Witness OCS 6D – Wielgus

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of	**)**	**Docket No. 10-035-124**
Rocky Mountain Power for Authority	**)**	
to Increase Its Retail Electric Service	**)**	**Direct Testimony**
Rate in Utah and for Approval of Its	**)**	**Paul Wielgus**
Proposed Electric Service Schedules	**)**	**For the Utah Office of**
And Electric Service Regulations	**)**	**Consumer Services**

May 26, 2010

REDACTED

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 1, 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. DO YOU HAVE ANY EXHIBITS IN SUPPORT OF YOUR TESTIMONY?

A. Yes, Confidential Exhibits OCS 6.1 and OCS 6.2 which are attached to my testimony.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. To provide an examination and review, along with conclusions and recommendations, regarding the results of the Company's Test Year natural gas and power trading activities.

Q. WHAT IS THE OBJECTIVE OF THE COMPANY'S NATURAL GAS AND POWER TRADING ACTIVITIES?

A. To reduce the volatility of Net Power Costs ("NPC"). The Company does this by placing natural gas and power trades.

Q. DOES THE COMPANY EXPECT TO BEAT THE MARKET THROUGH ITS NATURAL GAS AND POWER TRADING ACTIVITIES?

A. No.

Q. DOES THE COMPANY EXPECT THEIR NATURAL GAS AND POWER TRADING RESULTS TO BE LEAST COST?

A. No.

Q. DID THE COMPANY'S NATURAL GAS AND POWER TRADING RESULTS REDUCE THE VOLATILITY OF ITS NPC FOR THE TEST YEAR?

A. No.

Q. CAN YOU SHOW THAT THE COMPANY'S NATURAL GAS AND POWER TRADING HASN'T PRODUCED THE DESIRED RESULTS FOR THE TEST YEAR?

A. Yes, as seen in the graph in Confidential Exhibit OCS 6.1. As shown, the graph illustrates the Company's NPC both with and without the natural gas and power hedging results. As can clearly be seen, the NPC volatility is quite similar under both scenarios.

Q. DO THESE NATURAL GAS AND POWER TRADING RESULTS HAVE A COST ATTACHED TO THEM?

A. Yes, the NPC includes a [redacted] when taking into consideration both the gains and losses of the Company's natural gas and power trading activities that have been included in the Test Year.

Q. DOES THE COMPANY HAVE TRADING POLICIES AND PROCEDURES THAT THE COMPANY FOLLOWS TO IMPLEMENT ITS HEDGING ACTIVITIES THAT PRODUCED THESE RESULTS?

A. Yes.

Q. WHO DEVELOPED THESE TRADING POLICIES AND PROCEDURES?

A. The Company.

Q. WAS THE COMMISSION OR ANY OF THE PARTIES IN THIS DOCKET INVOLVED IN DEVELOPING THE COMPANY'S TRADING POLICIES AND PROCEDURES?

A. Not to my knowledge.

Q. WAS THE COMMISSION OR ANY OF THE PARTIES IN THIS DOCKET INVOLVED IN CHANGES TO THE COMPANY'S TRADING POLICIES AND PROCEDURES INCLUDING MOVING TO TEVAR MEASUREMENT?

A. Not to my knowledge.

Q. WAS THE COMMISSION OR ANY OF THE PARTIES IN THIS DOCKET INVOLVED IN THE OBJECTIVE SETTING OF THE COMPANY'S TRADING POLICIES AND PROCEDURES?

A. Not to my knowledge.

Q. WAS THE COMMISSION OR ANY OF THE PARTIES IN THIS DOCKET INVOLVED IN THE IMPLEMENTATION OF THE COMPANY'S TRADING POLICIES AND PROCEDURES?

A. Not to my knowledge.

Q. WAS THE COMMISSION OR ANY OF THE PARTIES IN THIS DOCKET INVOLVED IN THE COMPANY DECIDING WHICH COSTS WERE TO BE HEDGED?

A. Not to my knowledge.

Q. WAS THE COMMISSION OR ANY OF THE PARTIES IN THIS DOCKET INVOLVED IN DECIDING WHICH TRADING METHODS SHOULD BE USED TO HEDGE?

A. Not to my knowledge.

Q. ARE THERE OTHER FUEL COMMODITY COSTS THAT CAN IMPACT THE VOLATILITY OF FUEL COSTS AND THE NPC?

A. Yes, the cost of coal.

Q. DO THE COMPANY'S TRADING POLICIES AND PROCEDURES INCLUDE COAL PRICES?

A. No.

Q. DID COAL PRICES HAVE AN IMPACT ON THE VOLATILITY OF FUEL COSTS AND THE NPC FOR THE TEST YEAR?

A. Yes. According to the Company, approximately [redacted] of the Test Year NPC increase is attributable to coal.

Q. HOW TRANSPARENT ARE THE COMPANY'S TRADING ACTIVITIES?

A. Not very.

Q. WHY IS THAT?

A. Mostly by design. Trading systems and processes are considered extremely confidential and are not designed for third-party due diligence-like activities, thereby inherently making them not rate case intervener friendly. These are trading systems that cost in the tens of millions of dollars to implement and are supported by significant ongoing information technology ("IT") resources to maintain them. In addition, users change their systems over time and also replace them, negating institutional knowledge that may have been gained by an intervener in a previous rate case proceeding based on a replaced system. The learning curve for interveners is very steep and extremely resource intensive, and because of the inherent nature of trading systems, much of the intervener due diligence can only be done on site and only if the needed information is actually captured by the system.

