REDACTED
Rocky Mountain Power
Docket No. 23-035-01
Witness: John Fritz

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF UTAH

ROCKY MOUNTAIN POWER

REDACTED
Surrebuttal Testimony of John Fritz

January 2024

INTRODUCTION AND QUALIFICATIONS

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

A. My name is John Fritz, and my business address is 825 NE Multnomah Street, Suite 600, Portland, Oregon 97232. I am currently employed as the Director of Credit, Contracts, and Risk Management.

Q. Please describe your education and professional experience.

A. I received a Bachelor of Science degree with a focus on finance from the University of Central Florida. I was first employed by PacifiCorp in 2002, as a senior analyst in Strategy and Planning. In 2004, I moved to Risk Management, as senior risk management analyst, joining management in 2006. In 2009, I assumed responsibility of the Middle Office, and became the Director of Risk Management. In 2013, I assumed responsibility for Credit, and in 2022, assumed responsibility for Contract Administration. I have been a lead member of the Risk Oversight Committee since 2006, advising the committee and executive leadership about market and credit risk, hedging and risk management activities, policies, procedures, and controls. I participated in the Company's hedging collaborative workshops that began in 2009 which resulted in the adoption of new hedging metrics and programs. I led many technical conferences and workshops on hedging, risk management, and improvements to programs, policies, and energy balancing account filings. In 2021, I led the most recent redesign of the Company's power and natural gas hedging and risk management program.

Q. Did you offer prior testimony in this Docket?

A. No, however I am adopting the response testimony of Mr. Douglas R. Staples.

Q. Have you testified in any previous regulatory proceedings?

A. No.

PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony in this case?

A. My testimony responds to the rebuttal testimony of Mr. Philip DiDomenico and Mr. Dan F. Koehler of Daymark Energy Advisors, Inc. ("Daymark") who submitted rebuttal testimony on behalf of the Division of Public Utilities ("DPU" or "Division").

Q. Please describe how your testimony is organized.

A. My testimony discusses the differences between Daymark's position in their initial report and their position in rebuttal testimony. I then explain several factors that were not considered by Daymark, all of which create powerful disincentives for the use of index-priced products. Among them are the inclusion of price adders in indexed transaction prices and the failure of index-priced products [redacted]. I then explain why Daymark's contention that the Company paid above-market rates for these transactions is a misrepresentation before concluding with my recommendation to the Commission.

Q. What specific issues in Daymark's rebuttal testimony are you responding to?

A. My testimony provides additional context regarding the trades at issue in this docket and additional detail regarding the correct interpretation of the data request response upon which Daymark's relies for its assessment of imprudence.

Q. Does Daymark maintain that the transactions in question are imprudent because they represent [redacted]?

A. No. Mr. DiDomenico and Mr. Koehler agree [redacted] is prudent and supportable if the intention is to [redacted].

Q. Does this mean that Daymark no longer urges the Commission to find that the Company has failed to demonstrate the prudence of the transactions in question?

A. No. Daymark's witnesses agree that it is possible [redacted] even when the Company's position report [redacted], provided those purchases are [redacted] inherent in the Company's actual operations, which can only be imperfectly reflected in its forecast. However, Daymark's rebuttal asserts that only index-priced transactions are suitable for the purpose of acting as [redacted] under such circumstances. They contend that not only were the transactions in question fixed-priced, but that the Company had a choice of [redacted]. In that way, they are reaching the same conclusion, but for a different reason.

Q. Has Daymark interpreted the data request response referenced in their testimony correctly?[1]

A. No. The response correctly notes that index-priced transactions were considered because those products are considered as a matter of course.[2] However, at the time the

[1] Rebuttal Testimony of Philip DiDomenico and Dan F. Koehler at 5-6:59-72 (Jan. 8, 2024).
[2] DPU Exhibit 2.2R, RMP Confidential Response to DPU Data Request 19.2 (Jan 8, 2024).

