

Docket No. UE-227  
Exhibit PPL/406  
Witness: Stefan A. Bird

**BEFORE THE PUBLIC UTILITY COMMISSION  
OF THE STATE OF OREGON**

**PACIFICORP**

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**Surrebuttal Testimony of Stefan A. Bird**

**August 2011**

1 **Q. Are you the same Stefan A. Bird who filed direct testimony and rebuttal**  
2 **testimony in this proceeding on behalf of PacifiCorp (the Company)?**

3 A. Yes.

4 **Purpose and Summary of Testimony**

5 **Q. What is the purpose of your surrebuttal testimony?**

6 A. My surrebuttal testimony responds to the August 16, 2011 rebuttal testimony on  
7 the Company's hedging activities sponsored by Mr. Ed Durrenberger on behalf of  
8 the Oregon Public Utility Commission Staff (Staff), Messrs. Robert Jenks and  
9 Gordon Feighner on behalf of the Citizens' Utility Board of Oregon (CUB), and  
10 Mr. Donald Schoenbeck on behalf of the Industrial Customers of Northwest  
11 Utilities (ICNU). Specifically, my surrebuttal testimony:

- 12 • Concurs with Staff's conclusion that the Company's hedges in this  
13 proceeding were prudent given the information available at the time the  
14 hedge transactions were executed and recommends the Commission reject  
15 all of CUB's and ICNU's proposed adjustments related to hedging.
- 16 • Concurs with Staff's recommendation to enter into a series of workshops  
17 with interested parties to review the hedging process in detail and provide  
18 Staff and customer groups the opportunity for input into the Company's  
19 going forward risk management and hedging policies.
- 20 • Demonstrates that all of the contested hedges in this proceeding greater  
21 than 48 months of delivery were executed in compliance with the  
22 Company's risk management policy, which addresses and eliminates  
23 CUB's only remaining contested hedging issue in this proceeding.

- 1           • Demonstrates that there is no basis for a prudence disallowance based on  
2           ICNU's unsubstantiated assertions that the Company hedged too much or  
3           too far forward.

4           These conclusions are further supported by the surrebuttal testimony of third party  
5           expert, Mr. Frank C. Graves of the Brattle Group.

6   **Staff**

7   **Q. Do you agree with Staff's conclusion that all of PacifiCorp's hedges in this**  
8   **proceeding were prudent and that the Commission should reject CUB's and**  
9   **ICNU's proposed adjustments related to hedging?**

10   A. Yes.

11   **Q. Do you agree with Staff's recommendation to enter into a series of**  
12   **workshops with parties to review the hedging process in detail and provide**  
13   **Staff and customer groups the opportunity for input into the Company's**  
14   **going forward risk management policy and hedging program?**

15   A. Yes. If parties have concerns about the Company's approach to hedging, an ex  
16   ante review of the Company's risk management policy and hedging program is  
17   the appropriate response.

18   **Q. Did the Company recently commence a similar ex ante review process at the**  
19   **Utah Commission?**

20   A. Yes. In the recent stipulation settling the Company's 2011 Utah general rate case,  
21   the parties agreed to convene a collaborative process "to discuss appropriate  
22   changes to the Company's hedging practices to better reflect customer risk

1 tolerances and preferences.”<sup>1</sup> The Company agreed “to implement appropriate  
2 changes on a going-forward basis” resulting from the collaborative process. The  
3 Utah Stipulation lists a number of issues to be addressed in the collaborative  
4 process, including volume percentage limits and hedging time horizons, two key  
5 issues raised in this case.

6 **Q. Because the Company manages its hedging program on a total system basis,**  
7 **is it good policy for Oregon to conduct a collaborative process on the**  
8 **Company’s hedging program in tandem with Utah and potentially other**  
9 **states?**

10 A. Yes. This would permit the Company to reflect and work to harmonize the  
11 interests and concerns of stakeholders throughout its jurisdictions, in a manner  
12 similar to the Company’s integrated resource planning process. In the Utah  
13 Stipulation, the Company specifically agreed to work to resolve materially  
14 inconsistent policy changes sought in Utah and in other states.

