Witness OCS 4D– Wielgus

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of	**)**	**Docket No. 09-035-15**
Rocky Mountain Power for	**)**	**Direct Testimony**
Approval of its Proposed Energy	**)**	**Paul Wielgus**
Cost Adjustment Mechanism	**)**	**For the Office of**
	)	**Consumer Services**

REDACTED

June 16, 2010

Phase II, Part 1
Direct Testimony on Issues Relating to Hedging and
Reliance on Market Energy in Connection with an ECAM

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INTRODUCTION

Q. WHAT IS YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS?

A. My name is Paul J. Wielgus. I am a Managing Director with GDS Associates, Inc ("GDS"). My business address is 1850 Parkway Place, Marietta, GA, 30067.

Q. PLEASE DESCRIBE YOUR FIRM.

A. GDS is multi service consulting firm focused primarily on energy and utility related matters. Our main office is in Marietta, GA. We have over 150 employees and have clients across the U.S.

Q. HAVE YOU PREPARED A SUMMARY OF YOUR QUALIFICATIONS AND EXPERIENCE?

A. Yes. I have attached Appendix I, which is a summary of my experience and qualifications.

Q. ON WHOSE BEHALF ARE YOU APPEARING?

A. GDS was retained by the Utah Office of Consumer Services ("OCS") for this Docket. Accordingly, I am appearing on behalf of the OCS.

Q. HAVE YOU PREPARED ANY EXHIBITS IN SUPPORT OF YOUR TESTIMONY?

A. Yes. I have prepared Exhibit OCS 4.1, which is attached to this testimony.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to generally discuss natural gas hedging transaction costs and other related matters.

Q. WHAT DO YOU MEAN BY TRANSACTION COSTS?

A. The cost of a commodity usually includes the cost of the physical commodity itself, the cost of handling the commodity, the cost of transporting it, along with other incidental physical costs, such as storage, needed to get the physical commodity from its source point to its end use point. In addition to these physical costs, there are costs associated with completing and administering the transaction, such as legal and accounting costs. When companies move from very short term, point in time spot market pricing to a longer term fixed price for the commodity, additional costs are incurred to transact this way. Not only might some of the costs just mentioned with the physical commodity increase, but there will be additional hedging transaction costs that will be incurred. This is the case with natural gas, which is a traded commodity.

Q. WHAT DO YOU MEAN BY HEDGING TRANSACTION COSTS?

A. Hedging transaction costs can include a number of expenses. They can include the cost of the ongoing additional organizational functions needed

to plan for and implement the price hedging along with the associated risk management administrative activities and controls, which activities and controls are very specialized areas of expertise and services. These organizational functions can include traders, risk managers and administrators, and specialized modeling expertise to help evaluate and monitor the hedges. In addition, there are the costs for the necessary information technology or IT systems, the cost of credit associated with or as required by hedge counterparties, and other overhead costs such as additional legal, reporting, and accounting.

Q. PACIFICORP DOES HEDGE NATURAL GAS PRICES AND THEREFORE INCURS TRANSACTION COSTS, CORRECT?

A. Yes, the Company does hedge natural gas prices and does incur hedging transaction costs.

Q. DO YOU KNOW HOW MUCH THESE COSTS MIGHT BE FOR THE COMPANY?

A. When the Company was asked, in a data request OCS DR 4.1 in Docket No. 09-035-21 to provide estimates of its energy risk management transaction costs, the Company provided the expenses associated with just their employees, including contractors and employee expenses, working in the front, middle, and back offices of the risk management organization, plus other support areas including legal. These costs were

about $25 million in 2008. The Company didn't provide estimates of additional transaction costs in the response. However, according to a [redacted]

Q. HAS THE COMPANY IDENTIFIED OTHER TRANSACTION COSTS ASSOCIATED WITH ITS HEDGING?

A. Yes, one of the other transaction costs it identified was some of the credit costs associated with hedging. Entering into energy price hedges typically require some form of credit. [redacted]

[redacted] In a document labeled Attachment DPU 35.6-1 provided in Docket 09-035-23, a Company Internal Audit Report on Collateral requirements for the Company's energy hedging activities notes that if the Company's unsecured credit rating dropped one rating below investment grade, its quarterly estimated potential collateral needs would have been in the range of $300 to $400 million per quarter for the first three quarters of 2008.

