Introduction

Q. Please state your name, business address, and present position with PacifiCorp dba Rocky Mountain Power (the "Company").

A. My name is John A. Apperson. My business address is 825 NE Multnomah Street, Suite 600, Portland, Oregon 97232. I am Director of Trading, Commercial and Trading, for PacifiCorp Energy, a division of PacifiCorp.

Q. Have you previously filed testimony in this docket?

A. No.

Q. What is the purpose of your response testimony?

A. My testimony responds to the recommendations on trading activity of Utah Division of Public Utilities ("DPU") witness Mr. Richard S. Hahn, including his audit report, attached as DPU Exhibit 2.3 to his testimony (individually referred to herein as, "La Capra Report") and DPU witness Mr. Matthew Croft and the DPU audit report, attached to his testimony as DPU Exhibit 1.2 (individually referred to herein as, "DPU Report", and together with the La Capra Report, as "DPU Reports"), filed July 29, 2014. Most importantly, my testimony demonstrates that none of the transactions challenged in the DPU Reports violated Company policy and all transactions were prudent.

Q. What will your response testimony demonstrate regarding the challenged transactions in this docket?

A. My response testimony:

- Demonstrates that transactions that the DPU has suggested were "split" were done independently for reasonable purposes and in customers' best interests, and that there was no motive for the trader to "split the transactions" to "get around" trader restrictions.

- Demonstrates that the Commercial and Trading department was undertaking its normal job functions when it executed transactions the DPU characterizes as "discretionary" and that these transactions were in compliance with Company policies and have adequate documentation to indicate their purpose.
- Demonstrates the Company complied with its policies and individual governance rules which authorized traders to transact within individual notional contract value limits up to 84 months effective transaction period ("ETP"), rather than 48 months ETP as assumed by DPU.
- Responds to the DPU Reports recommendations for transaction documentation, competitive bids, risk policy current standards and guidelines and supporting documentation and data request process.

<u>General Response</u>

Q. Before addressing the specific transactions the DPU has recommended to be disallowed, do you have a general response to the DPU Reports?

A. Yes. The DPU Reports demonstrate that the DPU and La Capra seem to be unduly influenced by whether hedges settled out-of-the money. Since hedging is done to reduce the risk of price volatility and not to attempt to beat the market, the proper measure of prudence is whether the transactions comply with the Company's policies that were in effect at the time the transactions were executed. My testimony will demonstrate that they did. In addition, the issue raised by the DPU Reports regarding trades that allegedly exceed ETP limits is the same issue raised in the prior Energy Balancing Account ("EBA") reviews, which the Company believes had been resolved in prior settlements.

Perhaps more significantly, there is a suggestion in the DPU Reports that the Company is withholding information. The Company understands that this is a result of difficulties in responding to just a few of numerous data requests. The vast majority of the discovery responses, in which the Company provided over 2300 documents, were satisfactory to the DPU. In those few instances, the Company believed the requests were ambiguous or unduly broad, and this resulted in responses the DPU deemed to be unsatisfactory, "untimely" or both. Following extensive discussions with the DPU on these particular requests, the Company has been able to identify and provide relevant information to the DPU. The Company will continue to make every effort to provide the DPU with the requested information and trusts the clarifying discussions in this docket have addressed this challenge going forward.

With regard to documentation of future transactions in subsequent EBA filings, the Company is always willing to provide more information where it is reasonably available for transactions if doing so does not unreasonably interfere with traders' basic job function, making transactions that reduce risk of price volatility for the Company and its customers and balance the Company's needs and resources. Therefore, with regard to the DPU's recommendations for additional documentation of transactions the Company agrees with most of the DPU's recommendations, but notes that it is already complying with them as Company policies and practices have evolved since the hedging collaborative process.

<u>**Claimed "Split" Transactions**</u>

Q. Do you agree with La Capra's recommendation to disallow Utah allocated $281,832 due to the hedge losses associated with transaction nos. 1128158 and 1128159 Mr. Hahn states were split to avoid governance approvals?

A. No. The first hedge was executed prior to the time important market fundamental information was made available to the market, and the second hedge was executed after the information was made available. The evidence demonstrates that the trader engaged in two independent trades. No evidence suggests that the trader split what would have otherwise been one trade to avoid governance approvals.

Q. Is it unusual that the two transactions were for the same volume at the same location and with the same counterparty?

A. No. The volume for each was 10,000 MMBtu per day, which is a standard lot size most commonly traded in the market. The location for each was Northwest Pipeline - Rockies, which is the location used to hedge much of the Company's open natural gas position. The counterparty was one of the relatively few the Company is authorized to transact.