15 **Q. Do you agree with Staff that CUB does not clearly demonstrate its assertion**  
16 **that because PacifiCorp lacks a power cost adjustment mechanism (PCAM)**  
17 **in Oregon, hedging shifts risk from shareholders to customers?**

18 A. Yes.

19 **Q. Do you agree with Staff’s comment that it is possible that PCAM’s in**  
20 **PacifiCorp’s other jurisdictions have affected the incentives for careful**  
21 **hedging?**

22 A. No. The different net power cost regulatory recovery mechanisms across the

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<sup>1</sup> The Utah Stipulation (July 28, 2011) is available at:  
<http://www.psc.state.ut.us/utilities/electric/elecindx/2010/10035124indx.html>

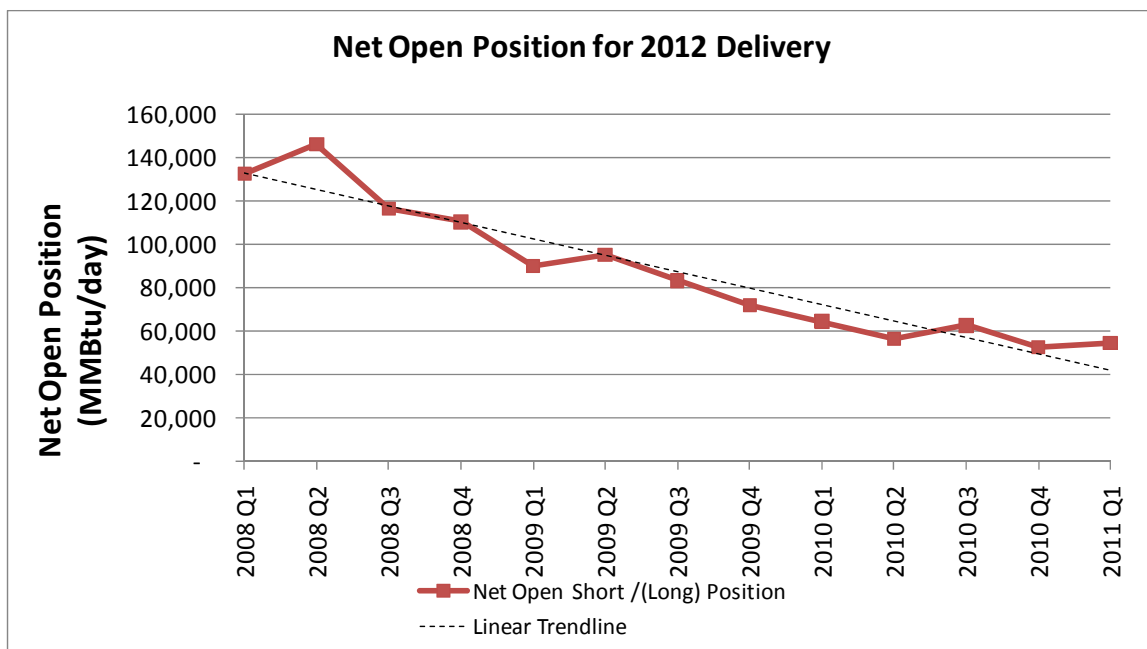
1 Company's six jurisdictions have not affected the Company's incentives for  
2 careful hedging. As Staff correctly notes, customers face significant risk in regard  
3 to commodity price volatility with or without the existence of a PCAM.  
4 PacifiCorp's risk management policy and hedging program are designed and  
5 implemented to mitigate this risk exposure to customers.

6 PacifiCorp's incentives for careful hedging arise from its fundamental  
7 commitment to customers, its obligation to serve, commodity price volatility that  
8 is out of the Company's control, the assumption that our customers are risk  
9 adverse and have a preference for stability, and the prudence standard for the  
10 Company to obtain cost recovery. The Company is committed to satisfying its  
11 customers' interests and is open to modifying its risk management policy and  
12 hedging program going forward if customers express a different risk preference.  
13 Staff's recommendation to enter into a series of workshops on the Company's  
14 hedging practices is an appropriate venue to consider any potential changes going  
15 forward.