Company was executing these hedges, volatility was quite high, which ordinarily commands a very high premium included with the index price. My testimony below includes more detail on the topic of these price adders. Particularly if the market is indicating scarcity, those adders increase a great deal because deliverability risks are exacerbated under those conditions, and the price adders are sometimes used to compensate sellers of firm products for shouldering the deliverability risk. The Company's response to the referenced data request emphatically was *not* intended to indicate that the Company [redacted] and chose to reject them.

Q. Please explain what is meant by the term "price adder."

A. In addition to the relative lack of availability of index-priced products for forward periods, most sellers are only willing to engage in floating priced transactions if there is a substantial price adder included in the transaction price, meaning sellers of index products during peak seasons require a large premium in addition to the daily settled price.

The use of index-priced products with minimal or no price adders is possible in some markets (e.g., natural gas) for a host of reasons, including but not limited to, a significantly larger number of available counterparties, differing sophistication levels among commodity producers, the presence of a liquid and established reference market (i.e., Henry Hub for natural gas), interest from financial market makers, and ease (or difficulty) of physical delivery. However, the index physical hedging alternative to fixed-price physical hedging suggested by Daymark's witnesses is not comparable or applicable in the physical power market of the Western United States.

In the power market, sellers will not simply agree to sell forward index at prices based on the prevailing market rate at the time of delivery, but routinely add a premium to that prevailing market rate. This is sometimes referred to as “index-plus” pricing. At locations like Four Corners, Mona, and Mid-C, it is not unusual for those adders to be as high [redacted] is somewhat more common, depending on the market and period in question.

Q. How do these price adders vary based on demand conditions?

A. As mentioned above, the index-plus pricing can compensate sellers of firm products for shouldering the deliverability risk (and costs) associated with marketing firm products. As demand increases, the physical system can become more and more congested, leading to difficulty ensuring physical delivery. For that reason, those price adders tend to be larger at times when prices and volatilities are high because those conditions are indicative of strong demand.

Q. How do price adders impact that suitability of index-forward physical purchases to hedge risk for customers?

A. Price adders can create a powerful disincentive to purchase forward power supply at index versus at a fixed price. Index-priced transactions do not protect customers from price risk, as the transaction price may settle higher than the market cap. They not only fail to offer protection against price swings, but they *guarantee* that the Company will pay more than the spot market demands to secure power, due to the price adders. This is sometimes acceptable if the price adders are minimal, but once they become material, they create compelling reasons to prefer a fixed price transaction.

As mentioned in the Mr. Staples response testimony in this docket,[3] scarcity can drive extremely high prices, and index-priced transactions would not only guarantee that customers would be exposed to those extreme prices but would in fact be required to pay over and above those rates as a consequence of the price adder.

Moreover, a consideration of possible alternatives weighs in favor of fixed price power purchases under these circumstances. [redacted]. Fixed price physical transactions [redacted]. That does not indicate that, *with the benefit of hindsight*, they will invariably be shown to have been optimal, but it does mean that if there is a reason to execute the transactions, fixed prices are a reasonable choice.

Consider Table 1 below, which compares the characteristics of the instruments available to procure firm power in power markets.

[3] Response Testimony of Douglas R. Staples at 15:287-295 (Dec. 7, 2023).

TABLE 1

Instrument	**Price**	**Price Volatility**	**Availability/ Liquidity**
Fixed-price physical forward purchases	A counterparty agrees to sell to the Company at a set price. This is the price paid regardless of where spot prices settle.	Price is fixed at transaction. Spot prices may settle higher or lower than fixed price of transaction. Reduces portfolio exposure to spot market volatility by fixing a portion of required purchases.	Generally available
Index-physical forward purchases	A counterparty agrees to sell to the Company at index plus a premium to compensate the seller for deliverability risk. The price paid will be the index settlement price plus the premium agreed to in the transaction.	Price will be higher than settlement index by amount of price adder. No reduction to spot market volatility.	Limited availability. May require a large price adder to get market makers to sell.
Spot purchases	The price paid will be the spot market price, potentially with an adder or discount.	No reduction to spot market volatility.	In extreme conditions, may not be available at any price.