Q. DO YOU VIEW THESE TRANSACTION COSTS TO BE MATERIAL?

A. Yes.

Q. HOW WOULD YOU ESTIMATE THE VALUE RATEPAYERS RECEIVE FROM INCURRING HEDGING TRANSACTION COSTS?

A. According to the Company's presentation at the May 2009 Technical Conference in Docket No. 09-035-21, [redacted] The value, therefore, of the Company's energy hedging program, including natural gas hedging, assuming it is consistent with the Company's

hedging policy, can be looked at by comparing [redacted] versus the associated hedging transaction costs.

Q. ARE THERE OTHER SOURCES THAT MIGHT CAUSE RATEPAYERS TO EXPERIENCE VOLATILITY THAT ARE NOT COVERED BY THIS HEDGING?

A. Yes.

Q. WHAT OTHER SOURCES MIGHT CAUSE RATEPAYERS TO EXPERIENCE VOLATILITY THAT ARE NOT COVERED BY THIS HEDGING?

A. Another source, as per Mr. Graves' Supplemental Direct Testimony mentioned earlier, is that the Company faces unavoidable and largely uncontrollable operating and quantity risks as a result of the circumstances that are intrinsic to system balancing in the utility power industry. OCS witness Dr. Lori Schell addresses this more in her testimony in this docket. Mr. Graves goes on to say that there are practical limitations on any utility's ability to precisely forecast and fully hedge some of its key uncertainties.

Q. WHAT ARE SOME OF THESE KEY UNCERTAINTIES?

A. Some of these other key uncertainties include weather, unplanned power pool generating and transmission outages, the price of energy and fuel supply and related services, energy and fuel related force majeure and defaults, regulatory, and economic conditions.

Q. WHAT ARE SOME OF THE CONSEQUENCES TO THESE UNCETAIINTIES?

A. Lumping most of these key uncertainties into the bucket of operational uncertainty, the most notable consequence of them is that the hedge that has been put on, because of some measurable operational change, is no longer needed, resulting in a mismatch of hedged quantities to actual physical quantities. In this case, it's not likely that the associated transaction costs will provide their intended benefit. Operational uncertainties or risks usually attract a lot of attention and discussion when transacting hedges, or at least they should. The other main bucket of uncertainty is price. That is, if the spot price falls below the hedged price, the associated transaction costs won't provide the benefit of the lower price, although it did provide volatility offset benefit. Because the Company uses price swaps and not price options, this outcome is generally the case in falling markets.

Q. WHAT WOULD BE THE BENEFIT TO RATEPAYERS IF OPTIONS WERE USED TO HEDGE PRICES INSTEAD OF SWAPS?

A. There would be at least two main benefits. One, the ratepayers would get the benefit of falling market prices while getting the protection from rising prices. This type of position is a much more desirable position for a buyer, which the ratepayer is, of a commodity. The other main benefit is that it can provide a more accurate view of the real costs of a buyer's transaction cost for price hedges that naturally address the buyer's short position for the commodity, in this case the commodity being natural gas.

Q. DO YOU HAVE AN ESTIMATE OF THE COST OF TRANSACTING USING NATURAL GAS OPTIONS?

A. Yes, but like natural gas prices, the costs of the options vary over time and with the level of price protection. Examples of historical costs of natural gas options are shown in the attached Exhibit OCS 4.1. As shown in these examples, the price of an option for the months shown, range from over $3.00/MMBtu to less than $0.30/MMBtu. These option prices tend to be a function of forward price trends, price volatility, level of protection or the strike price, and number of months prior to the settlement month. Generally, the more months out from settlement, the higher the option premium. A thorough analysis of transacting options as part of the risk management strategy to levelize ratepayer volatility would need to be conducted to best measure the associated transaction costs.

Q. ARE THERE ANY OTHER MATTERS RELATED TO HEDGING AND ASSOCIATED TRANSACTION COSTS THAT SHOULD BE DISCUSSED?

A. Yes. A report by NARUC entitled “Energy Portfolio Management: Tool & Resources for State Public Utility Commissions”, dated October 2006, states that the providers of the generation component of retail utility rate face a host of major uncertainties in addition to volatile natural gas prices. The report raised the issue of Enterprise Risk Management (“ERM”) a process which tries to aggregate all of a company’s risks including market, operations, credit, and regulatory risks. ERM is widely discussed as a corporate risk management topic. Because utilities, like the Company, and ultimately the ratepayer since they carry the long run cost of the utility, face all of these risks and others with limited capital, viewing natural gas price risk management from the enterprise level may be something that should be included in this docket.