16 **Q. How do you respond to Staff's general observation that the Company's**  
17 **hedges in this proceeding appear to be more sporadic than programmatic?**

18 A. The figure below shows the change in the Company's natural gas open position  
19 for the test period from the fourth quarter 2007 to the third quarter 2011 compared  
20 to a linear progression. The figure shows that the Company's net open position  
21 and associated risk for 2012 was reduced on a reasonably steady basis during that  
22 period, consistent with the Company's portfolio approach to hedging. However,  
23 the progression is not rigidly linear and this variability is the result of resource

1 portfolio changes (*i.e.*, the 500 MW Chehalis facility was added in September  
 2 2008 resulting in increased gas requirements), market changes (volatility in the  
 3 spread between forward electricity prices and forward natural gas prices resulting  
 4 in reduced or increased gas requirements), reserve requirement changes  
 5 (increasing with incremental wind assets and generally resulting in reduced gas  
 6 requirements) and trader discretion within the confines of the limits in the risk  
 7 management policy.



8 **CUB**

9 **Q. Did CUB change its position regarding hedging issues in its rebuttal**  
 10 **testimony?**

11 **A.** Yes. CUB modified its position on hedging issues based on the Company's  
 12 rebuttal testimony and conceded that it is prudent for the Company to contract for  
 13 hedges that are up to 48 months out as compared to its opening testimony  
 14 contesting hedges beyond 36 months.

1 **Q. Why did CUB make this change?**

2 A. As outlined in my rebuttal testimony, the Company's October and November  
3 2006 updates to its risk management policy (2006 Policy) included an amendment  
4 to reflect a 48 month maximum effective transaction period for natural gas  
5 hedges, which reflected an improvement in market liquidity in the 37 to 48 month  
6 range. CUB's rebuttal testimony cites the 2006 Policy and acknowledges this  
7 change in market conditions.

8 **Q. Does CUB have any other outstanding hedging concerns?**

9 A. Yes. CUB continues to contest hedges that were made more than 48 months in  
10 advance of delivery.

11 **Q. What is the basis for CUB's outstanding hedging concern?**

12 A. CUB asserts that the Company's hedges greater than 48 months prior to delivery  
13 were executed out of compliance with Company policy.

14 **Q. Please describe the hedges CUB contests.**

15 A. For the test period, there are 58 hedges that extend into the 49 to 60 month period.  
16 On average, these hedges extend 2.3 months beyond the standard 48 month tenor.

17 **Q. Does any other party share CUB's assertion?**

18 A. Yes. ICNU makes the same assertion.

19 **Q. Is CUB's and ICNU's assertion that these hedges were executed out of  
20 compliance with Company policy accurate?**

21 A. No. All of the Company's hedges in this proceeding were executed in compliance  
22 with the Company's risk management policy.

1 **Q. Please explain what was required for the Company to execute transactions**  
2 **over 48 months in compliance with the Company's risk management policy.**

3 A. Under the Company's Front Office Procedures section entitled "Transaction  
4 Approvals and Authorization" (section 7.1 in the 2004 version and section 6.1 in  
5 the 2008 version), transactions in excess of 48 months require advance approval  
6 by the Commercial and Trading Senior Vice President (a job that subsumed the  
7 role of Trading and Origination Managing Director referenced in the 2004  
8 version) or the Energy Trading Director, who reports to the Commercial and  
9 Trading Senior Vice President. See Exhibit PPL/407. The Front Office  
10 Procedures do not require written approval or specific analysis or documentation.

11 ICNU previously conceded in its rebuttal testimony that the Company's  
12 policies allowed for advance approval of transactions in excess of risk  
13 management policy limits.