Q. CAN YOU GIVE A SIMPLE EXAMPLE TO ILLUSTATE THE ABOVE?

A. Yes, one is regarding the Company's traders' commitment to a financial swap. It is my understanding that the Company's trading system does not log or capture competing prices, bid offer spreads, or other related market information at the time a commitment to transact is made. Just the

confirmation at which the transaction price was actually made is captured in the trading system. Information required to support the prudency of that trade and others doesn't exist in the trading system, just the end results of the trades.

Q. SHOULD THE COMPANY'S TRADING ACTIVITIES BE MORE TRANSPARENT?

A. Yes. Greater disclosure or transparency of utility trading activities is supported in the Standard & Poor's report, dated January 28, 2011, provided by the Company in Docket No. 09-035-15 and in response to OCS Data Request 24.1 in the current docket.

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Q. WHAT ELSE DID THE REPORT MENTION REGARDING REGULATED UTILITY HEDGING?

A. The report indicated that companies that have mostly regulated operations have limited use of hedges. It is important to note that there are companies that have both regulated and non-regulated generation and a lot of the trading done by those companies is for non-regulated generation.

Q. DOES YOUR EXPERIENCE CONFIRM THIS?

A. Yes.

Q. WHAT HAS BEEN THE OCS' POSITION REGARDING STAKEHOLDER PARTICIPATION IN THE COMPANY'S TRADING PROCESSES?

A. That the Commission should comprehensively investigate the Company's hedging practices and that the investigation should include stakeholder participation. As shown in my Confidential Exhibit OCS 6.1, the ratepayers have not benefitted from the Company's trading practices: the Company's Test Period NPC is still volatile; use of swaps does not permit the ratepayers to capture the benefits of prices favorable to them; and, it comes at a measurable cost to the ratepayers.

Q. WHAT IS THE COMMISSION'S POSITION REGARDING THE COMPANY'S TRADING ACTIVITIES?

A. In Docket No. 09-035-15 the Commission stated that the examination of the Company's hedging strategies and polices is the proper subject of a docket in which the Company seeks recovery of specific hedging transaction costs. In this docket the Company seeks recovery of hedging transaction costs, therefore, as per the Commission's order this is the appropriate time to examine the Company's hedging strategies and polices.

Q. BECAUSE THE COMPANY'S TRADING DECISIONS REST SOLEY WITH THE COMPANY, HOW SHOULD THE RESULTS OF THE COMPANY'S TRADING ACTIVITIES BE TREATED?

A. If the results of the Company's decisions don't meet the Company's objective with respect to reducing NPC volatility for its ratepayers, the Company should be responsible for the consequences.

Q. WHAT WOULD BE THE CONSEQUENCES?

A. The Company should be responsible for net losses associated with its natural gas and power trading activities.

Q. HOW CAN THE NET LOSSES BE MEASURED?

A. There are a number of ways. Dr. Lori Schell in her testimony in this docket provided a range of calculations that enable one to calculate the net loss. One way is simply to net the power trading gains in the Company's NPC for the Test Year against the natural gas trading losses in the Company's NPC for the Test Year. This method results in the highest calculated net loss for the Test Year. Measuring net trading losses by the term or duration of the trades is another reasonable way to calculate the net loss in the test period. That is, when prices are fixed so far forward from the prompt month, the Company should be responsible for any resultant losses or gains. In this instance, trades done by the Company to fix prices more than 36 months in advance are too far forward based on my experience. The net loss for natural gas and power trades included in the test period that were done more than 36 months in

advance equates to about [redacted], as provided in Dr. Schell's testimony.

Q. SO AGAIN, THESE LOSSES ARE ATTRIBUTABLE TO THE COMPANY'S TRADING POLICIES?

A. Yes, they are the consequences of the Company continuing down the same path of its energy trading practices which rely solely on entering into fixed price swaps up to [redacted] months out, either separately from physical contracts or through swaps being imbedded into physical contracts. The Company has chosen not to use other methods such as buying financial options, reducing the term of its trades, or even halting trading as an alternative.