Q. CAN YOU PROVIDE A BRIEF EXAMPLE OF HOW ERM MIGHT BE APPLIED IN THIS INSTANCE?

A. One example may be to thoroughly analyze the transaction costs associated with natural gas hedging, and power price hedging, and to determine how this partial levelizing of some of the volatility ratepayers experience is valued versus committing some or all of these same resources elsewhere. For instance, instead of hedging natural gas to

levelize ratepayer volatility, perhaps the Company can look at trading out of some of that price risk by taking on other non-natural gas capacity resources. When using option prices plus other associated transaction costs, it may be found that when taking into account all of the associated transactions costs, these hedging costs may outweigh the benefits of the partial volatility control they provide.

Q. BASED ON YOUR TESTIMONY, WHAT RECOMMEDATIONS DO YOU HAVE REGARDING HEDGING TRANSACTION COSTS AND RELATED MATTERS?

A. I have the following recommendations: (1) to better evaluate the results of hedging, there should be a thorough analysis of the associated transactions costs; (2) the use of options to reduce price volatility should be evaluated; (3) the partial leveling of rates that result from hedging natural gas should be valued; (4) how the value of hedging compares to other ways to address ratepayer pricing volatility including ERM methodology should be analyzed; and (5) this process should provide ample opportunity for all of the affected stakeholders including ratepayers to have input into this process, much of which is policy formulation.

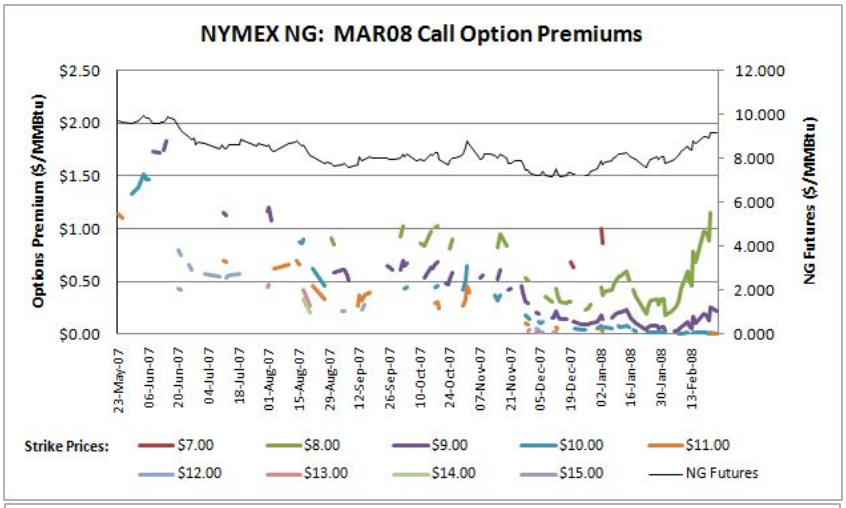
Q. DOES THIS CONCLUDE YOUR TESTIMONY?

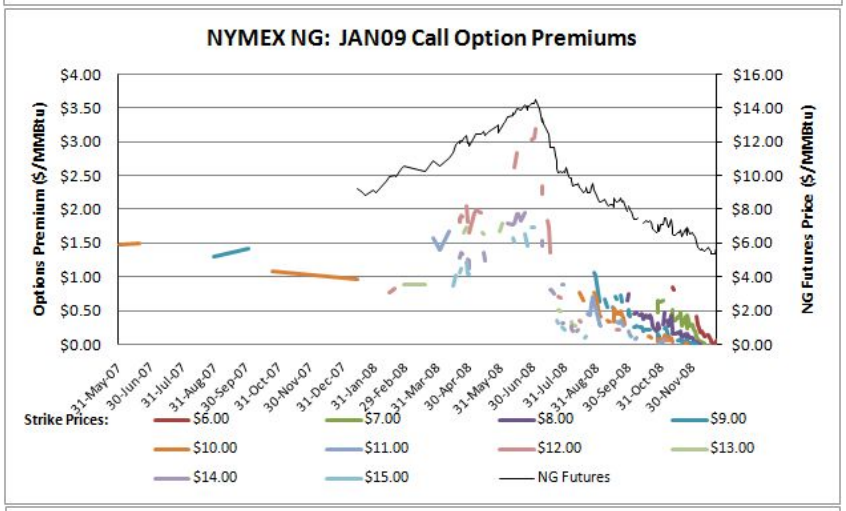
A. Yes.

