Witness OCS – 5.SR
Revenue Requirement

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of	**)**	
Rocky Mountain Power for	**)**	**Docket No. 10-035-124**
Authority to Increase Its Retail	**)**	**Surrebuttal Testimony**
Electric Utility Service Rates in Utah	**)**	**Lori Smith Schell**
And for Approval of Its Proposed	**)**	**For the Office of**
Electric Service Schedules and	**)**	**Consumer Services**
Electric Service Regulations	**)**	

July 19, 2011

Surrebuttal Testimony on Issues Relating to Hedging
In Connection with Rocky Mountain Power's General Rate Case

REDACTED

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

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

Q. HAVE YOU PREVIOUSLY TESTIFIED IN THIS DOCKET?

A. Yes. I provided direct testimony in this docket on May 26, 2011 and rebuttal testimony on June 30, 2011.

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

A. Yes, I have prepared Exhibit OCS-5.1SR Schell that illustrates the impact of hedging on net power cost volatility under varying market conditions.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of my surrebuttal testimony is to respond the rebuttal testimony of the Company's witnesses Mr. John A. Apperson, Mr. Stefan A. Bird, Mr. Gregory N. Duvall, and Mr. Frank C. Graves.

Q. PLEASE COMMENT ON THE TESTIMONY OF THE COMPANY'S WITNESSES THAT YOUR HEDGING RECOMMENDATION IS FOR THE COMPANY TO REPLACE SWAPS WITH OPTIONS.

A. My direct testimony clearly states at lines 295-297 that "[t]he options pricing results presented in Exhibit OCS-5.3 are intended to illustrate the potential costs to ratepayers of PacifiCorp's hedging practices." By converting the Company's Test Period natural gas and swap volumes into an equivalent number of options, I was able to make clear the potential costs of the Company's hedging program at a variety of at-the-money option premiums.

Q. HOW DO YOU INTERPRET MR. APPERSON'S TESTIMONY THAT THE ACTUAL COST OF OPTIONS PREMIUMS IN 2008 WOULD HAVE BEEN HIGHER THAN YOUR ASSUMED OPTIONS PREMIUMS?

A. This indicates to me that my assumptions were too conservative, and that the potential cost of the Company's hedging program may be even higher than I estimated in my direct testimony.

Q. CAN YOU COMMENT ON MR. APPERSON'S REBUTTAL TESTIMONY AT LINES 391-392 WHERE HE STATES THAT THE COMPANY HAS AVOIDED TRANSACTING ON THE NYMEX?

A. The Company's Confidential Filing Requirement R746-700-23-C.8 shows that [redacted] of the Company's [redacted] of natural gas swaps are actually tied directly to the Henry Hub, the NYMEX pricing point. The

Company also has [redacted] of related basis swaps, [redacted] of which are tied to the NYMEX at the Henry Hub (southern Louisiana). The use of basis swaps tied to the Henry Hub allows the Company to enter into swaps at less liquid regional market hubs such as Opal (southwestern Wyoming), AECO (southern Alberta), and Sumas (border between Washington and British Columbia) and to hedge the transportation differential between these regional market hubs and the more liquid Henry Hub. The fact that [redacted] of the Company's basis swaps are tied to the Henry Hub may indicate some understatement in Mr. Graves' assertion at lines 428-431 of his rebuttal testimony that "natural gas is a ***somewhat correlated*** product around the nation." (Emphasis added.)

Q. DID YOU PREVIOUSLY TESTIFY THAT THE COMPANY'S HEDGING POLICY REDUCES VOLATILITY?

A. The Company's hedging policy reduces the EXPOSURE to commodity price volatility, but whether the end result is a reduction in the volatility of net power costs will depend on the interaction of market conditions and net hedging gains or losses.

Q. CAN YOU DEMONSTRATE HOW THE VOLATILITY OF NET POWER COSTS IS AFFECTED BY MARKET CONDITIONS AND HEDGING GAINS OR LOSSES?

