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1 in natural gas since the filing of direct testimony in this proceeding. Would it be
2 appropriate to increase your natural gas price recommendation for Empire at this
3 time?

4 A. No. There are several reasons why it would not be appropriate to increase my
5 natural gas price recommendation at this time.

6
7 1) Since October 27, 2004, the date utilized by Mr. Beecher in his rebuttal
8 testimony, the futures price for natural gas has fallen dramatically. Based on the
9 settlement price on the close of business on November 22, 2004, the 12-month
10 NYMEX futures strip (December 2004 – November 2005) had fallen to \$6.9034
11 per MMBtu. The 24-month NYMEX futures strip (December 2004 – November
12 2006) had fallen to approximately \$6.76 per MMBtu. This is significantly lower
13 than the \$8.04 per MMBtu for the 12-month strip for 2005 and the \$7.50 per
14 MMBtu for the 24-month strip (January 2005 – December 2006) utilized by Mr.
15 Beecher in his rebuttal testimony.

16
17 2) The physical price of natural gas, the actual price of natural gas paid for
18 actual supplies of natural gas, is selling at a large discount compared to the futures
19 market. On November 22, 2004, the price for December futures on the NYMEX
20 closed at \$6.762 per MMBtu. On the same date, spot prices for next day delivery
21 (i.e. actual market prices for physical delivery) at the Henry Hub (this is the same
22 point where futures prices are based) were \$5.26 per MMBtu. This is a difference
23 of \$1.50 per MMBtu. This indicates to me that there are other forces (i.e.

1 speculators) that are artificially keeping natural gas futures prices above the level
2 at which it is fundamentally supported.

3
4 3) I do not believe that the market can continue to bear prices in the \$6 - \$9
5 per MMBtu range. Consumers have chosen natural gas because it was a low price
6 alternative. If prices remain at these inflated levels for prolonged periods of time,
7 consumers will begin to curtail their usage of natural gas. This has been
8 witnessed in the industrial sector with significant demand destruction over the
9 past few years due to high natural gas prices.

10
11 4) Current market conditions are trending toward a continued drop in natural
12 gas prices. First, storage reached record levels entering the winter withdrawal
13 season (November – March) and has remained there early into the season.
14 Second, the latest NOAA (National Oceanic and Atmospheric Administration)
15 winter weather outlook has indicated that the temperatures overall may not be as
16 cold as originally thought.
17 (<http://www.noaanews.noaa.gov/stories2004/s2342.htm>) These two factors plus
18 the huge difference between actual natural gas prices and futures natural gas
19 prices, leads me to believe that prices for natural gas could fall throughout the
20 winter.

21
22 5) I believe that the increase in natural gas prices between the filing dates of
23 direct and rebuttal testimony was driven primarily by Hurricane Ivan, which

1 swept through the Gulf of Mexico. Approximately 25% of the United States'
2 natural gas supplies come from the Gulf of Mexico. In September, Hurricane
3 Ivan ripped through the Gulf causing severe damage to the natural gas
4 infrastructure. This damage resulted in a major reduction in natural gas supplies.
5 This fact coupled with the fear of a colder-than-normal winter led the futures
6 market to skyrocket. However, since storage was able to reach record levels and
7 the winter forecast has moderated slightly, the natural gas price has fallen.

8
9 6) Finally, Empire's hedging program has allowed Empire to hedge a
10 significant portion of its anticipated natural gas needs for the next two years. This
11 price is actually near my price recommendation from my direct testimony, as
12 corrected in my rebuttal testimony. In fact, the current actual natural gas prices
13 are near my price recommendation. Thus prices only have to moderate slightly
14 for Empire to start seeing benefits from a built-in base rate of \$4.68 per MMBtu.

15
16 Q. On page 11, line 1 of his rebuttal testimony, Mr. Beecher indicates that his overall
17 natural gas price is \$6.02 per MMBtu. Do you agree with his methodology and
18 result?

19 A. No, I do not. First, his calculations rely solely on the futures price of natural gas
20 as of October 27, 2004 to estimate the price that Empire expects to pay in the
21 future for its currently unhedged natural gas needs. This heavy reliance on the
22 futures market, in my opinion, distorts the price Empire could reasonable be
23 expected to pay for natural gas due to short term market conditions and recent

1 events. As discussed previously, Hurricane Ivan had a tremendous impact on the
2 natural gas market and contributed to higher price increases. However, the
3 hurricane's impact should be resolved before next year's injection period (April –
4 October) begins, if not sooner. Thus, a short-term event has caused the futures
5 price to rise, even though the event will have no bearing on future natural gas
6 market fundamentals.

7 Second, Mr. Beecher calculates his price assuming a burn of 10,000,000
8 MMBtu, which I believe inflates Empire's expected burn. Over the past three
9 years, Empire has only burned 7,215,789 MMBtu on average. If Mr. Beecher
10 uses a more reasonable level of expected burn, such as 8,833,333, which is closer
11 to what Empire has reported in its gas position report, I believe his price would be
12 \$5.82 per MMBtu, based on his overly high natural gas prices. But as I have
13 shown in this testimony, prices have fallen substantially since Mr. Beecher's
14 rebuttal was prepared.

15 Furthermore, in Mr. Beecher's rebuttal testimony, page 5, lines 12 – 15,
16 page 6, lines 1 – 3, he indicates that various sources are calling for natural gas
17 prices in the \$5.94 - \$6.60 per MMBtu range. These prices are substantially
18 lower than the \$7.50 per MMBtu price used by Mr. Beecher.

19 Q. Why do you oppose using Mr. Beecher's estimated burn of 10,000,000 MMBtus
20 of natural gas?

21 A. As Mr. Beecher points out on page 4, lines 4 – 7 of his rebuttal testimony, factors,
22 such as the price of natural gas will affect the actual amount of natural gas burned

1 by Empire. At the inflated prices used by Mr. Beecher, I believe that Empire will
2 not burn that high a level of natural gas.

3 Q. Mr. Beecher, on page 12, lines 11 – 13 of his rebuttal testimony, criticizes your
4 use of historical prices in your analysis, calling your reliance on historical prices
5 potentially disastrous for the Company. Please respond.

6 A. The historical prices that I utilized in my analysis are in line with current market
7 conditions and expectations. The prices range from a low of \$3.686 in October
8 2002 to a high of \$9.133 in March 2003. The average for the 24-month period is
9 \$5.37 or 12 cents higher than the actual price of natural gas at the Henry Hub on
10 November 22, 2004. Thus, my use of historical prices is a reasonable
11 methodology to mitigate short-term fluctuations in the futures market in trying to
12 estimate the price for natural gas in the future. In fact, it is the sole reliance on the
13 futures market as an estimate of Empire's spot purchase prices (as done by Mr.
14 Beecher in his rebuttal testimony) that could have disastrous results, for Empire's
15 customers.

16 Whereas Mr. Beecher relies solely on futures prices in his analysis, my
17 recommendation utilizes both futures prices and historical prices. The use of
18 historical prices helps to offset the potential short-term impacts that can cause the
19 futures market to spike, similar to what happened this past fall.

20 Q. Does this conclude your surrebuttal testimony?

21 A. Yes it does.