Q. When were the two transactions executed?

A. The first transaction was at 07:29:23 Prevailing Pacific Time ("PPT") and the second was at 07:45:19 PPT, both on November 29, 2012, a Thursday.

Q. What were the transaction prices?

A. The first transaction was at $3.73 per MMBtu, the second at $3.65 per MMBtu, a difference of $0.08 per MMBtu. An $0.08 per MMBtu difference in price in such a short time was a substantial price movement. The fact that the hedges were executed at different prices indicates that the decision to execute the second hedge was made independently of the decision to execute the first hedge. Indeed, the reason for transacting the second deal was that the price was lower which results in lower net power costs for our customers.

Q. What was the important market information that was provided between the transactions and when was it provided?

A. Each week, on Thursday at or just after 07:30 PPT, the U.S. Energy Information Agency ("EIA") publishes the amount of natural gas storage injections or withdrawals that occurred during the previous week. In addition, there are several industry publications that forecast this value that will be published by the EIA. The market reacts to differences between the forecasts and the EIA published value. The day of these transactions in question, the market's reaction to the EIA value was bearish, resulting in a sudden drop in natural gas prices.

Q. Was there any review and approval of these transactions?

A. Yes. I reviewed and approved these transactions as part of the Company's Sarbanes-Oxley control procedures. This review and my approval is shown on the document attached as Confidential Exhibit RMP___(JAA-1AR). The first page of Confidential Exhibit RMP___(JAA-1AR) is the email sent by me to an archive location. My approval is indicated by the word "approval" typed by me in the

Subject line. The second page of Confidential Exhibit RMP___(JAA-1AR) is an excerpt of the attached spreadsheet showing a summary of all energy transactions approved that day. The full spreadsheet is available electronically in my confidential workpapers.

Q. Was there evidence that the trader attempted to split the transactions to avoid governance?

A. No.

Q. Was there motive for the trader to avoid governance?

A. No. There is no opportunity for personal gain and there is ample evidence supplied to the DPU of my approvals of transactions exceeding traders' limits so the trader would have no reason to believe he would not obtain approval of a larger transaction for the justification noted.

Q. Was there motive for the trader to *not* avoid governance?

A. Yes. The Corporate Governance and Approvals Process policy specifies processes to be observed in obtaining approvals for significant Company expenditures and matters. The policy notes that a key principle of the corporate governance and approvals process is that "matters will not be broken down for piecemeal approvals." Traders violating Company policy are subject to disciplinary action up to and including termination.

Hedges Transacted When the Open Position Is Not Exceeded

Q. Do you agree the Utah allocated $3,497,522 hedge losses associated with the transactions the DPU labels as "discretionary trades" should be disallowed, as recommended by the DPU?

A. No. None of the transactions, regardless of the DPU's "discretionary trade" label, should be disallowed. These are all transactions authorized by Company policy and there is no basis for the disallowance. The DPU's recommendation is based on whether the Company guessed correctly on prices going up or down, which is not the appropriate basis for disallowance. The DPU's recommendation is not based on whether the Company followed its hedge policies, which the Company did follow.

Q. What is the definition of "discretionary trades" as used in the DPU Reports?

A. The DPU Report refers to "…'discretionary trades' for which the Company provided no specific reason or purpose for executing the trade."[1] The La Capra Report states, "There were several 'discretionary trades' in our sample for which the Company provided no specific reason or purpose for executing the trade. We define 'discretionary trades' as trades that are not required to correct an excursion of a binding policy limit."[2]

Q. Does this or any definition of "discretionary trades" appear in the Company's Risk Management Policy?

A. No. The 2009 Risk Management Policy and 2010 Risk Management Policy contain no definition of "discretionary trades."

[1] Direct Testimony of Matthew Croft for the Division of Public Utilities, Docket No. 14-035-31, ll. 92-93 (July 29, 2014).

[2] Energy Balancing Account Audit for Rocky Mountain Power for Calendar Year 2013, La Capra Associates, Inc., Docket No. 14-035-31, P. 3 (July 29, 2014).

Q. Does this or any definition of "discretionary trades" appear in the Company's Front Office Procedures and Practices?

A. No. The July 30, 2008, Front Office Procedures and Practices contain no definition of "discretionary trades."

Q. Does this or any definition of "discretionary trades" appear in the Company's Governance and Approvals Process policy?

A. No. The PacifiCorp Governance and Approvals Process policy contains no definition of "discretionary trades."

Q. Do you agree these transactions should be labeled "discretionary trades"?

A. No. The term is misleading in that the reader may be led to believe these are transactions for the purpose of speculative trading, which they are not. Speculative trading is transacting purely to make a profit, while taking on the risk of incurring a loss. None of these transactions were done for the purpose of speculative trading.