14 **Q. Did you approve these transactions in advance, as required by the**  
15 **Company's risk management policy and front office procedures?**

16 A. Yes. In my capacity as Senior Vice President of Commercial and Trading, I gave  
17 advance approval for the use of standard market products to reduce the  
18 Company's hedging costs during this time period, even though in some  
19 circumstances the use of these products caused the hedges to extend beyond 48  
20 months. Under my supervision, the Director of Trading also gave advanced  
21 approval of these transactions. As I explained in my rebuttal testimony, we  
22 authorized this approach because it was the most economic way to maintain  
23 compliance with the risk management policy that required incremental hedging as

1 new months with large exposures rolled into the 48 month risk management  
2 horizon. With our advanced approval, these transactions were fully compliant  
3 with the Company's risk management policy.

4 **Q. What is the basis of CUB's and ICNU's claim of non-compliance?**

5 A. Both CUB and ICNU misinterpret the Company's response to ICNU 13.14 as  
6 evidence that the Company violated its risk management policy regarding the  
7 non-standard transactions in late 2007 and early 2008 that extended beyond 48  
8 months.

9 ICNU 13.14 asked the Company to provide *all documents and analysis the*  
10 *Company considered in its review to execution each of the non-standard*  
11 *transaction* [emphasis added]. The Company's response to this question was that  
12 it did not have the requested information. CUB and ICNU both imply that this  
13 response is an admission of the Company's non-compliance with its risk  
14 management policy. But ICNU 13.14 did not ask for the evidence establishing  
15 that the transactions were compliant with the risk management policy. As noted  
16 above, this evidence is my sworn testimony that the Company's Director of  
17 Trading and I personally pre-approved these transactions as required by the  
18 Company's risk management policy front office procedures. Compliance with  
19 these policies and procedures did not require the pre-approval analysis or  
20 documentation requested in ICNU 13.14.

21 **Q. Did customers benefit from the authorization of these non-standard**  
22 **transactions?**

23 A. Yes. As noted in my rebuttal testimony, these transactions provided customers

1 benefits from the reduced transaction costs associated with the use of standard  
2 market products.

3 **Q. Does Staff agree that the non-standard nature of these hedges does not mean**  
4 **that they are noncompliant with the risk management policy or imprudent?**

5 A. Yes. Staff correctly notes that the fact that these hedges required executive  
6 approval<sup>2</sup> does not make the actions imprudent and in fact makes the process  
7 more robust than it would be without this additional approval requirement.

8 **ICNU**

9 **Q. Did ICNU change its position regarding hedging in its rebuttal testimony?**

10 A. ICNU's adjustment has not changed. However, ICNU no longer asserts that the  
11 hedges between 37 and 48 months in advance were out of compliance with  
12 Company policy.

13 **Q. In addition to the greater than 48 month hedge transactions issue discussed**  
14 **above, does ICNU contest any other hedging issue?**

15 A. Yes. ICNU continues to promote an unsubstantiated after-the-fact programmatic  
16 hedging policy that results in their recommendation to arbitrarily reject a large  
17 portion of hedges in this proceeding that were executed greater than 36 months in  
18 advance of delivery.

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<sup>2</sup> While Staff is correct in stating that certain hedges reflected in this case required my pre-approval, these are the hedges over 48 months, not 36 months as noted by Staff at Staff/300, Durrenberger/8.

1 **Q. In ICNU/110, Schoenbeck/12, lines 3-7, Mr. Schoenbeck claims that the**  
2 **Company “has no documentation to support” the hedging transactions for**  
3 **which he seeks disallowance, which includes transactions in the 37 to 48**  
4 **month period as well as transactions greater than 48 months that ICNU**  
5 **disputes. Is this correct?**

6 A. No. The Company has documented each of these transactions, as is evident from  
7 the list of hedging transactions compiled in ICNU/103, Schoenbeck/9-10. In fact,  
8 the Company provides details on each transaction in the supporting workpapers  
9 provided to parties pursuant to the TAM Guidelines. *See* Order No. 09-274 at  
10 Appendix A, p 17 (Section A(3)(d)). In addition, the Company has provided its  
11 risk management policy and front office procedures documentation and has  
12 demonstrated that all transactions were executed in compliance with Company  
13 policy and procedures.