Q. CAN THE COST OF OPTIONS BE CONSIDERED IN REDUCING THE LOSSES?

A. Yes. If financial options were used prudently for hedging instead of financial swaps, the option premium would have to be taken into account as an offset when measuring the net loss. If financial options were used instead of financial swaps, assuming option premiums at $0.50 per MMBtu, $0.75 per MMBtu, and $1.00 per MMBtu of natural gas, the net losses for the test period would be about [redacted] after factoring in the cost of the options.

Q. PLEASE EXPLAIN HOW THE LOSSES CAN BE REDUCED WHEN CONSIDERING THE COST OF OPTIONS?

A. Confidential Exhibit OCS-6.2 illustrates how trading losses could be offset by the total cost of options. The trading loss would be reduced by the total cost of the options as follows: if ratepayers were to indicate that capping losses is worth paying an option premium of $0.50/MMBtu, the total cost to hedge the equivalent volume of natural gas and power hedged in the test period would be [redacted]; if capping losses is worth paying a premium of $0.75/MMBtu to ratepayers, the cost to hedge the equivalent volume of natural gas and power hedged in the test period would be [redacted] and if capping losses is worth a premium of $1.00/MMBtu, the total cost to hedge the equivalent volume of natural gas and power hedged in the Test Period would be [redacted]

Q. IS THERE A REASON THAT RATEPAYERS WOULD WANT TO PAY OPTION PREMIUMS AT A LEVEL OF $1.00 OR MORE PER MMBTU?

A. Not likely. Confidential Exhibit OCS 6.1 shows the volatility of the NPC that has resulted despite the Company's use of financial swaps to fix natural gas and power prices at a cost to ratepayers or net loss of about [redacted], approximating the cost of options at about $1.00/MMBtu. In addition, my experiences in instances like this haven't shown the willingness to pay premiums of this magnitude.

Q. IF OPTIONS RATHER THAN SWAPS WERE USED TO HEDGE PRICES, COULD THEIR USE PROVIDE A NET BENEFIT TO THE RATEPAYERS?

A. Yes. One benefit ratepayers would receive if options were used to hedge prices would be the benefit of any price movements in their favor. The other benefit is that the options premium paid can provide a transparent view of the transaction cost for price hedges, using a financial mechanism that better addresses the ratepayers' position for the commodity, whether it's downward moving prices for natural gas or upward moving prices for power.

Q. ARE THERE OTHER TRANSACTION COSTS THE COMPANY INCURS WHEN TRADING?

A. Yes. Other transaction costs can include the cost of the ongoing additional organizational functions needed to implement price hedging along with the associated risk management administrative activities and controls. These organizational functions can include traders, risk managers and administrators, and specialized models and modeling expertise to help evaluate and monitor the trades. In addition, there are the costs for the necessary 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. 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 indicated that the expenses associated with their employees, including contractors and employee expenses, working in the front, middle, and back offices of the trading risk management organization, plus other support areas including legal were about [redacted] According to a Company memo, the Company's new energy trading system, an IT program to help manage its hedges, was estimated to cost about [redacted] In this docket, the Company identified in UIEC DR 6.29 the [redacted] in trading broker fees that it has paid over the past five years. In the Supplemental Direct testimony of Frank G. Graves, in Docket 09-035-15, Mr. Graves stated that [redacted]

Q. HAS THE COMPANY ESTIMATED THE VALUE RATEPAYERS RECEIVE FROM HEDGING AND FROM INCURRING THE HEDGING TRANSACTION COSTS?

A. According to the Company's presentation at the May 2009 Technical Conference in Docket No. 09-035-21, the purpose of its risk management policy and hedge practice is to reduce the volatility of the Company's NPC. The Company contends, however, that the hedge cost benefit, if measuring the hedged energy cost to market prices over time, will average zero. All associated hedging transaction costs should be included when measuring the benefits.

Q. DID RATEPAYERS BENEFIT FROM THESE HEDGING TRANSACTIONS COSTS?

A. No, as is shown in Confidential Exhibit 6.1.

Q. BASED ON YOUR TESTIMONY, WHAT RECOMMENDATIONS DO YOU HAVE REGARDING THE COMPANY'S HEDGING ACTIVITIES?

A. I have the following recommendations: (1) there should be a formulation of policy regarding going forward energy price hedging; (2) affected stakeholders including ratepayers should have input into this process; (3) the Company's trading process should have greater transparency so all stakeholders will have the necessary understanding to assist in the policy formulation; (4) the Company should provide a comprehensive analysis

and report on all of the associated hedging transaction costs so that the Commission can determine the benefits/costs using all costs; (5) if hedging continues, the use of options and other alternatives should be evaluated; and (6) because the ratepayers did not benefit from the Company's self directed trading practices included in the Test Year, the Commission would be justified in disallowing an amount for the Company's Test Year NPC net hedging costs.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

Exhibit OCS 6.1 - Confidential

REDACTED

Exhibit OCS 6.2 Confidential

REDACTED

APPENDIX 1

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.