Q. How does the Company refer to these transactions?

A. In general, the Company records these transactions in the Endur trade capture system as "non-trading" transactions and refers to these as "hedges." The Company does not make or record the distinction between hedges transacted when the open energy position is exceeding risk limits versus hedges transacted when the open energy position is not exceeding risk limits.

Q. What was the nature and purpose of these hedges transacted when the open energy position has not exceeded a risk limit?

A. All 11 of the hedges transacted when the open position has not exceeded a risk limit were compliant with the Company's policy for hedging. These were all risk-reducing, not speculative trading. That is, these transactions were executed to reduce the Company's fixed-price exposure to future unfavorable wholesale prices. They were executed to maintain open energy positions within the Company's risk limits. The first nine transactions were completed under the former limits structure which provided maximum long and short fixed-price position limits, whereas the last two transactions were completed under the current limits structure which provides minimum and maximum natural gas percent hedge limits. Table 1 below lists the first nine transactions, the governing risk policy limit(s), and the before and after percentage of the applicable limit. The reduction in the *percentage of the hedge limit*, which is calculated as the open energy position divided by the hedge limit, demonstrates the risk-reducing nature of each transaction and that each transaction is within hedge limits. Table 2 below lists the last two transactions, the governing natural gas percent hedge risk policy limit, and the before and after natural gas percentage hedge value as compared to the allowable minimum and maximum percent hedge limit range. The increase in the *percent hedged*, which is calculated as the hedge volume divided by the unhedged open energy position, demonstrates the risk-reducing nature of each transaction and that each transaction is within hedge limits. In every case, the transaction resulted in the Company being more hedged, which means that every transaction reduced the Company's price risk. This demonstrates the purpose of each transaction was to hedge the Company's open energy position.

Table 1

Deal #	Type	Trade Date	Tenor	Applicable policy limit	Percent of Limit Before Transaction	Percent of Limit After Transaction	Notes
772398	Gas swap	12/17/08	Nov'12-Mar'13	Q4-2012 fixed price short position limit Q1-2013 fixed price short position limit	88.6% 98.5%	81.9% 91.0%	This transaction hedges two quarterly limits periods- Q4-2012 and Q1-2013. The short position limit was 150,000 MMBtu/day for both periods.
674809	Gas swap	11/2/09	Q1-2013	Q1-2013 fixed price short position limit	72.2%	67.5%	The short position limit was 150,000 MMBtu/day.
697009	Power swap	4/6/10	Q3-2013	Q3-2013 fixed price short position limit	30.2%	28.8%	The short position limit was 1,000 aMW.
697015	Power swap	4/12/10	Q3-2013	Q3-2013 fixed price short position limit	30.0%	28.5%	The short position limit was 1,000 aMW.
697030	Power swap	4/26/10	Q3-2013	Q3-2013 fixed price short position limit	28.2%	25.7%	The short position limit was 1,000 aMW.
696714	Power swap	4/30/10	Q3-2013	Q3-2013 fixed price short position limit	21.2%	15.1%	The short position limit was 1,000 aMW.
697068	Power swap	5/18/10	Q3-2013	Q3-2013 fixed price short position limit	14.0%	11.7%	The short position limit was 1,000 aMW.
697109	Power swap	6/2/10	Q3-2013	Q3-2013 fixed price short position limit	12.0%	7.2%	The short position limit was 1,000 aMW.
697110	Power swap	6/2/10	Q3-2013	Q3-2013 fixed price short position limit	12.0%	7.2%	The short position limit was 1,000 aMW.

Table 2

Deal #	Type	Trade Date	Tenor	Applicable policy limit	Percent Hedged Before Transaction	Percent Hedged After Transaction	Notes
1127544	Gas swap	11/28/12	Jul'13-Oct'13	Year 1 NG percent hedge limit range	63.7%	63.6%	Percent hedge limit range was 50-80%; "Year 1" changed from Dec'12-Nov'13 to Jan'13-Dec'13 from 11/27/12 to 11/28/12; as a result, Year 1 requirements increased from 49,337,666 to 54,513,994 MMBtu, and Year 1 hedges increased from 31,448,447 to 34,685,928 MMBtu.
1235914	Gas physical	7/18/13	Aug'13	Year 1 NG percent hedge limit range	55.8%	57.3%	Percent hedge limit range was 50-80%.

Q. Do you believe these transactions would not have been recommended by the DPU for disallowance if the Company had only transacted after the open energy position exceeded a risk limit?

A. Yes. Disallowance was recommended by the DPU only for transactions that were not a result of exceeding a risk limit, and no disallowance was recommended for transactions resulting from exceeding a risk limit.