14 **Q. Do you agree with ICNU that the relevant Company policy to address**  
15 **ICNU’s issues regarding hedges greater than 36 months in advance is the**  
16 **Company’s 2006 Policy?**

17 A. Yes, I have attached the November 26, 2006 Risk Management Policy as  
18 Confidential/Highly Confidential Exhibit PPL/408. However, an understanding  
19 of the Company’s current hedging practices is also important, both to show how  
20 the practices have evolved and adapted to current market conditions and to assess  
21 whether ex ante changes to the practices are warranted. In any event, the  
22 Company’s overall approach and philosophy toward hedging have not changed

1 materially since the time that the Company executed the hedges ICNU challenges  
2 in this case.

3 **Q. Do you agree with ICNU's statement that the Company was trying to beat**  
4 **the market in 2007 while using the 2006 Policy?**

5 A. No. As stated previously in my rebuttal testimony and the Company's IRP, also  
6 cited by ICNU, the Company hedges for the sole purpose of mitigating volatility,  
7 not to beat the market.

8 **Q. How does ICNU support its claim that the Company was trying to beat the**  
9 **market?**

10 A. ICNU appears to support this claim by reference to my rebuttal testimony where I  
11 showed that third party experts were projecting even higher gas costs as support  
12 for why it was prudent to hedge.

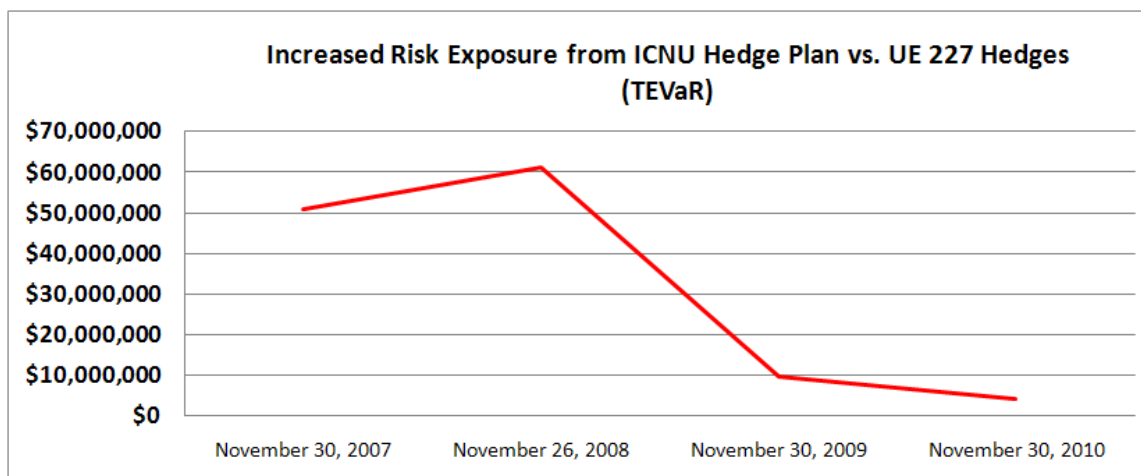
13 **Q. Does this reference support ICNU's claim?**

14 A. No. The point of including this third party data in my testimony was to  
15 demonstrate that at the time these hedges were made, there was significant risk  
16 that natural gas prices might escalate. Staff's testimony relies upon a similar  
17 summary of the status of the market at the time these hedges were made to  
18 support Staff's conclusion that the hedges were prudent. All of the hedges were  
19 entered to mitigate the risk of price escalation and were executed at then current  
20 forward market prices. No hedges were executed to try to beat the market.  
21 Indeed, ICNU's hindsight hedging strategy effectively proposes that the Company  
22 should have tried to beat the market instead of hedging based on sound risk  
23 management principles. ICNU's hindsight proposal demands that the Company

1 abandon sound risk management principles and instead increase its customer risk  
2 position in the face of elevated market risk and escalating forward prices.