The products have identical [redacted], meaning all are suitable for the purpose of avoiding a [redacted]. However, fixed-price products are generally more available, and have the effect of [redacted]. In addition, the prices may be above or below the clearing price, but there is clarity to the cost. Index-priced transactions offer no such clarity, and routinely require the Company to pay more than the market would demand to secure adequate supply.

Q. Does the prospect of scarcity actually bolster support for the use of fixed-price products, even when [redacted]?

A. Yes. High forward pricing is a strong indication that power may be scarce in the spot market, which is a signal of extreme price volatility. [redacted].

Q. Are there potential future situations where the Company may use index-priced transactions?

A. Yes. [redacted]

Q. Does Daymark's testimony offer any statements of technical details that require clarification?

A. Yes. Daymark asserts the transactions in question were [redacted]."[4]

Q. Please explain why the number identified by Daymark is a mischaracterization.

A. The calculation cited compares the transaction price to the prior day's mid-market forward price curve. This latter value cannot be used to infer an amount the Company *should have paid* in the execution of any given transaction to imply the Company paid above-market for the trades in question for several reasons discussed below.

First, the "above-market" value referenced above is based on a mid-market price. In other words, the mid-market price is based on an average of bid and offer

[4] Rebuttal Testimony of Philip DiDomenico and Dan F. Koehler at 6:77-78 (Jan. 8, 2024).

prices from third-party brokers. In markets where [redacted] can be a concern, including the third quarter in the Southwest, entities may be forced to transact at the offer price due to the dearth of sellers. PacifiCorp, as a utility, is a price taker. [redacted], so negative mark-to-market ("MTM") is expected and not an indication of paying above-market rates. This is particularly pronounced when markets are indicating [redacted], as the bid-offer spread tends to widen when [redacted].

For example, if the market was showing a bid price of $180 per MWh and an offer price of $220 per MWh, the mid-market would be $200 per MWh, and any entity transacting would measure the value of their trade against the mid-market price of $200 per MWh (accounting principles require use of mid-market prices for purposes of financial reporting). If that entity were a price taker, as utilities generally are, they would sell at $180 per MWh or purchase at $220 per MWh; in either case, the comparison to mid-market would show a "loss" of $20 per MWh. This is expected and not an indication of receiving below-market or paying above-market rates.

Further, the price quotes provided by third-party brokers used to develop the mid-market forward prices used in the trade purpose reports referenced by Daymark are for the purchase and sale of financial products (i.e., swap transactions with no physical delivery component). Physical products routinely command a premium to financial products given the additional delivery risks of physical products. As the trade purpose reports compared the transactions in question (which were physical hedges) to a quote for financial products, it is normal and expected that a physical transaction price may be higher than a price for a financial product, and therefore the resulting negative MTM from this calculation is also not an indication of paying above-market rates. In recognition of the increasing disparity between financial and physical product pricing, the Company began soliciting quotes for physical premiums from brokers to adjust its forward power prices to make them better reflect pricing of physical products (which the Company exclusively uses for its power hedging activities) to more accurately compare transaction prices to prior day's power market prices. This change was made at the end of the third quarter of 2022, after the trade dates of the hedges at issue.

In addition, there is a timing difference that potentially contributes to Daymark's observation. The trade purpose reports compare forward power prices from the day prior to transaction prices of hedges on the day of execution. In periods of low volatility, those prices can be assumed to be relatively similar. However, in periods of higher volatility, that timing difference can produce material pricing differences, which are also not an indication of paying above-market rates.

SUMMARY AND RECOMMENDATION

Q. Please summarize your argument and recommendation.

A. Daymark's recommendation fails to recognize that index-priced transactions are generally less ideal than fixed price transactions, even when [redacted]. The potential to lock in losses due to price adders and the failure to shelter customers from the high costs of purchasing at index prices [redacted] mean that fixed price products are generally the better option.

For these reasons, I recommend that the Commission find that those trades were reasonable and prudent at the time of execution and reject the proposed disallowance.

Q. Does this conclude your surrebuttal testimony?

A. Yes.