Q. Would it have been more prudent for the Company to wait until a risk limit had been exceeded prior to hedging?

A. No. Once a risk limit is exceeded, the Company has limited time to hedge to resolve the limit. This time limitation can cause the Company to transact during a time of less favorable wholesale prices resulting in increased costs to its customers.

Q. Are the Company's traders allowed to transact to move the Company's open energy position outside the Company's hedge limits?

A. No. Taking such action would be a violation of the Company's risk policy.

Q. Why did the Company execute these hedges on these particular days?

A. The Company's traders executed the hedge transactions to stay within applicable Company policy risk limits based on a view of how wholesale market prices would change from then-current prices. If the Company's open energy position is short (i.e., deficit) and the trader's view is that the prices will be increasing then the trader will hedge sooner. Conversely, if the trader's view is that the prices will be decreasing then the trader will wait and hedge later. If the trader has no view that prices will be increasing or decreasing, then the trader may "average in" by transacting smaller amounts over a longer period of time to stay within risk policy limits. In any case, the trader will not execute a transaction that results in the open energy position exceeding risk policy limits. These decisions are all consistent with the normal job functions of a commercial and trade department and the reasons why the department exists.

Q. How is the trader's price view implemented in the hedging decision?

A. If the Company's open energy position is short, which is normally the case for the Company's natural gas position, the trader will hedge to the more hedged end of the hedge limits if the price view is that prices will be increasing. The Company's open energy position can change significantly each month due to the current month dropping out and the thirteenth month becoming the twelfth month in the 12-month risk limit period. Therefore, the trader would transact to maintain the desired hedge position in an attempt to reduce hedge costs. The Company's open energy position can also change due to daily changes in natural gas and power wholesale prices, which also can result in the trader hedging.

Q. Were any of these transactions done speculatively for the purpose of making a profit?

A. No. These transactions were done to hedge the Company's exposure to unfavorable prices.

Q. Do the Company's traders know with any certainty if prices will be increasing or decreasing?

A. No. Wholesale prices fluctuate as a result of a free trade market, and PacifiCorp traders have no special knowledge that other market participants do not have to predict wholesale prices.

Q. Is it reasonable for the Company to be judged and penalized by the DPU, i.e., base the disallowance of certain transactions, on its ability to predict future prices?

A. No. While the Company attempts to reduce net power costs by purchasing at times of lower prices and selling at times of higher prices, it does not have perfect foresight of future prices. Therefore, a measure based on perfect hindsight of market prices, as the DPU is essentially employing, is not reasonable.

Q. Should the hedge losses be treated differently than hedge gains associated with the hedges transacted when the open position is not exceeded, as recommended by the DPU?

A. No. The La Capra Report states:

> In cases when our review determined that the Company had acted imprudently, or had failed to adequately demonstrate that it acted prudently, in executing a given transaction, we then considered what if any adjustment should be made to the requested EBA deferral amount. For hedging transactions that finished "out of the money" (i.e. the hedge resulted in higher NPC than if the position had been

> allowed to settle at market prices), we recommend disallowing the loss associated with the hedge. If the Company can't justify why it made a hedge, ratepayers should be made whole for any losses associated with the hedge. **If the questionable transaction finished "in the money" (i.e. the hedge resulted in lower NPC than if the position had been allowed to settle at market prices), we do not conversely recommend that the associated gains be removed from NPC (which would increase the EBA deferral amount). The Company should not be rewarded - and ratepayers should not be held liable - for imprudent or inappropriate actions by the Company.**"[3] [Emphasis added]

This statement shows that the DPU's recommended disallowance of so-called "discretionary trades" is not based on whether they were prudent at the time they were made, but whether in hindsight they are "in the money" or "out of the money." This is not the appropriate test for prudence. Gains and losses should be treated equally, as the Company has equal lack of perfect foresight for wholesale prices becoming more favorable or more unfavorable. Again, these transactions were hedges executed in compliance with Company policy for the purpose of reducing risk.

Authorizations

Q. Do you agree with La Capra's recommendation to disallow Utah allocated $1,448,098 due to the hedge losses associated with transaction nos. 674556 and 674806 Mr. Croft states did not receive proper governance approvals?

A. No.

[3] Energy Balancing Account Audit for Rocky Mountain Power for Calendar Year 2013, La Capra Associates, Inc., Docket No. 14-035-31, P. 39 (July 29, 2014).

