacifiCorp Energy was generally in compliance with its then-current
11 volume-based hedge targets. I also provided direct testimony in Phase II,
12 Part 1 of this docket on June 16, 2010, that recommended that PacifiCorp
13 Energy reduce its Year 1 maximum natural gas hedge target to no more
14 than 85 percent of PacifiCorp's "Total MWh Requirements" to account for
15 system balancing requirements.

16

17 **Q. HAVE YOU PREPARED ANY NEW EXHIBITS IN SUPPORT OF YOUR**
18 **TESTIMONY?**

19 A. Yes, I have prepared Exhibit OCS-2.1SR that compares PacifiCorp's total
20 system balancing purchases and sales volumes, based on the summary
21 Net Power Cost ("NPC") data that was previously provided in Exhibit OCS-
22 2.2.

23

24 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

25 A. The purpose of my testimony is to respond to several points made in the
26 July 20, 2010, Rebuttal Testimony of Gregory N. Duvall filed in this docket.
27 I will clarify my comments with respect to the reduced transparency
28 associated with PacifiCorp Energy's recently implemented To-Expiry
29 Value-at-Risk ("TEVaR") metric as compared to its former volume-based
30 hedge targets. I will expand upon my recommendation to reduce the level
31 of PacifiCorp Energy's volume-based hedge targets and examine the
32 potential impact on natural gas costs of that recommendation. I will also
33 explain why that recommendation is not inconsistent with the testimony
34 filed by Office of Consumer Services ("OCS") witness Mr. Dan Gimble that
35 expresses OCS' ongoing concerns that PacifiCorp's resource
36 procurement is overly reliant on market purchases.

37

38 **Q. DO YOU AGREE WITH MR. DUVALL'S CLAIM THAT THE TEVaR**
39 **METRIC IS ACTUALLY MORE TRANSPARENT THAN THE FORMER**
40 **VOLUME-BASED HEDGE TARGETS?**

41 A. I believe our disagreement is one of semantics rather than content. My
42 previous testimony at lines 213-231 acknowledged several benefits of the
43 TEVaR metric, primary among them that "it is driven by the potential rate
44 impact on ratepayers." I do not disagree that the TEVaR metric is more
45 *informative* than the former volume-based hedge targets. However, the
46 inputs and calculations required to determine the value of the TEVaR

47 metric are much more complex than the relatively simple volume-based
48 data and calculations required to determine the level of volume-based
49 hedge targets. In that sense, I maintain that the TEVaR metric is less
50 transparent in its derivation than were the former volume-based hedge
51 targets.

52

53 **Q. WHAT WAS THE BASIS OF YOUR RECOMMENDATION TO REDUCE**
54 **THE LEVEL OF PACIFICORP ENERGY'S VOLUME-BASED HEDGE**
55 **TARGETS, WITH WHICH THE TEVaR HEDGE TARGETS ALLEGEDLY**
56 **WERE DESIGNED TO PROVIDE "REASONABLE CONTINUITY"?**

57 A. My recommendation to reduce the level of PacifiCorp Energy's volume-
58 based hedge targets was based on my analysis that short-term system
59 balancing requirements have averaged approximately 15 percent of
60 PacifiCorp's "Total MWh Requirements," based on the past six NPC filings
61 made by the Company. System balancing requirements occur within each
62 delivery month as a result of intra-month changes in the Company's
63 natural gas and electricity requirements due to the dynamic and inter-
64 related nature of variables including natural gas prices, power prices,
65 generation unit availability, and customer load. The Company's own
66 witnesses acknowledge that system balancing requirements cannot be
67 hedged effectively.¹

¹ Rebuttal Testimony of Mr. Gregory N. Duvall, July 20, 2010, at Lines 91-93. Rebuttal Testimony of Mr. Gregory N. Duvall, December 2009, at Lines 269-286, Lines 342-344. Rebuttal Testimony of Dr. Karl McDermott, December 2009, at Lines 191-192. Rebuttal

68

69 **Q. ARE THERE TRANSACTION COSTS ASSOCIATED WITH HEDGING?**70 A. Yes. As discussed by OCS witness Mr. Paul Wielgus, there are
71 transaction-related costs associated with hedging.

72

73 **Q. DO TRANSACTION-RELATED HEDGING COSTS DIFFER FROM**
74 **HEDGING-RELATED MARKET GAINS OR LOSSES?**75 A. Yes. Transaction-related hedge costs can be incurred at the time of and
76 as a result of a hedge being executed. After a hedge is settled, there can
77 be a market loss or gain because the initial locked-in hedge price can
78 differ from the market price at the time of settlement. It is important to
79 maintain a clear distinction between transaction-related hedging costs and
80 after-the-fact potential market losses or gains.