A. Exhibit OCS-5.1SR illustrates the potential impact of hedging on net power costs for three different market conditions (i.e., rising, flat, and falling commodity prices) over two time periods. The first time period is assumed to have hedging gains and the second time period is assumed to have hedging losses of equal magnitude. The top illustration for each market condition shows the unhedged price direction and the direction in which the hedging gains or losses will move the net power costs in each period. The bottom illustration for each market condition compares the unhedged price direction with the resultant hedged price direction.

Q. WHAT DO YOU CONCLUDE FROM THE ILLUSTRATIVE EXAMPLES SHOWN IN EXHIBIT OCS-5.1SR?

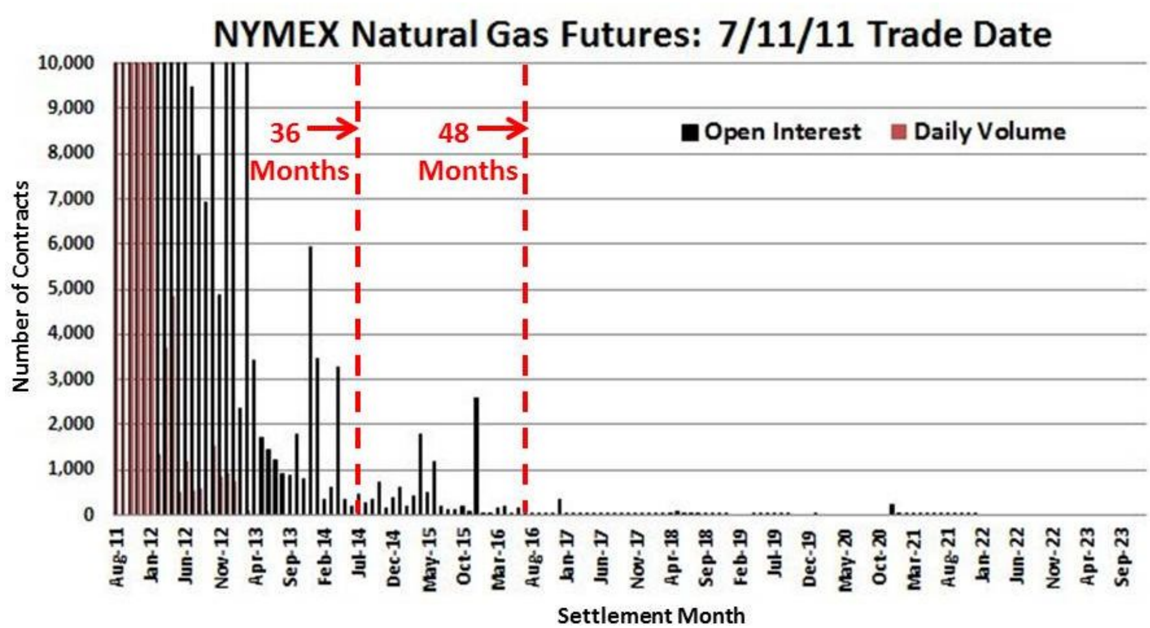
A. Under circumstances that approximate the conditions leading up to the Company's 2011 general rate case (Test Period net hedging losses following a period of net hedging gains), hedging against exposure to commodity price volatility actually results in increased net power cost volatility for two out of three market price conditions.

Q. IS THERE A DIFFERENCE BETWEEN REDUCING NET POWER COST VOLATILITY AND REDUCING EXPOSURE TO COMMODITY PRICE VOLATILITY?

A. Yes. As shown above, reducing exposure to commodity price volatility may or may not reduce the volatility of net power cost. Mr. Bird testifies at lines 322-324 of his rebuttal testimony that one of the goals of the Company's risk management program is to "reduce net power cost volatility." Mr. Duvall testifies at lines 2775-2777 of his rebuttal testimony that "I demonstrated [in the ECAM docket] that the Company's hedging program reduces NPC volatility caused by changes in market prices and protects against high NPC outcomes." Mr. Duvall's testimony appears to imply that reducing "changes in market prices" (*i.e.*, commodity price volatility) necessarily reduces net power cost volatility. Exhibit OCS-5.1 SR demonstrates that this is not necessarily the case.