Q. What is the basis for the DPU's recommended disallowance of these two hedge transactions?

A. The DPU Reports conclude that two natural gas swap hedges exceeding this threshold were not authorized by Company policy and, therefore, required a policy exception approval from Stefan Bird, the senior vice president of PacifiCorp Energy Commercial and Trading, which approval was not obtained. Thus the DPU concludes these two hedges were executed out of compliance with Company policy:

> In DPU data request 6.1(d), the Company provided the following for trade authorization limits. Bruce Evan's dollar limit is $5 million, his max tenor limit is 12 months and his max ETP is 36 months. John Apperson's dollar limit is $10 million, his max tenor limit is 36 months and his max ETP is 48 months. Stefan Bird's dollar limit is $50 million, his max tenor limit is 48 months and his max ETP is 60 months.
>
> Based on the documents reviewed, the Division found two transactions out of the 28 transactions that lacked documentation to support that higher approvals were obtained when the trader exceeded his limits. The first deal lacking support was gas financial deal number 674556. The deal exceeded the trader's dollar and ETP limits. The Company provided documentation showing that proper higher authority was obtained for the dollar limit. This higher authorization for the dollar limit was obtained from John Apperson. **However the ETP limit exceeded Mr. Apperson's authority and no evidence was provided that showed that Mr. Bird's approval was obtained.**
>
> The second deal lacking support was gas financial deal number 674806. The trade executed had a tenor of 45.6 months and an ETP of 48.9 months Based on these terms, this transaction would have been required to have approval by Mr. Bird. **No evidence was provided that showed that Mr. Bird's approval was obtained.**
>
> Both of the exceptions noted above were gas financial transactions. Since the proper approvals for these deals were not obtained, the Division believes these deals should be removed from the EBA. Removing deal number 674556 reduces total Company adjusted actual NPC by $1,914,411 and Utah's EBA deferral balance by

> $588,853. Removing deal number 674806 reduces total Company NPC by $2,520,000 and Utah's EBA deferral balance by $859,245. No exceptions were found by the Division in the gas physical, power financial and power physical transactions reviewed.[4] [Emphasis added.]

Q. What is "ETP"?

A. ETP is the effective transaction period. This is the number of months from the day the transaction is executed to the last settlement or delivery day of the transaction.

Q. Did the DPU Report cite any policy language that specifically indicated Stefan Bird's approval was required?

A. No. No such language existed at the time these transactions were executed.

Q. Please explain the Company's Governance and Approvals Process policy and its Risk Management Policy on hedging.

A. First, it is important to note that there are two policies, not just one. The Company has a Governance and Approval Process policy *and* a Risk Management Policy, which explicitly references the former. The DPU witnesses have focused much more on the Risk Management Policy and discuss the Governance and Approvals Process policy on a very limited basis. A copy of the Governance and Approvals Process policy is attached hereto as Confidential Exhibit RMP___(JAA-2AR).

Q. How does the Risk Management Policy address governance?

A. The first of the two transactions discussed above (transactions no. 674556) was done on February 26, 2010, and was governed by the January 13, 2010, Risk Management Policy; the second transaction discussed above (transaction no.

[4] Utah Division of Public Utilities Audit of Rocky Mountain Power's Energy Balancing Account, Docket No. 14-035-31, P. 31-32 (July 29, 2014).

674806) was done on September 30, 2009, and was governed by the July 6, 2009, Risk Management Policy. Both versions of the Risk Management Policy refer to the Corporate Governance and Approvals Process policy for governance of Commercial and Trading. Section 9.6 of each policy states,

> "The governance process applicable to commercial and trading is outlined in PacifiCorp's Governance and Approvals Process document and is outside the scope of this policy."

Neither version of the policy had any restrictions on the maximum effective transaction period or tenor of transactions.

Q. Please explain the Corporate Governance and Approvals Process policy.

A. The Company's governance policy is set forth in the Corporate Governance and Approvals Process policy. This document is referenced in the version of the Risk Management Policy that was in effect when each of the two referenced transactions was executed. Exhibit 1 to the Corporate Governance and Approvals Process policy provides specific authorities and approval limits for certain Company executives. As shown in Exhibit 1, the PacifiCorp Energy president has authorization for energy trading/hedging transactions up to $100,000,000 with a maximum ETP of 84 months and maximum tenor of 60 months.

All individuals involved in executing energy transactions that report up to the PacifiCorp Energy president are also limited to the same maximum ETP and maximum tenor shown in Exhibit 1 for the PacifiCorp Energy president, or 84 months and 60 months, respectively. Since none of the transactions in the EBA exceeded 84 months ETP and 60 months tenor, none of the transactions in the EBA required approval from the president of PacifiCorp Energy to comply with the Corporate Governance and Approvals Process policy.

Q. Which is controlling -- the Corporate Governance and Approvals Process policy or the Risk Management Policy?

A. The Corporate Governance and Approvals Process policy is the Company's controlling policy for transaction limits. Both of the transactions discussed above were within those ETP limits.

Q. In addition to the controlling policy requirements listed above, did the Commercial and Trading department self-impose additional steps in practice?