81

82 **Q. HOW ARE THE COMPANY'S SYSTEM BALANCING REQUIREMENTS**
83 **RELATED TO TRANSACTION-RELATED HEDGING COSTS?**84 A. Exhibit OCS-2.1SR compares PacifiCorp's total system balancing sales to
85 its system balancing purchases, as provided in the past six NPC studies
86 filed by the Company.² System balancing sales are typically larger than
87 system balancing purchases. If PacifiCorp Energy is fully hedged going
88 into a delivery month and must make intra-month system balancing sales,

Testimony of Dr. Frank C. Graves, December 2009, Lines 63-69, Lines 88-92, Lines 149-173, Lines 528-530, Lines 640-642.

² All of the numbers in Exhibit OCS-2.1SR can be found in Exhibit OCS-2.2 Schell, which was previously filed in this docket.

89 those system balancing sales volumes will require the underlying hedges
90 to be reversed, in effect incurring additional transaction-related hedging
91 costs. These transaction-related hedging costs could be avoided by
92 reducing the hedge targets to reflect the fact that system balancing
93 requirements are inevitable and, in PacifiCorp's case, have tended to be
94 dominated by sales rather than by purchases. Industry norm would be to
95 minimize hedging volumes that are as uncertain as those associated with
96 PacifiCorp's system balancing requirements.

97

98 **Q. WHAT WOULD THE IMPACT ON RATEPAYERS BE IF PACIFICORP**
99 **ENERGY WERE TO HEDGE LESS THAN 100% OF PACIFICORP'S**
100 **"TOTAL MWH REQUIREMENTS"?**

101 A. As explained in my Direct Testimony of June 16, 2010, PacifiCorp's rate
102 volatility could be expected to increase. The impact of PacifiCorp Energy
103 hedging less than 100 percent of PacifiCorp's "Total MWh Requirements"
104 would be lower costs on the open positions (i.e., on the unhedged
105 volumes) in a declining price environment, and higher costs in a rising
106 price environment.

107

108 **Q. IS YOUR RECOMMENDATION TO REDUCE THE LEVEL OF**
109 **PACIFICORP ENERGY'S VOLUME-BASED HEDGE TARGETS**
110 **INCONSISTENT WITH MR. GIMBLE'S TESTIMONY REGARDING OCS'**

111 **CONCERNS THAT PACIFICORP IS OVERLY RELIANT ON MARKET**
112 **PURCHASES?**

113 A. No. My recommendation to reduce the Company's volume-based hedge
114 targets addresses short-term, unavoidable intra-month system balancing
115 issues. Mr. Gimble's concerns address the Company's longer-term
116 procurement practices and resultant generation resource mix. Regardless
117 of the long-term resource mix of the Company, there will always be short-
118 term, intra-month system balancing purchases and sales requirements
119 that should be considered in conjunction with the Company's hedging
120 activities.

121

122 **Q. DO YOU HAVE ANY CORRECTIONS RELATED TO YOUR PREVIOUS**
123 **TESTIMONY?**

124 A. Yes. In my previous testimony, I have referred to PacifiCorp Energy's
125 volume-based hedged targets as being contained in its Risk Management
126 Policy. The volume-based hedge targets are actually found in PacifiCorp
127 Energy's "Commercial and Trading Front Office Procedures and
128 Practices," which are subject to compliance with the PacifiCorp Energy
129 Risk Management Policy.

130

131 **Q. WHAT DO YOU CONCLUDE?**

132 A. I reiterate my previous conclusions that the Company's former volume-
133 based hedge targets should have been reduced to reflect historical system

134 balancing requirement levels and that the acceptable range of TEVaR
135 values should be re-examined for the three reasons stated in my previous
136 testimony.

137

138 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

139 **A. Yes.**

**PACIFICORP NET POWER COST (“NPC”) STUDIES OVER TIME:
TOTAL SYSTEM BALANCING SALES AND PURCHASES³**

Docket No.	09-035-23	08-035-38	07-035-93	06-035-21	04-035-42	03-2035-02
NPC Study Time Period	7/09-6/10	1/09-12/09	1/08-12/08	10/06-9/07	4/05-3/06	1/03-12/03
Total System Balancing Sales (MWh)	8,191,332	7,089,132	6,593,286	6,782,735	5,904,652	4,696,267
Total System Balancing Purchases (MWh)	2,340,902	3,392,108	7,191,171	5,810,125	3,152,921	1,604,784

³ Most recent data provided in Exhibit ____ (GND-1) in Docket No. 09-035-23. Other data provided in response to Division of Public Utilities Data Request 4.3.