Q. PLEASE COMMENT ON MR. GRAVES' TESTIMONY THAT NATURAL GAS CONTRACTS ARE AVAILABLE WELL BEYOND THE COMPANY'S HEDGING HORIZON.

A. Mr. Graves at lines 287-289 of his rebuttal testimony claims that "natural gas contracts available at Henry Hub and elsewhere are now available for well beyond a four year horizon into the future. This shows that both buyers and sellers do value longer term price certainty." While it is true that NYMEX natural gas futures contract prices are now quoted 12 years into the future, there are very few contracts traded beyond the first 36 months to support Mr. Graves' assertion of how buyers and sellers "value longer term price certainty." The lack of liquidity for NYMEX natural gas futures beyond 36 months is demonstrated in the graph below for the 7/11/2011 trade date. This graph includes all quoted settlement months and is similar to the graph presented in my direct testimony, except that I have limited the maximum value of the vertical axis to 10,000 contracts in an attempt to show greater detail for settlement months beyond 48 months out.



Q. WHAT CONCLUSIONS DO YOU DRAW FROM MR. APPERSON'S CONFIDENTIAL FIGURE 2, WHICH SHOWS THE NUMBER OF

Redacted

CREDITWORTHY COUNTERPARTIES WILLING TO ENTER INTO NATURAL GAS HEDGES FOR DIFFERENT TIME PERIODS?

A. Mr. Apperson's Confidential Figure 2 clearly supports my argument that there is little market liquidity more than 36 months out given that (i) [redacted] of the Company's creditworthy trading partners are unwilling to transact [redacted] and (ii) [redacted] can only transact [redacted] with specific management approval. This means that [redacted] of the Company's creditworthy trading partners are unwilling on a routine basis to transact beyond 36 months out.

Q. DO YOU AGREE WITH MR. APPERSON'S CLAIM THAT BID-ASK SPREADS ARE A MORE DIRECT MEASURE OF LIQUIDITY?

A. Bid-ask spreads are a direct measure of liquidity, but only one among the several measures discussed above. However, Mr. Apperson's statement at lines 189-194 that "[t]he Company does not record nor has access to comprehensive bid ask spread data" does not provide the Commission a reliable source of bid-ask spread information on which to make a judgment. Although Mr. Apperson indicates that the Company "has paid as little as $0 per MMBtu in bid ask spread" in Year 1, it is likely that this is an exceptional case, since consistent zero bid-ask spreads would quickly drive profit-seeking businesses out of the commodity trading business.

Q. PLEASE COMMENT ON MR. APPERSON'S DISCUSSION OF HOW THE COMPANY'S CUSTOMERS HAVE BENEFITTED FROM THE HERMISTON PLANT'S LONG-TERM NATURAL GAS SUPPLY AGREEMENT.

A. Per the response to OCS Data Request 36.1, the 15-year natural gas supply agreement cited by Mr. Apperson is actually a collection of four separate long-term gas agreements that were entered into in 1993 and 1994, long before the Company's risk management program was put into place. Indeed, entering into a 15-year hedge would have been a violation of the Company's risk management program.

Q. WHAT DO YOU CONCLUDE?

A. I conclude that market liquidity does not support a hedging horizon beyond 36 months and that none of the evidence provided by the Company has demonstrated otherwise. I also conclude that there may be some confusion about whether the goal of the Company's hedging program is to reduce exposure to commodity price volatility or to reduce net power cost volatility. As demonstrated in my surrebuttal testimony, market conditions may preclude accomplishing both goals simultaneously.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

ILLUSTRATIVE IMPACT OF HEDGING ON NET POWER COST VOLATILITY

Redacted