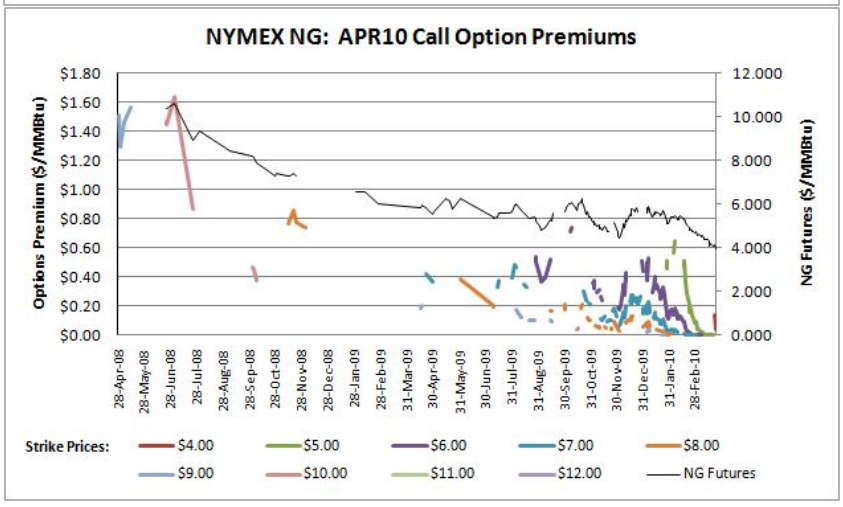
Exhibit OCS 4.1

NYMEX NATURAL GAS CALL OPTION PREMIUMS vs.

FUTURES CONTRACT SETTLEMENT PRICES







EDUCATION:

Juris Doctorate, 1996, licensed in Texas
South Texas College of Law, Houston, Texas

MBA, 1985, graduated with Honors, presented thesis on electric utility marketing to the IAEE North American Conference.
Lamar University, Beaumont, Texas

MS, MINERAL ECONOMICS, 1979, awarded Federal Mining Fellowship. Thesis analyzed coal transportation pricing and structures.
West Virginia University, Morgantown, West Virginia

BS, ECONOMICS, 1977, energy economics concentration.
West Virginia University, Morgantown, West Virginia

EXECUTIVE PROFILE:

As a senior executive in the energy industry, was engaged in the development and implementation of strategic business plans, directed the start up of multiple business units for top tier industry players in the power industry, and provided the strategic, commercial and risk management experience required in formulating the direction needed for the approval and closure of large energy related transactions and capital projects. Currently advise clients in most aspects of power project development including fuel planning, contracting, and price hedging.

PROFESSIONAL EXPERIENCE:

GDS ASSOCIATES, INC, Atlanta, Georgia 2008 - Present
Managing Director
Report to Vice President. Practice areas include energy project development and management, asset evaluation, fuels, risk management, and regulatory and expert witness testimony.

NRG Energy, New Roads, Louisiana 2006-2008
Vice President – Development
Reported to Regional President. Developed and implemented project development and commercial marketing plans for a 700 MW pulverized coal unit and a 200 MW pet coke, coal, and biomass fueled CFB repowering unit.

GDS ASSOCIATES, INC, Atlanta, Georgia 2002-2006
Managing Director
Reported to founding partner. Developed a comprehensive power asset risk management service targeted to electric cooperatives and municipals. Practice areas included energy assets, supply, fuels, risk management, regulatory, and expert witness testimony.

ENTERGY WHOLESALE OPERATIONS (EWO), Houston, Texas 1999-2002
Senior Vice President - Business Management
Reported to COO. Selected to head up newly created and expanded Business Management function responsible for the P&L and operations of asset fleet.

Senior Vice President - Business Development
Developed and implemented a strategic business plan for the start up of a regional IPP asset development program targeted at a 10 state market.

AMERICAN ELECTRIC POWER (AEP), Columbus, Ohio and Houston, Texas 1997-1999
Vice President - Project Development - North America
Reported to Executive Vice President. Developed and implemented a strategic business plan for the North American market.

ENRON CAPITAL AND TRADE (ECT), Houston, Texas 1991-1997
Director
Reported to Vice President. Developed and implemented a wide range of commercial business strategies focused on growth opportunities.

PEPSICO (FRITO-LAY), Plano, Texas 1987-1991
Manager
Developed and implemented a national business plan that transitioned the company's 40+ manufacturing facilities from regulated utility service to the then emerging unregulated direct purchase energy market and price hedging including cogeneration.

Continuous record of prior professional experience provided upon request.