3 **Q. What incremental customer risk exposure would have resulted if the**  
4 **Company had instead adopted ICNU's proposed hedging plan?**

5 A. The Company calculated time to expiry value-at-risk (TEVaR) with forward  
6 prices, volatilities and correlations known during the historical period from 2007  
7 through 2010. The chart below shows the increased risk to customers that result  
8 from ICNU's hypothetical hedging plan as compared to the Company's actual  
9 hedges in UE 227. The results demonstrate ICNU's proposed hedging plan would  
10 have increased risk to customers as much as \$60 million as of November 30,  
11 2008. This increased risk results from a much larger net open position exposure  
12 in the face of escalating forward prices and high price volatility at the time.



13 **Q. Do you agree with ICNU that past hedging benefits should not be considered**  
14 **in the decision in the current proceeding?**

15 A. I agree that it is inappropriate to consider hedging gains or losses to determine if  
16 the hedges in any period were prudent. However, since ICNU is highlighting  
17 hedging losses in the current proceeding, it is disingenuous for ICNU to ignore

1 the fact that customers have received benefits from the Company's hedging  
2 activity in prior proceedings. Given that commodity prices are volatile and  
3 unpredictable, one would reasonably expect that there will be hedging gains in  
4 some periods and hedging losses in others and that, in fact, is the Company's  
5 experience.

6 **Q. Were any of the transactions in the current proceeding also included in the**  
7 **Company's previous TAM proceeding?**

8 A. Yes. Approximately 20 percent of the natural gas hedge transactions in this  
9 proceeding—including all of the Company's hedges executed in 2007—also had  
10 settlement dates in the UE 216 test period. These hedges were uncontested in the  
11 Company's last rate case and are currently reflected in Oregon rates. ICNU's  
12 adjustment includes over one-half of the subset of hedges included in both UE  
13 216 and this filing. ICNU has not explained this fact, nor justified why the  
14 Commission should remove multi-year hedges already in rates.

15 **Q. Did the Company's hedging activities reduce net power costs in UE 216?**

16 A. Yes. As shown in Mr. Duvall's Exhibit PPL/108, the Company's hedges  
17 provided \$10.5 million in benefits to customers on a total company basis.

18 **Q. What does ICNU conclude from its review of the Company's electricity**  
19 **hedging in this proceeding?**

20 A. ICNU does not contest any of the Company's electricity hedges in this  
21 proceeding.

1 **Q. What is the benefit to customers of the Company's electricity hedges in this**  
2 **proceeding?**

3 A. \$24.4 million based on the Rebuttal Update.

4 **Q. Do you agree with Mr. Schoenbeck's observation that, as compared to the**  
5 **last TAM (UE 216), the test period in UE 227 reflects a significant decline in**  
6 **short term firm electricity sales, a significant decline in favorable net electric**  
7 **swap expense and a modest decline in natural gas swap expense?**

8 A. Yes.

9 **Q. Do these figures help explain the net hedging loss in UE 227?**

10 A. Yes, however, it is important to understand what is driving these changes. The  
11 Company's risk management policy, hedging program and implementation of its  
12 policy were consistent in UE 216 and UE 227. What changed, and therefore what  
13 drives these results, is the Company's load and resource balance. These changes  
14 are described by Mr. Duvall in his surrebuttal testimony and are detailed in the  
15 workpapers in the Company's initial TAM filing.

16 In brief, the Company's natural gas requirements increased and the  
17 Company's available electric capacity decreased in the test period in UE 227. As  
18 a result, the Company's natural gas requirements as compared to its excess  
19 electricity sales was much greater in UE 227 than in UE 216. Given this starting  
20 position, under the Company's progressive portfolio hedge program, the  
21 Company's natural gas hedges occurred in advance of electricity hedges and in  
22 much greater volumes.

1 **Q. What do you conclude from comparing those hedges the parties accept as**  
2 **prudent and those they challenge?**

3 A. The Company has applied the same general risk management principles to all of  
4 its hedging practices, natural gas and electric, and in this case and in the last.

5 Given this fact, it is difficult for me not to conclude that the parties' positions on  
6 whether or not the Company's hedges are prudent are inappropriately driven by  
7 opportunistic hindsight and not on sound risk management principles.

8 **Q. Does this conclude your surrebuttal testimony?**

9 A. Yes.