PUBLIC

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Request of Rocky Mountain Power for Authority to Increase its Retail Electric Utility Service Rates in Utah and for approval of Its Proposed Electric Service Schedules and Electric Service Regulations	**DOCKET NO. 09-035-23** **Exhibit No. DPU 12.0** **Testimony** **Douglas D. Wheelwright**

FOR THE DIVISION OF PUBLIC UTILITIES
DEPARTMENT OF COMMERCE
STATE OF UTAH

Testimony of

Douglas D. Wheelwright

October 8, 2009

Q: Please state your name, business address and title.

A: My name is Douglas D. Wheelwright. I am a Utility Analyst in the Division of Public Utilities (Division). My business address is 160 East 300 South, Salt Lake City, Utah 84114.

Q: On whose behalf are you testifying?

A: The Division of Public Utilities.

Q: Please describe your position and duties with the Division.

A: I review public utility documents and financial data and conduct other research to support Division policy positions.

Q: What is the purpose of your testimony?

A: My purpose is to present part of the Division's position on the hedging policies and practices currently in place at PacifiCorp (Company).

Q: Why is this issue included in the general rate case?

A: Natural gas fired power plants represent 22% of the Company's total owned generating capacity and represented 12% of the energy supplied in 2008. As part of this application, the Company has included an expense of $174.2 million[1] in the net power costs for natural gas swaps relating to the Company's purchases in the hedging program. The Company has also included revenue of $187.8 million[2] from electric swaps for a net reduction of $13.6 million in net power costs. While the primary focus of this analysis is dealing with natural gas hedging, the net result of the natural gas and the electric hedging program should be reviewed. The Company provided information in the May 18, 2009 technical conference indicating a strong correlation between the power and the natural gas hedges. Concerns with hedging were raised in the previous general rate case, Docket No. 08-035-38, by the Division and by other intervening parties. On April 9, 2009, the Utah Public Service Commission (Commission) opened Docket No. 09-035-21 to further study the natural gas price risk

[1] Exhibit RMP ___(GND-1), page 5 – line labeled Gas Swaps.
[2] Exhibit RMP ___(GND-1), page 4 – line labeled STF Electric Swaps.

Commission should explore these possibilities in pursuit of a more balanced hedging strategy.

Q: What is the Division's second concern?

A: A key part of the Company's hedging strategy is the balancing of gas swaps with electric swaps, as I described above. However, this strategy assumes two things: 1) That gas and electricity prices will always move in close tandem, and 2) That gas and electric swaps must be conceptualized together.

Q: Why is this first assumption a problem?

A: While gas and electricity prices are often correlated, there are times when their prices diverge or the price of one commodity moves proportionally more than the other. The 2001 western states electricity crisis, for example, was one such time. So too was the aftermath of Hurricanes Katrina and Rita. Thus, even though in more "normal" times, one might expect swaps wins when electricity prices are falling to offset swaps losses from similarly falling natural gas prices, there are times when these will not offset and the net effect will be higher customer costs, so long as simple swaps such as the Company has employed are used.

Q: Why is conceptualizing gas and electric swaps together a problem?

A: The Division feels that the Company and Commission should explore whether the Company should structure its overall swaps policy not as an electricity / natural gas tandem, but rather as two separate strategies – protection for the Company (and ratepayers) as a natural gas consumer and a separate strategy to protect the Company as an electricity seller. For example, contracts can be structured such that the up-side risk of gas is capped, while at the same time the upside price of electricity has no ceiling. Thus, if both commodities' prices rise in tandem, the Company's cost for gas is capped, but its increased revenues from electricity would not be limited. Similar protections can be achieved through other contract structured with options and bands. This permits both ratepayer protection against rising gas costs or falling electricity market prices, and the opportunity for ratepayers to benefit from

falling gas costs and rising electricity market prices. As it is now, ratepayers have all of the former but none of the latter.

Q: What is the Division's third concern?

A: Our third concern is simply that fact that the current swapping strategy that the Company has employed has been conducted without the scrutiny or approval of regulators. The current policy, in essence, provides the Company with full protection against price risks, so long as most or all of its hedges for a given time period are completed before the filing of a rate case. That is, so long as the Commission approves – either explicitly or tacitly – the recovery of swapping costs, the Company has no price risk so long as rates remain in effect during the life of those swaps contracts. This elimination of risk to the Company, and the rate stability that goes with it, may well be something that the Commission would see as beneficial, but in recent rate cases, the issue has not been explored. We are concerned that this aspect of Company operation, involving as it does, hundreds of millions of dollars every year, receive careful and periodic review. This will help to ensure that the policy preferences of the Commission with regard to the tradeoff between price volatility risk and least-cost pricing be addressed and clear guidance be given to the Company on how to proceed.

Q: How does the Company use different types of instruments to manage different types of risk?

A: The Company uses financial hedges to manage the price volatility and physical hedges to manage the volumes. PacifiCorp manages its natural gas supply requirements by entering into forward commitments for physical delivery of natural gas.

PacifiCorp manages its exposure to increases in natural gas supply costs through forward commitments for the purchase of forecasted physical natural gas requirements at fixed prices and financial swap contracts that settle in cash based on the difference between a fixed price that PacifiCorp pays and a floating market-based price that PacifiCorp receives. PacifiCorp reported hedging percentages in its 10-K reports as of December 31, 2008, had economically hedged 64% of its forecasted physical exposure and 94% of its forecasted financial exposure