A. Yes. Although not technically official policy requirements at the time the two transactions were executed, the Commercial and Trading department in practice employed more conservative individual governance authorization levels including ETP and tenor that were subordinate to the levels authorized by the Corporate Governance and Approvals Process policy. The unofficial authorization levels employed in this practice are shown below.

	ETP	Tenor
Senior Vice President	60 months	48 months
Director	48 months	36 months
Manager	36 months	12 months
Trader	36 months	12 months

Q. Explain how you employed this practice.

A. While not a policy compliance obligation, we collected approvals in transaction records consistent with these unofficial individual ETP and tenor authorization levels. This action, together with verbal pre-approvals, provide a mechanism for the Commercial and Trading management to be informed of longer ETP or tenor transactions and to be engaged in the decision-making process for those transactions.

Q. Were Utah customers harmed as a result of the two missing approvals?

A. No. The transactions were prudent in every respect, and complied with the Company's policies in effect at the time they were executed.

Q. Has the Company since implemented the ETP and tenor thresholds that were previously part of the Commercial and Trading department practice in a formal policy?

A. Yes. Following control improvements placed in service in 2008, the new Endur trade capture system placed in service in 2011 and ultimately modifying SAP (Systems Applications and Products) to capture ETP and tenor, the Company implemented these ETP and tenor authorization levels as additional formal limits to notional amount levels for Commercial and Trading personnel into SAP in 2013. No other modification of policy was required to formally implement these additional authorization levels because the Corporate Governance and Approvals Process policy already references SAP as the location of delegated individual authorization levels.

Transaction Documentation

Q. What does the DPU recommend regarding documentation of the purpose and reason for transactions?

A. The DPU Report recommends the Commission:

> Require the Company to document the purpose and reason for executing all future gas physical, gas financial, power physical, and power financial transactions. Such documentation should explain why the deal was made when it was made with the specific counterparty at a specific location. This need not be burdensome, as

> evidenced by the sometimes terse and conclusory communications the Division has accepted as sufficient in this case.[5]

Q. Do you agree with DPU's recommendation?

A. Yes, to a limited extent, because it recognizes that the documentation should not be burdensome. The Company currently documents transaction purpose as Trading, Non-trading, and Arbitrage. This is sufficient for determining if the transaction is risk-increasing, risk-reducing or risk-neutral, respectively. The Company currently documents the open energy position by location, and documents the location of each transaction. This is sufficient for determining why the transaction was done at a particular location. The Company currently documents which counterparties are approved to transact and documents the counterparty for each transaction. Additionally, the Company documents if a transaction is executed through a broker. This is sufficient for determining why a transaction was executed with a particular counterparty. The Company agrees to continue to perform this level of documentation, which is sufficient for an auditor to determine if the Company is transacting within its policy.

<u>**Competitive Bids**</u>

Q. What does the DPU recommend regarding obtaining competitive bids for transactions?

A. The DPU Report recommends the Commission:

> Require the Company to document its traders' "best efforts to seek out at least two competitive bids or offers compared to the next best alternative using good judgment and discretion."[6]

---

[5] Utah Division of Public Utilities Audit of Rocky Mountain Power's Energy Balancing Account, Docket No. 14-035-31, P. 57 (July 29, 2014).
[6] Utah Division of Public Utilities Audit of Rocky Mountain Power's Energy Balancing Account, Docket No. 14-035-31, P. 5 (July 29, 2014).

Q. Did the Company's 2009 and 2010 Risk Policy require this documentation?

A. No.

Q. Does the Company's 2008 Front Office Procedures and Practices document require this documentation?

A. No. The Front Office Procedures and Practices document specifies "the trader or originator shall make best efforts to seek out at least two competitive bids or offers compared to the next best alternative using good judgment and discretion." The document does not require documentation of these efforts, only that the trader or originator perform these duties when executing a transaction.

Q. Do brokers provide competitive bids for the Company?

A. Yes. Brokered transactions inherently have multiple competitive bids; this is the service that a broker provides. When the Company utilizes a broker to complete a transaction, the broker gathers bids or offers from all participants in the market, filters the bids to the list of counterparties authorized by then-current Company credit guidelines, selects the best bid or offer, and facilitates the transaction between the Company and the counterparty with the best bid or offer. The Company documents the broker, if any, involved in each transaction.

Q. What is the Company's intention going forward regarding non-brokered transactions?

A. At the time the Company contemplates a non-brokered transaction, the trader always compares the counterparty's price with the price through a broker (typically the Intercontinental Exchange). Going forward, the Company will record the competitive price for non-brokered transactions.

<u>Risk Policy Current Standards and Guidelines</u>

Q. What does the DPU recommend regarding risk policy current standards and guidelines?

A. The DPU Report states:

> The Division recommends that the Commission order the Company to provide additional information concerning the current standards and guidelines established in the current Risk Management Policy. Specifically, the cumulative Mark-to-Market thresholds should be established and reported and additional information on the use of TEVaR and HVaR should be provided to the Commission. Since the TEVaR metric is one of the key components used to determine the timing of future gas and electric transactions, the Company should provide information relating to how the current standards have been determined and how changes in the commodity price and volatility can impact future purchase decisions. Last, the Company should inform the Commission, the Division and other interested parties when it makes modifications to its policy. Not only should the changes be identified but the Company should explain in detail why the changes were made.[7]

Q. Do you agree with the DPU's recommendation?

A. Yes. The Company is planning to establish cumulative mark-to-market thresholds to monitor the cumulative change in value of electricity and natural gas positions. Upon reaching a pre-specified threshold, the risk oversight committee will meet and discuss conditions causing such excursion, and determine what changes, if any, are warranted in response. The functionality to calculate cumulative mark-to-market on all elements of the portfolio is being implemented in advance of the expected upgrade of the energy trading system in 2015. The Company has been and plans to continue to be responsive to data requests regarding the to-expiry value-at-risk ("TEVaR") metric. The Company plans to inform the Commission, the DPU

[7] Utah Division of Public Utilities Audit of Rocky Mountain Power's Energy Balancing Account, Docket No. 14-035-31, P. 53 (July 29, 2014).

and other interested parties when it makes modifications to its policy, including a detailed explanation why the changes were made.

Q. If cumulative mark-to-market thresholds had been in place since February 2011, would that have impacted the hedge losses realized by the Company?

A. No. Cumulative mark-to-market thresholds provide visibility into the cumulative change in value of hedged positions; however, they do not provide a means to stop or cap losses from changes in market prices.

Q. What is the value of a cumulative mark-to-market?

A. The cumulative mark-to-market is useful for a speculative trading company to limit its losses by liquidating its open energy positions. The cumulative mark-to-market has limited usefulness for a utility such as the Company in evaluating the Company's long term approach to hedging; however, the Company cannot liquidate its open energy positions due to its obligation to serve retail load.

Q. What does the DPU state with regard to relaxing standards and limits?

A. The DPU Report states:

> In 2009 through 2012, the Company was dealing with increased criticism of the hedging policy from the Utah Commission and other parties. The combination of the higher hedge volume allowed under the previous policy and the reduction in the price of natural gas due to shale gas development created large mark-to-market losses and other compliance concerns. To the Division it appears as though the standards and limits were relaxed over time in order to remain in compliance with the risk management policy instead of Commercial and Trading (C&T) changing behavior to follow policy. Position limits were relaxed and were measured on a quarterly basis instead of monthly to allow greater flexibility.
>
> The loss limits were relaxed from limits to guidelines and then the guidelines were suspended. While the suspension of the guidelines has been attributed to the implementation of the new C&T reporting platform, it is difficult to understand why the Company has been unable to create a report to monitor the guidelines and why the

> guidelines have remained suspended for over 3 years. The passage of time has allowed the previously hedged contract positions to reach the maturity date and reduces the monitoring and reporting requirement.[8]

Q. Do you agree the Company's Risk Policy was relaxed to remain in compliance?

A. Absolutely not. The changes to the risk management policy from 2009 to 2012, as shown in the policy revision log of the risk management policy, were primarily to refine risk management metrics and associated hedging requirements consistent with feedback, including feedback from the DPU, received throughout the hedging collaborative process, particularly in outer years of the position management horizon. This was accomplished by removing fixed-price position limits for electricity and natural gas portfolios and replacing them with the newly-created TEVaR metric, which allows traders to continue to manage the overall exposure of the combined portfolio, but with greater choice of commodity, delivery point, and tenor to hedge within an annual period, versus the more-prescriptive fixed-price position limits. These metrics were supplemented later in May 2012 by adding natural gas percent hedge limits and reducing the open position management horizon from 48 to 36-months, both in response to feedback received as part of the collaborative hedging process. These changes had the effect of reducing the volume of hedge transactions, particularly in outer years, as requested of the Company in the collaborative hedging process.

As discussed above, the Company cannot employ stop-loss limits on its portfolio, as traders cannot liquidate all open positions and insulate the Company

[8] Utah Division of Public Utilities Audit of Rocky Mountain Power's Energy Balancing Account, Docket No. 14-035-31, P. 52 (July 29, 2014).

from future changes in market prices. This was reflected in the change from "stop-loss limits" to "cumulative mark-to-market thresholds". While these metrics have not yet been implemented in the new energy trading system, management has visibility to changes in value of its hedges and open positions through net power cost modeling as well as daily monitoring of exposures with counterparties which are heavily influenced by the mark-to-market value of hedges. The Company plans to implement logic in the new energy trading system to provide detailed profit and loss data as part of the upgrade to the energy trading system, currently scheduled for early 2015. These tools, while expected to provide better visibility into changes in value of open energy positions, will not provide ability for the Company to "stop" losses of current or future hedges.

Supporting Documentation and Data Request Process

Q. What does the DPU recommend regarding supporting documentation and data request process?

A. The DPU Report recommends the Commission:

> Take steps to dramatically improve the level of thoroughness and completeness of the Company's responses and the documentation provided in future proceedings. Among the effective steps would be refusing to consider as evidence data provided after due dates or data that should have been provided in response to earlier data requests.[9]

Q. Do you agree with the DPU's recommendation?

A. No. There is a suggestion in the DPU Reports that the Company is withholding information. The Company understands that this is a result of difficulties in

[9] Utah Division of Public Utilities Audit of Rocky Mountain Power's Energy Balancing Account, Docket No. 14-035-31, P. 57 (July 29, 2014).

responding to just a few of numerous data requests. The vast majority of the discovery responses, in which the Company provided over 2300 documents, were satisfactory to the DPU. In those few instances, the Company believed the requests were ambiguous or unduly broad, and this resulted in responses that the DPU deemed to be unsatisfactory, “untimely” or both. Following extensive discussions with the DPU on these particular requests, the Company has been able to identify and provide relevant information to the DPU. The Company will continue to make every effort to provide the DPU with the requested information and trusts the clarifying discussions in this docket have addressed this challenge going forward.

Q. Do you believe the DPU’s statement “First, the Company’s data request responses are often times not only late but significantly late” fairly characterizes the discovery process?

A. No. The responses the DPU characterizes as “significantly late” were all supplemental responses where the Company found the original request to be unclear. As stated above, the Company believed the initial requests were ambiguous or unduly broad, and this resulted in responses that the DPU deemed to be unsatisfactory, which in turn resulted in additional data requests. The required follow up requests and clarifications took additional time. The Company engaged in nine conference calls with the DPU and La Capra that were approximately one hour each in length. We agree with the DPU and La Capra that these direct conversations appeared to be helpful for the DPU and La Capra understanding the Company’s transactions. It is unfair to suggest that the Company has been unresponsive.

Q. Do you agree with the DPU's statement "Second, the Company has established a pattern of withholding, whether intentional or not, key information"[10]?

A. No. The Company has not intentionally withheld information, and we do not agree that a pattern has been set. As stated above, the Company believed a few of the initial requests were ambiguous or unduly broad, and this resulted in responses that the DPU deemed to be unsatisfactory, which in turn resulted in additional data requests. The Company responded with voluminous information it believed to the best of its judgment to be responsive and accurate. For example, Set 13 of the current docket requests "Please provide all documentation available for this transaction" and "Please provide all documentation available." This data request resulted in several supplemental responses. This process, while painful for both parties, resulted in the DPU ultimately receiving all data requested. Again, this occurred only on a very limited scope of issues. Once the Company fully understood the request, the data was provided. Going forward the Company will attempt to better understand and provide the requested information sooner in the process.

Summary and Conclusion

Q. Please summarize your testimony.

A. The DPU's recommended disallowances related to hedge losses should not be approved because the only evidence used to support the proposed disallowances is that the transactions were out of the money. Each of the transactions was executed

[10] Utah Division of Public Utilities Audit of Rocky Mountain Power's Energy Balancing Account, Docket No. 14-035-31, P. 53 (July 29, 2014).

in compliance with Company policies in effect at the time the transaction was executed, was prudent based on the information available at the time and performed in the normal course of business of the Commercial and Trading department. Prudence should not be based on the measure of perfect hindsight of wholesale prices. The Company is willing to provide additional reasonable information to the DPU and other stakeholders as described above and has already adapted its policies and procedures to gather information that the DPU states it needs. The Company has not withheld information from the DPU or changed its processes or policies to accommodate trades that DPU has alleged were improper. Instead, the Company has made changes to its risk management policy and reporting consistent with the consensus that emerged from the collaborative hedging workshops conducted in Utah and in other states. The DPU has received a significant semi-annual hedge report that the Company has been producing since 2012 and has consistently stated the Company is in compliance with its hedge policy. The Company is confident that it can continue to work collaboratively with its stakeholders including the DPU to not only agree on hedging guidelines, but also ensure the DPU has appropriate transparency to audit the Company's hedging transactions to demonstrate compliance with the guidelines resulting from that collaboration.

Q. Does this conclude your response testimony?

A. Yes.